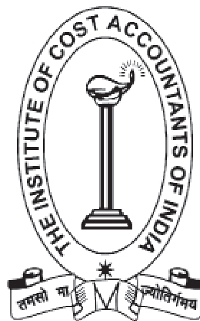
FINAL
Paper 18

Corporate Financial Reporting

Study Notes

SYLLABUS 2022



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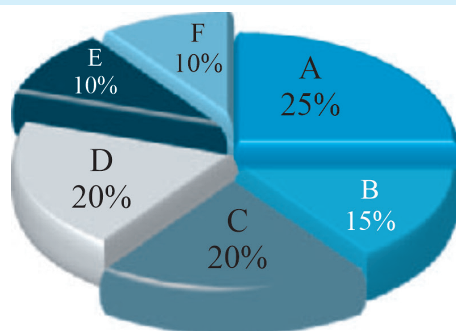
PAPER 18 : CORPORATE FINANCIAL REPORTING

Syllabus Structure:

The syllabus in this paper comprises the following topics and study weightage:

Module No.	Module Description	Weight
Section A: Indian Accounting Standards		**25%**
1	Specific Accounting Standards	25%
Section B: Valuation of Shares, Accounting and Reporting of Financial Instruments and NBFCs		**15%**
2	Valuation of Shares (Including Determination of Goodwill, Post-Valuation of Tangible and Intangible Assets)	15%
3	Accounting of Financial Instruments	
4	NBFCs – Provisioning Norms, Accounting and Reporting	
Section C: Accounting for Business Combination and Restructuring (in Compliance with Ind ASs)		**20%**
5	Accounting for Business Combinations and Restructuring	20%
Section D: Consolidated Financial Statements and Separate Financial Statements (in Compliance with Ind ASs)		**20%**
6	Consolidated Financial Statements and Separate Financial Statements	20%
Section E: Recent Developments in Financial Reporting		**10%**
7	Recent Developments in Financial Reporting	10%
Section F: Government Accounting in India		**10%**
8	Government Accounting in India	10%



Learning Environment – Paper 18

Subject Title	**CORPORATE FINANCIAL REPORTING**
Subject Code	**CFR**
Paper No.	**18**
Course Description	The subject Corporate Financial Reporting focuses (i) primarily on corporate financial accounting and reporting based on Ind AS, (ii) on recent developments in financial reporting beyond Ind AS, and (iii) on government accounting. In primary focus, selected Ind ASs are included to transfer in-depth knowledge in a precise manner on the entire field of corporate accounting and reporting with special emphasis on accounting and reporting of groups.
CMA Course Learning Objectives (CMLOs)	1. Interpret and appreciate emerging national and global concerns affecting organizations and be in a state of readiness for business management. a. Identify emerging national and global forces responsible for enhanced/varied business challenges. b. Assess how far these forces pose threats to the status-quo and creating new opportunities. c. Find out ways and means to convert challenges into opportunities 2. Acquire skill sets for critical thinking, analyses and evaluations, comprehension, syntheses, and applications for optimization of sustainable goals. a. Be equipped with the appropriate tools for analyses of business risks and hurdles. b. Learn to apply tools and systems for evaluation of decision alternatives with a 360-degree approach. c. Develop solutions through critical thinking to optimize sustainable goals. 3. Develop an understanding of strategic, financial, cost and risk-enabled performance management in a dynamic business environment. a. Study the impacts of dynamic business environment on existing business strategies. b. Learn to adopt, adapt and innovate financial, cost and operating strategies to cope up with the dynamic business environment. c. Come up with strategies and tactics that create sustainable competitive advantages. 4. Learn to design the optimal approach for management of legal, institutional, regulatory and ESG frameworks, stakeholders' dynamics; monitoring, control, and reporting with application-oriented knowledge. a. Develop an understanding of the legal, institutional and regulatory and ESG frameworks within which a firm operates. b. Learn to articulate optimal responses to the changes in the above frameworks. c. Appreciate stakeholders' dynamics and expectations, and develop appropriate reporting mechanisms to address their concerns. 5. Prepare to adopt an integrated cross functional approach for decision management and execution with cost leadership, optimized value creations and deliveries. a. Acquire knowledge of cross functional tools for decision management. b. Take an industry specific approach towards cost optimization, and control to achieve sustainable cost leadership. c. Attain exclusive knowledge of data science and engineering to analyze and create value.

<table>
<tr><td>Subject Learning Objectives [SLOB(s)]</td><td>1. To obtain in-depth knowledge on accounting and reporting of financial information for different types of corporate entities engaged in activities across certain sectors based on specified Ind ASs. (CMLO 1 a, c; 4 a, b)
2. To acquire in-depth knowledge on accounting and reporting of different modes of business combinations including other complications associated in Ind AS environment. (CMLO 1 a, c; 4 a, c)
3. To develop detail understanding on preparation of consolidated and separate financial statements by companies having significant influence on, joint control or control of other entities in an Ind AS environment. (CMLO 1 a, c; 4 a, c)
4. To expose students to the contemporary research and developments on corporate financial reporting from the viewpoint of all the stakeholders in global context beyond the boundary of Ind AS. (CMLO 1 a, b, c; 2 b, c; 4 c)
5. To equip students with in-depth knowledge on the traditional and modern approaches to valuation of business, goodwill and shares based on corporate financial reporting. (CMLO 5 c)
6. To expose students to the financial reporting of NBFCs, to government accounting, and to XBRL. (CMLO 4 a, c)</td></tr>
<tr><td>Subject Learning Outcome [SLOC(s)] and Application Skill [APS]</td><td>SLOC(s):
1. Students will be able to perform accounting and reporting of financial events of corporate entities including NBFCs based on Ind AS and to decide on the judgemental issues associated.
2. Students will be able to perform accounting and reporting of different modes of business combinations of corporate entities based on Ind AS and to decide on the associated judgemental issues.
3. Students will be able to prepare consolidated and separate financial statements based on Ind AS and to decide on issues associated with decision management.
4. Students will get reasonable exposure to the recent developments on financial reporting in a wider perspective from the holistic point of view whether or not captured in regulatory framework.
5. Students will get in-depth knowledge on valuation principles and practice, relevant for corporate financial decision.
6. Students will get exposures to government accounting and reporting through XBRL.
APS:
1. Students will develop skills to independently prepare necessary accounts and draft mandatory financial statements of various companies including NBFCs as per the provisions of Companies Act and applicable Ind ASs.
2. Students will acquire skills to independently prepare necessary accounts and draft mandatory financial statements for different cases of business combinations.
3. Students will develop skills to independently prepare necessary accounts and draft mandatory consolidated financial statements for the group and separate financial statements for the investor company.
4. Students will attain capabilities to independently value business, intangible assets (goodwill, in particular) and shares.
5. Students will be able to maintain statutory books under government accounting and prepare documents for XBRL filing.</td></tr>
</table>

Module wise Mapping of SLOB(s)			
Module No.	**Topics**	**Additional Resources (Research articles, books, case studies, blogs)**	**SLOB Mapped**
Section A: Indian Accounting Standards			
1	**Indian Accounting Standards**	Indian Accounting Standards (Texts): https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html#:~:text=The%20Indian%20Accounting%20Standards%20(Ind,held%20by%20the%20IFRS%20Foundation.	To obtain in-depth knowledge on accounting and reporting of financial information for different types of corporate entities engaged in activities across certain sectors based on specified Ind ASs.
Section B: Valuation of Shares, Accounting and Reporting of Financial Instruments and NBFCs			
2	**Valuation of Shares**	Some "Conceptualizing" on Goodwill – Gynther https://www.jstor.org/stable/243799	To equip students with in-depth knowledge on the traditional and modern approaches to valuation of business, goodwill and shares based on corporate financial reporting.
3	**Accounting of Financial Instruments**	Indian Accounting Standards (Texts) on Financial Instruments: https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html	To obtain in-depth knowledge on accounting and reporting of financial information for different types of corporate entities engaged in activities across certain sectors based on specified Ind ASs.
4	**NBFCs – Provisioning Norms, Accounting and Reporting**	NBFC Prudential Norms by RBI: https://rbi.org.in/Scripts/BS_NBFCNotificationView.aspx?Id=1007	To expose students to the financial reporting of NBFCs, to government accounting, and to XBRL.
Section C: Accounting for Business Combination and Restructuring (in Compliance with Ind ASs)			
5	**Accounting for Business Combination and Restructuring**	Indian Accounting Standards (Texts) on Business Combination: https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html	To acquire in-depth knowledge on accounting and reporting of different modes of business combinations including other complications associated in Ind AS environment.

Module wise Mapping of SLOB(s)			
Module No.	**Topics**	**Additional Resources (Research articles, books, case studies, blogs)**	**SLOB Mapped**
Section D: Consolidated Financial Statements and Separate Financial Statements (in Compliance with Ind ASs)			
6	**Consolidated Financial Statements and Separate Financial Statements**	Indian Accounting Standards (Texts) on Consolidation: https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/accounting-standards.html	To develop detail understanding on preparation of consolidated and separate financial statements by companies having significant influence on, joint control or control of other entities in an Ind AS environment.
Section E: Recent Developments in Financial Reporting			
7	**Recent Developments in Financial Reporting**	Integrated Reporting Framework: https://www.integratedreporting.org/ The global standards for sustainability reporting https://www.globalreporting.org/standards/	To expose students to the contemporary research and developments on corporate financial reporting from the viewpoint of all the stakeholders in global context beyond the boundary of Ind AS.
Section F: Government Accounting in India			
8	**Government Accounting in India**	Indian Government Accounting Standards: https://dea.gov.in/budgetdivision/indian-government-accounting-standards	To expose students to the financial reporting of NBFCs, to government accounting, and to XBRL.

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1.2 Income Taxes (Ind AS 12)

1.3 Property, Plant and Equipment (Ind AS 16)

1.4 Leases (Ind AS 116)

1.5 The Effects of Changes in Foreign Exchange Rates (Ind AS 21)

1.6 Borrowing Costs (Ind AS 23)

1.7 Impairment of Assets (Ind AS 36)

1.8 Intangible Assets (Ind AS 38)

1.9 Share based Payment (Ind AS 102)

1.10 Operating Segments (Ind AS 108)

1.11 Fair Value Measurement (Ind AS 113)

1.12 Revenue from Contracts with Customers (Ind AS 115)

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Section-A

Indian Accounting Standards

Specific Accounting Standards 1

This Module Includes

1.1 Accounting Policies, Changes in Accounting Estimates and Errors (Ind AS 8)

1.2 Income Taxes (Ind AS 12)

1.3 Property, Plant and Equipment (Ind AS 16)

1.4 Leases (Ind AS 116)

1.5 The Effects of Changes in Foreign Exchange Rates (Ind AS 21)

1.6 Borrowing Costs (Ind AS 23)

1.7 Impairment of Assets (Ind AS 36)

1.8 Intangible Assets (Ind AS 38)

1.9 Share based Payment (Ind AS 102)

1.10 Operating Segments (Ind AS 108)

1.11 Fair Value Measurement (Ind AS 113)

1.12 Revenue from Contracts with Customers (Ind AS 115)

Specific Accounting Standards

SLOB Mapped against the Module

To obtain in-depth knowledge on accounting and reporting of financial information for different types of corporate entities engaged in activities across certain sectors based on specified Ind ASs.

Module Learning Objectives

- A cost and management accountant (CMA) should obviously be strong in cost accounting and in management accounting, but at the same time a CMA should no less be strong in financial accounting. Corporate financial accounting is mandatorily done in compliance with Indian Accounting Standards for listed and other specified companies and with Accounting Standards for the residual huge mass of corporate entities in India.
- This module takes up selected Indian Accounting Standards not only with the purpose of equipping the students with in-depth knowledge about the guidelines provided in the standards but also to make them well conversant with their use in practical accounting application. The expected outcome of this module is to make students able to reflect the standards in journal, balance sheet, Statement of Profit and Loss, notes and in statement of cash flows.

Introduction

1

The Indian Accounting Standards (Ind ASs) are the standards prepared by the Accounting Standard Board (ASB) of the Institute of the Chartered Accountants of India (ICAI) in convergence with International Financial Reporting Standards (IFRSs) [where IFRS includes International Accounting Standards (IAS)]. It implies India did not fully adopt IFRS, rather modified it in the way compatible to conditions in India and it is considered as converged IFRS.

The Companies (Indian Accounting Standards) Rules, 2015 (and subsequent amendments to the Rules) made Ind AS applicable to the specified entities, leaving AS [as per the Companies (Accounting Standards) Rules, 2021 (replacing the Companies (Accounting Standards) Rules, 2006)] applicable to other entities.

Ind ASs are mandatorily applicable to specified entities with effect from specified dates. A summary of the applicability of Ind ASs is tabulated below.

Types of Companies/entities	Threshold Limit of Net worth (INR)	Applicable from	Ind AS applicability on 01/04/22
Listed Companies/ Companies in process of Listing in India or outside India or Parent, Subsidiary, Associate, and Joint Venture of above	500 Cr or more	01/04/2016	Applicable
	less than 500 Cr	01/04/2017	Applicable
Unlisted Companies/ Pvt. Ltd. Companies	500 Cr or more	01/04/2016	Applicable
	250 Cr or more	01/04/2017	Applicable
	less than 250 Cr		Not Applicable
Companies listed in SME			Not Applicable
NBFC – Listed	500 Cr or more	01/04/2018	Applicable
	Less than 500 Cr	01/04/2019	Applicable
NBFC – Unlisted	500 Cr or more	01/04/2018	Applicable
	250 Cr or more	01/04/2019	Applicable
	Less than 250 Cr		Not Applicable
Banks			Not Applicable (Implementation deferred)

Types of Companies/entities	Threshold Limit of Net worth (INR)	Applicable from	Ind AS applicability on 01/04/22
Insurance co			Not Applicable (Implementation deferred)
Urban Cooperative Bank			Not Applicable
Rural Regional Bank			Not Applicable

As on 01-04-2022 Ministry of Corporate Affairs (MCA) has notified 42 Ind ASs out of which 3 were omitted leaving 39 in application at present.

The full list is presented below:

Ind AS 101	First-time adoption of Ind AS
Ind AS 102	Share Based payments
Ind AS 103	Business Combination
Ind AS 104	Insurance Contracts (to be replaced by Ind AS 117 Insurance Contracts, not yet notified by the MCA)
Ind AS 105	Non-Current Assets Held for Sale and Discontinued Operations
Ind AS 106	Exploration for and Evaluation of Mineral Resources
Ind AS 107	Financial Instruments: Disclosures
Ind AS 108	Operating Segments
Ind AS 109	Financial Instruments
Ind AS 110	Consolidated Financial Statements
Ind AS 111	Joint Arrangements
Ind AS 112	Disclosure of Interests in Other Entities
Ind AS 113	Fair Value Measurement
Ind AS 114	Regulatory Deferral Accounts
Ind AS 115	Revenue from Contracts with Customers (Ind AS 11 and Ind AS 18 replaced)
Ind AS 116	Leases (Ind AS 17 replaced)
Ind AS 1	Presentation of Financial Statements
Ind AS 2	Inventories Accounting
Ind AS 7	Statement of Cash Flows
Ind AS 8	Accounting Policies, Changes in Accounting Estimates and Errors
Ind AS 10	Events after Reporting Period

Ind AS 12	Income Taxes
Ind AS 16	Property, Plant and Equipment
Ind AS 19	Employee Benefits
Ind AS 20	Accounting for Government Grants and Disclosure of Government Assistance
Ind AS 21	The Effects of Changes in Foreign Exchange Rates
Ind AS 23	Borrowing Costs
Ind AS 24	Related Party Disclosures
Ind AS 27	Separate Financial Statements
Ind AS 28	Investments in Associates and Joint Ventures
Ind AS 29	Financial Reporting in Hyperinflationary Economies
Ind AS 32	Financial Instruments: Presentation
Ind AS 33	Earnings per Share
Ind AS 34	Interim Financial Reporting
Ind AS 36	Impairment of Assets
Ind AS 37	Provisions, Contingent Liabilities and Contingent Assets
Ind AS 38	Intangible Assets
Ind AS 40	Investment Property
Ind AS 41	Agriculture

Out of total of 39 standards some were already introduced in the intermediate course, some others, on the basis of their relevance and weightage have been selected in the final course as enumerated below;

In the following section shall discuss the following selected Ind ASs:

1. Accounting Policies, Changes in Accounting Estimates and Errors (Ind AS 8)
2. Income Taxes (Ind AS 12)
3. Property, Plant and Equipment (Ind AS 16)
4. Leases (Ind AS 116)
5. The Effects of Changes in Foreign Exchange Rates (Ind AS 21)
6. Borrowing Costs (Ind AS 23)
7. Impairment of Assets (Ind AS 36)
8. Intangible Assets (Ind AS 38)
9. Share-based Payment (Ind AS 102)
10. Operating Segments (Ind AS 108)
11. Fair Value Measurement (Ind AS 113)
12. Revenue from Contracts with Customers (Ind AS 115)

Accounting Policies, Changes in Accounting Estimates and Errors (Ind AS 8)

1.1

Objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities. 2 Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in Ind AS 1 Presentation of Financial Statements.

This Standard shall be applied in

- selecting and applying accounting policies, and
- accounting for changes in accounting policies,
- changes in accounting estimates and
- corrections of prior period errors.

Selecting and applying accounting policies

When an Ind AS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Ind AS.

In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in relevant and reliable information.

Relevant means the information is useful for making economic decisions.

Reliable means the financial statements

(i) represent faithfully the financial position, financial performance and cash flows of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all material respects.

In making the judgement management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements in Ind ASs dealing with similar and related issues; and

(b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework.

(c) other sources not in conflict with (a) and (b) in the following order

(i) most recent pronouncements of International Accounting Standards Board

(ii) in absence of thereof, those of the other standard setting bodies that use a similar conceptual framework to develop accounting standards,

(iii) other accounting literature and

(iv) accepted industry practices

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions.

Change in an Accounting Policy

An entity shall change an accounting policy only if the change: (a) is required by an Ind AS; or (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. The following are not changes in accounting policies:

(a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and

(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.

The initial application of a policy to revalue assets in accordance with Ind AS 16 Property, Plant and Equipment or Ind AS 38 Intangible Assets is a change in an accounting policy to be dealt with as a revaluation in accordance with Ind AS 16 or Ind AS 38, rather than in accordance with this Standard.

When a change in accounting policy is applied retrospectively, the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

When change of accounting policy is due to initial application of an Ind AS that has an effect on the current period or any prior period, an entity shall disclose:

(a) the title and nature of the Ind AS,

(b) description and future effects, if any, of the transitional provisions

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

   (i) for each financial statement line item affected; and

   (ii) if Ind AS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable. Financial statements of subsequent periods need not repeat these disclosures.

When the change in accounting policy is voluntary (a) and (b) above are replaced by the following:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information.

Change in an Accounting Estimate

To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

The effect of other changes 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.

An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect. 40 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

Correction of Prior Period Errors

An entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Limitations on retrospective restatement

A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the error.

When it is impracticable to determine effects of error in certain prior periods, the entity shall restate from the earliest period or from the prospective date it becomes practicable.

An entity shall disclose the following:

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction:

  (i) for each financial statement line item affected; and

  (ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;

(c) the amount of the correction at the beginning of the earliest prior period presented; and

(d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

Income Taxes (Ind AS 12)

1.2

Objective: The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of: (a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet; and (b) transactions and other events of the current period that are recognised in an entity's financial statements. It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Standard requires an entity to recognise a deferred tax liability (deferred tax asset), with certain limited exceptions. This Standard requires an entity to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised outside profit or loss (either in other comprehensive income or directly in equity), any related tax effects are also recognised outside profit or loss (either in other comprehensive income or directly in equity, respectively). Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill arising in that business combination or the amount of the bargain purchase gain recognised. This Standard also deals with the recognition of deferred tax assets arising from unused tax losses or unused tax credits, the presentation of income taxes in the financial statements and the disclosure of information relating to income taxes.

This standard shall be applied in accounting for income taxes.

Accounting for income taxes is made in financial accounting by recognising

(A) Tax expenses,

(B) Current and deferred tax liabilities and

(C) Current and deferred tax assets in the financial statements.

Tax expense includes (I) Current taxes and (II) Deferred taxes (that increases or reduces deferred tax liabilities/ assets). Current taxes are based on Taxable profits (Tax loss) determined in accordance with taxation laws, which may be different from accounting profit (before tax).

Current and future tax consequences (payments and savings) arise from two sources:

(a) future recovery/settlement of carrying amount of assets/liabilities recognised in balance sheet.

(b) transactions or other events recognised in financial statements (in SOPL, OCI, Other equity, or Goodwill/ Gain on bargain purchase in business combination). The carrying amount recognised in balance sheet may differ from the carrying amount determined for tax purpose, which is called Tax base of an asset/liability. The difference is called temporary difference, classified into two groups: (i) Taxable temporary differences having effect on deferred tax expense and deferred tax liabilities and (ii) Deductible temporary differences having effect on deferred tax expense and deferred tax assets.

At this point we may define the terms used so far.

- **Accounting Profit** is profit or loss for a period before deducting tax expense.
- **Taxable Profit** (tax loss) is the profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable).
- **Tax Expense** (tax income) comprises current tax expense (current tax income) and deferred tax expense (deferred tax income).
- **Current Tax** is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period.
- **Deferred Tax Liabilities** are the amounts of income taxes payable in future periods in respect of taxable temporary differences.
- **Deferred Tax Assets** are the amounts of income taxes recoverable in future periods in respect of:
  (a) deductible temporary differences;
  (b) the carry forward of unused tax losses; and
  (c) the carry forward of unused tax credits.

Temporary Differences are differences between the carrying amount of an asset or liability in the balance sheet and its tax base. Temporary differences may be either:

(a) taxable temporary differences, which are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled; or

(b) deductible temporary differences, which are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

The tax base of an asset or liability is the amount attributed to that asset or liability for tax purposes.

The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.

Most deferred tax liabilities/assets arise where the source income/expense is included in accounting profit in current period and included in taxable profit in later period.

Illustration 1

A company measured accounting profit of ₹ 80,000 after charging depreciation of ₹12,000. On interest receivable income tax is levied on cash basis. Included in accounting profit is Interest accrued ₹ 5,000, which is not included in taxable profit of ₹ 67,000. Tax rate is 30%. For tax purpose depreciation admissible is ₹ 20,000. Carrying amount of fixed assets was ₹ 68,000 and tax base of fixed assets ₹60,000 before charging depreciation for the current year. Find:

(i) Carrying amount and tax base of the fixed assets and tax base of Interest accrued at the end of the year.

(ii) Temporary Differences for fixed assets and interest accrued

(iii) current tax expenses and deferred tax expenses

(iv) deferred tax liabilities and deferred tax assets, if any.

Solution: **(Amount in ₹)**

Particulars	Carrying amount	Tax base	Taxable Temporary difference	Current tax	Deferred tax	Deferred tax liabilities	Tax Expense
	(i)	(ii)	(ii)	(iii)	(iii)	(iv)	(v)
Fixed Assets (before depreciation)	68,000	60,000					
Less: Depreciation	12,000	20,000					
Balance	56,000	40,000	16,000		4,800	4,800	
Interest Accrued	5,000	0	5,000		1,500	1,500	
Total			1,000		6,300	6,300	
Taxable Profit			67,000	20,100			
Accounting Profit			80,000				24,000

Illustration 2(a)

(a) A fixed asset is acquired at ₹1,50,000 with life 5 years, no residual value and Depreciation chargeable at SLM for accounting purpose. For tax purpose depreciation is admissible at ₹ 50,000 for first 3 years only. Show tax consequences for all the years.

Solution: **(Amount in ₹)**

Year	0	1	2	3	4	5	6
a. Fixed Asset	1,50,000						
b. Depreciation		25,000	25,000	25,000	25,000	25,000	25,000
c. Carrying amount	a - b	1,25,000	1,00,000	75,000	50,000	25,000	0
d. Depreciation for tax purpose		50,000	50,000	50,000	0	0	0
e. Tax base	a - d	1,00,000	50,000	0	0	0	0
f. Temporary difference	c - e	25,000	50,000	75,000	50,000	25,000	0
g. Deferred tax liabilities recognised in balance sheet @30% on temporary differences		7,500	15,000	22,500	15,000	7,500	0
h. Deferred tax expense recognised in Statement of Profit and Loss (change in liabilities)	g(t+1) - gt	7,500	7,500	7,500	(7,500)	(7,500)	(7,500)

(b) Show the tax expenses for the above case if before depreciation accounting profits are same as before depreciation taxable profits for the years as stated below: (Amount in ₹)

	0	1	2	3	4	5	6
a. Accounting profits before depreciation	1,50,000	1,80,000	2,00,000	1,60,000	1,90,000	2,20,000	2,40,000

Solution:

Year		1	2	3	4	5	6
a. Accounting profits before depreciation		1,80,000	2,00,000	1,60,000	1,90,000	2,20,000	2,40,000
b. Depreciation		25,000	25,000	25,000	25,000	25,000	25,000
c. Accounting profits	a - b	1,55,000	1,75,000	1,35,000	1,65,000	1,95,000	2,15,000
d. Depreciation for tax purpose		50,000	50,000	50,000	0	0	0
e. Taxable profits	a - d	1,30,000	1,50,000	1,10,000	1,90,000	2,20,000	2,40,000
f. Current tax expenses 30%*e	c - e	39,000	45,000	33,000	57,000	66,000	72,000
g. Deferred tax expense recognised in SOPL	Ah	7,500	7,500	7,500	(7,500)	(7,500)	(7,500)
h. Tax expenses	f + g	46,500	52,500	40,500	49,500	58,500	64,500

Illustration 3

A company creates provision for Gratuity and Leave encashment and recognises liability of ₹50,000. This is the only difference between taxable profits and accounting profits. The company measures current tax of ₹ 48,000 at tax rate of 25%. Compute Tan Expenses.

Solution:

Particulars	(₹)
(i) Carrying amount of Liabilities for Gratuity and Leave encashment	50,000
(ii) Tax base (since provision is not admissible for tax purpose)	0
(iii) Temporary difference (i) - (ii)	50,000
(iv) Deferred tax asset 25% × c	12,500
(v) Deferred tax expenses (change in deferred tax asset)	(12,500)
(vi) Current tax expenses (given)	48,000
(vii) Tax expenses (v) + (vi)	35,500

If carrying amount is recoverable and it is greater than tax base, tax is payable in future and there arise deferred tax liability.

If carrying amount is recoverable and it is less than tax base, for loss tax is deductible in future and there arise deferred tax asset.

If carrying amount is payable and it is greater than tax base, tax is deductible in future and there arise deferred tax asset.

Disclosure:

The major components of tax expense (income) shall be disclosed separately. Components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

The following shall also be disclosed separately:

(a) the aggregate current and deferred tax relating to items that are charged or credited directly to equity

(b) the amount of income tax relating to each component of other comprehensive income.

Property, Plant and Equipment (Ind AS 16)

1.3

Objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

1. (a) The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if: (i) it is probable that future economic benefits associated with the item will flow to the entity; and (ii) the cost of the item can be measured reliably.

(b) Property Plant and Equipment are initially recognized at cost. The elements of costs are stated in the standard.

(c) Subsequently, Property Plant and Equipment are carried at

(i) cost less depreciation less impairment loss, or

(ii) Revalued amount less post revaluation depreciation and impairment loss.

(d) Revaluation loss is charged to P&L (to revaluation surplus to the extent it already exists)

(e) Revaluation profit is credited to revaluation surplus (to P&L to reverse a revaluation loss charged to P&L before).

2. Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and

(b) are expected to be used during more than one period.

3. However, Ind AS 16 does not apply to

(a) PPE classified as held for sale as per Ind AS 105

(b) Biological assets (other than bearer plants) related to agricultural activity (Ind AS 41)

(c) Assets in exploration for and evaluation of Mineral Resources (Ind AS 106)

(d) Mineral rights and mineral reserves such as oil, natural gas etc.

4. Initial recognition at cost (i.e., at historical cost)

The elements of costs are :

(a) Purchase Price—

i. trade discount and rebate are deducted

ii. duties and non-refundable taxes are added

iii. cash discount not subtracted

iv. GST not added

v. only cash price to be recognized; if interest element is included in the price, that should be subtracted (unless capitalized as per Ind AS 23).

vi. if the asset is acquired in exchange of another asset, purchase price is the fair value of the assed acquired or the asset given up (the carrying amount of the asset given up when neither of the fair values is reliably measured).

(b) Costs directly attributable to bringing the asset to its location and in the condition so as to make it available for its intended use —

i. employee cost

ii. cost of preparing the site

iii. freight and delivery cost

iv. installation and assembly cost

v. costs during the test run

vi. Professional fees (Architects fees)

(c) Dismantling cost —

a. The estimated dismantling cost at present value.

b. Estimated cost of removing the item and restorating site at present value.

(d) Elements of costs not included:

i. Administration and general overhead.

ii. Advertising and promotion cost of a new product.

iii. Cost of relocating

iv. Initial losses when asset is operating at low level

v. Incidental cost not directly related to installation.

5. Subsequent measurement of carrying amount:

(a) at cost less depreciation less impairment loss, or

(b) at revalued amount at fair value less post revaluation depreciation and impairment loss.

(c) addition of all capital expenditure to (a) or (b)

(i) expenditure which enhances the revenue generating capacity

(ii) cost of replacements

(iii) major inspection and overhauling expenses

6. Class of property, plant and equipment:

a. Land

b. Land and building

c. Machinery

d. Ships

e. Aircraft

f. Motor vehicles

g. Furniture and future

h. Office equipment and

i. Bearer plants.

7. Depreciation:

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Depreciable amount is the cost of an asset or other amount substituted for cost, less its residual value. The revalued amount is one such other amount substituted for cost. The fair value on exchange is another such amount.

8. Methods of depreciation are:

(a) The straight line method: Annual depreciation amount = Depreciable amount/ No. of years of useful life. It is a constant amount.

(b) The reducing (diminishing) balance method: Annual depreciation is calculated at a fixed percentage on the carrying amount. The carrying amount is getting reduced over the years and at the end of useful life of the asset it becomes equal to the estimated residual value. Here the annual depreciation amount is reducing over the years.

(c) The units of production method: Annual depreciation amount = (Annual production units/ Life time production units) × Depreciable amount.

9. Impairment Loss: It is dealt in Ind AS 36

Impairment Loss = Carrying amount less recoverable amount

Recoverable amount is the higher of the fair value of asset less cost to sell and the value in use. Fair value is defined in Ind AS 113. It is the exit value in an orderly transaction between market participants. Value in use is the entity specific value. It is the present value of all expected future cash flows from the asset.

10. Accounting of PPE: It involves—

a. Recognition as non-current and as PPE classified as in Para 5.

b. Measurement at initial cost

c. Subsequent measurement based on initial cost or on subsequent revaluation for subsequent measurement of PPE two deductions are there—

(i) Depreciation

(ii) Impairment loss

d. Presentation:

(i) PPE appears under non-current assets classified as per Para-5.

(ii) Revaluation profit/Loss is accounted through revaluation surplus a/c or P&L A/c.

(iii) Depreciation and impairment loss are accounted through P&L A/c.

11. Derecognition

The carrying amount of an item of property, plant and equipment shall be derecognised:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless Ind AS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.

The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

12. Disclosure: The financial statements shall make necessary disclosures as required in the Ind AS- 16.

The financial statements shall disclose, for each class of property, plant and equipment:

(a) the depreciation methods used;

(b) the useful lives or the depreciation rates used;

(c) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(d) a reconciliation of the carrying amount at the beginning and end of the period showing:

  (i) additions;

  (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with Ind AS 105 and other disposals;

  (iii) acquisitions through business combinations;

  (iv) increases or decreases resulting from revaluations under paragraphs 31, 39 and 40 and from impairment losses recognised or reversed in other comprehensive income in accordance with Ind AS 36;

  (v) impairment losses recognised in profit or loss in accordance with Ind AS 36;

  (vi) impairment losses reversed in profit or loss in accordance with Ind AS 36;

  (vii) depreciation;

  (viii) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and

  (ix) other changes.

The financial statements shall also disclose:

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(d) if it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

13. Illustrative Examples:

Illustration 4

X Ltd. Sets up a plant at the purchase price of ₹5,00,000 plus GST at 18% (Intra-state). Freight paid ₹ 20,000 plus GST at 18% (Intra-state). Paid ₹10,000 as employee expenses for installation of the planet. After the plant was put to use maintenance cost incurred ₹ 5,000. Measure the initial cost to be recognized and pass journal. Estimated dismantling cost ₹30,000, present value ₹12,000.

Solution:

An asset is recognized in the class Machinery under the item PPE in the non-current group of assets. The initial cost of the asset is measured as —

Particulars	(₹)
Purchase Price	5,00,000

Particulars	(₹)
Freight	20,000
Installation cost	10,000
Present value of dismantling cost	12000
	5,42000

GST and maintenance cost not to be recognized in initial cost of asset.

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Particulars	(₹)	(₹)
Machinery A/c Dr.	5,42,000	
Input CGST A/c Dr.	46,800	
Input SGST A/c Dr.	46,800	
Maintenance Exp. A/c Dr.	5,000	
To, Bank A/c		6,28,600
To Liability for Dismantling A/c		12,000

Working:

GST	State (9%)	Central (9%)
On ₹5,00,000	₹45,000	₹45,000
On ₹ 20,000	₹1,800	₹1,800
Total	₹46,800	₹46,800

Illustration 5

B Ltd. has incurred the following transactions in respect of acquiring a plant is exchange of an old plant :

(i) The old site was dismantled at a cost of ₹ 8,000, No estimated dismantling cost was capitalized for the old plant. Scrap from the old site sold at ₹ 1,000.

(ii) The new site was constructed at a cost of ₹ 48,000.

(iii) The supplier of the new plant agreed to take away the old plant at fair value of ₹ 1,26,000.

(iv) The new plant price was ₹ 3,20,000. The carrying amount of the old plant was ₹ 1,00,000.

(v) The present value estimate of dismantling the site is ₹ 16,000.

(vi) Wages paid for installation of the plant ₹ 4,000 for trial run ₹1,600.

(vii) Freight paid ₹ 8,000.

(viii) GST applies on supply of plant of 18% (Intra state) and on freight at 18% (intra state)

(ix) Loss amounted to ₹40,000 for low capacity utilization of the plant after installation.

(x) ₹ 10,000 was paid as cost of launching the product to be produced from the plant. Recognise the asset value and pass journal.

Solution:

Asset is recognized in the class Machinery under PPE as non-current asset. It is valued at initial cost measured as follows :

Particulars	(₹)
Cost of construction of new site	48,000
Price of the new plant	3,20,000
Present value estimate of dismantling the site	16,000
Installation and trial Run	5,600
Freight	8,000
Machinery at initial cost :	3,97,600

Particulars		Dr. (₹)	Cr. (₹)
Old Machinery A/c	Dr.	8,000	
To, Cash A/c			8,000
(Dismantling of old sets)			
Cast A/c	Dr.	1,000	
To, Old Machinery A/c			1,000
(Scrap realized)			
Machinery (New) A/c	Dr.	3,97,600	
To, Old Machinery A/c.(1,00,000 + 8,000 – 1,000)			1,07,000
To, Profit on Sale of Old Plant A/c (1,26,000 – 1,07,000)			19,000
To, Supplier A/c or Cash A/c (3,20,000 – 1,26,000)			1,94,000
To Cash A/c (Freight installation + construction of site)			61,600
To Liability for dismantling A/c			16,000

Note : (ix) Loss ₹40000 and (x) cost of launching product ₹10,000 are charged to Profit and Loss A/c.

2. GST accounting has not been shown.

Illustration 6

A Ltd. Purchased an aircraft at a price of ₹6,300 crores that requires major inspection and overhauling every 4 years. The estimated life of the aircraft is 15 years. The aircraft was purchased in 2015 and major inspection and overhauling made in 2019 at a cost of ₹ 100 crores. In 2020 A Ltd. Further incurred repair and maintenance in the engine to raise it capacity by 10% amounting to ₹ 70 crores. One worn out component in the wing was replaced in 2020 at a cost of ₹ 80 crores. The carrying amount of the old component was ₹ 30 crores. Scrap realized ₹ 12 crores. find the amount to be recognized as expense and as asset in 2019 and in 2020 and also show the carrying amount. The aircraft residual value is estimated at ₹ 300 crores.

Solution: **(₹in Crore)**

	Expense	Asset	
		Recognised	Carrying amount
In 2018			
Depreciation ₹(6,300 - 300)/15	400		
Carrying amount			4,700 (6300 – 4×400)
In 2019			
Depreciation = ₹400 + (₹100/4)	425		
Major Inspection overhauling		100	
Carrying amount [₹4,700 + ₹100 – ₹425]			4,375
In 2020			
Depreciation	425		
Repair & Maintenance (Capacity increase)		70	
Replacement		80	
Old component derecognized		(30)	
loss on disposal of old component ₹(30 – 12)	18		4,058
Carrying amount (₹4,375 + ₹70 +₹80 –₹30 – ₹437)			

Notes :

1. Depreciation At straight line for 15 years useful life.
2. Major inspection and overhauling capitalized and depreciated at straight line for 4 years.
3. Repair & maintenance and replacement of old component depreciated at straight line for residual life i.e. 15–5=10 years.
4. Full depreciation is changed in the year it is recognized.

Illustration 7

X Ltd. Purchased a machine at a price of ₹ 1,200 Lakhs. It paid freight 40 and installation cost ₹ 80 Lakhs. IGST paid at 18%. Share of general overhead ascertained for the trial run of the machine ₹ 30 Lakhs. The labour cost and direct expenses for trial run is ₹ 60 Lakhs. The machine has been put to use on 01.04.2019.

The estimated dismantling cost of the machine at the end of its useful life of 10 years is ₹ 400 Lakhs. Discounting rate to be applied is 5%. [PV estimated at ₹ 246 Lakhs]

The machine requires major over hauling every 2 years at cost of ₹ 26 lakhs.

Pass journal entries and accounting treatments for the year 2019-20 and 2020-21.

Solution:

Working note 1: Initial Cost Recognized

Particulars	₹in Lakhs	₹ in Lakhs
Purchase Price	1,200	
Freight	40	
Installation Cost		80
IGST not considered		—
General overhead not considered		—
Labour cost and expense for trial run		60
P.V. of estimated dismantling cost		2,46
Depreciable amount		1,626
Less: Overhauling cost		26 to be depreciated in 2 years
Balance		1,600 to be depreciated in 10 years
Annual depreciation ₹13 + ₹160 = ₹173		

Working note 2:

P.V. of Dismantling Cost		**= ₹ 246 Lakhs**
5% discounting unwinded in year 1	= ₹ 246 Lakhs × 5%	= ₹ 12.3 Lakhs
Provision for dismantling cost is revised to	= ₹ 246 Lakhs + ₹12.3 Lakhs	= ₹ 258.3 Lakhs
Discount unwinded in year 2	= ₹ 258.3 Lakhs × 5%	= ₹ 12.92 Lakhs (Approx)
And prov. for dismantling cost is raised to	= ₹258.3 Lakhs + ₹12.92 Lakhs	= ₹ 271.22 Lakhs

Illustration 8

Alfa Ltd. Has machinery at cost ₹ 4,800 and provision for depreciation ₹ 1,600 as on 01.04.2018. On that date the remaining life of the machine is 6 years with residual value of ₹ 800. On the same date one component of the machine is replaced, the price of the new component is ₹ 600 and the cost of the old component was ₹ 500 with accumulated depreciation ₹ 200. The supplier of the new component took the old component at a fair value of ₹ 360.

On 31.03.2019 the machine is revalued as per company policy at ₹ 5000. On 31.03.2020 an impairment loss of ₹ 900 has been recognized for the machine. Pass journal entries and show the accounting treatments to be made in the financial statement for the years ending on 31.03.2019, 31.03.2020 and 31.30.2021. Depreciation to be charged based on straight line method.

Solution:

Working note-1

Particulars	(₹)	(₹)
On 1.4.2018 : Carrying amount ₹ (4,800 – 1,600)		
Add. Replacement Cost of New Component (600 - Carrying amount of old ₹ 500 – ₹ 200 i.e ₹ 300) [Profit on disposal of old machinery = ₹ 360 – ₹ 300 = ₹ 60]	300	
Carrying amount	3,500	
Depreciation for 2018-2019 : ₹(3,500 – ₹ 800)/6 [Carrying amount – residual value] ÷ Life]	(450)	
On 31.03.2019 Depreciated value		**3,050**
On 31.03.2019 : Revalued at	5,000	
Depreciation for 2019-2020 (₹ 450 + ₹ 1950/5)	(840)	
Depreciated value ₹ (5,000 – 840)	4,160	
Less: Impairment Loss	(900)	
On 31.03.2020 Carrying amount after Impairment		**3,260**
Depreciation. For 2020-2021: ₹ (3,260 – 800)/4		**615**

Note :

(i) 1/5th of Revaluation surplus is to be transferred from Revaluation Surplus other compre (OCI) to Retained earnings for 2018-19 [as depreciation (1/5th) is realized]

(ii) Impairment loss is charged to P & L a/c but as Revaluation Surplus exists it is charged to Revaluation surplus on 31.03.2020.

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Date	Particulars		(₹)	(₹)
01.04.2018	Machinery A/c	Dr.	600	
	To, Supplier A/c			600
	Prov. for Depreciation A/c	Dr.	200	
	Supplier A/c	Dr.	360	
	To, Machinery A/c			500
	To, Profit on Disposal of Machinery A/c			60
31.03.19	Depreciation A/c	Dr.	450	
	To, Provision for Depreciation A/c			450
31.03.19	Machinery A/c	Dr.	100	
	Provision for Depn. A/c	Dr.	1,850	
	To, Revaluation Surplus A/c			1,950

Date	Particulars		(₹)	(₹)
31.03.20	Depreciation A/c	Dr.	840	
	To, Provision for Depreciation A/c			840
	Impairment loss A/c	Dr.	900	
	To, Machinery A/c.			900
31.03.21	Depreciation A/c	Dr.	615	
	To, Provision for Depreciation A/c			615

Accounting treatment to be shown in the financial statements :

On 31.03.2019

In Statement of P & L —

(i) Profit on disposal of machinery is shown as income ₹ 60

(ii) Annual depreciation is shown as expense ₹ 450

(iii) Revaluation surplus recognized as other comprehensive Income ₹ 1,950

In Balance Sheet—

(i) Machinery is shown under PPE ₹ 5,000 (Revalued)

(ii) Provision for depn. NIL

(iii) Revaluation surplus is recognized as other comprehensive income and shown under other equity.

On 31.03.2020

In Statement of P & L—

(i) Annual Depreciation is shown as expense ₹ 840

(ii) Revaluation surplus as OCI is reduced for impairment loss ₹ 900

(iii) Transfer from Revaluation profit to retained Earnings ₹ 390

In Balance Sheet—

(i) Machinery is shown under PPE ₹ 4,100

(ii) Provision for depreciation ₹ 840

(iii) Revaluation surplus under other equity₹ 660 (₹ 1,950 –₹ 390 ₹ 900)

On 31.03.2021

In Statement of P & L—

(i) Depreciation ₹ 615

(ii) Transfer from revaluation profit to retained darning's 1/4th ×₹ 660 = ₹ 165

In Balance Sheet—

(i) Machinery ₹ 4,100

(ii) Prov. for Depn.₹ (840 + 615) = ₹ 1,455

(iii) Revaluation Profit under other equity =₹₹660 – ₹ 165 = ₹ 495

Leases (Ind AS 116) 1.4

This Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity. 2 An entity shall consider the terms and conditions of contracts and all relevant facts and circumstances when applying this Standard. An entity shall apply this Standard consistently to contracts with similar characteristics and in similar circumstances.

At inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the **right to control the use of an identified asset** for a period of time in exchange for consideration.

To assess whether a contract conveys the right to control the use of an identified for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

(a) the right to obtain substantially all of the economic benefits from use of the identified asset; and

(b) the right to direct the use of the identified asset.

Accounting of leases in the books of the Lessee:

At the commencement date, the lessee shall recognise (I) a right-of-use asset and (II) a lease liability.

Exemption: A lessee may elect not to recognise under this standard

(i) short-term leases; and

(ii) leases for which the underlying asset is of low value.

No asset/ liability recognized under Ind AS 116 if the contract is not, does not contain a lease.

At the commencement date**, a lessee shall measure the right-of-use (ROU) of asset at cost.**

The cost of the right-of-use of asset shall comprise:

(i) the amount of the initial measurement of the lease liability

(ii) any lease payments made at or before the commencement date, less any lease incentives received;

(iii) any initial direct costs incurred by the lessee; and

(iv) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset.

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. **The lease payments shall be discounted using the interest rate implicit in the**

lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

At the commencement date, the **lease payments included in the measurement of the lease liability** comprise the following payments for the right to use the underlying asset during the lease term that are not paid at the commencement date:

(i) fixed payments (including in-substance fixed payments as described in paragraph B42), less any lease incentives receivable;

(ii) variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;

(iii) amounts expected to be payable by the lessee under residual value guarantees;

(iv) the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and

(v) payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies the revaluation model as applied to the particular class of PPE.

To apply a cost model, a lessee shall measure the right-of-use asset at cost: (a) less any accumulated depreciation and any accumulated impairment losses; and (b) adjusted for any remeasurement of the lease liability specified.

A lessee shall apply the depreciation requirements in Ind AS 16, Property, Plant and Equipment, in depreciating the right-of-use asset (for the lease term or the useful life based on the lease condition).

If during lease any increase or decrease in liability arises when there exists a balance in ROU, to that extent ROU will be debited/credited and the balance would be transferred to P&L.

A lessee shall either present in the Balance Sheet, or disclose in the notes:

(a) right-of-use assets separately from other assets. If a lessee does not present right-of-use assets separately in the balance sheet, the lessee shall:

  (i) include right-of-use assets within the same line item as that within which the corresponding underlying assets would be presented if they were owned; and

  (ii) disclose which line items in the balance sheet include those right-of-use assets.

(b) lease liabilities separately from other liabilities. If a lessee does not present lease liabilities separately in the balance sheet, the lessee shall disclose which line items in the balance sheet include those liabilities.

The above requirement does not apply to right-of-use assets that meet the definition of investment property, which shall be presented in the balance sheet as investment property.

In the statement of profit and loss, a lessee shall present interest expense on the lease liability separately from the depreciation charge for the right-of-use asset. Interest expense on the lease liability is a component of finance costs, to be presented separately in the statement of profit and loss.

In the statement of cash flows, a lessee shall classify:

(a) cash payments for the principal portion of the lease liability within financing activities;

(b) cash payments for the interest portion of the lease liability within financing activities applying the requirements in Ind AS 7, Statement of Cash Flows, for interest paid; and

(c) short-term lease payments, payments for leases of low-value assets and variable lease payments not included in the measurement of the lease liability within operating activities.

(d) Any payments of unrecognized lease arrangement should also be treated like (c).

Accounting of leases in the books of the Lessor:

A lessor shall classify each of its leases as either an operating lease or a finance lease.

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Finance Lease

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as **a finance lease** are:

(a) the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;

(b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;

(c) the lease term is for the major part of the economic life of the underlying asset even if title is not transferred;

(d) at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and

(e) the underlying asset is of such a specialised nature that only the lessee can use it without major modifications.

The net investment in the lease consists of the present value of the lease payments plus the present value of the guaranteed residual value, both discounted at the interest rate implicit in the lease, plus the present value of unguaranteed residual value, less deferred selling profit. (Deferred selling profit is calculated as the lease receivable less the carrying amount of the underlying asset, net of unguaranteed residual.) It may be mentioned that the net investment in the lease is subject to the same considerations as other assets when classifying its components as current or noncurrent assets in the balance sheet.

Interest income includes interest on the lease receivable, accretion of the unguaranteed residual value and amortisation of deferred selling profit. The rate for recognising interest income to produce a constant periodic rate of return on the remaining net investment is IRR.

Operating Lease

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis. The lessor shall apply another systematic basis if that basis is more representative of the pattern in which benefit from the use of the underlying asset is diminished.

A lessor shall recognise costs, including depreciation, incurred in earning the lease income as an expense.

A lessor shall add initial direct costs incurred in obtaining an operating lease to the carrying amount of the underlying asset and recognise those costs as an expense over the lease term on the same basis as the lease income.

The depreciation policy for depreciable underlying assets subject to operating leases shall be consistent with the lessor's normal depreciation policy for similar assets. A lessor shall calculate depreciation in accordance with Ind AS 16 and Ind AS 38.

A lessor shall apply Ind AS 36 to determine whether an underlying asset subject to an operating lease is impaired and to account for any impairment loss identified.

A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

Presentation

A lessor shall present underlying assets subject to operating leases in its balance sheet according to the nature of the underlying asset.

Disclosure

The objective of the disclosures is for lessors to disclose information in the notes that, together with the information provided in the balance sheet, statement of profit or loss and statement of cash flows, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor.

A lessor shall disclose the following amounts for the reporting period:

(a) for finance leases: (i) selling profit or loss; (ii) finance income on the net investment in the lease; and (iii) income relating to variable lease payments not included in the measurement of the net investment in the lease.

(b) for operating leases, lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.

Illustration 9

Lessor Y leases out an equipment (carrying amount ₹ 1,36,000 having 5 years life) to Lessee X for 3 years for annual payment of ₹ 50,000 (at the end of every year) and residual value of ₹50,000, guaranteed by X up to loss of ₹ 30,000. Interest rate implicit is 10%. At the end of the lease the equipment is valued at ₹ 33,000. Show accounting in books of X. Interest rate implicit in lease payments is 10%. At the end of the lease the equipment is valued at ₹ 33,000. Show accounting of lease classified as finance lease in books of Y. The rate of interest income on the net investment in lease, however, is 19.274%.

Solution:

In books of Lessee X:

At 10% implicit rate of interest the (Right-of-use) ROU Asset and Lease Liability are initially recognised at present value of payments as shown below.

Year	Payments (₹)	Disc. Factor	DCF at 10% (₹)
1	50,000	0.90909091	45,454.55
2	50,000	0.82644628	41,322.31
3	50,000	0.7513148	37,565.74

Year	Payments (₹)	Disc. Factor	DCF at 10% (₹)
3	Guaranteed 30,000	0.7513148	22,539.44
Present value			1,46,882

Lease Liability repayment and interest

Year	Interest (₹)	Payments/remission (₹)	Balance (₹)
0			1,46,882
1	14,688.2	50,000	1,11,570.2
2	11,157.02	50,000	72,727.27
3	7,272.727	50,000	30,000
3	0	17,000 guarantee payments (50,000 – 33,000)	13,000
3	0	13,000 guarantee remissions (30,000 – 17,000)	0

ROU Asset Depreciation for the lease period

Year	Depreciation Straight line (₹)	Balance (₹)
0		1,46,882
1	48,961	97,921
2	48,961	48,960
3	48,960	0

After the commencement date, a lessee shall measure the right-of-use asset applying a cost model, unless it applies the revaluation model as applied to the particular class of PPE.

To apply a cost model, a lessee shall measure the right-of-use asset at cost: (a) less any accumulated depreciation and any accumulated impairment losses; and (b) adjusted for any remeasurement of the lease liability specified.

A lessee shall **apply the depreciation requirements in Ind AS 16, Property, Plant and Equipment**, in depreciating the right-of-use asset (for the lease term or the useful life based on the lease condition).

Journal **Dr.** **Cr.**

	Particulars		Dr. (₹)	Cr. (₹)
At inception	ROU Asset A/c	Dr.	1,46,882	
	To, Lease Liability A/c			1,46,882
At the end of Year 1	Interest Expenses A/c	Dr.	14,688	
	To, Lease Liability A/c			14,688
	Lease Liability A/c	Dr.	50,000	
	To, Bank A/c			50,000

	Particulars		(₹)	(₹)
	Depreciation A/c To, ROU Asset	Dr.	48,961	 48,961
At the end of Year 2	Interest Expenses A/c To, Lease Liability A/c	Dr.	11,157	 11,157
	Lease Liability A/c To, Bank A/c	Dr.	50,000	 50,000
	Depreciation A/c To, ROU Asset	Dr.	48,961	 48,961
At the end of Year 3	Interest Expenses A/c To, Lease Liability A/c	Dr.	7,273	 7,273
	Lease Liability A/c To, Bank A/c	Dr.	50,000	 50,000
	Depreciation A/c To, ROU Asset A/c	Dr.	48,960	 48,960
	Lease Liability A/c To, Bank A/c (₹50,000 – ₹33,000 = ₹17,000, guaranteed up to ₹30,000) To, P&L (liability remission) ##	Dr.	30,000	 17,000 13,000

if during lease any increase or decrease in liability arises when there exists a balance in ROU, to that extent ROU will be debited/credited instead of P&L.

Presented in the Financial Statements:

Balance Sheet

Particulars	At the end of Year 1 (₹)	At the end of Year 2 (₹)	At the end of Year 3 (₹)
ROU Asset	97,921	48,960	0
Lease Liability	1,11,570	72,727	0

Statement of P&L **(Amount in ₹)**

		Year 1	Year 2	Year 3
Interest A/c	Dr.	14,688	11,157	7,273
Depreciation A/c	Dr.	48,961	48,961	48,960
Guarantee remission A/c	Cr.			13,000

Statement of Cash Flows **(Amount in ₹)**

	Year 1	Year 2	Year 3
Cash used in financing activities	50,000	50,000	50,000
Cash used in financing activities			17,000

I may take up accounting of leases in the books of the lessor in another issue.

In the books of Y

Working notes:

(a) present value of lease receivable = ₹1,46,882 (Amount in ₹)

Year	Payments	Disc. Factor	DCF at 10%
1	50,000	0.90909091	45,454.55
2	50,000	0.82644628	41,322.31
3	50,000	0.7513148	37,565.74
3	Guaranteed 30,000	0.7513148	22,539.44
Present value			1,46,882

(b) Deferred selling profits at inception:

Particulars	(₹)
Revenue = Present value of lease receivable	1,46,882
Cost of goods sold = 136000 – 15026 (Carrying amount - Present Value of Unguaranteed residual*)	1,20,974
Deferred selling profits at inception	25,908

*₹20,000 × 0.7513 = ₹15,026

(c) Net Investment in Lease at inception = Present value of lease receivable + P. V. of Unguaranteed residual – Deferred selling profits = ₹ 1,46,882 + ₹ 15,026 – ₹ 25,908 = ₹ 1,36,000 = Carrying amount of the underlying asset.

(d) Interest income on net investment in lease (19.274%) includes interest on the lease receivable, accretion of the unguaranteed residual value and amortisation of deferred selling profit.

Interest Income	(₹)
Net Investment in Lease	1,36,000
Add Interest Income @ 19.274% = ₹ 1,36,000 × 19.274%	26,213
Total	1,62,213
Less Payment	50,000
Balance at the end of year 1	1,12,213

Interest Income	(₹)
Add Interest Income @ 19.274% = ₹1,12,213 × 19.274%	21,628
Total	1,33,841
Less Payment	50,000
Balance at the end of year 2	83,841
Add Interest Income @ 19.274% = ₹83,841 × 19.274%	16,159
Total	1,00,000
Less Payment	50,000
Less Payment for Guaranteed loss borne by Lessee	17,000
Returned at residual value at the end of year 3	33,000

Journal **Dr.** **Cr.**

Date	Particulars		(₹)	(₹)
At the inception	Net Investment in Lease A/c	Dr.	1,36,000	
	To, PPE			1,36,000
At the end of year 1	Bank A/c	Dr.	50,000	
	To, Interest Income A/c			26,213
	To, Net Investment in Lease A/c [50,000 – 26,213]			23,787
At the end of year 2	Bank A/c	Dr.	50,000	
	To, Interest Income A/c			21,628
	To, Net Investment in Lease A/c			28,372
At the end of year 3	Bank A/c	Dr.	50,000	
	To, Interest Income A/c			16,159
	To, Net Investment in Lease A/c			33,841
	PPE A/c	Dr.	33,000	
	Bank A/c	Dr.#	17,000	
	To, Net Investment in Lease A/c			50,000

Residual Value = ₹33,000. Loss = ₹50,000 – ₹33,000 = ₹17,000 borne by lessee (guaranteed by lessee up to ₹ 30000)

(Amount in ₹)

P&L	Year 1	Year 2	Year 3
Interest Income	26,213	21,628	16,159

Balance sheet	At inception	At the end of Year 1 (₹)	At the end of Year 2 (₹)	At the end of Year 3 (₹)
Net Investment in Lease	1,36,000	1,12,213	83,841	0
PPE	(1,36,000)			+33,000
Cash				+17,000

Statement of Cash Flows	At the end of Year 1 (₹)	At the end of Year 2 (₹)	At the end of Year 3 (₹)
Cash from investing activities	50,000	50,000	50,000
Cash from investing activities			17,000

The Effects of Changes in Foreign Exchange Rates (Ind AS 21)

1.5

The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

1. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

   This Standard shall be applied:

   (a) in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of Ind AS 109, Financial Instruments;

   (b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation or the equity method; and

   (c) in translating an entity's results and financial position into a presentation currency.

   In preparing financial statements, each entity translates foreign currency items into its functional currency and reports the effects of such translation.

   Initial recognition

   A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

   (a) buys or sells goods or services whose price is denominated in a foreign currency;

   (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

   (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

   A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

2. **Reporting at the ends of subsequent reporting periods:** At the end of each reporting period: (a) foreign currency monetary items shall be translated using the closing rate; (b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and (c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.

3. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is the lower of cost and net realisable value in accordance with Ind AS 2 Inventories. Similarly, in accordance with Ind AS 36 Impairment of Assets, the carrying amount of an asset

for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:

(a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e. the rate at the date of the transaction for an item measured in terms of historical cost); and

(b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (eg the closing rate at the end of the reporting period). The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa.

Ezample 1: (impairment loss)

Entity A's functional currency is Rupee. It has a building located in US acquired at a cost of US$ 20,000 when the exchange rate was US$ 1= ₹ 60. The building is carried at cost in the financial statements of Entity A. For the purpose of this example depreciation is ignored. At the balance sheet date, there is an indication of impairment for this building. Consequently, an impairment test has been made in accordance with Ind AS 36 as at the balance sheet date and the recoverable amount of the building is determined to be US$ 19,000. The exchange rate as at the balance sheet date is US$ 1= ₹ 64. Cost translated at the exchange rate on the date of acquisitionUS$20,000 @ ₹ 60 per US$ is ₹ 12,00,000 Recoverable amount translated at the exchange rate on the balance sheet date-US$19,000 @ ₹ 64 per US$ is ₹ 12,16,000. Though there is an impairment loss of US$ 1000 (US$20,000-US$19,000) in terms of foreign currency, there is no impairment loss in terms of functional currency. This is because, recoverable amount in terms of functional currency (₹ 12,16,000) exceeds carrying amount (ie cost in this example) in terms of functional currency (₹ 12,00,000). Hence, no impairment loss is recognised for the building.

4. Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise.

5. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates during each period. When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss shall be recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.

6. Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment.

7. When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements. If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements. If

such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements. Such exchange differences are recognised in other comprehensive income in the financial statements that include the foreign operation and the reporting entity (i.e. financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method).

Example 2:

Entity P has a foreign subsidiary Entity S1. The functional currencies of Entities P and S1 are Rupee and US$ respectively. Accounting Year of both the entities ends on March 31. The presentation currency for Entity P's separate as well as consolidated financial statements is Rupee. Entity S1 owes to Entity P US$2,000 towards a loan obtained some years back. Exchange rates as at 31 March 20X0 and 31 March 20X1 were US$ 1= ₹ 58 and US$ 1= ₹ 60 respectively. In the above situation, in the individual financial statements of Entity S1, no exchange difference arises on the loan since it is denominated in its own functional currency. In the separate financial statements of Entity P, an exchange gain of ₹ 4,000 arises as shown below: Loan asset of US$2,000 translated @ exchange rate as at 31 March 20X1(₹ 60 per US$) is ₹ 1,20,000 @ exchange rate as at 31 March 20X0(₹ 58 per US$) 1,16,000 Exchange gain ₹ 4,000. In the consolidated financial statements of Entity P, the exchange gain of ₹ 4,000 will be recognised in other comprehensive income and accumulated in equity.

8. When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

   The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

   (a) assets and liabilities for each balance sheet presented (ie including comparatives) shall be translated at the closing rate at the date of that balance sheet;

   (b) income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

   (c) all resulting exchange differ.

9. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate.

10. On the partial disposal of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

11. Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have tax effects. Ind AS 12 Income Taxes applies to these tax effects.

12. An entity shall disclose:

    (a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 39;

(b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period; and

(c) net exchange differences recognised directly in equity and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.

13. When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact, the reason for the change in functional currency and the date of change in functional currency shall be disclosed.

    The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income are not reclassified from equity to profit or loss until the disposal of the operation.

14. When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with Indian Accounting Standards only if they comply with all the requirements of each applicable Standard

When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency, it shall:

(a) clearly identify the information as supplementary information to distinguish it from the information that complies with Indian Accounting Standards;

(b) disclose the currency in which the supplementary information is displayed; and

(c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Borrowing Costs (Ind AS 23) 1.6

Objective of this standard is to provide principles for recognising borrowing costs as asset or expense depending on the circumstances.

1. An entity shall apply this Standard in accounting for borrowing costs.
2. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.
   - 2.1. The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.
   - 2.2. An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of: (a) a qualifying asset measured at fair value, for example, a biological asset; or (b) inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis.
3. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
4. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.
   - 4.1. Borrowing costs may include: (a) interest expense calculated using the effective interest method as described in Ind AS 39 Financial Instruments: Recognition and Measurement; (b) finance charges in respect of finance leases recognised in accordance with Leases; and (c) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.
   - 4.2. With regard to exchange difference required to be treated as borrowing costs the manner of arriving at the adjustments stated therein shall be as follows:
     - (i) the adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the cost of borrowing in functional currency when compared to the cost of borrowing in a foreign currency.
     - (ii) where there is an unrealised exchange loss which is treated as an adjustment to interest and subsequently there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain to the extent of the loss previously recognised as an adjustment should also be recognised as an adjustment to interest."
5. An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them.
   - 5.1. To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual

borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

5.2. To the extent that an entity borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate shall be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that an entity capitalises during a period shall not exceed the amount of borrowing costs it incurred during that period.

5.3. An entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

(a) it incurs expenditures for the asset;

(b) it incurs borrowing costs; and

(c) it undertakes activities that are necessary to prepare the asset for its intended use or sale.

5.4. An entity shall suspend capitalisation of borrowing costs during extended periods in which it suspends active development of a qualifying asset.

5.5. An entity shall cease capitalising borrowing costs when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

5.6 When an entity completes the construction of a qualifying asset in parts and each part is capable of being used while construction continues on other parts, the entity shall cease capitalising borrowing costs when it completes substantially all the activities necessary to prepare that part for its intended use or sale.

6. An entity shall disclose:

(a) the amount of borrowing costs capitalised during the period; and

(b) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Impairment of Assets (Ind AS 36)

1.7

The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures.

1. **Impairment of assets is recognized as per Ind AS 36 for assets including PPE, Intangible assets and good will but excluding:**

   (a) inventories

   (b) assets arising from construction contracts (Ind AS 11) and Revenue (Ind AS 18)

   (c) deferred tax assets

   (d) assets arising from employee benefits (Ind AS 19)

   (e) Financial assets (Ind AS 109)

   (f) biological assets (Ind AS 41)

   (g) non-current assets classified as held for sale (Ind AS 105)

   When is impairment of asset recognized ?

   An asset is impaired when the carrying amount of the asset exceeds its recoverable amount. Recoverable amount is the higher of the fair value less cost to sell and value in use.

Illustration 10

(a) A Ltd. Has a machine whose original cost was ₹ 45,000. The accumulated depreciation on the machine is ₹ 15,000. Similar machine has recently been sold in the same locality at ₹ 25,000 with selling expenses ₹ 2,000. Management determined the entity specific present value of future cash flows of the machine as ₹ 28,000. Find

(b) Fair value less cost to sell

(c) Recoverable amount

(d) Impairment loss

(e) Carrying amount of the machine after impairment.

Solution:

(a) Fair value less cost to sell = ₹ 25,000 – ₹ 2,000 = ₹ 23,000

(b) Recoverable amount is the higher of the fair value less cost to sell and value in use i.e. higher of ₹ 23,000 and ₹ 28,000 i.e. ₹ 28,000

(c) Impairment loss is the carrying amount before impairment less the recoverable amount =₹ (45,000 – 15,000) - ₹ 28,000 = ₹ 2,000

(d) Carrying and after impairment = ₹ 30,000 – ₹ 2,000 = ₹ 28,000 (equal to recoverable amt.)

If the machine were revalued and there remains any revaluation profit accumulated balance as OCI under other equity, that should be used first and then profit and loss a/c will be used to close the impairment loss a/c.

2. Special issues about impairment of assets:

(a) The Ind AS 36 : Impairment of assets prescribes the procedure to ensure that its assets are carried at no more than their recoverable amount.

(b) Recoverable amounting determined for an individual asset. If the asset does not generate cash inflows that are largely independent of those from other assets the recoverable amount is determined for cash generating unit to which the asset belongs.

(c) A cash generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash in flows from other assets or group of assets.

(d) The recoverable amount of an asset or a Cash Generating Unit (CGU) is measured whenever there is an indication that the asset may be impaired.

(e) At each reporting date an entity assesses whether there is any indication that an asset (or) CGU) may be impaired.

(f) The recoverable amount of the following assets we measured annually.

(i) An intangible asset with an indefinite useful life.

(ii) An intangible asset not yet available for use

(iii) Goodwill

(g) The recoverable amount of an asset or a cash generating unit is the higher of its fair value less costs to sell and its value in use.

(h) An impairment loss is the excess of the carrying amount over the recoverable amount and it is recognized in P & L a/c immediately, unless the asset is carried at revalued amount in which case any impairment loss of a revalued asset should be treated as a revaluation decrease to the extent of the carrying amount revaluation profit.

(i) After the recognition of an impairment loss, depreciation (or amortization) change for the asset will be calculated based on the revised carrying amount and its remaining useful life.

(j) When impairment loss is computed for a cash generating unit, it should be allocated to reduce the carrying amount of the assets of the CGU in the following order.

First, to goodwill (to the extent of the carrying amount of goodwill).

Then to all other assets of the unit in pro-rata basis on the carrying amount of the assets of the unit. Thus impairment loss in always shown as deduction from individual assets even when it is measured on the CGU.

In case of assets of a CGU, for allocation of the impairment loss the revised carrying amount of the assets should not be reduced below the highest of the following

(i) its net selling price

(ii) its value in use

(iii) zero

If the allocation of impairment loss cannot be made fully, the unallocated part shall again be re- allocated to other assets pro-rata.

(k) Reversal of impairment loss: If the recoverable amount subsequently increases, the previously recognized impairment loss shall be reversed not exceeding the carrying amount without any impairment.

(l) In case of reversal of impairment loss of CGU, first, assets other than goodwill shall be written up on pro-rata on carrying amount and then, goodwill will be written up.

Illustration 11

An entity has the following assets with relevant data on the reporting data : (₹ in Lakhs)

Assets	Carrying Amount	Fair value less cost to sell	Value-in-use
A	280	300	250
B	460	400	390
C	220	240	270
D	180	150	170
E	100	80	—

Assets C and D were revalued before. The carrying amounts of revaluation surplus are ₹ 40 Lakhs and ₹ 30 Lakhs respectively. Asset E falls in the cash generating unit consisting of goodwill ₹ 50 Lakhs and intangible asset 90. The fair value less cost to sell of the CGU is ₹ 180 Lakhs and value-in-use is ₹ 170 Lakhs.

Determine impairment loss and revised carrying amount of all the assets stated above. Show the accounting treatment.

Solution: **(₹ in Lakhs)**

Asset	Recoverable Amount	Impairment Loss	Revised Carrying Amount
A	300	—	280
B	400	60	400
C	270	—	220
D	170	10 β	170
CGU	180	60	180
Goodwill		50@	NIL
Intangible asset		4.47	85.26
E		5.26	94.74

Working Note:

CGU consist of :	(₹ in lakhs)
Goodwill	50
In-Tangible	90
Asset E	100
Carrying Amount	**240**
Recoverable Amount	180

Difference in Impairment Loss is ₹ 60,00,000.

∴ Impairment loss is charged to P & L a/c except β.

@ : First goodwill is reduced by the impairment loss of the CGU. & : Next other assets are reduced impairment loss CGU pro-rata.

β : Impairment Loss is charged against revaluation surplus.

Illustration 12

An entity has a machinery on 01.04.2017 with carrying amount of ₹ 28,00,000 after annual depreciation of ₹ 3,00,000 with remaining useful life of 9 years and residual value of ₹ 1,00,000. Depreciation is charged on straight line method. In 31.03.2018 the machine is revalued at ₹ 29,00,000. On 31.03.2020 the machine has fair value less cost to sell ₹ 20,00,000 and value in use ₹ 21,00,000. Show how the transactions would be reflected in the financial statements of the entity as on 31.03.18, 31.03.19, 31.03.20 and 31.03.21.

Solution:

Working Note 1:

Particulars	(₹)
Carrying Amount on 01.04.2017	28,00,000
Less: Depreciation during 2017-18	3,00,000
	25,00,000
Add: Revaluation Profit (₹29,00,000 – ₹25,00,000)	4,00,000
Carrying out on 31-03-2018	29,00,000
Less Depreciation during 2019-2020 = (₹29,00,000 – ₹1,00,000)/8	3,50,000
Carrying and on 31-03-19	25,50,000
Less Depreciation during 2020-2021	3,50,000
Carrying out on 31-03-20	22,00,000
Less Impairment loss (Carrying amt less recoverable amount.# = 2200000 - 2100000)	1,00,000
Carrying amt on 31.03.2020	21,00,000
Less Depreciation during 2020-2021 = (₹21,00,000 – ₹1,00,000)/6	3,33,333
Carrying Amount on 31.3.21	17,66,667

#(Recoverable amount is higher of fair value less cost to sell ₹ 20,00,000 and Value-in-use ₹ 21,00,000)

* : Higher of the fair value less cost to sell and value-in-use

: Carrying Amount — Recoverable amount when carrying amount > Recoverable amount otherwise NIL.

$: Carrying Amount — Impairment loss.

(Amount in ₹)

Statement of Profit & Loss:	31.03.18	31.03.19	31.03.20	31.03.21
Depreciation	(–) 3,00,000	(–) 3,50,000	(–) 3,50,000	(–) 3,33,333
Other comprehensive Income:				
Revaluation Profit	+ 4,00,000			
For Annual realization of revaluation Profit through depreciation transfer from Revaluation profit to retained earnings [Note 2]				
Revaluation Profit (OCI)		(–) 50,000	(–) 50,000	(–) 33,333
P & L		+ 50,000	+ 50,000	+ 33,333
Impairment loss charged against revaluation profits			(–) 1,00,000	

(Amount in ₹)

Balance Sheet:	31.03.18	31.03.19	31.03.20	31.03.21
PPE – Machinery	29,00,000	25,50,000	21,00,000	17,66,667
Revaluation Profit under Other equity [Note 3]	4,00,000	3,50,000	2,00,000	1,66,667

Note 2 : Revaluation profit subsequent transfer to P & L 31-03-19 4,00,000 ÷ 8 = ₹50,000

31-03-20 4,00,000 ÷ 8 = ₹50,000

31-03-21 2,00,000 ÷ 6 = ₹33,333

Note 3: Revaluation Profit under Other equity (Amount in ₹)

Particulars		(₹)
Revaluation profit (OCI) under other equity carrying amount on 31.03.18		4,00,000
Transfer to Retained Earnings (P & L) for 2018-2019		(50,000)
For 2019-2020		(50,000)
		3,00,000
Less Impairment loss on 31.03.20		1,00,000
Carrying amount on 31.03.20		2,00,000
Less Transfer to P & L		33,333
Carrying amount on 31.03.20		1,66,667

Intangible Assets (Ind AS 38) 1.8

The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets and requires specified disclosures about intangible assets.

An intangible asset is an identifiable non-monetory asset without physical substance. It excludes

(i) financial assets (ii) the recognition and measurement of exploration and evaluation assets (Ind AS 106), (iii) expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources; and (iv) intangible assets that are within scope of another standard — for example.

(a) Ind AS 2 : Inventory

(b) Ind AS 12 : Income Taxes

(c) Ind AS 116 : Leases

(d) Ind AS 19 : Employee Benefits

(e) Financial assets (Ind AS 32, Ind AS 107, Ind AS 109)

(f) Ind As 103 : Business combination

(g) Ind AS 104 : Insurance contracts

(h) Ind AS 105 : Non-current Assets held for sale and discontinued operations.

(i) Ind As 115 : Revenue from contracts with customers.

Only in limited cases goodwill can be recognized as intangible asset; otherwise Ind AS 38 is mostly inapplicable to good will because (a) Internally generated goodwill is not recognized as intangible asset and (b) goodwill acquired in business combination is excluded.

An intangible asset is initially recognized at cost of all of the following criteria are met:

(a) the asset is identifiable and controlled by the entity,

(b) future economic benefits will flow to the entity,

(c) cost can be measured reliably.

Intangible assets may be purchased or acquired through business combination or generated internally.

However Internally generated goodwill, brands, mastheads, publishing titles, customer lists and similar items are not recognized as intangible assets they are all expensed. Research expenditure are also recognized as expense. Development expenditure are conditionally recognized as intangible asset — the necessary conditions to be satisfied are —

(i) technical feasibility

(ii) intention and ability to complete the intangible asset and to use or sell it.

(iii) ability to measure the expenditure

(iv) technical, financial and other resource to complete it and to use or sell it.

(v) ability to generate future economic benefits: the subsequent expenditure on an intangible asset shall be added to the cost of intangible asset only if :

  (a) there is increase in future economic benefits

  (b) expenditure can be measured and attributed to the asset reliably.

Subsquent Measurement:

(a) The intangible asset will be carried at cost less accumulated amortization and impairment losses . This is the cost model. Amortization is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Intangible asset may be carried at a revalued amount (fair value). And subsequently carried at revalued amount less post revaluation amortization and impairment losses.

However revaluation can be made only if there exists an active market for the asset.

Amortization is done only if the intangible asset has finite useful life. There is no amortization of intangible assets with indefinite useful life. In such case annually it should be tested for impairment.

Case 1:

After acquiring control of the subsidiary company, the draft of consolidated balance sheet of parent included the following intangible assets which did not appear in the draft individual balance sheet of the subsidiary :

(i) Customers list

(ii) Publishing titles

One view is that as the items were not recognized by the subsidiary company it should not be recognized by the parent also. Do you agree to this view ?

Solution:

The intangible assets may be internally generated (or not fulfill up the conditions of being recognized as intangible asset) and hence they were not recognized as intangible asset by the subsidiary company.

But under Ind AS 103 such intangible assets are identifiable and arising based on contractual right and recognized at fair value in the consolidated balance sheet of parent.

Share Based Payment (Ind AS 102)

1.9

The objective of this Standard is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. In particular, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

1. Transaction:

In a share-based payment transaction the entity

(a) receives goods or services from the supplier or employee and recognizes it as asset or as expense (when no asset is qualified for recognition), and

(b) issues equity instruments (called equity-settled transaction) or incurs liability to transfer cash or other asset based on the value of the equity instruments of the entity or another group entity (cash-settled) to settle the transaction, or

(c) neither issues equity instruments nor incurs liability as parent or any other entity in the group settles the transaction (it is also called equity-settled).

Equity instruments include shares and share options and warrants.

2. Types of transactions and recognition:

Three types: (a) Equity-settled (b) Cash-settled and (c) Settlement by choice.

(a) For the equity-settled transactions, the entity measures the goods or services received, and the corresponding increase in equity, directly, at the Fair Value (FV) of the goods or services received (at the measurement date). If the entity cannot estimate reliably the FV of the goods or services received, measure their value, and the corresponding increase in equity, indirectly, by reference to the FV of the equity instruments granted (at the grant date).

For transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received. If the equity instruments granted vest immediately, on grant date the entity shall recognize the services received in full, with a corresponding increase in equity. If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the vesting period recognized in proportion of the period expired to the total vesting period.

Subsequent to grant date market value of equity instruments are not relevant in equity-settled transactions (except in rare cases where fair value of grant date cannot be reliably measured).

The **entity in a group** receiving the goods and services shall measure them as equity settled if it has no obligation to settle (issue of equity or incurring liability for cash arises to other entity in the group). The

entity in a group settling the transaction shall recognize the transaction as equity settled if it is settled by issue of its own shares and as cash-settled otherwise.

(b) For the cash-settled transactions, the entity measures the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall **re-measure the fair value** of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

(c) Where the terms of the arrangement provide the entity or the counter party with the **choice** of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction as a **cash-settled** share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an **equity-settled** share-based payment transaction if, and to the extent that, no such liability has been incurred.

3. Hypothetical Cases:

After a brief theoretical introduction to the standard on share-based payment transaction some hypothetical cases (simple) on the subject are discussed in the following section.

Illustration 13

a. D Ltd. offers shares to its employees as bonus for meeting a target. Is it a share based payment transaction? Is it equity settled or cash settled?

Solution:

It is share-based payment transaction. It is equity settled share based payment transaction as D issues its own shares against receiving of services from the employees.

b. Mr. Z is granted share options conditional upon completing 2 years' service. How is the transaction recognised?

Solution:

The transaction will be recognized as equity-settled share based payment transaction. The services from the employee will be assumed to be rendered in future during the vesting period. In each financial statements falling in the vesting period the fair value of the share options as on the grant date will be recognized in proportion of the period expired to the total vesting period.

c. Mr. X is an employee of P Ltd. and also holder of equity shares of P. P makes a right issue on equity and X receives his right. Is it a share-based payment transaction?

Solution:

No. For the purpose of this standard, a transaction with an employee or other party in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction.

d. D Ltd. grants 10 share appreciation rights to Q, an employee, entitling him to receive cash payment for the increase in quoted price of D's shares from the exercise price of ₹500 per share after 3 years. How the transaction should be recognized if it is assumed for i) for his past service, ii) for his service in future 3 years?

Solution:

The transaction should be recognized as cash-settled share based payment transaction. a) For past service, the entity shall recognize immediately the services received and a liability to pay for them at fair value of the rights on the grant date. b) For future service transaction will be recognized in the financial statements at fair value of the rights on the grant date proportionate to the period expired to total vesting period.

e. What amount of expenses will be recognized in each year?

(i) Z Ltd. grants 100 share options to each of its 400 employees conditional on their continuing in service for 3 years. Fair value of share option on the grant date is ₹ 30.

Calculation of Remuneration expense and Cumulative remuneration expense for 3 years

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense recognized in each year (₹)
1	400 × 100 × 30 × 1/3	4,00,000	4,00,000
2	400 × 100 × 30 × 2/3	8,00,000	4,00,000
3	400 × 100 × 30 × 3/3	12,00,000	4,00,000

(ii) Z Ltd. estimates that 20 per cent of employees will leave during the three-year period and therefore forfeit their rights to the share options.

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense recognized in each year (₹)
1	400 × 100 × 30 × 80% × 1/3	3,20,000	3,20,000
2	400 × 100 × 30 × 80% × 2/3	6,40,000	3,20,000
3	400 × 100 × 30 × 80% × 3/3	9,60,000	3,20,000

f. A company agrees to pay ₹ 10,000 in cash to an employee at the end of year 2 if in this two years the company's earnings increases by average 10% pa. Does this agreement attracts Ind AS 102?

Solution:

No, the payment is not based on value of any equity instruments.

g. A company agrees to pay an employee ₹ 10,000 by grant of 50 equity shares of ₹ 10 each at grant date fair value of ₹ 200 per share to be vested at the end of 2 year service of the employee if in this two years the company's earnings increases by average 10% pa. However at the end of year 2 the market price of equity share stands at ₹ 220. Does this agreement attracts Ind AS 102 and at what value the transaction will be recognised?

Solution:

It is equity-settled share based payment transaction under Ind AS 102. The transaction will be recognised at the grant date fair value of ₹ 10000 (50*200) and the market price of ₹ 220 when the shares are vested is not recognised.

h. An entity purchased goods and issued 500 ₹ 10 shares at a market price of ₹ 25.

Solution: **Dr.** **Cr.**

Particulars		(₹)	(₹)
Purchase A/c	Dr.	12,500	
To, Equity A/c			12,500

i. An entity purchased a machine (market price ₹60,000) and granted 1000 equity shares of ₹ 10.

Solution: **Dr.** **Cr.**

Particulars		(₹)	(₹)
Machinery A/c	Dr.	60,000	
To, Equity A/c			60,000

j. An entity purchased a machine (market price ₹ 60,000) and another entity in the group (parent or subsidiary or subsidiary of parent) granted 1000 equity shares of ₹ 10.

k. Another entity in the group (parent or subsidiary or subsidiary of parent) granted 1000 equity shares of ₹ 10 to the employee of an entity .

Solution: **Dr.** **Cr.**

Particulars		(₹)	(₹)
Employee Expense A/c	Dr.	60,000	
To, Equity A/c			60,000

4. Some important terms in share based payment (SBP) transactions are stated below.

- The day a share based payment plan is announced and accepted by the counterparty is called grant date.
- Vest means to become an entitlement.
- The day the employee (or the other supplier of goods and services) becomes entitled to such payments is called vesting date.
- The period between grant date and vesting date is called vesting period.
- Vesting Conditions are the conditions that have to be fulfilled for vesting.
- Vesting conditions are the conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity under a share-based payment arrangement.
- The vesting condition may be a service condition or a performance condition.
- If the condition requires completing a specified period of service only, it is a service condition;
- Otherwise it is a performance condition.
- When a performance condition is related to the market price of equity instruments it is a market condition.
- When the performance is not related to market price of equity instruments it is non- market performance condition such as meeting the target sales or profits or any other activity of the entity.
- On the other hand if the condition is not related to services for which counterparty is entitled to share based payment, it is a non-vesting condition.
- In equity-settled transactions the fair value of equity instruments is estimated with reference to the grant date. In cash-settled transactions the fair value of consideration (based on equity instruments) is recognised at the recognition date. The Expense and Equity (for equity settled)/Liability (for cash settled) will be recognized in each.

5. **Thus, based on different types of vesting conditions, share based payment transactions with employees are divided into four categories:**

Table 1. **Whether vesting condition requires only specified period of service?**

YES It is service condition (SC)	NO It is performance condition (PC)	
	Is the performance is related to market price of equity instruments?	
	YES Market condition (MC)	NO (NMC) Non-market performance condition

SC: Vesting period is fixed as agreed and cannot be revised.

PC: It will be either MC or NMC

MC: Vesting period cannot be revised

NMC: Vesting period can be revised

The practical problems are again complicated with the revision of estimate and actual during the vesting period.

Table 2.

	Problems on		
Revision of	Vesting Period (T)	Other than vesting period	
		No. of employees (N)	Performance (P)

6. **Accounting for share-based payment transactions:**

   Before Ind AS, for the traditional cases of issuing shares to the employees in exchange of their service Guidance Note of the ICAI was followed.

   Now, Ind AS 102 provides standard for all types of share-based payment transactions for goods and service received from suppliers and employees.

   When the payment is recognised immediately at the grant date: For equity-settled transaction:

   Asset/Expense Dr. and Equity Cr. For cash-settled transaction:

   Asset/Expense Dr. and Cash/ Other Asset Cr.

   When payment is recognised during the vesting period

For equity settled transactions the accounting shall be made as follows:

- Annually during the vesting period: Dr. Cr.

Particulars	(₹)	(₹)
Expense/ Asset A/c Dr.	xxxx	
To, Share Based Payment Reserve (Other Equity) A/c		xxxx

- When shares are actually issued: Dr. Cr.

Particulars	(₹)	(₹)
Share based payment reserve (Other Equity) A/c Dr.	xxxx	
To, Equity Share Capital A/c		xxxx
To, Other Equity (Security Premium) A/c		xxxx

For cash settled transactions the accounting shall be made as follows:

- Annually during the vesting period: Dr. Cr.

Particulars	(₹)	(₹)
Expense/ Asset A/c Dr.	xxxx	
To, Share Based Payment Liability A/c		xxxx

- When liability is paid:

Particulars	(₹)	(₹)
Share Based Payment Liability A/c Dr.	xxxx	
To, Cash/Other Asset A/c		xxxx

Illustration 14 (Equity settled) based on Service condition (SC) and revision in number of employees (N)

Z Ltd. grants 100 share options to each of its 400 employees conditional on their continuing in service for 3 years. Fair value of share option on the grant date is ₹ 30. During year 1, 18 employees leave. The entity revises its estimate of total employee departures over the three- year period from 20 per cent to 16 per cent. During year 2, a further 20 employees leave. The entity revises its estimate of total employee departures over the three-year period from 16 per cent to 13 per cent. During year 3, a further 14 employees leave. All the continuing employees exercised the option to subscribe in the equity shares of ₹ 10 each at ₹ 50 only, when market price stands at ₹ 84. Pass Journal Entries of all the years and show the working.

Solution:

The market price of equity shares subsequent to grant date is considered only when fair value at the grant date is not reliably measurable. Hence, market price ₹ 84 is not considered.

Calculation of Expenses recognized during the vesting period:

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense recognized in each year (₹)
1	400 × 100 × 30 × 84% × 1/3 (Note #)	3,36,000	3,36,0001

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense recognized in each year (₹)
2	400 × 100 × 30 × 87% × 2/3 (Note #)	6,96,000	3,60,0002
3	348 × 100 × 30 × 3/3 (Note #)	10,44,0004	3,48,0003

Note #: At the end of year 1, 16% is revised estimated departure, balance 84% is taken for calculation, at the end of year 2, 13% is revised estimated departure, balance 87% is taken for calculation and at the end of year 3, 52 is actual departure, and balance 348 is taken for calculation.

During the vesting period:

In the books of Z Ltd.:

Journal **Dr.** **Cr.**

	Particulars		(₹)	(₹)
Year 1	Employee Expenses A/c	Dr.	3,36,000	
	To, Share Based Payment Reserve (Other Equity) A/c			3,36,0001
Year 2	Employee Expenses A/c	Dr.	3,60,000	
	To, Share Based Payment Reserve (Other Equity) A/c			3,60,0002
Year 3	Employee Expenses A/c	Dr.	3,48,000	
	To, Share Based Payment Reserve (Other Equity) A/c			3,48,0003

When shares are actually issued:

Exercise price ₹50; Cash Payment for subscription in shares ₹50. Fair Value of Option granted ₹30. Equity shall be credited by Exercise price plus option value = ₹(50+30) = ₹80; nominal value ₹10 and Security premium ₹ 70; market price ₹ 84 is not recognised.

In the books of Z Ltd.:

Journal **Dr.** **Cr.**

Particulars		₹ ₹	₹
Bank A/c [348 × 100 × 50]	Dr.	17,40,000	
Share Based Payment Reserve (Other Equity) A/c	Dr.	10,44,0004	
To, Equity Share Capital A/c [348 × 100 × 10]			3,48,000
To, Other Equity (Security Premium) A/c			24,36,000

Now we shall take an illustration where a company grants share appreciation rights (SAR) to employees in consideration of services to be received in future during a 3 years of service.

It is a cash settled share based payment transaction where vesting condition is 3 year service and revision is made in estimate of the number of employees.

Employee expenses are recognized during the vesting period and the liability is measured at fair value at the time of recognition. When the liability is actually settled by payment of cash, the difference between the carrying value of liability and actual payment is adjusted through (profit or loss) employee expense.

Illustration 15 (Type: Cash settled)

PQR Ltd. grants 80 cash share appreciation rights (SARs) to each of its 400 employees, on condition that the employees remain in its employment for the next three years. During year 1, 30 employees leave. The entity estimates that a further 50 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 30 will leave during year 3. During year 3, 40 employees leave. At the end of year 3, all SARs held by the remaining employees vest.

At the end of year 3, 100 employees exercise their SARs, another 120 employees exercise their SARs at the end of year 4 and the remaining employees exercise their SARs at the end of year 5.

The fair value of the SARs at the end of each year in which a liability exists and the intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of years 3, 4 and 5 are shown below.

At the end of Year	Fair Value ₹	Intrinsic Value ₹
1	15	
2	16	
3	18	15
4	21	20
5		24

Pass journal entries and show working notes.

Solution:

a. Basis of Calculation

At the end of Year	[Actual]+Estimated reduction in no. of employees	Expense and liability recognized for revised estimated no. of employees at fair value	SAR exercised by actual no. of employees at intrinsic value	Remaining Employees for which liability is carried forward
1	[30] + 50 = 80	320 employees at ₹ 15		
2	[30 + 40] + 30 = 100	300 employees at ₹16		
3	[30 + 40 + 40] = 110	290 employees at ₹18	100 employees at ₹ 15	190
4			120 employees at ₹ 20	70
5			70 employees at ₹ 24	0

b. Calculation of employee expense and liability

Year	Calculation		Annual Expense ₹	Liability at the end ₹
1	(400 – 80) × 80 × 15 × 1/3		1,28,000	$1,28,000_{L1}$
2	(400 – 100) × 80 × 16 × 2/3 – L1		1,28,000	$2,56,000_{L2}$
3	(400 -110 -100) × 80 × 18 – L2	17,600		$2,73,600_{L3}$

Year	Calculation		Annual Expense ₹	Liability at the end ₹
	100 × 80 × 15 [expense recognized and paid]	1,20,000		
			1,37,600	
4	(190 – 120) × 80 × 21 – L3	-1,56,000		$1,17,600_{L4}$
	120 × 80 × 20	1,92,000		
			36,000	
5	0 – L4	-1,17,600		0
	70 × 80 × 24	1,34,400		
			16,800	
			4,46,400	

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	Particulars		(₹)	(₹)
Year 1	Employee Expenses A/c	Dr.	1,28,000	
	To, Share Based Payment Laibility A/c			1,28,000
	(Fair value of SAR recognized)			
Year 2	Employee Expenses A/c	Dr.	1,28,000	
	To, Share Based Payment Laibility A/c			1,28,000
	(Fair Value of SAR recognized and remeasured)			
Year 3	Employee Expenses A/c	Dr.	1,37,600	
	To, Share Based Payment Laibility A/c			1,37,600
	(Fair Value of SAR recognized and remeasured)			
	Share Based Payment Liability A/c	Dr.	1,20,000	
	To, Cash A/c			1,20,000
	(SAR settled for 100 employees)			
Year 4	Share Based Payment Liability A/c	Dr.	1,56,000	
	Employee Expenses A/c	Dr.	36,000	
	To, Cash A/c			1,92,000
	(SAR settled for 120 employees)			
Year 5	Share Based Payment Liability A/c	Dr.	1,17,600	
	Employee Expenses A/c	Dr.	16,800	
	To, Cash A/c			1,34,400
	(SAR settled for 70 employees)			

Some employee share-based payment arrangements permit the employee to choose whether to receive cash or equity instruments. In this situation, a compound financial instrument has been granted, ie a financial instrument with debt and equity components.

Here is one illustrative problem of share based payment arrangement with compound financial instrument.

Illustration 16 (Type: Compound Instrument)

On condition of completion of 3 years service an employee is granted the right to choose either -

(i) right to cash payment equal to the value of 3000 shares, or

(ii) 3600 shares with restriction to hold them for 3 years after vesting. The share price (nominal value ₹ 10) at the grant date is ₹ 60 and after taking the effect of the post-vesting transfer restriction the fair value is estimated at ₹ 54 per share. At the end of the years 1, 2 and 3 the share price is ₹ 64, ₹68 and ₹ 72 respectively.

At the end of year 3, the employee chooses: (a) the cash alternative; (b) the equity alternative. Show the necessary workings and pass the journal entries.

Solution:

A brief discussion of the relevant parts of the standard (Ind AS 102) is made before the solution.

When the fair value of equity alternative at the grant date is greater than the fair value of the cash alternative at the grant date, the excess is measured as the fair value of the equity component of the compound financial instrument.

Both the equity component and liability component will be recognized during the vesting period proportionate to the period expired to the total vesting period. Until the liability is settled, the entity shall re-measure the fair value of the liability at the end of each reporting period.

At the end of the vesting period if the employee chooses cash alternative the liability will be paid by cash. If equity alternative is chosen, the liability will be settled by issue of equity. The equity already recognized during the vesting period for the equity component shall remain within the equity.

Working Note 1: Fair value of equity component:

The fair value of the equity alternative = 3600 shares × ₹ 54 per share = ₹ 1,94,400 The fair value of the cash alternative = 3000 shares × ₹ 60 per share = ₹ 1,80,000 The fair value of the equity component = ₹ 1,94,400 – ₹ 1,80,000 = ₹ 14,400

Working Note 2: Expenses, Equity and Liabilities recognized in the years 1, 2, and 3.

Year		Expenses (₹)	Equity (₹)	Liabilities (₹)
1	Liability Component 3000× ₹64 × 1/3	64,000		64,000
	Equity Component 14,400 × 1/3	4,800	4,800	
2	Liability Component 3000 × ₹68 × 2/3 – ₹64,000 = ₹1,36,000 - ₹64,000	72,000		72,000
	Equity Component ₹14,400 × 1/3	4,800	4,800	
3	Liability Component 3000 × ₹72 – ₹1,36,000 = ₹2,16,000 - ₹1,36,000	80,000		80,000

Year		Expenses (₹)	Equity (₹)	Liabilities (₹)
	Equity component ₹14,400×1/3	4,800	4,800	
Total		2,30,400	14,400	2,16,000

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Year	Particulars		Dr. (₹)	Cr. (₹)
1	Employee Expenses A/c	Dr.	68,800	
	To, Share Based Payment Reserve (Other equity)A/c			4,800
	To, Share Based Payment Liability A/c			64,000
	(recognition of equity option and cash settlement option)			
2	Employee Expenses A/c	Dr.	76,800	
	To, Share Based Payment Reserve (Other equity) A/c			4,800
	To, Share Based Payment Liability A/c			72,000
	(recognition of equity option and cash settlement option)			
3	Employee Expenses A/c	Dr.	84,800	
	To, Share based payment reserve (Other equity)			4,800
	To, Share based payment liability			80,000
	(recognition of equity option and cash settlement option)			
3	(a) Cash alternative:			
	Share based payment liability A/c	Dr.	2,16,000	
	To Cash A/c			2,16,000
	(settlement in cash)			
	(b) Equity alternative:			
	Share based payment liability A/c	Dr.	2,16,000	
	To, Equity Share Capital (₹10 × 3000) A/c			30,000
	To, Security Premium (₹62 × 3000) A/c			1,86,000
	(settlement in equity)			
	Share based payment Reserve	Dr.	14,400	
	To, Equity Share Capital (₹10×600)			6,000
	To, Security Premium (balancing figure)			8,400

Illustration 17 (Type: Equity settled)

Grant with a non-market performance condition, in which the length of the vesting period varies:

At the beginning of year 1, X Ltd. grants 200 shares each to 400 employees, conditional upon the employees' remaining in employment with the company during the vesting period. The shares will vest at the end of year 1 if the entity's earnings increase by more than 15 percent; at the end of year 2 if the entity's earnings increase by more

than an average of 12 per cent per year over the two-year period; and at the end of year 3 if the entity's earnings increase by more than an average of 10 per cent per year over the three-year period.

The shares have a fair value of ₹40 per share at the start of year 1. No dividends need be considered.

By the end of year 1, the entity's earnings have increased by 13 per cent, and 32 employees left. The entity expects further 30 employees to leave during year 2. By the end of year 2, the entity's earnings have increased by only 11 per cent and 27 employees left during the year. The entity expects a further 25 employees to leave during year 3. By the end of year 3, 22 employees left and the company's earnings increased by (a) 9 percent, (b) 6 percent.

Find the Remunertion expenses to be recognised in each year.

Solution:

The share based payments to be accounted as follows:

Year	Calculation	Cumulative Remuneration Expense (₹)	Remuneration Expense for the Year (₹)
1	338 × 200 × ₹40 × 1/2	13,52,000	13,52,000
2	316 × 200 × ₹40 × 2/3	16,85,333	3,33,333
3 (a)	319 × 200 × ₹40 × 3/3	25,52,000	8,66,667
3 (b)	Not vested	0	-16,85,333

1. At the end of year 1 and year 2 shares were not vested as performance condition is not satisfied. But at the end of year 3 (a) the shares were vested as average increase in earnings was (13+11+9)/3 = 11>10 and (b) the shares were vested as average increase in earnings was (13+11+6)/3 = 10 is not greater than10
2. Revised no. of employees at the end of year 1: 400 – 32 -30 = 338 Revised no. of employees at the end of year 2: 400 – 32 -27- 25 = 316 Revised no. of employees at the end of year 3: 400 – 32 -27 – 22 = 319

(a) **Journal**

Particulars	Yr 1 (₹)		Yr 2 (₹)		Yr 3 (₹)	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Employee Expenses A/c Dr.	13,52,000		3,33,333		8,66,667	
To, Share Based Payment Reserve (Other equity)A/c		13,52,000		3,33,333		8,66,667

Year 3

Particulars	Dr. (₹)	Cr. (₹)
Share Based Payment Reserve (Other equity)A/c Dr.	25,52,000	
To, Equity Share Capital A/c (10)		6,38,000
To, Security Premium A/c (40-10)		19,14,000

(b)

Particulars		Yr 1 (₹)		Yr 2 (₹)	
Employee Expenses A/c	Dr.	13,52,000		3,33,333	
To, Share Based Payment Reserve (Other equity)A/c			13,52,000		3,33,333

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Particulars		(₹)	(₹)
Share based payment reserve (Other equity)	Dr.	16,85,333	
To, Employee Expenses A/c			16,85,333

Illustration 18

Grant with a performance condition, in which the number of equity instruments varies (Type: Equity settled).

At the beginning of year 1, X Ltd. grants options to 200 employees. The share options will vest at the end of year 3, provided that the employees remain in the entity's employment, and provided that revenues of the company increases by at least at an average of 8 percent per year. If the per cent of increase is 8 percent and above but below 10 per cent per year, each employee will receive 120 share options, if 10 percent and above but below 15 percent each year, each employee will receive 240 share options and if on or above 15 percent, each employee will receive 360 share options. On grant date, X Ltd. estimates that the share options have a fair value of ₹40 per option and also estimates that 16 per cent of employees will leave before the end of year 3.

By the end of year 1, 12 employees have left and the entity still expects that a total of 32 employees will leave by the end of year 3. In year 1, revenue has increased by 12 per cent and the company expects this rate of increase to continue over the next 2 years. By the end of year 2, a further 10 employees have left, bringing the total to 22 to date. The entity now expects only 5 more employees will leave during year 3, and therefore expects a total of 27 employees will have left during the three-year period. Revenue in year 2 increased by 18 per cent, resulting in an average of 15 per cent over the two years. By the end of year 3, a further 8 employees have left. The revenue increased by an average of 16 per cent per year in the three year period.

Find the Remunertion expenses to be recognised in each year.

Solution:

Year	Calculation	Cumulative Remuneration Expense (₹)	Remuneration Expense for the Year (₹)
1	168 × 240 × 40 × 1/3	5,37,600	5,37,600
2	173 × 360 × 40 × 2/3	16,60,800	11,23,200
3	170 × 360 × 40 × 3/3	24,48,000	7,87,200

Illustration 19

Grant with a performance condition, in which the exercise price varies (Type: Equity settled, NMCP).

At the beginning of year 1, an entity grants to a senior executive 10,000 share options, conditional upon the executive's remaining in the entity's employment until the end of year 3. The exercise price is ₹40. However, the exercise price drops to ₹30 if the entity's earnings increase by at least an average of 10 per cent per year over the three-year period.

On grant date, the entity estimates that the fair value of the share options, with an exercise price of ₹30, is ₹16 per option. If the exercise price is ₹40, the entity estimates that the share options have a fair value of ₹12 per option. During year 1, the entity's earnings increased by 12 per cent, and the entity expects that earnings will continue to increase at this rate over the next two years. The entity therefore expects that the earnings target will be achieved, and hence the share options will have an exercise price of ₹30. During year 2, the entity's earnings increased by 13 per cent, and the entity continues to expect that the earnings target will be achieved. During year 3, the entity's earnings increased by only 3 per cent, and therefore the earnings target was not achieved. The executive completes three years' service, and therefore satisfies the service condition. Because the earnings target was not achieved, the 10,000 vested share options have an exercise price of ₹40.

Find the Remunertion expenses to be recognised in each year.

Solution:

The exercise price varies depending on the outcome of a performance condition that is not a market condition, the effect of that performance condition (i.e. the possibility that the exercise price might be ₹40 and the possibility that the exercise price might be ₹30) is not taken into account when estimating the fair value of the share options at grant date. Instead, the entity estimates the fair value of the share options at grant date under each scenario (ie exercise price of ₹40 and exercise price of ₹30) and ultimately revises the transaction amount to reflect the outcome of that performance condition, as illustrated below.

Year	Calculation	Cumulative Remuneration Expense (₹)	Remuneration Expense for the Year (₹)
1	10,000 options × ₹16 × 1/3	53,333	53,333
2	10,000 options × ₹16 × 2/3	1,06,667	53,334
3	10,000 options × ₹12 × 3/3	1,20,000	13,333

Illustration 20 **(Type: Equity settled) For grants of equity instruments with market conditions.**

At the beginning of year 1, an entity grants to a senior executive 10,000 share options, conditional upon the executive remaining in the entity's employment until the end of year 3. However, the share options cannot be exercised unless the share price has increased from ₹50 at the beginning of year 1 to above ₹65. If the share price is above ₹65 the share options can be exercised at any time till the end of year 10. The entity applies a binomial option pricing model, which takes into account the possibility that the share price will exceed ₹65 (and hence the share options become exercisable) and the possibility that the share price will not exceed ₹65 (and hence the options will be forfeited). It estimates the fair value of the share options with this market condition to be ₹24 per option.

Find the Remunertion expenses to be recognised in each year.

Solution:

The entity expects the executive to complete the three-year service period, and the executive does so, the entity recognises the following amounts in years 1, 2 and 3:

Year	Calculation	Cumulative Remuneration Expense (₹)	Remuneration expense for the year (₹)
1	10,000 options × ₹24 × 1/3	80000	80000
2	10,000 options × ₹24 × 2/3	160000	80000
3	10,000 options × ₹24 × 3/3	240000	80000

Operating Segments (Ind AS 108)

1.10

Many enterprises provide groups of products and services or operate in geographical areas that are subject to differing rates of profitability, opportunities for growth, future prospects, and risks. Information about different types of products and services of an enterprise and its operations in different geographical areas - often called segment information - is relevant to assessing the risks and returns of a diversified or multi-locational enterprise but may not be determinable from the aggregated data. Therefore, reporting of segment information is widely regarded as necessary for meeting the needs of users of financial statements.

- **Objective of the Standard**

  The objective of this Standard is to establish principles for reporting financial information, about the different segments. Such information helps users of financial statements:

  (a) better understand the performance of the enterprise;

  (b) better assess the risks and returns of the enterprise; and

  (c) make more informed judgements about the enterprise as a whole

- **Scope of the Standard**

  This Accounting Standard shall apply to companies to which Indian Accounting Standards (Ind ASs) notified under the Companies Act apply.

- **Core Principle of the Standard**

  An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. Accordingly, it shall report specified information about its operating segments.

- **Meaning of Operating Segments**

  An operating segment is a component of an entity:

  (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity);

  (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance; and

  (c) for which discrete financial information is available.

  An operating segment may engage in business activities for which it has yet to earn revenues, for example, start-up operations may be operating segments before earning revenues.

Not every part of an entity is necessarily an operating segment or part of an operating segment. For example, a corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the entity and would not be operating segments.

- **Reportable Segments**

An entity shall report separately information about each operating segment that:

(a) has been identified in accordance with the meaning stated in the previous section (Ref: Meaning of Operating Segments) or results from aggregating two or more of those segments as mentioned in the aggregation criteria, and

(b) exceeds the quantitative thresholds.

- **Aggregation Criteria**

Operating segments often exhibit similar long-term financial performance if they have similar economic characteristics. For example, similar long-term average gross margins for two operating segments would be expected if their economic characteristics were similar. Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this Ind AS, the segments have similar economic characteristics, and the segments are similar in each of the following respects:

(a) the nature of the products and services;

(b) the nature of the production processes;

(c) the type or class of customer for their products and services.

(d) the methods used to distribute their products or provide their services; and

(e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.

- **Quantitative Threshold**

An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

(a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.

(b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.

(c) Its assets are 10 per cent or more of the combined assets of all operating segments.

Operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements.

An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria.

If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, information about that segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability.

If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the criteria for reportability in the prior period, unless the necessary information is not available and the cost to develop it would be excessive.

However, there may be a practical limit to the number of reportable segments that an entity separately discloses beyond which segment information may become too detailed. Hence, as the number of segments that are reportable increases above ten, the entity should consider whether a practical limit has been reached.

Illustration 21

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in ₹'000)

Particulars	A	B	C	D	E	F	G	H	Total (Segment)
1. Segment Revenue									
(a) External Sales	-	663	37	25	13	125	50	87	1000
Inter Segment Sales	250	150	75	13	-	-	12	-	500
2. Segment Results Profit/ (Loss)	15	(270)	45	(15)	24	(15)	15	21	
3. Segment Assets	15	5	5	60	3	5	5	2	100

Identify the reportable segments as per Ind AS 108.

Solution: **(₹ in '000)**

(a) Segment Revenue Criterion:

Threshold = 10% of total revenue = 10% of (1,000 + 500) = ₹150

Reportable Segments are A and B.

(b) Result Criterion:

Threshold = 10% of total profit (₹120) or total loss (₹ 300) – higher of the two = ₹30

Reportable Segments are B and C.

(c) Asset Criterion:

Threshold = 10% of total assets = 10% of 100 = ₹10

Reportable Segments are A and D.

Total external revenue of A, B, C and D = Nil + 663+ 37+ 25 = ₹725 which is lower than 75% of total external revenue of ₹1000 (i.e., ₹750).

No additional segment has been identified by the management as per their discretion.

It is assumed than the company will select segment F to meet the 75% threshold criteria.

Hence the reportable segments are A,B, C, D and F.

- **Disclosure:**

An entity shall disclose the following for each period for which a statement of profit and loss is presented:

(a) General information;

(b) Information about reported segment profit or loss, including specified revenues and expenses included in reported segment profit or loss, segment assets, segment liabilities and the basis of measurement; and

(c) Reconciliations of the totals of segment revenues, reported segment profit or loss, segment assets, segment liabilities and other material segment items to corresponding entity amounts. Reconciliations of the amounts in the balance sheet for reportable segments to the amounts in the entity's balance sheet are required for each date at which a balance sheet is presented. Information for prior periods shall be restated.

I. **General Information:** An entity shall disclose the following general information:

(a) factors used to identify the entity's reportable segments;

(b) the judgements made by management in applying the aggregation criteria; and

(c) types of products and services from which each reportable segment derives its revenues.

II. **Information about profit or loss, assets and liabilities:** An entity shall report a measure of profit or loss for each reportable segment. An entity shall report a measure of total assets and liabilities for each reportable segment if such amounts are regularly provided to the chief operating decision maker. An entity shall also disclose the following:

(a) Revenues from external customers;

(b) Revenues from transactions with other operating segments of the same entity;

(c) Interest revenue (separately from interest expense);

(d) Interest expense;

(e) Depreciation and amortisation and other material non-cash items;

(f) Material items of income and expense

(g) The entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;

(h) Income tax expense or income.

III. **Measurement:** The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance.

IV. **Reconciliations**: An entity shall provide reconciliations of all of the following total of the reportable segments to that of the entity:

(a) Revenue.

(b) Profit or loss before tax and discontinued operations.

(c) Assets

(d) Liabilities

(e) Amount for every other material item of information.

V. **Entity-wide disclosures:** Following information shall be provided by an entity only if it is not provided as part of the reportable segment information (unless the necessary information is not available and the cost to develop it would be excessive):

(A) Information about products and services: An entity shall report the revenues from external customers for each product and service, or each group of similar products and services.

(B) Information about geographical areas: An entity shall report the following geographical information,

(a) revenues from external customers

(i) attributed to the entity's country of domicile and

(ii) attributed to all foreign countries in total (separately if material).

(b) non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts

(i) located in the entity's country of domicile and

(ii) located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets shall be disclosed separately.

(C) Information about major customers: An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues.

Fair Value Measurement (Ind AS 113)

1.11

1. Objectives:

(a) To define fair value

(b) To set up a framework for measurement of fair value

(c) To specify requirements of disclosure of fair value measurement.

2. Scope:

It applies when another Ind AS requires or permits fair value measurements or disclosures about fair value measurements except cases under Ind AS 17, Ind AS 19, and Ind AS 102. It does not apply to values similar to fair value, such as 'net realizable value' in Ind AS 2 or Recoverable amount in Ind AS 36. Thus, which assets or liabilities or equity instruments are subject to measurement at fair value that is beyond the scope of Ind AS 113.

3. Definition:

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

3.1. Fair value is a market-based measurement, not an entity-specific measurement. The use value or entry value to the entity is not relevant; rather the exit value in the market is important. It is the exit price to the holder of asset or bearer of liability. That exit price may be directly observed in the market or it may be estimated from the market information or by using a valuation technique. Fair value in any circumstance remains to be the exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Thus, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value.

4. Measurement :

4.1 The asset or liability:

(a) The measurement is affected by the characteristics of assets or liabilities that are relevant for the market participants, such as, (a) the condition and location of the asset; and (b) restrictions, if any, on the sale or use of the asset.

(b) The asset or liability measured at fair value might be either of the following:

(i) a stand-alone asset or liability (eg a financial instrument or a non-financial asset); or

(ii) a group of assets, a group of liabilities or a group of assets and liabilities (eg a cash-generating unit or a business).

4.2 The transaction:

(a) The transaction of exchange of the asset or liability is not an actual but an assumed transaction. It

is required that the transaction must be an orderly transaction (it is not a forced transaction, forced liquidation or distress sale).

(b) A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

(i) in the principal market for the asset or liability; or

(ii) in the absence of a principal market, in the most advantageous market for the asset or liability.

(c) In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.

(d) If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.

(e) The principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity.

4.3 The market participants are assumed to act in their economic best interest.

4.4 The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs but shall be adjusted for transport costs.

4.5 Application to non-financial assets.

a) 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.

(b) 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.

(c) If the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the market participant already holds the complementary assets and the associated liabilities.

(d) If the highest and best use of the asset is to use it on a stand-alone basis, the fair value of the asset is the price that would be received in a current transaction to sell the asset to market participants that would use the asset on a stand-alone basis.

4.6 Application to liabilities and an entity's own equity instruments

(a) The transfer of a liability or an entity's own equity instrument assumes that

(i) A liability would remain outstanding and the market participant transferee would be required to fulfil the obligation. The liability would not be settled with the counterparty or otherwise extinguished on the measurement date.

(ii) An entity's own equity instrument would remain outstanding and the market participant transferee would take on the rights and responsibilities associated with the instrument. The instrument would not be cancelled or otherwise extinguished on the measurement date.

4.7 Non-performance risk

The fair value of a liability reflects the effect of non-performance risk. Nonperformance risk includes,

but may not be limited to, an entity's own credit risk (as defined in Ind AS 107, Financial Instruments: Disclosures). Non-performance risk is assumed to be the same before and after the transfer of the liability.

4.8 Fair value at initial recognition:

If another Ind AS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that Ind AS specifies otherwise.

4.9 Valuation techniques:

(a) An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

(b) Three widely used valuation techniques are the market approach, the cost approach and the income approach.

(i) The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (ie similar) assets, liabilities or a group of assets and liabilities, such as a business.

(ii) The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost). From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

(iii) The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts. From the perspective of a market participant seller, the current market expectation is the price that would be received for the asset based on the expected income to a market participant buyer from that asset.

4.10 Fair value hierarchy:

This Ind AS establishes a fair value hierarchy that categorises into three levels of the inputs to valuation techniques for measuring fair value.

(i) Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

(ii) Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

(iii) Level 3 inputs are unobservable inputs for the asset or liability.

The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

5. Disclosure of Fair Value Measurement:

(a) An entity shall disclose information that helps users of its financial statements assess both of the following:

(i) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurements.

(ii) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

(b) An entity shall disclose, at a minimum, the following information for each class of assets and liabilities measured at fair value in the balance sheet after initial recognition:

(i) for recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement.

(ii) for recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3).

(iii) for recurring fair value measurement, the detail about the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy.

(iv) for recurring and non-recurring fair value measurements categorised within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement.

(v) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances.

(vi) for recurring fair value measurements categorised within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period included in profit or loss that is attributable to the change in unrealised gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in profit or loss in which those unrealised gains or losses are recognised.

(vii) for recurring and non-recurring fair value measurements categorised within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity.

(c) An entity shall present the quantitative disclosures required by this Ind AS in a tabular format unless another format is more appropriate.

Revenue from Contracts with Customers (Ind AS 115)

1.12

The objective of this Standard is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer.

1. Introduction

This standard states how to recognize revenue and to measure the amount at which revenue is recognized from contracts with customers.

Revenue is the consideration for satisfying performance obligation undertaken in the contract. Revenue is recognized as and when performance obligation is satisfied and it is measured at the amount of transaction price attributable to the satisfied performance obligation.

In an ordinary contract for sale of goods the performance obligation is satisfied when goods are transferred to the customer and revenue (Sale) is recognized at the (sale value) transaction price.

But there may be complications at different stages in revenue recognition and measurement. The different stages can be enumerated as below :

I. Identifying the contract.

II. Identifying performance obligation.

III. Satisfaction of performance obligation.

IV. Determination of and allocation of transaction price to performance obligation. While stages I to III are for recognition of revenue stage IV is for its measurement.

The discussion will elaborate each stage with explanatory notes and illustrative examples. Besides other matters of the standard will also be briefly discussed.

Rest of the discussion is arranged in the following sequence. 2. Objectives and scope. 3. Four stages. 4. Contract cost. 5. Presentation and disclosure. 6. Service concession arrangement.

2. Scope

To meet the objective, the core principle of this Standard is that an entity shall recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

An entity shall apply this Standard to all contracts with customers, except the following:

(a) lease contracts within the scope of Ind AS 116 on Leases;

(b) insurance contracts within the scope of Ind AS 104 on Insurance Contracts;

(c) financial instruments and other contractual rights or obligations within the scope of Ind AS 109 Financial Instruments, Ind AS 110 Consolidated Financial Statements, Ind AS 111 Joint Arrangements, Ind AS 27 Separate Financial Statements and Ind AS 28 Investments in Associates and Joint Ventures; and

(d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

This Standard specifies the accounting for the incremental costs of obtaining a contract with a customer and for the costs incurred to fulfil a contract with a customer if those costs are not within the scope of another Standard. An entity shall apply those paragraphs only to the costs incurred that relate to a contract with a customer (or part of that contract) that is within the scope of this Standard.

An entity shall apply this standard to a contract (other than exception listed above) only if the counterparty to the contract is a customer.

3. Four stages:

Stage I. Identifying the contract –

3.1 An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

(b) the entity can identify each party's rights regarding the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession.

3.2 There does not exist a contract of each party to the contract has the unilateral enforceable right to continue a wholly unperformed contract without compensating the other parties. A contract is wholly unperformed if—

(i) No transfer of promised goods or services to the customer, and

(ii) No consideration is received or entitled to receive.

3.3 A contract meeting the criteria at inception shall not be reassessed unless significant changes take place. However, a contract failing to meet the criteria shall continue to reassess to determine if the criteria are met subsequently.

3.4 When a contract with a customer does not meet the criteria and an entity receives consideration from the customer, the entity shall recognise the consideration received as revenue only when either of the following events has occurred:

(a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable; or

(b) the contract has been terminated and the consideration received from the customer is non-refundable.

3.5 The consideration received shall be recognized as liability until any of the criteria is met at the time of the consideration received.

3.6 Combination of contracts:

When there are two or more contracts with same customer (or related party) at or near the same time, they will be combined into a single contract if either—

(i) Contracts are negotiated as a package with single commercial objective.

(ii) The consideration of one contract depends on the price of performance of the other, or

(iii) There is single performance obligation.

Note : Revenue is recognized for performance obligation satisfied under a single contract or multiple contracts combined into a single contract.

3.7 Contract modifications:

An entity shall account for a contract modification as

A a separate contract (if conditions satisfied)

B: termination of the existing contract and creation of a new contract for the remaining performance.

C: Continuation of existing contract with modifications.

A. contract modification is a change in scope or price (or both) of a contract that is approved by the parties to the contract.

The conditions to be satisfied for contract modification A:

(i) additional performances are distinct.

(ii) additional consideration is stand-alone selling price.

When condition (ii) is not satisfied but remaining performances are distinct it will be contract modification

B. The consideration allocable to the remaining performances is the sum total of the unrecognized revenue of the existing contract and the consideration promised for contract modification.

It will be a contract modification C if the remaining performances are not distinct. In such case the total performance obligations (existing and modifications) are related to total transaction price (existing and modification), and allocation of transaction price to performance obligation is revised. The revenue recognized for performance obligations satisfied is adjusted for the revised allocation (cumulative catch-up basis).

In illustrations it may be shown how revenue recognition and amount are changed for different types of contract modifications.

Stage II. Identifying performance obligation.

3.8 Performance obligation is a promise to transfer

(i) a good or service (or a bundle of goods and services) that is distinct or

(ii) a series of distinct goods and services (substantially some with same pattern of transfer)

A contract with a customer generally explicitly states the goods or services that an entity promises to transfer to a customer However, implied promises by the customary business practice, published policies or specific statements are also identified as performance obligation. But some activities other than transfer of good or service, which an entity must undertake to fulfill a contract are not a performance obligation (Jay, various administrative tasks to set up a contract)

3.9 Examples of promised goods or services.

a. Sale of goods produced by as entity. (for example, inventory of a manufacturer)

b. Resale of goods purchased by an entity. (for example, merchandise of a retailer)

c. Resale of rights to goods or services purchased by an entity.

d. Performing contractually agreed-upon takes for a customer.

e. Providing a service of standing ready to provide goods or services (snacks and drinks in hotel room with price tag)

f. Agency service for another party to transfer goods or services.

g. Granting rights to goods and services to be provided in the future (Free air tickets for purchase of VIP suitcase)

h. Contracting, manufacturing or developing an asset on behalf of a customer.

i. Granting licenses.

j. Granting options to purchase of additional goods or services.

3.10 A good or service that is promised to a customer is distinct if both of the following criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the goods or services is capable of being distinct); and

(b) the entity's promise to transfer the goods or services to the customer is separately identifiable from other promises in the contract (ie the goods or services is distinct within the context of the contract).

3.11 If a promised goods or services is not distinct, an entity shall combine that goods or services with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Stage III Satisfaction of performance obligations.

3.12 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised goods or services (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

3.13 An entity shall determine at contract conception whether it satisfies the performance obligation over time. If not, it is performance obligation satisfied at a point of time.

3.14 Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

(a) using the asset to produce goods or provide services (including public services);

(b) using the asset to enhance the value of other assets;

(c) using the asset to settle liabilities or reduce expenses;

(d) selling or exchanging the asset;

(e) pledging the asset to secure a loan; and

(f) holding the asset.

Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly.

An entity transfers control of a goods or services over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

(a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;

(b) the entity's performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced or

(c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time.

For each performance obligation satisfied over time, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation.

Appropriate methods of measuring progress include output methods and input methods.

Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract.

As a practical expedient, if an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice.

The outputs used under output method to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.

Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

When a cost incurred is not proportionate to the entity's progress in satisfying the performance obligation. In those circumstances, the best depiction of the entity's performance may be to adjust the input method to recognise revenue only to the extent of that cost incurred.

An entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation.

Stage IV. Determination of and allocation of transaction price to performance obligation.

When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price that is allocated to that performance obligation.

Determining the transaction price

An entity shall consider the terms of the contract and its customary business practices to determine the

transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price. When determining the transaction price, an entity shall consider the effects of all of the following:

(a) variable consideration;

(b) constraining estimates of variable consideration;

(c) the existence of a significant financing component in the contract;

(d) non-cash consideration; and

(e) consideration payable to a customer.

(a) 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.

(a1) An entity shall estimate an amount of variable consideration by using either of the following methods:

(i) The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts.

(ii) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

(a2) To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity shall recognise all of the following:

(i) revenue for the transferred products in the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);

(ii) a refund liability; and

(iii) an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

(b) An entity shall include in the transaction price some or all of an amount of variable consideration estimated only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

(c) If significant financing component exists in the contract whether explicitly or implicitly, that would be separately recognised as interest income.

(d) To determine the transaction price for contracts in which a customer promises consideration in a form other than cash, an entity shall measure the non-cash consideration (or promise of non- cash consideration) at fair value.

(e) An entity shall account for consideration payable to a customer, if any, as a reduction of the transaction price.

Allocating the transaction price to performance obligations :

An entity shall allocate the transaction price to each performance obligation identified in the contract

(A) On a relative stand-alone selling price basis as per the standard,

(B) Except for

(B1) allocating discounts, and

(B2) allocating variable consideration

(A) To allocate the transaction price to each performance obligation on a relative stand-alone selling price basis, an entity shall determine the stand-alone selling price at contract inception of the distinct good or service underlying each performance obligation in the contract and allocate the transaction price in proportion to those stand-alone selling prices.

(B1) the entity shall allocate a discount proportionately to all performance obligations in the contract except observable evidence exists for the discounts being entirely related to one or more performance obligations.

(B2) Variable consideration attributable to the entire contract or to a specific part of the contract is allocated accordingly.

An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception.

In Bill-and-hold transaction, the entity holds the goods as custodian and revenue is recognised. However, for establishing transfer of control, all the following criteria must be met:

(a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);

(b) the product must be identified separately as belonging to the customer;

(c) the product currently must be ready for physical transfer to the customer; and

(d) the entity cannot have the ability to use the product or to direct it to another customer.

4. Contract costs

Incremental costs of obtaining a contract

(i) An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.

The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

Costs to fulfil a contract

(ii) If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, Ind AS 2, Inventories, Ind AS 16, Property, Plant and Equipment or Ind AS 38, Intangible Assets), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);

(b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and

(c) the costs are expected to be recovered.

5. Presentation and disclosure.

(i) When either party to a contract has performed, an entity shall present the contract in the balance sheet as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

(ii) The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:

(a) its contracts with customers;

(b) the significant judgements, and changes in the judgements, made in applying this Standard to those contracts; and

(c) any assets recognised from the costs to obtain or fulfil a contract with a customer.

6. Service concession arrangement.

(i) Infrastructure for public services—such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks— has traditionally been constructed, operated and maintained by the public sector and financed through public budget appropriation.

In recent times, governments have introduced contractual service arrangements to attract private sector participation in the development, financing, operation and maintenance of such infrastructure. The infrastructure may already exist, or may be constructed during the period of the service arrangement.

An arrangement within the scope of the Appendix C of Ind AS 115 typically involves a private sector entity (an operator)

- constructing the infrastructure used to provide the public service or
- upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period of time.

The operator is paid for its services over the period of the arrangement.

The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

Such an arrangement is often described as a 'buildoperate-transfer', a 'rehabilitate-operate- transfer' or a 'public-to-private' service concession arrangement.

(ii) Infrastructure within the scope of this Appendix shall not be recognised as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract.

(iii) Under the terms of contractual arrangements within the scope of this Appendix, the operator acts as a service provider. The operator constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

(iv) The operator shall recognise and measure revenue in accordance with Ind AS 115 for the services it performs. The nature of the consideration (received as a financial asset and as an intangible asset) determines its subsequent accounting treatment. Construction or upgrade services

The operator shall account for construction or upgrade services in accordance with Ind AS 115. The operator shall account for operation services in accordance with Ind AS 115.

(v) All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes in accordance with Appendix D of Ind AS 115.

Illustration 22 A

Z Ltd. Agrees to sell 200 units of product A to a customer for ₹3,20,000 (₹1,600 per unit). The product A units are transferred over to the customers from 01.01.2019 to 30.06.2019. On 31.03.2020 after transfer of control of 100 units of A, the contract is modified to deliver additional 50 units at the then market price of ₹1,400 per unit to be delivered in following 3 months. Show how the transaction will be accounted in books of Z ltd.

Solution:

During F.Y. 2019-2020 revenue will be recognized for the performance obligation satisfied in regard the identified contract. Although the contract is modified, the modification is accounted as a distinct separate contract with its stand-alone price.

Thus in regard the original contract the transaction price to be allocated to the satisfied performance obligation is (100×₹3,20,000)/200 = ₹ 1,60,000 to be recognized as revenue to be credited to P & L.

In F.Y. 2019-20, on satisfaction of performance obligation of the original contract the balance ₹ 1,60,000 of the transaction price will be recognized as revenue. Further, for the modifications of the contract, treated as another distinct and new contract the transaction price is 50 × ₹ 1,400 = ₹ 70,000 to be recognized as revenue on satisfaction of performance obligation, i.e. on transfer of control of the units in 3 months.

Illustration 22 B

On 1.4.2020 the contract is modified to deliver 150 units of A instead of remaining 100 units by 30.6.2020 at ₹ 1,500 per unit. Here additional performances are distinct but additional consideration is not stand-alone selling price; hence, it is modification B.

Solution:

For FY 18-19 revenue recognition is ₹ 1,60,000 for 100 units at ₹ 1,600 p.u.. For 2020-2021:

Unrecognised revenue of the original contract (as if terminated)	Nil
Contract modification 150×₹1500	₹ 225,000
Total	₹ 225,000

C: Original contract price of a project was ₹ 50,000 based on estimated 200 production hours at a rate of ₹ 250 per hour. After revenue recognition for 100 hours the contract is modified to increase the required hours by 50 (i) at hourly rate by ₹200; (ii) at hourly rate of ₹ 200 for the remaining hours; (iii)) at hourly rate of ₹ 200 for the total hours required

The remaining performance is not distinct in the modified estimate of input hours, hence it is modification C.

(i) at hourly rate of ₹ 200 for 50 hours	Hours	Rate (₹)	(₹)
Original contract	200	250	50,000

Modification	50	200	10,000
Total	250	240	60,000
Revenue recognised (A)	100	250	25,000
Modified recognition (B)	100	240	24,000
Adjustment for past revenue recognition (A – B)			(1,000)
Revenue recognition in future	150	240	36,000

(ii) at hourly rate of ₹ 200 for 150 hours	Hours	Rate (₹)	(₹)
Revenue recognised (A)	100	250	25,000
Modification for remaining hours	150	200	30,000
Total	250	220	55,000
Modified recognition (B)	100	220	22,000
Adjustment for past revenue recognition (A – B)			(3,000)
Revenue recognition in future	150	220	33,000

(iii) at hourly rate of ₹200 for 250 hours	Hours	Rate (₹)	(₹)
Modification for total hours	250	200	50,000
Revenue recognised (A)	100	250	25,000
Modified recognition (B)	100	200	20,000
Adjustment for past revenue recognition (A – B)			(5,000)
Revenue recognition in future	150	200	30,000

Illustration 23

Determine whether there arise single or multiple performance obligations for the following contracts with customers?

(a) A Ltd. Enter into a contract with a customer for installing a central air-conditioner system including site preparation, assembling of plants and test running the system.

(b) A Ltd. enter into a contract with a customer for installing a central air-conditioning system and a power generating plant for support of the air-conditioning system. However, the power generating unit can also serve other electrical uses and could be acquired from other suppliers separately.

(c) A Ltd. enter into a contract with a customer for installing a power generating plant which includes designing and construction of the plant.

   (i) Designing could have been made by any other independent designer. Based on the approved design construction of the plant has to be done.

   (ii) Designing and construction are continuously modified during installation.

(d) A Ltd. enter into a contract with a customer for transfer of a software license including its installation, where:

(i) Installation does not modify the software and installation could be done by any other entity.

(ii) Installation is customised to modify the software with additional functionalities.

Solution:

(a) site preparation, assembling of plants and test running are integrated in single performance obligation.

(b) As power generating unit can serve other uses and could be procured from different supplier installation of power generation unit is distinct from installation of air-conditioning system. Hence, there are multiple performance obligations.

(c) (i) Designing and construction are distinct performance obligations.

(ii) They are integrated and bundled into single performance obligation.

(d) (i) Software license transfer and installation are distinct and there are two performance obligations.

(ii) They are integrated and bundled into single performance obligation.

Illustration 24

On 31.03.2020 A Ltd. enter into a contract with a customer for sale of goods of ₹ 4,000 granting 50% discount voucher to be availed in future purchase up to ₹ 3,000 within 30 days. Ordinarily 10% discount is allowed on sales. Ordinary discount will not be available to avail the 50% discount voucher. There is 60% probability that the customer will redeem the discount voucher and the estimated amount of purchase is ₹ 2,000 In April 2020 the discount vouchers are redeemed for purchase of additional goods of ₹ 2800. Find revenue recognition in 2019-20 and in 2020-21.

Solution:

There are two performance obligations one for sale of goods and other for sale of discount vouchers. Their standalone prices:

Goods 4000 less 10% ordinary discount	₹ 3,600
Discount Vouchers	₹ 480
Total	₹ 4080

[Value of vouchers = Discount in excess of ordinary rate of 10%× estimated Purchase amount × probability of purchase = (50 – 10)% × 2000 × 60% = 480]

Transaction price is ₹ 3600 which is sale price less current discount of 10%. It is to be allocated between performance obligations of goods and discount vouchers proportionately.

Allocation to goods	₹3,600 × (₹3600/ ₹4080)	= ₹3,176
Allocation to Discount Voucher	₹3,600 × (480/4080)	= ₹ 424

Thus in 2019-20 Revenue is recognised for ₹ 3176 only, which is transaction price less future discount. Discount Voucher is carried as a liability at ₹ 424.

In 2020-21 this liability will be cancelled and revenue will be recognised for₹424, when the discount voucher is redeemed or expired.

The Transaction Price for additional sale is ₹2,800 less 50% discount voucher = ₹ 1,400; Total Revenue recognised is ₹1,400 + ₹ 424 =₹ 1,824.

Thus we see that ₹ 424 is deducted from revenue of 2019-20 and added to revenue of 2020-21.

Illustration 25

On 01.08.2019 A Ltd. enter into a contract with a hotel for daily sanitisation of the building for 3 years at ₹ 12,000 per month. The customer receives and consume benefits each day. Determine the revenue to be recognised in 2019-20.

Solution:

It is a series of distinct goods and services constituting a single performance obligation to be satisfied over time and transaction price has to be allocated proportionately to the performance obligation satisfied.

Accordingly, for 8 months @ ₹ 12,000 per month, ₹ 96,000 will be the revenue to be recognised in 2019-20.

Illustration 26

On 01.01.2020 A Ltd. entered into a contract with B to sell 20 TV sets at a price of ₹ 50,000 per set and the goods were delivered in February, 2020. Determine revenue to be recognised by A in 2019-20 in the following circumstances:

(i) 2 sets found damaged at the time of receiving and returned by B.

(ii) 4 sets found not properly functioning in March, 2020 and they were replaced by A as per terms of warranty.

(iii) It is not a sale but goods sent on consignment and B will sell the TV sets at ₹ 50,000 per set. 12 sets were sold by B.

(iv) It is a contract of sale or return. The TV sets can be returned by B unconditionally within 3 months. The entity expects (a) full return; (b) 50% return

Solution:

(i) Revenue is recognised for 18 sets at ₹ 9,00,000. 2 sets returned to inventory of defective items.

(ii) Revenue is recognised for 20 sets at ₹ 10,00,000 at delivery (assumed warranty is required by law and subsequent replacement is not considered as performance obligation to be satisfied over time and to attract any allocation of contract price).

(iii) Revenue is recognised for 12 sets at ₹ 6,00,000. The other 8 sets are recognised as asset (inventory) at cost.

(iv) (a) No revenue is recognised on delivery as right of the customer to unconditionally return the goods has not expired and full return is expected. The amount received or receivable on delivery of the sets is recognised as a liability and asset (inventory) is recognised for all 20 sets at cost. The performance obligation will be satisfied at the point of time when that right to return will expire and then only revenue will be recognised cancelling the liability.

(b) Revenue will be recognised at ₹ 5,00,000 (50% of delivery) and for balance ₹ 5,00,000, liability will be recognised. Further, asset (inventory) should be recognised for 10 sets at cost.

Illustration 27

A. On 31.03.2017 X Ltd. Sold goods at a price of ₹ 1,33,100 payable on 31.03.2020. The implicit interest rate is 10% p.a. What would be the revenue to be recognized for the year 2016-17, 2017-18, 2018-19 and 2019-20?

Recognition Criteria.

I. There is a contract with the customer in 2016-17.

II. There is a performance obligation–selling goods.

III. Transaction Price is determinable. The sale price is ₹ 1,33,100 payable after 3 yrs. Interest component at

10% pa is included in the price. The revenue to be recognised (₹1,33,100 × 1) ÷ $(1.10)^3$ = ₹1,00,000 in the financial year 2016-17.

IV. Transaction price is fully allocated to the performance obligation.

V. Revenue is recognized as performance obligation is satisfied.

The interest component of ₹ (1,33,100 –1,00,000) = ₹ 33,100 will be recognized as interest income in F.Y.

2017-18 : ₹ 10,000 (10% × ₹1,00,000)

2018-19 : ₹ 11,000 (10% × ₹1,10,000)

2019-20 : ₹ 12,100 (10% × ₹1,21,000)

Accounting for the years	Particulars		Dr. (₹)	Cr. (₹)
16-17	Customer A/c	Dr.	1,00,000	
	Accrued Interest A/c	Dr.	33,100	
	To, Sales A/c			1,00,000
	To, Liability for Unearned Interest A/c			33,100
17-18	Liability for Unearned Interest A/c	Dr.	10,000	
	To, Interest Income A/c			10,000
18-19	Liability for Unearned Interest A/c	Dr.	11,000	
	To, Interest Income A/c			11,000
19-20	Liability for Unearned Interest A/c	Dr	12,100	
	To, Interest Income			12,100
19-20	Bank a/c	Dr.	1,33,100	
	To, Customer a/c			1,00,000
	To, Accrued Interest a/c			33,100

B. On 01.04.2019 X Ltd. Sold goods at a price of ₹ 1,30,000 payable on 31.07.2019. The implicit interest rate is 12% p.a. What would be the revenue to be recognized for the year 2019-20?

Solution:

The financing component for 4 months amounts to ₹ 1,30,000× r/(1+ r) = ₹5000, [where r = 0.12×4/12 = 0.04]But such financing component is not considered significant as the period is normal credit period. Hence, the entire sale value is recognised as revenue from contract with customer.

C. On 01.04.2019 X Ltd. sold goods at a price of ₹ 1,25,000 plus interest at the rate of 30% pa payable on 31.07. 2019 at the end of normal credit period of 4 months. What would be the revenue to be recognized for the year 2019-20?

Solution:

Any abnormal interest charged is not considered a financing component of the contract price, rather included as part of revenue from contract with customer. As the credit period is normal ₹ 1,25,000 plus interest ₹ 10,000 = ₹ 1,35,000 is recognised as revenue from contract with customer.

D. On 31.07.2019 X Ltd. sold goods at a price of ₹ 1,25,000 plus interest at the rate of 30% pa payable on 31.07.2020. Normal interest rate is 10% pa. What would be the revenue to be recognized for the year 2019-20?

Solution:

As the credit period is longer than normal and the rate of interest charged is significantly different from normal, ₹ 1,25,000 plus interest in excess of normal = ₹ 1,25,000 + 20% × ₹ 1,25,000 = ₹ 1,50,000 is recognised as revenue from contract with customer in 2019-20 as the performance obligation is satisfied by sale of goods. The normal interest for 1 year is recognised as interest income to be distributed for 8 months in year 2019-2020 and for 4 months in 2020-2021.

Illustration 28

On 01.12.2019 A Ltd. enter into a contract with customer to install a system at ₹ 20 lakhs and implement a software by June 2020 at ₹ 80 lakhs plus ₹ 15 lakhs bonus for completing software implementation by April 2020. Initially A Ltd. estimated the contract price at 1 crore for two performance obligations – system installation and software implementation by June 2020.

In March 2020 the company found system installation complete and software implementation 80% complete with confidence to earn bonus of ₹ 15 lakhs by completing implementation by April 2020. Compute revenue to be recognised in 201920-20.

Solution:

Bonus of ₹ 15 Lakhs is the variable consideration considered as change in contract price to be allocated to performance obligation of software implementation and recognised to the extent of performance obligation satisfied over time.

Thus, revenue recognition in 2019-2020:

System installation completed ₹ 20 Lakhs; and

Software implementation 80% completed = (₹ 80 lakhs + ₹ 15 lakhs) × 80% = ₹ 76 lakhs.

Had the software implementation be satisfied at a point in time when completed and control is transferred in April 2020, no revenue would be recognised proportionately in 2019-2020 for software implementation.

Illustration 29

A Ltd. enter into a contract with a customer for construction of a machine at the site of the customer at ₹ 8 lakhs and for supply of spare parts at ₹ 1.6 lakhs in the next financial year but to hold the spare parts in A Ltd's warehouse separately to be delivered to the customer's factory as and when required in following 3 financial years for additional consideration of ₹ 20,000 pa. Recognise revenue in the financial years if the contract is duly performed.

Solution:

In the year of contract no revenue is recognised as no performance obligation satisfied.

In the next year ₹8 lakhs is recognised for completing the construction and transfer of control at the point in time.

Further ₹ 1.6 lakhs is recognised for supply of spare parts although it is held in warehouse of A Ltd. as custodian as control is transferred.

₹ 20,000 in each of the 3 years next shall be recognised as revenue from custodial services.

Solved Case

Case 1

The accountant of Forest Ltd. is provided the following data about the Ind AS complied company.

(Amount in ₹)

Year 2021-2022	For Accounting Purpose	For Taxation Purpose
Accounting Profit	2,00,000	
Depreciation	40,000	60,000
Accrued Interest	20,000	
Interest Received for the current year	10,000	10,000
Carrying amount of PPE before charging current depreciation	2,40,000	
Tax Base of PPE before charging current depreciation		2,00,000
Provision for Gratuity and Leave encashment	30,000	
Tax rate is 30%		

The accountant is seeking your help accounting for income taxes in financial accounting based on Ind AS 12.

Prepare a note to help the accountant in defining and computing (i) Taxable Profit; (ii) Current Taxes; (iii) Carrying amount of assets and liabilities; (iv) Tax Base; (v) Taxable Temporary Differences/ Deductible Temporary Differences (vi) Deferred Tax Liabilities/Deferred Tax assets; (vii) Deferred Tax and (viii) Tax Expenses.

Solution:

(i) Taxable Profits = Accounting Profits + Accounting Depreciation + Provision for Gratuity etc. – Accrued Interest income – Taxable Depreciation = ₹2,00,000 + ₹40,000 + ₹30,000 – ₹20,000 – ₹60,000 = ₹1,90,000

			Carrying Amount ₹	(iv) Tax Base (₹)	(v) Taxable / (Deductible) Temporary difference [Deferred Tax Liab./(Asset)] (₹)	(₹)
	a	PPE before depreciation	2,40,000	2,00,000	40,000	
	b	Less: Depreciation	40,000	60,000		
(iii)	c	Balance	2,00,000	1,40,000	60,000	
(iii)	d	Interest accrued	20,000	0	20,000	
(iii)	e	Prov for Gratuity and Leave encashment	30,000	0	(30,000)	

	f	Change in Temporary Difference (c-a+d+e)			10,000	
(vii)	g	Deferred Tax= 0.3 × f				3,000
(ii)	h	Current Tax = 0.3 × Taxable Profit= 0.3 × 190000				57,000
(viii)	i	Tax Expense = Accounting profit × 0.3= 200000 × 0.3[g+h]				60,000
(vi)	j	Deferred Tax Assets [e]				30,000
(vi)	k	Deferred Tax Liabilities [c+d]				80,000

Case 2

River Ltd. has entered into a 3-year contract with Ocean Ltd. of an equipment for annual payments (at the end of every year) of ₹ 80000 and the residual value at the end of lease of ₹ 50000, guaranteed up to a loss of ₹ 40000. The contract conveyed the right to control the use the machine in its factory. Interest rate implicit is 10%. At the end of the lease the machine is valued at ₹22000.

A. You are required to make accounting of the transactions in compliance with Ind AS 116 in the books of Hill Ltd. Apply SLM for depreciation.

B. Mountain Ltd. carried the machine at ₹ 220000 having 5-year life with residual value of ₹ 50000 at the end of lease term. The lease transferred substantially all the risks and rewards incidental to ownership of the machine. IRR = 13.87%.

You are required to make accounting of the transactions in compliance with Ind AS 116 in the books of Mountain Ltd.

Solution:

A. Here, we find that the contract is, or contains, a lease.

At the commencement date, the lessee (X) shall recognise (I) a right-of-use asset and (II) a lease liability.

At the commencement date, a lessee shall measure the right-of-use asset at cost. The cost of the right-of-use asset shall comprise the amount of the initial measurement of the lease liability. The lease payments shall be discounted using the interest rate implicit in the lease. Lease payments included in the measurement of the lease liability comprise fixed payments and amounts expected to be payable by the lessee under residual value guarantees.

At 10% implicit rate of interest the (Right-of-use) ROU Asset and Lease Liability are initially recognised at present value of payments as shown below.

Year	Payments (₹)	Disc. Factor	DCF at 10% (₹)
1	80,000	0.909091	72,727
2	80,000	0.826446	66,116
3	80,000	0.751315	60,105
3	40,000	0.751315	30,053

Year	Payments (₹)	Disc. Factor	DCF at 10% (₹)
Present value			2,29,001

Lease Liability repayment and interest

Year	Interest (₹)	Payments/remission (₹)	Balance (₹)
0			2,29,001
1	22,900	80,000	1,71,901
2	17,190	80,000	1,09,091
3	10,909	80,000	40,000
3	0	28,000	28,000
3	0	12,000	0

ROU Asset Depreciation for the lease period

Year	Depreciation Straight line (₹)	Balance (₹)
0		2,29,001
1	76,334	1,52,667
2	76,334	76,334
3	76,334	0

A lessee applied the depreciation requirements in Ind AS 16, Property, Plant and Equipment, in depreciating the right-of-use asset for the lease term using SLM.

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
At commencement	ROU Asset A/c	Dr.	2,29,001	
	To Lease Liability A/c			2,29,001
At the end of Year 1	Interest Expenses A/c	Dr.	22,900	
	To Lease Liability A/c			22,900
	Lease Liability A/c	Dr.	80,000	
	To Bank A/c			80,000
	Depreciation A/c	Dr.	76,334	
	To ROU Asset A/c			76,334
At the end of Year 2	Interest Expenses A/c	Dr.	17,190	
	To Lease Liability A/c			17,190

Date	Particulars		(₹)	(₹)
	Lease Liability A/c To Bank A/c	Dr.	80,000	 80,000
	Depreciation A/c To ROU Asset A/c	Dr.	76,334	 76,334
At the end of Year 3	Interest Expenses A/c To Lease Liability A/c	Dr.	10,909	 10,909
	Lease Liability A/c To Bank A/c	Dr.	80,000	 80,000
	Depreciation A/c To ROU Asset A/c	Dr.	76,334	 76,334
	Lease Liability A/c To Bank A/c (50,000 – 22,000 = 28,000, guaranteed up to 40,000) To P&L A/c (liability remission = 40,000 – 28,000)	Dr.	40,000	 28,000 12,000

Balance Sheet	At the end of Year 1	At the end of Year 2	At the end of Year 3
ROU Asset	1,52,667	76,334	0
Lease Liability	1,71,901	1,09,091	0

Statement of P&L	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)
Interest Dr	22,900	17,190	10,909
Depreciation Dr	76,334	76,334	76,334
Guarantee remission Cr			12,000

Statement of Cash Flows	Year 1 (₹)	Year 2 (₹)	Year 3 (₹)
Cash used in financing activities	80,000	80,000	80,000 28,000

B. It is a finance lease as the lease transferred substantially all the risks and rewards incidental to ownership of the machine.

(a) present value of lease receivable

Year	Payments	Disc. Factor	DCF at 10%
1	80,000	0.909091	72,727

Year	Payments	Disc. Factor	DCF at 10%
2	80,000	0.826446	66,116
3	80,000	0.751315	60,105
3	40,000	0.751315	30,053
Present value			**2,29,001**

(b) Deferred selling profits at commencement

Particulars	Workings	₹
Revenue = Present value of lease receivable		2,29,001
Cost of goods sold:		2,12,487
Carrying Value	2,20,000	
Less: Unguaranteed residual ₹10,000 × 0.7513	7,513	
Deferred selling profits at inception		16,514

(c) Net Investment in Lease at commencement = Present value of lease receivable + Unguaranteed residual – Deferred selling profits = ₹ 2,20,000 = Carrying amount of the underlying asset.

(d) Interest income includes interest on the lease receivable, accretion of the unguaranteed residual value and amortisation of deferred selling profit. The rate for recognising interest income to produce a constant periodic rate of return on the remaining net investment is IRR = 13.87% [excel fx: IRR (-₹2,20,000,₹80,000,₹80,000,₹1,30,000) = 13.87%]

(e) Interest Income and balance of Net Investment in Lease

	(₹)
Net Investment in Lease at commencement	2,20,000
Add Interest Income @ 13.87% = ₹2,20,000 × 13.87%	30,514
Total	2,50,514
Less Payment	80,000
Balance at the end of year 1	1,70,514
Add Interest Income	23,651
Total	1,94,165
Less Payment	80,000
Balance at the end of year 2	1,14,165
Add Interest Income	15,835
Total	1,30,000
Less Payment	80,000

	(₹)
Less Payment for Guaranteed loss borne by Lessee	28,000
Returned at residual value at the end of year 3	22,000
Net Investment in Lease at the end of Lease	0

Journal: **Dr.** **Cr.**

Date	Particulars		Dr. (₹)	Cr. (₹)
At the inception	Net Investment in Lease	Dr.	2,20,000	
	To PPE			2,20,000
At the end of year 1	Bank	Dr.	80,000	
	To Interest Income			30,514
	To Net Investment in Lease [80000 – 30514]			49,486
At the end of year 2	Bank	Dr.	80,000	
	To Interest Income			23,651
	To Net Investment in Lease			56,349
At the end of year 3	Bank	Dr.	80,000	
	To Interest Income			15,835
	To Net Investment in Lease			64,165
	PPE	Dr.	22,000	
	Bank	Dr.	28,000	
	To Net Investment in Lease			50,000

Balance sheet	At inception	At the end of Year 1	At the end of Year 2	At the end of Year 3
Net Investment in Lease	2,20,000	1,70,514	1,14,165	0
PPE				22,000

SP&L	Year 1	Year 2	Year 3
Interest Income	30,514	23,651	15,835

Statement of Cash Flows	At the end of Year 1	At the end of Year 2	At the end of Year 3
Cash from investing activities	80,000	80,000	80,000 28,000

Case 3

Dawn Ltd. owns one acre of land with an old building beside a river. Currently the property is used as a holiday resort and market value of the property is ₹ 2 Crores for land and 0.5 crore for the building. However, Dawn Ltd. has also contemplated the idea of converting the property into an amusement park for which the existing building has to be demolished and many new small constructions and other developments of the land have to be made. The management found this alternative use of the property to be physically possible, legally permissible and financially more viable. The market value of the land at its potential use as amusement park is estimated at ₹ 4 crores. Costs of demolition of the old building, erecting other constructions and making other developments for converting the holiday resort into amusement park are determined at ₹ 80 lakhs in total.

The management is confused about the fair valuation of the property. They asked for opinion of a professional accountant in regard the following alternative propositions:

i. The property's fair value under its current use as a holiday resort should be the market value of ₹ 2.5 crores.

ii. The property's fair value should be the market value of ₹ 4 crores for the land's potential use as amusement park.

iii. The property's fair value should be ₹ 4.5 crores being the market value of ₹ 4 crores for the land's potential use as amusement park plus the market value of the building of ₹ 0.5 crore.

iv. The fair value of land should be ₹ 3.2 crores (being the market value of for the land's potential use as amusement park of ₹ 4 crores less total conversion costs of ₹ 80 lakhs) and fair value of building should be ₹ 0.5 crore.

v. The fair value of land should be ₹ 3.2 crores and fair value of building should be nil.

Give your opinion as a professional accountant with due reference of relevant Ind AS.

Solution:

Ind AS 113 Fair Value Measurement is applicable. The 'highest and best use' is the appropriate model of measuring fair value.

i. Current use of property is not the highest and best use. Hence, based on current use market value of ₹ 2.5 crores are not acceptable as fair value.

ii. Market value of ₹ 4 crores for the land's potential use as amusement park is also not acceptable as fair value at the reporting date as redevelopment/conversion cost is not adjusted.

iii. The property's fair value of ₹ 4.5 crores being the market value of ₹ 4 crores for the land's potential use as amusement park plus the market value of the building of ₹ 0.5 crore is also not acceptable as conversion cost is not adjusted and the building attracts no share of the market value of the amusement park, where the building has to be demolished.

iv. The fair value of land should be ₹ 3.2 crores being the market value of for the land's potential use as amusement park of ₹ 4 crores less total conversion costs of ₹ 80 lakhs, but the market value of the current building on the property's current use is no more relevant and acceptable.

v. The fair value of land should be ₹ 3.2 crores being the market value of for the land's potential use as amusement park less total conversion costs. The adjusted market value of potential use of the property being greater than the market value under current use, based on 'best and highest use' the adjusted market value of the potential use has been recognised as fair value. Fair value of building should be nil as the market value of the current building on the property's best and highest use as amusement park is zero.

Case 4

Dust Ltd. has an equity investment in Dark Ltd.'s shares and accounts for the shares at fair value through profit and loss. Dark Ltd.'s shares are quoted in BSE and in Japan Exchange Group. On 31-03-2022 Dark Ltd.'s share is closed at ₹780 in BSE and at equivalent to ₹875 in Japan Exchange Group. However, significant activities on the shares are being done in BSE only.

(i) The accountant of Dust Ltd. argues that fair value of a share in Dark Ltd. should be measured based on the Market Approach and the quoted price in Japan Exchange Group being higher is considered as level I input. Accordingly, fair value is determined at ₹ 875.

After markets closed on 31.03.2022 Dark Ltd. announced news of some bad events occurred during the day and in the next morning Dark Ltd.'s shares opened in BSE at ₹ 645 and at equivalent to ₹ 730 in Japan Exchange Group.

(ii) The accountant of Dust Ltd. sticks to the fair value of ₹ 875 per share on the argument that it is based on the Input Level I quoted price in the active market on the measurement date of 31.03.2022.

Examine the validity of the arguments of the accountant of Dust Ltd. and determine the fair value of a share in Dark Ltd. with due reference of the relevant Ind AS.

Solution:

(i) The argument of the accountant that the higher of the quoted prices should be taken as the fair value is not tenable as the most advantageous market can be considered only in absence of a principal market. Since significant activities on the shares are being done in BSE only, BSE is the principal market and the quoted price in the BSE is the Level I input for fair value measurement. Thus, ₹ 780 should be the fair value of a share in the accounts of Dust Ltd. Further, when quoted price in active market is available as Level I input, there is no need for and scope of using any valuation techniques like market approach as suggested by the accountant.

(ii) Again, the accountant's argument is not tenable as the quoted price does not faithfully represent the fair value on the measurement date due to the bad news announced after the close of trading. Dust Ltd. should adjust the quoted price on 31.03.2022 for the new information and measure the fair value at ₹ 645 (information adjusted observable input) and disclose the measurement as Level II input.

Exercise

A. Theoritical Questions:

Multiple Choice Questions

1. The major three approaches to valuation of shares are:
   a. Income Approach
   b. Net Assets Approach
   c. Market Approach
   d. All of the above

2. The major bases of asset valuation for a going concern:
   a. Book Value
   b. Net Replacement Value
   c. Net Realisable Value
   d. All of the above

3. The Income approach for Valuation of Shares includes the models/Techniques:
   a. Discounted Cash Flow
   b. Dividend Discount Model
   c. Maintainable Profits Basis
   d. All of the above

4. Some of the methods of Goodwill Valuation are
   a. Capitalisation method
   b. Super profits method
   c. Average Maintainable Profits method
   d. All of the above

5. The ways of determining the value of goodwill using the capitalisation approach
   a. Capitalisation of Average Profits
   b. Capitalisation of Super Profits
   c. Both a and b
   d. Capitalisation of Average Future maintainable profit

6. The _____________ of an item of property, plant and equipment shall be recognised as an asset if, and only if: (i) it is probable that ___________ associated with the item will flow to the entity; and (ii) the ___________ of the item can be measured reliably.
   a. cost, future economic benefits, cost
   b. future economic benefits, cost, future economic benefits
   c. cost, cost, cost
   d. future economic benefits, future economic benefits, future economic benefits

7. Property Plant and Equipment (PPE) are initially recognized at __________
   a. purchase price
   b. fair value
   c. cost
   d. future economic benefits

Answer:

1.	2.	3.	4.	5.	6.	7.
d.	d.	d.	d.	c.	a	c

Fill in the Blanks

1. Every firm in an industry is expected to earn a normal rate of return. If a particular firm of the industry manages to earn a rate of return that happens to be more than the normal industry rate of return, then such a firm is said to be earning _________.

2. ________ refers to a series of continuous cash flows (either cash inflows or cash outflows) of equal amount that occur in every period, over a specified period of time.

3. ___________ refers to the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the external liabilities.

4. The phrase _______________ refers to the expected number of future years for which the firm is expected to earn the average profit from the year of purchase.

5. _________ represents the capacity of the business to earn excess profit for a period of time over normal profit.

Answer:

1.	super profits	**2.**	Annuity
3.	Net Assets	**4.**	Number of Years of Purchase
5.	Goodwill		

Short Essay Type Questions

1. State some of the most important purposes of Share Valuation.
2. Enumerate the different factors that affect the valuation of shares.
3. Explain in brief the different variables which influence the valuation of goodwill under ‘Super Profit method’.
4. State the steps involved to find value per share based on market approach.

Essay Type Questions

1. Under Income Approach how is the value of a business measured using different methods or techniques? Explain. Examine whether capitalisation of income is an application of valuation under income approach.
2. Explain different methods of goodwill valuation. Do you think valuation of goodwill is required to find value per share under (i) income approach; (ii) net asset approach; and (iii) market approach.

B. Numerical Questions:

Multiple Choice Question

1. X Ltd. borrowed \$6000 for construction of a qualifying asset at 3% interest pa on 01.04.2021 when \$1 = ₹60, which is due for payment on 31.03.2023. The company could borrow the amount in rupees at 12% interest pa. Interest is payable on 31st 2023. Construction of asset will continue till 31-03-2023. Answer Q (i) to Q (ix).

(i) If on 31.03.2022 \$1 = ₹ 70 which of the following statements is not true?

a. Exchange loss = ₹(60 – 70) × \$ 6,000 = ₹ 60,000

b. Cost of borrowing in foreign currency = 3% × \$ 6,000 × ₹ 70 = ₹ 12,600

c. Cost of borrowing in functional currency = 12% × \$ 6,000 × ₹ 60 = ₹ 43,200

d. Cost of borrowing in foreign currency = 3% × \$ 6000 × ₹ 60 = ₹10,800

(ii) If on 31.03.2021 \$1 = ₹ 70, borrowing cost = Cost of borrowing in foreign currency plus

a. Exchange loss of ₹ 60,000

b. Exchange loss less cost of borrowing in foreign currency = ₹ 60,000 – ₹ 12,600 = ₹ 47,400

c. Cost of borrowing in functional currency less Cost of borrowing in foreign currency = ₹ 43,200 – ₹12,600 = ₹ 30,600 (not exceeding exchange loss)

d. ₹ 60,000 – ₹ 43,200 = ₹ 16,800

(iii) If on 31-03-20X2 \$1 = ₹ 70, borrowing cost is

a. ₹ 60,000

b. ₹ 12,600 + ₹ 30,600 = ₹ 43,200

c. ₹ 12,600 + ₹16,800 = ₹ 29,400

d. ₹30,000

(iv) If on 31-03-20X2 \$1 = ₹ 63, borrowing cost is

a. Exchange loss of ₹ 18,000

b. Cost of borrowing in foreign currency = 3% × 6000 × ₹ 63 = ₹ 11,340

c. Cost of borrowing in functional currency = ₹12% × 6000 × ₹60 = ₹ 43,200

d. ₹ 11,340 + ₹ 18,000 [(c-b) not exceeding (a)] = ₹ 29,340

(v) If on 31-03-20X2 \$1 =₹ 70 and on 31-03-20X3 S1 = ₹ 54, borrowing cost in the year ending on 30-03-20X3 is

a. reduced by exchange gain = ₹ (60 – 54) × \$ 6000 = ₹ 36,000

b. reduced by exchange gain not exceeding exchange loss previously recognised as adjustment = ₹30,600

c. increased by exchange gain = ₹ (60 – 54) × \$ 6000 =₹ 36,000

d. increased by ₹ 30,600

(vi) If on 31-03-2022 \$1 = ₹ 70 and on 31-03-2023 S1 = ₹ 57, borrowing cost in the year ending on 30 03-2023 is

a. reduced by exchange gain not exceeding exchange loss previously recognised as adjustment = ₹ (60 – 57) × \$ 6000 = ₹ 18,000

b. exchange loss previously recognised as adjustment = ₹ 30,600

c. increased by exchange gain = ₹ 18,000

d. increased by ₹ 30,600

(vii) If on 31-03-2022 \$1 =₹ 70, in the year ending on 30 03-20X2:

a. borrowing cost capitalised is ₹ 12,600 and Exchange loss expensed in SOPL is ₹ 60,000

b. borrowing cost capitalised is ₹ 12,600 + ₹ 30,600 = ₹ 43,200 and Exchange loss expensed in SOPL is ₹ (60,000 – 30,600) = ₹ 29,400

c. borrowing cost capitalised is ₹ 30,600 and Exchange loss expensed in SOPL is ₹ (60,000 – 30,600) = ₹ 29,400

d. None of the above

(viii) If on 31-03-2022 \$1 =₹ 70 and on 31-03-2023 S1 = ₹ 54, in the year ending on 30-03-2023:

a. borrowing cost capitalised is ₹ 9,720 - ₹ 36,000 = - ₹ 26,280.

b. borrowing cost capitalised is ₹ 9,720

c. borrowing cost capitalised is ₹ 9,720 -₹ 30,600 = - ₹ 20,880

d. Nil

(ix) If on 31-03-2022 \$1 = ₹ 70 and on 31-03-2023 S1 =₹ 57, in the year ending on 30-03-2023:

a. borrowing cost capitalised is ₹ 10,260 - ₹ 18,000 = - ₹ 7,740

b. borrowing cost capitalised is ₹ 10,260

c. borrowing cost capitalised is ₹ 10,260 - ₹ 30,600 = ₹ 20,340.

d. Nil

2. X Ltd. borrowed ₹6,00,000 at 15% interest from bank and issued 12% Debenture of ₹ 4,00,000 for construction of a factory and an office building on 01.04.2021. The amount was utilised for construction of factory ₹3,00,000 on 01.07.2021 and for construction of building ₹ 7,00,000 on 01.10.2021, the unutilised amount was invested at 10% Bonds. Answer Q10 to Q11.

(i) Which of the following statements is not true?

a. The capitalisation rate is 15 × 0.6 + 12 × 0.4 = 13.8%

b. Borrowing cost for factory without adjusting investment income is 13.8% × ₹ 3,00,000 = ₹ 41,400

c. Borrowing cost for building without adjusting investment income is 13.8% × ₹ 7,00,000 = ₹ 96,600

d. Borrowing cost for building without adjusting investment income is 13.8% × 7,00,000 × 6/12 = ₹ 48,300

(ii) Which of the following statements is not true?

a. The investment income is ₹ 3,00,000 × 3/12 × 7% + ₹ 7,00,000 × 6/12 × 7% = ₹ (5,250 + 24,500) = ₹ 29,750

b. The investment income is ₹ 3,00,000 × 6/12 × 7% + ₹7,00,000 × 3/12 ×7% = ₹ (10,500 + 12,250) = ₹ 22,750

c. borrowing cost capitalised for factory is ₹ 41,400 - ₹ 5,250 = ₹ 36,150.

d. borrowing cost capitalised for building is ₹ 96,600 - ₹ 24,500 = ₹ 72,100.

Answer:

1. (i)	**1. (ii)**	**1. (iii)**	**1. (iv)**	**1. (v)**	**1. (vi)**	**1. (vii)**	**1. (viii)**	**1. (ix)**	**2. (i)**	**2. (ii)**
d.	**c.**	**c.**	**d.**	**b.**	**a.**	**d.**	**c.**	**a.**	**d.**	**b.**

Comprehensive Numerical Problems

1.

Year	2018	2019	2020	2021
CF (₹ in Lakhs)	500	600	700	800

(a) Find value of the business on 01-01-2021, if CF remains constant from 2021 to infinity, given that WACC = 10%.

(b) Find value of the business on 01-01-2020 if CF grows at 4% pa from 2022 to infinity, given that WACC = 10%.

(c) Find value of the business on 01-01-2019 if CF remains constant from 2021 to infinity, given that WACC = 10%.

2.

Data provided for forthcoming Year 1	**₹ in Lakh**
EBIT	800
Depreciation	160
Capex	200
Interest	300
Increase in non-cash working capital	100
Debt Capital at year 0	3,000
Debt repaid during year 1	500
Debt issued during year 1	600

Further information:

Tax rate = t	25%
WACC	10%
No of equity shares	6000000

Find:

(a) NOPAT;

(b) CF;

(c) FCFF;

(d) FCFE;

(e) Value of business based on constant (i) CF; (ii) FCFF; (iii) FCFE

(f) Value of business when growth rate is 5% based on (i) CF; (ii) FCFF; (iii) FCFE

(g) Value per share based on FCFF when constant growth rate is 5%.

(h) Value per share based on FCFE when constant growth rate is 5%.

3. The following abridged Balance Sheet as on 31st March, 2021 pertains to K Ltd.

Liabilities	₹in lakhs	Assets	₹in lakhs
Share Capital :		Goodwill, at cost	600
100 lakh Equity shares of ₹10 each, fully paid up	1,000	Other Fixed Assets	9,030
60 lakh Equity shares of ₹10 each, ₹8 paid up	480	Current Assets	3,000
50 lakh Equity shares of ₹5 each, fully paid-up	250	Loans and Advances	900
Reserves and Surplus	4,000		
Secured Loans	5,000		
Current Liabilities	2,000		
Provisions	800		
	13,530		**13,530**

You are required to calculate the following for each one of three categories of equity shares appearing in the above-mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Net Assets;

(ii) Value per share on the basis of dividend yield.

Normal rate of dividend in the concerned industryis12%, whereas K Ltd. has been paying 15% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2021 the company has earned ₹1740 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of ₹10 of a Company in the same industry is ₹1.8.

4. AB Ltd, earned profits during the past 5 years as follows:

Year	20 × 1	20 × 2	20 × 3	20 × 4	20 × 5
Profits (₹)	30,000	36,000	40,000	44,000	50,000

Determine the value of goodwill at the end of 20x5 in each of the following independent cases:

Case (a):

It was decided to value the Goodwill on the basis of 2 years' purchase of average profit of last five years.

Case (b):

It was decided to value the Goodwill on the basis of 4 years' purchase of average profit of last five years after giving weights of 1, 2, 3, 6 and 8 to the profits chronologically.

Case (c):

It was decided to value the Goodwill on the basis of 3 years' purchase of weighted average profit of last five years giving maximum weightage to the recent results.

Case (d):

It was decided to value the Goodwill on the basis of 3 years' annuity of expected annual profits of ₹ 50,000 at 10% rate of discounting.

Case (e):

It was decided to value the Goodwill on the basis of 4 years' purchase of super profits, normal rate of return is 10%. Average capital employed is ₹ 4,00,000. Future maintainable profit is the simple average profit of last five years.

Case (f):

It was decided to value the Goodwill on the basis of capitalization of super profits, capitalization rate is 10%. Average capital employed is ₹ 4,00,000. Future maintainable profit is ₹ 50,000.

Case (g):

It was decided to value the Goodwill on the basis of 2½ years' purchase of simple average profit of last five years. In this regard the following were observed:

(i) an abnormal loss of ₹ 1,000 was charged against the profit of 20x3;

(ii) Profit of 20x4 included a non-recurring receipt of ₹ 2,000.

(iii) closing stock of 2015 was over-valued by ₹ 3,000.

5. The following is the Balance Sheet (extract) of Z Ltd. as on 31st March, 2021:**Balance Sheet**

Equity and Liabilities	₹ in Lakh	Assets	₹ in Lakh
3,00,000 Equity shares of ₹10 each fully paid	30,00,000	Building	20,00,000
		Plant & Machinery	22,00,000
12%Redeemable preference shares of ₹100 each fully paid	19,00,000	Furniture	10,00,000
General Reserve	15,00,000	Investments	16,00,000
Profit & Loss A/c	3,00,000	Stock	12,00,000
Secured Loan	10,00,000	Debtors	20,00,000
Creditors	27,00,000	Bank Balance	4,00,000
	1,04,00,000		**1,04,00,000**

Additional Information:

(i) PPE are worth 10% more than book value. Stock is overvalued by ₹2,00,000. Debtors are to be reduced by ₹80,000. Trade investments, which constitute 10% of the total investments are to be valued at 20% below cost.

(ii) Trade investments were purchased on 01.04.2020. 50% of non-trade investments were purchased on 01.04.2019 and the rest on 01.04.2020. Non-trade investments yielded 15% return on cost.

(iii) In 2019-2020 Furniture with a book value of ₹1,00,000 was sold for ₹50,000. This loss should be treated as non- recurring or extraordinary item for the purpose of calculating adjusted average profit.

(iv) In 2018-2019 new machinery costing ₹2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) Return on capital employed is 18% in similar businesses.

(vi) Profits of last four years are as under:

Year	₹ in Lakhs
2017-2018	13,00,000
2018-2019	14,00,000
2019-2020	17,00,000
2020-2021	20,00,000

(vii) It is assumed that preference dividend has been paid till date.

(viii) Depreciation on the overall increased value of PPE (worth 10% more than book value) need not be considered. Depreciation on the additional value of only plant and machinery to be considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.

Compute Goodwill at three years purchase of super profits based on simple average profits of last four years.

Section - B

Valuation of Shares, Accounting and Reporting of Financial Instruments and NBFCs

Valuation of Shares (including Determination of Goodwill, Post-Valuation of Tangible and Intangible Assets)

2

SLOB Mapped against the Module

To equip students with in-depth knowledge on the traditional and modern approaches to valuation of business, goodwill and shares based on corporate financial reporting.

Module Learning Objectives

- To make the students understand the perspectives of valuation of shares
- To enrich the students with in depth knowledge about the concept of valuation of a business, of shares, of tangible and intangible assets including goodwill and
- To develop skill in measurement of value of business and shares based on different approaches and by use of different methods.

Valuation of Shares (including Determination of Goodwill, Post-Valuation of Tangible and Intangible Assets)

2

The valuation of the shares of a company uses information not restricted to financial statements only and it is also not an integral part of financial accounting in true sense. Valuation of share is essentially connected with valuation of business, valuation of goodwill, valuation of tangible net assets and valuation of other intangible assets.

A share is the smallest unit of ownership of acompany. It happens to be one of the sources by which a company raises funds from the market. The value of a share does not remain static over its life-time. Rather it changes over the period due to various circumstances. Thus, knowing the value of share at a particular point of time is of great importance.

Purpose of Share Valuation

The shares of a company are required to be valued for various purposes. Some of the most important purposes include the following:

1. For selling shares of a shareholder to a purchaser (which are not quoted in the stock exchange)
2. For acquiring a block of shares which may or may not give the holder thereof a controlling interest in the company.
3. To shares by employees of the company where the retention of such shares is limited to the period of their employment.
4. To formulate schemes of merger and acquisition.
5. To acquire interest of dissenting shareholders under a scheme of reconstruction.
6. For granting loans on the basis of security of shares
7. To compensate shareholders on the acquisition of their shares by the government under a scheme of nationalization.
8. For conversion of securities, say preference shares into equity shares.
9. To resolve a deadlock in the management of a company on the basis of the controlling block of shares given to either of the parties.

Factors Affecting Valuation of Shares

The different factors that affect the valuation of shares are:

1. Nature of the industry to which the company belongs
2. The companies past performance
3. Economic conditions of the country

4. Other political and economic factors (e.g., possibility of nationalization, excise duty on goods produced, etc.)
5. Demand and supply of shares
6. Income yielding capacity of the company
7. The availability of sufficient assets over liabilities
8. Proportion of liabilities and capital
9. Rate of proposed dividend and past profit of the company
10. Yield of other related shares of the Stock Exchange.

There are different approaches to valuation and with clear understanding of the purpose of valuation an accountant has to use judgement, experience and knowledge to find the relevant value of a share. The true value remains always unknown and all valuation techniques are applied to find the value nearest to its true value.

The major three approaches to valuation of shares are:

A. Income Approach
B. Net Assets Approach
C. Market Approach

A. Income Approach (Under this approach different alternative terms are used: DCF method, Intrinsic Valuation, Yield value etc.)

The Income Approach indicates the value of a business or equity based on the value of the future income (represented by cash flows, operating profits, net profits or dividends as the case may be) that a business is expected to generate in future. This approach is appropriate in most going concern situations as the worth of a business or equity is generally a function of its ability to earn income/cash flow in future.

The Income approach includes a number of models/Techniques:

(1) Discounted Cash Flow
(2) Dividend Discount Model
(3) Maintainable Profits Basis and
(4) Other bases.

1. Discounted Cash Flow (DCF) model

It indicates the fair market value of a business (or Equity) based on the value of cash flows that the business (or Equity) is expected to earn in future. This method involves the estimation of Net Operating Profits Adjusted Tax (NOPAT) for the projected period, the business's requirement of reinvestment in terms of capital expenditure and incremental working capital and appropriate cost of capital that reflects the risks of the corresponding return.

(a) Merits of DCF model:

(i) Cash flows are unaffected by any differences of accounting policies, principles, conventions and methods.

(ii) It provides the intrinsic or economic value unaffected by market forces.

(b) De-merits of DCF model:

It is hard

(i) to estimate future cash flows, and

(ii) to apply appropriate rate of discounting

(c) Computation of value per share = Value of Equity/ No. of equity shares

Value of Equity = Value of the business less value of Debt Capital

Value of business = Aggregate of future cash flows (or Free Cash flows) discounted at its present worth

(d) Let us see how cash flows are computed so that future cash flows can be projected.

a. Cash Flows (CF) = NOPAT + Depreciation, amortisation, impairment etc. (non-cash expenses charged against profits) + (-) Decrease (Increase) in non-cash working capital

Net Operating Profits Adjusted Tax (NOPAT) = EBIT×(1 -t)

EBIT (Earnings Before Interest and Tax) is Net Operating Profits.

t = Tax Rate = Tax expenses/Earning Before Tax (EBT)

b. Free Cash Flows are of two types: (A) Free Cash Flows to the Firm (FCFF) and (B) Free Cash Flows to the Equity (FCFE)

b1. FCFF = CF – Capex (Capex means capital expenditures made within the business for expansion, replacement etc.)

b2. FCFE {Free Cash Flow to the Equity} = FCFE = Net Income – Increase in non-cash WC – Net Capex + Net Debt Issue

Or, FCFE = FCFF – Interest net of tax + Net Debt Issued

Interest net of tax = Interest × (1 – t)

(e) Terminal Value or continuing value:

As business is a going concern, at the end of the limited period for which future cash flows (CF, FCFF or FCFE) are projected, the terminal value has to be computed by aggregating the discounted cash flows from that moment till infinity. Thus, Terminal Value = ∑DCF commencing from the end of projection period continued up to infinity.

(i) Two assumptions are made for finding terminal value for business valuation:

a. There is an infinite series of cash flows (CF, FCFF or FCFE)

b. Cash flows are either (a) constant or (b) growing at a constant rate

(ii) Growth rate (g) in cash flows is determined by multiplying Re-investment rate (RR) with Return on invested capital (ROIC) or return on capital employed (ROCE in absence of ROIC).

g = RR× ROIC (or, ROCE)

(iii) Re-investment rate = Re-investment/NOPAT, where Re-investment = Net change in non-cash working capital + Net Capex (where, Net Capex = Capex less Depreciation etc.)

(f) Value of business = Aggregate of future cash flows (or Free Cash flows) discounted at its present worth = ∑DCF (for the period future cash flows are projected) + Terminal Value (Continuing Value) discounted at its present worth

Terminal Value (Continuing Value) at constant cash flows assumption = TVn = CF(n+1)/k, where, k is the discounting rate

Terminal Value (Continuing Value) at constant growth rate of cash flows assumption = TVn = CF(n+1)/(k – g), where, k = WACC is the discounting rate

(i) If there is no period of projected cash flows, continuing value is measured at period 0. In that case

Value of business = V0 = Continuing Value = CF1/k (at constant cash flows assumption)

And V0 = CF1/(k – g) [at constant growth rate of cash flows assumption)

(ii) When there is 'n' period of projected cash flows, continuing value is measured at period 'n'. In that case

Value of business = V0 = ∑DCF (for the years 1 to n) + TVn discounted for 'n' years (for the cash flows from n+1 year to infinity)

Illustrative examples of Discounted Cash Flow (DCF) model:

Illustration 1

Yr.	2018	2019	2020	2021	2022	……….
CF (₹)	500	600	700	800	800	continued at 800

(a) Find value of the business on 01-01-2021, given that WACC = 10%.

(b) Find value of the business on 01-01-2020, given that WACC = 10%.

(c) Find value of the business on 01-01-2019, given that WACC = 10%.

Solution:

(a) From the date of valuation all future cash flows are constant at ₹ 800. Thus, in accordance with para 1.6.1 the formula of Continuing value is $V_0 = CF_1/k = V_{1\text{-}1\text{-}21} = CF_{2021}/WACC = 800/10\%$ = ₹ 8,000

(b) From the date of valuation future cash flows for 2020 is projected at ₹700 and at the end of the projection period on 01.01.2021 we may apply the formula of Terminal Value which we already found in part (a) at ₹ 8,000. Thus, in accordance with para 1.6.2 the formula of business value is

$V_{1\text{-}1\text{-}20}$ = 700/(1.1) + (800/.1)/(1.1) [DCF for 2020 + PV of the Terminal Value] = 7909

(c) From the date of valuation future cash flows for 2019 and 2020 are projected at ₹600 and ₹700 and at the end of the projection period on 01.01.2021 we may apply the formula of Terminal Value which we already found in part (a) at ₹ 8,000. Thus, in accordance with para 1.6.2 the formula of business value is

$V_{1\text{-}1\text{-}19}$ = 600/(1.1) 700/(1.1)^2 + (800/.1)/(1.1)^2 [DCF for 2019 and 2020 + PV of the Terminal Value]

= **₹7,736 (Approx.)**

Workings: **(₹ in Lakh)**

Particulars	01.01.2019	2019	2020	2021 onwards continued to infinity
CF		600	700	800
Terminal Value (TV)			8,000	
DCF of 2019	545.45455			
DCF of 2020	578.5124			
PV of TV	6611.5702			
$V_{01\text{-}01\text{-}2019}$	**7735.5372**			

Illustration 2

Forthcoming Year 1	₹ in Lakh
Data provided:	
EBIT	700
Depreciation	120
Capex	180
Interest	60
Increase in non-cash working capital	100
Debt Capital	3,000

Further information:

Tax rate = t	25%
WACC	10%
No of equity shares	50,00,000

Find:

(a) NOPAT,

(b) CF,

(c) FCFF,

(d) Value of business based on

(i) CF;

(ii) FCFF,

(e) Value of business when growth rate is 5% based on

(i) CF;

(ii) FCFF,

(f) Value per share based on FCFF when growth rate id 5% and

(g) Value per share based on FCFE when constant growth rate is 5%.

Solution: (₹ in. Lakh)

(a) NOPAT = EBIT×(1 – t) = 700×(1 - 0.25) = 525

(b) CF = NOPAT + Depreciation - Increase in non-cash working capital = 525 + 120 – 100 = 545

(c) FCFF = CF – Capex = 545 – 180 = 365

(d) Value of business based on

(i) CF:

Value of business = V_0 = Continuing Value = CF/WACC (at constant cash flows assumption)
= 545/ 0.1 = 5450

Value of business based on

(ii) FCFF

Value of business = V_0 = Continuing Value = FCFF/WACC (at constant cash flows assumption)

= 365/0.1 = ₹3,650 Lakhs

(e) (i) Value of business = V_0 = Continuing Value at growth rate of 5%= CF/(k – g) = 545/(0.10 – 0.05)

= 545/ 0.05 = ₹ 10,900

(ii) Value of business = V_0 = Continuing Value = FCFF/(k – g) = 365/(0.10 – 0.05) = 365/ 0.05 = ₹7,300

(i) CF; (ii) FCFF

(f) Value per share based on FCFF when constant growth rate is 5%

V_0 = ₹7,300;

Equity = V_0 – Debt Capital = ₹7,300 – ₹3,000 = ₹4,300

No. of equity shares = 50 lakhs

Value per share = ₹4,300/50 = ₹ 86

(f) FCFE = FCFF – Interest net of tax + Net Debt Issued = 365 – 80×(1 – 0.25) + (140 – 90) = 355

Value of equity = FCFE/ (Ke – g) = 355/(0.125 – .05) = 355/0.075 = ₹4,733.33

Value per share = Equity/ n = ₹4,733.33/50 = ₹91.67

(2) Dividend Discount Model

Here, Value per share = Dividend per Share/ Ke [when constant dividend is assumed for infinity]

Value per share = Dividend per Share/ (Ke – g), [when constant growth of dividend is assumed for infinity]

Ke is the cost of equity and g is the growth rate of dividend. This model is based on Gordon's model of share pricing.

(3) Maintainable Profits Basis

Value of equity under Maintainable Profits Basis = Maintainable Profits available to equity/ Equity capitalisation rate (Ke)

Value per share = Value of Equity/no. of equity shares

Average Maintainable Profits are computed to find out expected future earnings of the Equity. Hence all non-recurring or abnormal items of income and expenses are eliminated. Simple or weighted average of past years (excluding any abnormal year) adjusted earnings are computed.

(4) Other bases

(i) Yield-Basis Method:

Yield is the effective rate of return on investments which is invested by the investors. It is always expressed in terms of percentage. Since the valuation of shares is made on the basis of Yield, it is called Yield-Basis Method.

Under Yield-Basis method, valuation of shares is made on either of the following basis:

(a) Profit Basis; or (b) Dividend Basis.

(a) **Under Profit Basis:** Under this method, at first, profit should be ascertained on the basis of past average profit; thereafter, capitalized value of profit is to be determined on the basis of normal rate

of return, and, the same (capitalized value of profit) is divided by the number of shares in order to find out the value of each share.

The following steps are followed for the purpose of valuation:

$$\text{Capitalised Value of Profit} = \frac{\text{Profit}^1}{\text{Noramal Rate of Return}} \times 100$$

$$\text{Value of each Equity Share} = \frac{\text{Capitalised Value of Profit}}{\text{Number of Shares}}$$

$$\text{Or, Value of each Equity Share} = \frac{\text{Profit}}{\text{Normal Rate of Return} \times \text{Number of Equity Shares}} \times 100$$

(b) **Under Dividend Basis:** Valuation of shares may be made either (I) on the basis of total amount of dividend, or (II) on the basis of percentage or rate of dividend:

(I) on the basis of Total Value of Dividend:

$$\text{Capitalised Value of Profit} = \frac{\text{Dividend Profit i.e. Total Amount of Dividend}}{\text{Normal Rate of Returni.e. Yield}} \times 100$$

$$\therefore \text{ Value of each Equity Share} = \frac{\text{Capitalised Value of Profit}}{\text{Number of Equity Shares}}$$

$$\text{Or, Value of each Equity Share} = \frac{\text{Divisible Profit} \times 100}{\text{Normal Rate of Return} \times \text{Number of Equity Shares}}$$

(II) On the basis of percentage or Rate of Dividend:

$$\text{Value of each Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value of exach Equity Share}$$

When the Rate of Dividend is not given

$$\text{Rate of Dividend} = \frac{\text{Profit}}{\text{Equity Share Capital (Paid-up)}} \times 100$$

Whether Profit Basis or Dividend Basis method is to be followed for ascertaining the value of shares depends on the shares that are held by the respective shareholders. In other words, the shareholders holding minimum number of shares (i.e., minority holding) may determine the value of shares on dividend basis in order satisfy the rate of dividend which is recommended by the Board of Directors, i.e. such shareholders have no such power to control the affairs of the company.

On the contrary, the shareholders holding maximum number of shares (i.e., majority holding) have got more controlling rights over the affairs of the company including the recommendation for the rate of dividend among others. Under the circumstances, valuation of shares should be made on profit basis. In short, Profit Basis should be followed in the case of Majority Holding, and Dividend Basis should be followed in the case of Non-controlling Holding.

(ii) Fair Value Method:

There are some valuers who do not accept either the Intrinsic Value or the Yield Value for ascertaining the value of shares. They prescribe the Fair Value Method which happens to be the arithmetic mean

of Intrinsic Value Method (net asset method) and Yield Value Method. The same provides a better indication about the value of shares than the earlier two methods.

$$\text{Fair Value} = \frac{(\text{Intrinsic Value} + \text{Yield Value})}{2}$$

B. Net Assets Approach or Asset-Backing Method:

Since the valuation is made on the basis of the assets of the company, it is known as Asset-Basis or Asset-Backing Method. At the same time, the shares are valued on the basis of real internal value of the assets of the company and that is why the method is also termed Intrinsic Value Method or Real Value Basis Method. Under net assets basis value of equity is determined by subtracting ascertained value of liabilities from the value of assets.

This method may be made either:

(a) On a going concern basis; or

(b) On Break-up value basis.

In case of the former, the utility of the assets is to be considered for the purpose of arriving at the value of the assets, but, in the case of the latter, the realizable value of the assets is to be taken.

(1) Valuation of assets and liabilities:

(a) There are three major bases of asset valuation for a going concern:

(I) Book Value;

(II) Net Replacement Value;

(III)Net Realisable Value

Assets include all tangible assets including contingent assets and intangible assets including goodwill.

Liabilities include contingent liabilities also. For valuing equity shares dues of preference shareholders are also considered as liabilities.

(b) In case of liquidation, however, break-up value is computed based on sale value of individual assets and remission value of individual liabilities.

Thus, under net assets approach

Value per share = Net Assets/ no. of equity shares

Net Assets = Value of all tangible assets including contingent assets (using an appropriate basis of valuation) + Value of Goodwill and other Intangible assets – Ascertained value of liabilities including Contingent liabilities and dues of preference shareholders, if any.

Computation of Net Assets

Particulars	₹	₹	₹
Net Assets			
Fixed Assets (PPE)	xxxx		
Investments (Financial assets)	xxxx		
Current Assets	xxxx		
Goodwill if any	xxxx		

Particulars	₹	₹	₹
Total Assets		xxxxx	
Less:			
Current Liabilities (including Contingent Liability)	xxxx		
Debentures	xxxx		
Preference Share Capital (with arrear dividend)	xxxx	xxxxx	
		xxxxx	
Net Assets/Funds Available for Equity Shareholders			xxxxx
Value per share = Net Assets/ No. of equity shares =			xxxxx

Therefore, next we take up valuation of goodwill.

(2) Valuation of Goodwill

Goodwill represents the capacity of the business to earn excess profit for a period of time over normal profit. The value of goodwill is the aggregate of such excess profit for the period of consideration duly discounted to their present worth (or without adjusting for time value of money). The popular measure of determining excess profit or super profit is the average maintainable profits less normal profits. The period for which such excess profit is computed may be assumed to be infinite time or it may be assumed to be limited to certain years (3 to 5 years, for instance).

Accordingly, different methods of valuation of goodwill are broadly classified as follows:

(a) Capitalisation method: It assumes constant super profit for infinite years.

(b) Number of years' purchase method: It assumes constant super profit for limited number of years (usually 3 to 5 years).

(a) Under capitalisation method

(i) aggregate of constant super profits discounted at normal rate of return (= WACC) for infinite number of years is computed.

Goodwill (capitalisation of super profits) = ∑Discounted Super Profits (for infinite years) = Super Profits/Normal rate of return

Super Profits = Average (Simple or Weighted) Maintainable Profits – Normal Profits

Normal Profits = Average Capital Employed×Normal rate of return

[hence, Average Capital Employed = Normal Profits/ Normal rate of return]

Thus, Goodwill = {Average (Simple or Weighted) Maintainable Profits – Normal Profits}/ Normal rate of return

= Average (Simple or Weighted) Maintainable Profits/ Normal rate of return - Normal Profits/ Normal rate of return

Thus, we find:

(ii) Goodwill = Capitalised value of Average Maintainable Profits – Average Capital Employed

[When goodwill is valued in this manner it is not at all different from the capitalisation of super profit method, but it is popularly named as capitalisation of Average Maintainable Profits method]

(b) Number of years' purchase method:

(i) Super profits method:

(I) Goodwill = Super profits × number of years' purchase (without adjusting for time value of money). It is assumed that the business will earn constant super profits for a fixed number of years. Value of goodwill is the aggregate of such super profits.

(II) Goodwill = Super Profits × Present Value of Annuity (It computes the present value worth, and is called Annuity method)

(ii) Average Maintainable Profits method:

Instead of super profits, Average Maintainable Profits are used to find value of goodwill.

(I) Goodwill = Average Maintainable Profits × number of years' purchase (without adjusting for time value of money). It is assumed that the business will earn constant Average Maintainable Profits for a fixed number of years. Value of goodwill is the aggregate of such Average Maintainable Profits.

(II) Goodwill = Average Maintainable Profits × Present Value of Annuity (It computes the present value worth, and is called Annuity method)

[Thus, under Annuity method both super profit and average maintainable profits are used]

Now, we shall see how the values for the following variables are determined for valuation of goodwill:

(i) Average (Simple or Weighted) Maintainable Profits

(ii) Average Capital Employed

(ii) Normal rate of return

Average Maintainable Profits are computed to find out expected future operating income of the business. Hence all non-operating and non-recurring or abnormal items of income and expenses are eliminated.

In the same way corresponding assets (investments etc) and liabilities are also excluded from Average Capital Employed.

Normal Rate Of Return: Weighted Average Cost of Capital (WACC) represents normal rate of return.

WACC = Weight of Equity × Cost of Equity + Weight of Debt Capital × Cost of Debt Capital

(3) Valuation of other intangible assets

Other intangible assets are identifiable and they can be valued on (i) cost basis, (ii) market basis and (iii) income basis.

(i) Value of intangible asset under cost basis is the current replacement cost of the identified intangible asset

(ii) Value of intangible asset under market basis is similar to the market approach for business valuation. Market value of equivalent asset in peer group is related to its base value (such as historical cost, replacement cost or book value or ascertainable income from such asset) and the average of the relatives or multiples is applied on the base value of the required intangible asset.

Thus, Value of intangible asset = Base value × Market value relative or multiple.

(iii) Value of intangible asset under income basis is similar to the income approach for business valuation. As life of other intangible asset is finite capitalisation method is not applicable.

Value of intangible asset = $\sum$DCF (for the years 1 to '*n*', where estimated life is *n* years)

Illustration 3

The following a bridged Balance Sheet as on 31st March, 2021 pertains to S Ltd. (₹ in Lakhs)

Liabilities	(₹)	Assets	(₹)
Share Capital:		Goodwill, at cost	420
180lakh Equity shares of ₹10 each,fully paid up	1,800	Other Fixed Assets	11,166
90lakh Equity shares of ₹ 10each, ₹ 8 paid up	720	Current Assets	2,910
150 lakh Equity shares of ₹5 each, fully paid-up	750	Loans and Advances	933
Reserves and Surplus	5,457		
Secured Loans	4,500		
Current Liabilities	1,242		
Provisions	960		
	15,429		**15,429**

You are required to calculate the following for each one of three categories of equity shares appearing in the above-mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Assets and Liabilities including goodwill;

(ii) Value per share on the basis of dividend yield. Normal rate of dividend in the concerned industry is 15%, whereas Glorious Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2021 the company has earned ₹1,371 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of ₹10 of a Company in the same industry is ₹2.

(A) Calculation of Intrinsic value [Based on book value]

Particulars	₹ in lakhs
Goodwill Fixed Assets Current Assets Loan Advances	420 11,166 2,910 933
Total	15,429
Less: Provision Currentliabilities	960 1,242
Secured loans	4,500
Net Assets available for Equity shareholder	8,727
Add: Notional calls [90 × 2]	180

Particulars	₹ in lakhs
$\frac{\text{Total Assets}}{\text{Equity Share Capital}} = \frac{₹8,907}{1800+900+750} = \frac{₹8,907}{3,450}$	
Intrinsic value per Rupee Paid up value ₹10 × 2.58 = Paid up value ₹8 × 2.58 = Paid up value ₹5 × 2.58 =	₹2.58 ₹25.8 ₹20.64 ₹12.90

$$\text{Dividend Yield} = \frac{\text{Dividend Rate}}{\text{Normal rate of Return}} \times \text{Paid-up Share Capital}$$

$$\text{Paid-up value ₹10} = \frac{20\%}{15\%} \times ₹10 = ₹\ 13.33$$

$$\text{Paid-up value ₹10} = \frac{20\%}{15\%} \times ₹8 = ₹\ 10.67$$

$$\text{Paid-up value ₹10} = \frac{20\%}{15\%} \times ₹5 = ₹\ 6.67$$

(c) Earningper Rupee of Share Capital $= \frac{\text{Earning after Tax}}{\text{Paid-up Share Capital}}$

$$= \frac{1,371}{3,270} = 0.419$$

Earning per fully paid shares of ₹10	= 0.419 × ₹10	= ₹ 4.19
Earning per share of ₹10 each,₹8 paid-up	= ₹ 0.419 × ₹8	= ₹ 3.35
Earning per share of ₹5, fully paid-up	= ₹ 0.419 ×5	= ₹2.10
Value of fully paid share of ₹10	= 10	= ₹ 20.95
Value of share of ₹10,₹8 paid-up	$= ₹\frac{4.19}{2} \times 10$	= ₹16.75
Value of fully paid-up share of ₹5	$= ₹\frac{4.19}{2} \times 10$	= ₹10.50.

Illustration 4

The following is the Balance Sheet (as on 31st December, 2017) of N Ltd.: (₹ in Lakh)

Liabilities	(₹)	Assets	(₹)
Equity Share Capital:		**Fixed Assets:**	
80,000 Equity shares of ₹10 each fully paid-up	8,00,000	Goodwill	1,00,000
50,000 Equity shares of ₹10 each 8 paid-up	4,00,000	Plant and Machinery	8,00,000
36,000 Equity shares of ₹5 each fully paid-up	1,80,000	Land and Building	10,00,000

Liabilities	(₹)	Assets	(₹)
30,000 Equity shares of ₹5 each 4 paid-up	1,20,000	Furniture and Fixtures	1,00,000
		Vehicles	2,00,000
Other Equity:		Investments	3,00,000
General reserve	1,40,000	**Current Assets:**	
Profit and Loss account	3,50,000	Stock	2,10,000
Non-current liabilities:			
3,000 10% Preference shares of ₹100 each fully paid	3,00,000		
12% debentures	2,00,000	Debtors	1,95,000
15% Term Loan	1,50,000	Prepaid Expenses	40,000
Deposits	1,00,000	Advances	45,000
Current Liabilities:		Cash and Bank balance	2,00,000
Bank Loan	50,000		
Creditors	1,50,000		
Outstanding expenses	20,000		
Provision for tax	2,00,000		
Accrued Preference Dividend	30,000		
	31,90,000		**31,90,000**

Additional Information:

(1) In 2015 a new machinery costing ₹50,000 was purchased, but wrongly charged to revenue (no rectification has yet been made for the same).

(2) Stock is overvalued by ₹10,000 in 2016. Debtors are to be reduced by ₹5,000 in 2017, some old furniture (Book value ₹10,000) was disposed of fort ₹6,000.

(3) Fixed assets are worth 5 per cent more than their actual book value. Depreciation on appreciated value of Fixed assets except machinery is not to be considered for valuation of goodwill.

(4) Of the investment 20 per cent is trading and the balance is non-trading. All trade investments are to be valued at 20 per cent below cost. Trade investment were purchased on 1st January, 2017. 50 per cent of the non-trade investments were acquired on 1st January, 2015 and the rest on January, 2016. A uniform rate of dividend of 10 percent is earned on all investments.

(5) Expected increase in expenditure without commensurate increase in selling price ₹20,000.

(6) Research and Development expenses anticipated in future ₹30,000 per annum.

(7) In a similar business a normal return on capital employed is10%.

(8) Profit (after tax) are as follows:

In 2015 — ₹2,10,000, in 2016 — ₹1,90,000 and in 2017 — ₹2,00,000.

(9) Current income tax rate is 50%, expected income tax rate will be 40%. From the above, ascertain the intrinsic value for different categories of Equity shares. For this purpose goodwill may be taken as 3 years purchase of super profits. Depreciation is charged on machinery @10% on reducing system.

Solution:

Computation of Value of Shares:

	₹
Value of Net Assets (As computed for Goodwill)	17,72,073
Value of Goodwill [Refer W.N.3]	1,10,406
Non-trade investments	2,40,000
Net Assets available for Equity Shareholders	21,22,479

Computation of Number of Equivalent Equity Shares:

Equity shares	No. of Equivalent Shares
80,000 shares + 50,000 shares = 1,30,000 shares of ₹10 each $1,30,000 \times \frac{10}{10}$	1,30,000
36,000 shares + 30,000 shares = 66,000 shares of ₹5 each $66,000 \times \frac{5}{10}$	33,000
Total Equivalent Equity Shares of ₹10 each	1,63,000

Calculation of intrinsic value of different categories of Equity Shares of N Ltd.

Value of Net Assets = ₹ 21,22,479

Net assets available to deemed fully paid-up Equity Shareholders

= Net Assets as computed above + Notional Cash from partly paid-up shares

= ₹ 21,22,479 + (50,000 × 2 + 30,000 × 1)

= ₹ 21,22,479 + 1,00,000 + 30,000

= ₹ 22,52,479

Computation of intrinsic value per share*

(i) Value of ₹10 fully paid Equity Share $= \frac{22,53,479}{1,63,000}$ = ₹13.82 per share (approx.)

(ii) Value of ₹8 paid-up Equity Share = 13.82 - 2 = ₹11.82 per share (approx.)

(iii) Value of ₹5 fully paid-up Equity Share $= 13.21 \times \frac{5}{10}$ = ₹6.91per share (approx.)

(iv) Value of ₹4 paid-up Equity Share = 6.91 – 1 = ₹5.91 per share (approx.)

Working Notes:

1. Calculation of Average Capital Employed

	(₹)	(₹)
Fixed Assets:		
Plant and Machinery (including ₹36,450 for a Machine charged in 2013)		8,36,450
Land and Building		10,00,000
Furniture & Fixtures (1,00,000 - 4,000)		96,000
Vehicles		2,00,000
		21,32,450
Add : Appreciation @ 5%		1,06.623
		22,39,073
Trade Investment $(3,00,000 \times \frac{20}{100}) \times \frac{80}{100}$		48,000
Current Assets:		
Stock		2,10,000
Debtors (1,95,000-5,000)		1,90,000
Prepaid Expenses		40,000
Advances		45,000
Cash & Bank Balance		2,00,000
		29,72,073
Less : Outside Liabilities:		
Accrued Preference Dividend*	30,000	
3,000 10% Preference shares of ₹100 each fully paid*	3,00,000	
12% Debentures	2,00,000	
15% Term Loan	1,50,000	
Deposits	1,00,000	
Bank Loan	50,000	
Creditors	1,50,000	
Outstanding Expenses	20,000	
Provision for Tax	2,00,000	12,00,000
Capital employed at the end of the year i.e. Net Assets		17,72,073
Less: 1 of the current year's Accounting Profit after Tax:		
Profit before Tax#	3,80,950	
Less : Tax 40% of ₹3,80,950	1,52,380	
	2,28,570	
50% of ₹2,28,570		1,14,285
Average capital employed		16,57,788

*** Preference Share Capital and accrued preference dividend are liabilities.**

2. Future Maintainable Profits Statement of Average Profit

Particulars	2015 (₹)	2016 (₹)	2017 (₹)
Profit after Tax	2,10,000	1,90,000	2,00,000
Profit before Tax (PAT × $\frac{1}{0.50}$)	4,20,000	3,80,000	4,00,000
Add: Capital expenditure charged to revenue	—	50,000	—
Less : Depreciation of the Machinery	(5,000)	(4,500)	(4,050)
Dividend on Non-Trade Investments	(12,000)	(24,000)	(24,000)
Over-valuation of closing stock	-	(10,000)	—
Add : Overvaluation of opening stock	-	-	10,000
Add: Loss on sale of furniture	-	-	-
(Presumed to be extra ordinary items)	-	-	4,000
Less: Provision for debtors			(5,000)
	4,03,000	3,91,500	3,80,950
Total profit for the three years		11,75,450	
Average Profit = $\frac{₹11,75,450}{3}$		3,91,817	
Less: Depreciation @ 10% on increase in the value of machinery			
$8,36,450 \times \frac{5}{100} \times \frac{10}{100} = ₹\,41,823 \times \frac{10}{100}$ i.e.	4,182		
Expected increase in expenditure	20,000		
Annual R & D Expenses anticipated in future	30,000	54,182	
Future Maintainable profit before tax		3,37,635	
Less: Tax @ 40% of 3,37,635		1,35,054	
Future Maintainable Profit After Tax		2,02,581	

3. Computation of Goodwill

	₹
Future Maintainable Profit After Tax	2,02,581
Less: Normal Profit (10% of ₹16,57,788)	1,65,779
Super Profit	36,802
Value of Goodwill = Super Profit × No. of years' purchase = ₹36,802 × 3	1,10,406

Illustration 5

Following is the Balance Sheet of Z Ltd. as on 31st March, 2021: (₹ in Lakh)

Liabilities	(₹)	Assets	(₹)
1,00,000 Equity Shares of ₹10 each	10,00,000	Preliminary expenses	5,00,000
10,000 12% Preference Shares of ₹100 each	10,00,000	Goodwill	15,00,000
General Reserve	6,00,000	Buildings Plant	10,00,000
Profit and Loss Account	4,00,000	Plant	4,80,000
15% Debentures	10,00,000	Investment in 10% Stock	6,00,000
Creditors	8,00,000	Stock-in - trade	4,00,000
		Debtors	2,20,000
		Cash	1,00,000
	48,00,000		**48,00,000**

Additional information are given below:

(a) Nominal value of investment is ₹5,00,000 and its market value is ₹5,20,000.

(b) Following assets are revalued: (₹)

(i) Building 32,00,000

(ii) Plant 18,00,000

(iii) Stock-in-trade 4,50,000

(iv) Debtors 3,60,000

(a) Average profit before tax of the company is ₹12,00,000 and 12.50% of the profit is transferred to general reserve, rate of taxation being 50%.

(b) Normal dividend expected on equity shares is 8% while fair return on closing capital employed is10%.

(c) Goodwill may be valued at three year's purchase of super profits.

(d) Ascertain the value of each equity share under fair value method.

Solution:

1. Calculation of Capital Employed

Assets:	(₹)
Buildings	32,00,000
Plant	18,00,000
Stock	4,50,000
Debtors	3,60,000
Cash	1,00,000
	59,10,000

	(₹)	(₹)
Less: Liabilities:		
Creditors	8,00,000	
10,000 12% Preference Shares of ₹100 each	10,00,000	
Debentures	10,00,000	28,00,000
Total Capital Employed		31,10,000

2. Calculation of Acutal Profit

Average Profit before Tax (given)	12,00,000
Less: Income from Investment (5,00,000 × 10%)	50,000
	11,50,000
Less: Income Tax @ 50%	5,75,000
Preference dividend	1,20,000
Actual Profit	4,55,000

3. Profit for Equity Shareholders

Actual Profit (as calculated above)	4,55,000
Less: Transfer to Reserve @ 12.50%	(56,875)
Profit available to Equity Shareholders.	3,98,125

4. Normal Profit

10% of Capital Employed

= 10% of ₹31,10,000 = ₹3,11,000

5. Super Profit = Actual Profit – Normal Profit

= ₹4,55,000 – ₹3,11,000 = ₹1,44,000

6. Goodwill = ₹1,44,000 × 3 = ₹4,32,000

7. Net Assets for Equity Shareholders

= Capital Employed + Goodwill + Investment

= ₹31,10,000 + ₹4,32,000 + ₹4,80,000

= ₹40,22,000

Value per share (Based on Intrinsic Value Method)

$$= \frac{₹\ 40,22,000}{1,00,000 \text{ Shares}} = ₹\ 40.22$$

Value per share (Based on Yield Method)

$$\text{Yield on Equity Share} = \frac{\text{Profit for Equity Shareholders}}{\text{Equity Share Capital}} \times 100$$

$$= \frac{₹\ 3,98,125}{10,00,000} \times 100 = 39.81\%$$

Value per share = $\frac{38.31}{8} \times 10 = ₹\ 49.77$

Value of Equity Share Under Fair Value Method

$= \frac{\text{Intrusic value + yield value}}{2} = \frac{40.22 + 49.77}{2} = \frac{89.99}{2} = ₹\ 45$ (approx).

Illustration 6

The Balance Sheet of Q Limited as on 31.12.2021 is as follows : (₹ in Lakh)

Liabilities	(₹)	Assets	(₹)
1,00,000 Equity shares of ₹10 each fully paid-up	10	Goodwill	5
1,00,000 equity shares of ₹6 each fully paid-up	6	Fixed Assets	15
Reserves & Surplus	2	Other Tangible Assets	5
Liabilities	10	Intangible Assets	
		(Market Value)	3
		Misc. Expenditure to the extent	
	28		**28**

Fixed assets are worth ₹24 lakhs. Other tangible assets are valued at ₹3 lakhs. The company is expected to settle the disputed bonus claim of ₹1 lakh, not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It is considered reasonable to increase the value of goodwill by an amount equal to average of the book value and a valuation made at 3 years purchase of average super profit for the last 4 years.

After tax profits and dividend rates were as follows:

Year	PAT (in lakhs) %	Dividend
2014	3.00	11
2015	3.50	12
2016	4.00	13
2017	4.10	14

Normal expectation in the industry to which the company belongs to is 10%. Kamalesh holds 20,000 equity shares of ₹10 each fully paid up and 10,000 equity shares of ₹4 each fully paid up. He wants to sell away his holdings.

(i) Determine the break-up value and market value of both kinds of shares.

(ii) What should be the fair value of shares, if controlling interest is being sold?

Note : Make necessary assumptions, wherever required.

Solution:

(i) Break up value of ₹1 of share capital $= \dfrac{\text{Net assets available for shareholder}}{\text{Total share capital}}$

$$= \frac{₹\ 28.98 \text{ lakhs}}{₹\ 16.00 \text{ lakhs}} = ₹\ 1.81$$

Breakup value of ₹10 paid up share = 2.07 × 10 = ₹ 18.10 Breakup value of ₹ 6 paid up share = 2.07 × 6 = ₹ 10.86

Market value of shares

Average dividend $= \dfrac{11\% + 12\% + 13\% + 14\%}{4} = 12.5\%$

Market value of ₹ 10 paid up share $= \dfrac{12.5\%}{10\%} \times 10 = ₹12.50$

Market value of ₹ 6 paid up share $= \dfrac{12.5\%}{10\%} \times 4 = ₹\ 7.50$

(ii) Breakup value of share will remain as before even if the controlling interest is being sold. But the market value of share will be different as the controlling interest would enable the declaration of dividend upto the limit of disposable profit.

$$\frac{\text{Average Profit}}{\text{Paid up value of shares}} \times 100 = \frac{₹\ 3.4 \text{ lakhs}}{₹\ 16 \text{ lakhs}} \times 100 = 21.25\%$$

Market value of shares:

Fort 10 paid up share $= \dfrac{21.25\%}{10\%} \times 10 = 21.25$

For 6 paid up share $= \dfrac{21.25\%}{10\%} \times 10 \ \times 10 \times 6 = 12.75$

For value of shares $= \dfrac{\text{Break up value} + \text{Market value}}{2}$

Fair value of ₹10 paid up share $= \dfrac{18.10 + 21.25}{2} = 19.68$

Fair value of ₹ 6 paid up share $= \dfrac{18.10 + 12.75}{2} = 11.81$

Working Notes: **(₹ in lakh)**

	Particulars		(₹)
1	**Calculation of average capital employed**		
	Fixed assets		24.00
	Other tangible assets		3.00

	Particulars		(₹)
	Intangible assets		3.00
	Less: Liabilities	10	30.00
	Bonus	1	(11.00)
	Net assets (excluding goodwill/Closing capital employed)		19.00
	Less: ½ of profits [½ (4.10 - 1.0 (i.e. Disputed Bonus)]		(1.55)
	Average Capital Employed		17.45
2.	**Calculation of average super profit for 4 years**		
	Average profit = ¼ [3+3.5+4+4.1 - 1.0(i.e. Bonus)] = ¼ × 13.60		3.400
	Less: Normal Profit 10% of ₹17.45 lakhs		(1.745)
	Super Profit		1.655
3.	**Calculation of goodwill [See Assumption below]**		
	3 years' purchase of average super profit		
	= 3 ×1.655 = ₹4.965 lakhs		
	Increase in value of goodwill = ½ (Book value + 3 years super profit)		
	= ½ (5+ 4.965) = ₹4.9825 lakhs		
	Net assets as valued in W.N. 1 including book value of goodwill Add: Goodwill as per the balance sheet	5.00	19.00
	Add: Increase in goodwill (rounded off)	4.98	9.98
	Net Assets available for shareholders.		28.98

Note: Tax effect on disputed bonus and corporate dividend tax has been ignored.

Assumption: Goodwill has been calculated on the basis of average capital employed. Alternatively it may be calculated on the basis of closing capital employed. Accordingly, the closing capital employed will be ₹19lakhs, super profit will be ₹1.5 lakhs, increase in the value of goodwill will be ₹4.75 lakhs and net assets available for shareholders will be ₹28.75 lakhs. In such a case, the break-up value of ₹1of share capital will be ₹1.80 (instead of 1.81)

Illustration 7

The following is the Balance Sheet of K Ltd. as on 31st March, 2021:

Balance Sheet **(₹ in Lakh)**

Liabilities	(₹)	Assets	(₹)
3,00,000 Equity shares of ₹10 each fully paid	30,00,000	Goodwill	3,00,000
		Building	20,00,000
12.5% Redeemable preference shares of ₹100 each fully paid	19,00,000	Plant & Machinery	22,00,000

Liabilities	(₹)	Assets	(₹)
General Reserve	15,00,000	Furniture	10,00,000
Profit & Loss A/c	3,00,000	Investments	16,00,000
Secured Loan	10,00,000	Stock	12,00,000
Creditors	30,00,000	Debtors	20,00,000
		Bank Balance	4,00,000
	1,07,00,000		**1,07,00,000**

Additional Information:

(i) Fixed assets are worth 20% more than book vaIue. Stock is overvalued by ₹1,00,000. Debtors are to be reduced by ₹40,000. Trade investments, which constitute 10% of the total investments are to be valued at 10% below cost.

(ii) Trade investments were purchased on 1.4.2020. 50% of non-trade investments were purchased on 1.4.2019 and the rest on 1.4.2020. Non-trade investments yielded 15% return on cost.

(iii) In 2019-2020 Furniture with a bookvalue of ₹1,00,000 was sold for ₹50,000. This loss should be treated as non- recurring or extraordinary item for the purpose of calculating adjusted average profit.

(iv) In 2018-2019 new machinery costing ₹2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) Return on capital employed is 20% in similar business.

(vi) Goodwill is to be valued at two years purchase of super profits based on simple average profits of last four years.

Profits of last four years are as under:

Year	(₹)
2017-2018	13,00,000
2018-2019	14,00,000
2019-2020	16,00,000
2020-2021	18,00,000

(vii) It is assumed that preference dividend has been paid till date.

(viii) Depreciation on the overall increased value of assets (worth 20% more than book value) need not be considered. Depreciation on the additional value of only plant and machinery to be considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.

Find out the intrinsic value of the equity share. Ignore income tax and dividend tax.

Solution:

1. Calculation of Goodwill

(i) Capital Employed

Particulars	(₹)	(₹)
Fixed assets:		
Building	20,00,000	
Plant and machinery (₹22,00,000 + ₹1,45,800)	23,45,800	
Furniture	10,00,000	
	53,45,800	
Add: 20% Appreciation	10,69,160	
	64,14,960	
Trade investments (₹16,00,000 × 10% × 90%)	1,44,000	
Debtors (₹20,00,000 - ₹40,000)	19,60,000	
Stock (₹12,00,000 - ₹1,00,000)	11,00,000	
Bank Balance	4,00,000	1,00,18,960
Less: Outside liabilities:		
Redeemable preference shares of ₹100 each fully paid	19,00,000	
Secured Loan	10,00,000	
Creditors	30,00,000	(59,00,000)
Capital employed		41,18,960

(ii) Future Maintainable Profit

Calculation of Average Adjusted Profit

Particulars	2017-2018 (₹)	2018-2019 (₹)	2019-2020 (₹)	2020- 2021 (₹)
Profit	13,00,000	14,00,000	16,00,000	18,00,000
Add: Capital Expenditure of Machinery charged to revenue		2,00,000		
Loss on sale of furniture			50,000	
	13,00,000	**16,00,000**	**16,50,000**	**18,00,000**
Less: Depreciation on machinery		(20,000)	(18,000)	(16,200)
Income from non-trade investments (W.N.2)			(1,08,000)	(2,16,000)
Reduction in the value of stock				(1,00,000)
Bad debts				(40,000)
Adjusted Profit	13,00,000	15,80,000	15,24,000	14,27,800

Particulars	2017-2018 (₹)	2018-2019 (₹)	2019-2020 (₹)	2020- 2021 (₹)
Total adjusted profit for four years				58,31,800
Average profit (₹ 58,31,800/4)				14,57,950
Less: Depreciation at 10% on Additional Value of Machinery				
(22,00,000 + 1,45,800) × 20% × 10%				(46,916)
Average Adjusted Profit				14,11,034

(iii) Normal Profit 20% on Capital Employed, i.e. 20% on ₹ 41,18,960 = ₹ 8,23,792

(iv) Super Profit = Average Adjusted profit – Normal profit

= ₹ 14,11,034 – ₹ 8,23,792 = ₹ 5,87,242

(v) Goodwill

= 2 years purchase of super profit

= ₹ 5,87,242 × 2 = ₹ 11,74,484

2. Trade investments = ₹16,00,000 × 10% × 90% = ₹ 1,44,000

Non-trade investment = ₹ 16,00,000 – ₹ 1,60,000 = ₹ 14,40,000

Non-trade investment purchased on 1.4.2016 = 50% of ₹ 14,40,000 = ₹ 7,20,000

Non-trade investment purchased on 1.4.2020 = ₹ 14,40,000 - ₹7,20,000 = ₹ 7,20,000

Income from non-trade investment:

In the year 2017-2018 : 7,20,000 × 15% = ₹ 1,08,000

In the year 2018-2019 : 7,20,000 × 15% = ₹ 1,08,000

7,20,000 × 15% = ₹ 1,08,000

= ₹ 2,16,000

Calculation of Intrinsic Value of Equity Shares of K Ltd.

Net Assets available for Equity Shareholders.

Particulars	(₹)	(₹)	(₹)
Goodwill (W.N.1)			11,74,484
Sundry fixed assets			64,14,960
Trade and non-trade investments			15,84,000
(₹ 1,44,000 + ₹ 14,40,000)			
Debtors			19,60,000
Stock			11,00,000
Bank balance			4,00,000
Total Assets			1,26,33,444

Particulars	(₹)	(₹)	(₹)
Less: Outside liabilities			
Redeemable preference shares of ₹ 100 each fully paid	19,00,000		
Secured loan	10,00,000		
Creditors	30,00,000	59,00,000	
			(59,00,000)
Net assets available for equity shareholders			67,33,444

$$\text{Value of a equity shares} = \frac{\text{Net Assets available to Equity Shareholders}}{\text{Number of Equity Shares}}$$

$$= \frac{₹\ 67,33,444}{3,00,000} = ₹\ 22.44 \text{ (approx)}$$

Student Note:

The variables which influence the valuation of goodwill are discussed hereunder:

- **Profit:** The term 'profit', here, refers to the past profits earned by the firm. These past profits are required to be adjusted/ modified for any abnormal or non-recurring items (whether gain or loss), which are not expected to arise in the future under normal circumstances. The past profit figures are, thus to be used to determine the 'Future Maintainable Profits' that is expected to be earned by the entity.

- **Simple Average Profit:** When there is no definite trend in the past profits, the past profits are simply aggregated and then divided by the number of years to determine the Average Profit. Since, in this case no weights are used on the past profits, the Average Profit, so determined, is referred to as Simple Average Profit.

  $\therefore$ Simple Average Profit = $\frac{P1 + P2 + ... + Pn}{n}$ where, P = Profit of respective year;

  n = Number of years

- **Weighted Average Profit:** When there exists a clear trend (either increasing or decreasing) in the past profits, the past profits are firstly by multiplied by certain 'weights', and then the products are aggregated. Finally, the aggregate figure is divided by the 'aggregate of all the weights' to arrive at the Weighted Average Profit.

  $\therefore$ Weighted Average Profit = $\frac{P1.W1 + P2.W2 + ... + Pn.Wn}{W1 + W2 + ... + Wn}$ where, P = Profit of respective year;

  W = Weight of respective year;

  n = Number of years

- **Number of Years' Purchase:** For valuation of goodwill, the average profit determined is usually multiplied by a figure referred to as "Number of Years' Purchase". The phrase 'Number of Years' Purchase' refers to the expected number of future years for which the firm is expected to earn the average profit from the year of purchase. In other words, it is assumed to be the time period during which the entity will enjoy the profit earning capacity.

Illustration 8

XY Ltd, a partnership firm, earned profits during the past 5 years as follows:

Year	2017	2018	2019	2020	2021
Profits (₹)	27,000	36,000	37,200	42,000	46,800

Determine the value of goodwill in each of the following independent cases:

Case (a): It was decided to value the Goodwill on the basis of 2 years' purchase of average profit of last five years.

Case (b): It was decided to value the Goodwill on the basis of 3½ years' purchase of average profit of last five years after giving weights of 1, 2, 3, 6 and 8 to the profits chronologically.

Case (c): It was decided to value the Goodwill on the basis of 3 years' purchase of weighted average profit of last five years giving maximum weightage to the recent results.

Case (d): It was decided to value the Goodwill on the basis of 2½ years' purchase of simple average profit of last five years. In this regard the following were observed:

(i) an abnormal loss of ₹ 1,800 was charged against the profit of 2019;

(ii) Profit of 2014 included a non-recurring receipt of ₹ 2,500.

(iii) closing stock of 2015 was over-valued by ₹ 2,400.

Solution:

Case (a):

Average profit $= \dfrac{₹\,27{,}000 + ₹\,36{,}000 + ₹\,37{,}000 + ₹\,42{,}000 + ₹\,46{,}800}{5} = ₹\,37{,}800$

∴ Value of Goodwill = ₹ 37,800 × 2 years' purchase = ₹ 75,600

Case (b):

Weighted average profit $= \dfrac{(₹27{,}000 \times 1) + (₹36{,}000 \times 2) + (₹37{,}200 \times 3) + (₹42{,}000 \times 6) + (₹46{,}800 \times 8)}{1 + 2 + 3 + 6 + 8}$

= ₹ 41,850

∴ Value of Goodwill = ₹ 41,850 × 3½ years' purchase = ₹ 1,46,475

Case (c):

Weighted average profit $= \dfrac{(₹27{,}000 \times 1) + (₹36{,}000 \times 2) + (₹37{,}200 \times 3) + (₹42{,}000 \times 4) + (₹46{,}800 \times 5)}{1 + 2 + 3 + 4 + 5}$

= ₹ 40,840

∴ Value of Goodwill = ₹ 40,840 × 3 years' purchase = ₹ 1,22,520

Case (d):

For valuation of goodwill under simple average method, average profit of last few years is to be multiplied by number of year of purchase. Here, the term 'profit' refers to 'Future Maintainable Profits' that the entity can expect to earn in the future. For determining such maintainable profit, past profits are required to be adjusted/ modified for any abnormal or non-recurring items (whether gain or loss), which are not expected to arise in the future under normal circumstances.

In this case,

Profit of 2019 = Profit (as given) + Abnormal loss sustained in 2019 (which cannot be expected to occur in future)

= ₹ 37,200 + ₹ 1,800 = ₹ 39,000

Profit of 2020 = Profit (as given) – Non-recurring receipt of 2020 (which cannot be expected to occur in future)

= ₹ 42,000 – ₹ 2,500 = ₹ 39,500

Profit of 2021 = Profit (as given) – Overvaluation of closing stock (rectification of profit)

= ₹ 46,800 – ₹ 2,400 = ₹ 44,400

$$\text{Simple Average profit} = \frac{₹27,000 + ₹36,000 + ₹39,000 + ₹39,500 + ₹44,400}{5} = ₹\ 37,180$$

∴ Value of Goodwill = ₹ 37,180 × 2½ years' purchase = ₹ 92,950

Super Profit Method:

- As per this method, the value of goodwill depends on the extra (i.e. super) profit earning capacity of an entity.
- Such 'Super Profit' refers to the excess profit earned by the entity over the normal profit that should be earned by a similar firm in the industry.
- Mathematically, Super Profit = Average Future Maintainable Profit – Normal Profit
- i.e. Super Profit = Average Future Maintainable Profit – (Average Capital Employed × Normal rate of return)
- Finally, the value of goodwill is determined by multiplying the Super Profit, so calculated, by certain 'No. of Years' Purchase'.

∴ Value of Goodwill = Super Profit × No. of Years' Purchase

Student Note:

The different variables which influence the valuation of goodwill under 'Super Profit method' are:

- **Super Profit:** Every firm in an industry is expected to earn a normal rate of return. If a particular firm of the industry manages to earn a rate of return that happens to be more than the normal industry rate of return, then such a firm is said to be earning 'Super Profits'. The value of goodwill, under this method, is correlated with this extra profit earning capacity of the firm.
- **Average Future Maintainable Profit:** It refers to the profit that is expected to be earned by the entity in the future under normal circumstances. For this purpose, the past profits that are required to be adjusted/ modified for any abnormal or non-recurring items (whether gain or loss).
- **Capital Employed:** Capital Employed refers to the amount of capital that has been invested in the firm. It is measured as the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the current liabilities. Alternatively, it is the aggregate of Owned Capital, Accumulated Profits and Borrowed Capital, if any.
- **Average Capital Employed:** Average Capital Employed is determined by averaging the capital employed at the beginning of the accounting period and that at the end of the accounting period. Mathematically,

$$\text{Average Capital Employed} = \frac{\text{Opening Capital Employed} + \text{Closing Capital Employed}}{2}$$

- **Normal Rate of Return:** It is the rate of return that is usually earned by any firm belonging to a particular industry.
- **Number of Years' Purchase:** For valuation of goodwill, the super profit is usually multiplied by a figure referred to as "Number of Years' Purchase". The phrase 'Number of Years' Purchase' refers to the expected number of future years for which the firm is expected to earn such super profits from the year of purchase.

Illustration 9

XY Ltd, a partnership firm, earned profits during the past 4 years as follows:

Year	2018	2019	2020	2021
Profits (₹)	42,000	46,000	52,000	46,500

Firm has total assets worth ₹ 82,000 and its current liability includes only creditors of ₹ 12,800. The normal rate return is 10%. Determine the value of goodwill on the basis of 2½ year's purchase of super profits.

Solution:

Average Future Maintainable Profit $= \dfrac{₹42{,}000 + ₹46{,}000 + ₹52{,}000 + ₹46{,}500}{4} = ₹\ 46{,}625$

Here, Capital employed = Total assets – Current Liabilities = ₹ 82,000 – ₹ 12,800 = ₹ 69,200

Normal profit = Capital employed × Normal rate of return = ₹ 69,200 × 10% = ₹ 6,920

∴ Super profit = Average Future Maintainable Profit – Normal profit

= ₹ 46,625 – ₹ 6,920 = ₹ 39,705

∴ Value of Goodwill = ₹ 39,705 × 2½ years' purchase = ₹ 99,263 (approx.)

Annuity Method:

- This method of goodwill valuation considers the 'time value of money'.
- Under this method, Value of Goodwill = Super Profit × Annuity Value

Student Note:

The different variables which influence the valuation of goodwill under 'Super Profit method' are:

- **Super Profit**: It refers to the excess profit earned by the entity over the normal profit that should be earned by a similar firm in the industry.
- **Annuity:** Annuity refers to a series of continuous cash flows (either cash inflows or cash outflows) of equal amount that occur in every period, over a specified period of time.
- **Annuity Value**: It is determined either from the Annuity Table or may be ascertained from the following formula:

  Annuity Value $= \dfrac{(1-r)^n}{r\,(1-r)^n}$ where, r = Rate of Interest per period, and n = Number of periods.

Illustration 10

From the following particulars you are required to determine value of goodwill of ABX Ltd.

Super Profit (Computed) : ₹ 4,50,000

Normal rate of return : 12%

Present value of annuity of ₹1 for 4 years @ 12% : 3.0374

Solution:

Value of goodwill = Super profit × P.V of Annuity of ₹ 1for 4 years @ 12%

= ₹ 4,50,000 × 3.0374 = ₹ 13,66,830

Illustration 11

The following details relate to M/s XYZ, a firm:

Average profit of last four years : 7,00,000

Average capital employed by the firm : ₹ 55,00,000

Normal rate of return : 10%

Present value of annuity of ₹1 for 4 years @ 10% : 3.1699

Determine the value of goodwill on the basis of annuity of super profit.

Solution:

Super Profit = Average Future Maintainable Profit – Normal Profit

= Average Future Maintainable Profit – (Average Capital Employed X Normal rate of return)

= ₹ 7,00,000 – (₹ 55,00,000 × 10%)

= ₹ 1,50,000

∴ Value of goodwill = Super profit × P.V of Annuity of ₹ 1for 4 years @ 10%

= ₹ 1,50,000 × 3.1699 = ₹ 4,75,485

Capitalisation Method:

- There are two ways of determining the value of goodwill using the capitalisation approach. They are:
  - Capitalisation of Average Profits; and
  - Capitalisation of Super Profits.
- **Capitalisation of Average Profits:** When the average profits are capitalised, then firstly, the 'Capitalised Value of the firm' is determined and there from the 'Net Assets' are deducted to arrive at value of goodwill.

  Mathematically, Capitalised Value of the firm = $\frac{\text{Average Future maintainable profit}}{\text{Normal rate of return (\%)}}$; and

  Value of Goodwill = Capitalised Value of the firm **Less** Net Assets

- **Capitalisation of Super Profits**: When the super profits are capitalised, then the value of goodwill is directly ascertained.

$$\text{Value of Goodwill} = \frac{\text{Super Profit}}{\text{Normal rate of return (\%)}}$$

Student Note:

The different variables which influence the valuation of goodwill under 'Super Profit method' are:

- **Capitalised Value of the firm:** It refers to the standard value of the firm i.e. what ought to be the value of the firm considering its profit earning capacity at the normal rate of return.
- **Net Assets:** It refers to the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the external liabilities. In other words, it refers to the Net Worth of the entity.
- **Super Profit**: It refers to the excess profit earned by the entity over the normal profit that should be earned by a similar firm in the industry.

Illustration 16

A firm values goodwill under 'Capitalisation of profits' method. Its average profits for past 4 years has been determined at ₹ 72,000. Net Assets and Capital employed in the business is ₹4,80,000 and ₹ 5,00,000 respectively; and its normal rate of return is 12%.

Determine value of goodwill based on:

(a) Capitalisation of Average Profits

(b) Capitalisation of Super Profits

Solution:

(a) Capitalisation of Average Profits

In this case, Capitalised Value of the Business $= \frac{\text{Expected Average Profit}}{\text{Normal rate of Return}} = \frac{₹\ 72{,}000}{12\%} = 6{,}00{,}000$

∴ Value of Goodwill = Capitalised Value of the Business **Less** Net Assets

= ₹ 6,00,000 – ₹4,80,000 = ₹ 1,20,000

(b) Capitalisation of Super Profits

In this case, Value of Goodwill $= \frac{\text{Super Profit}}{\text{Normal rate of return (\%)}}$

Super profit = Average profit – Normal Profit = Average profit – (Capital employed × Normal rate of return)

= ₹ 72,000 – (₹ 5,00,000 × 12%)

= ₹ 72,000 – 60,000

= ₹ 12,000

$$\therefore \text{ Value of Goodwill} = \frac{\text{Super Profit}}{\text{Normal rate of Return (\%)}} = \frac{12{,}000}{12\%} = ₹\ 1{,}00{,}000$$

C. Market Approach

Under market approach, value of equity is determined by applying relative or multiple to the base value of the company. Relative or multiple is the ratio of market price to some accounting variable of the company taken as the base value.

Most common multiples are price-earnings (P/E) ratio, price-sales (P/S) ratio, price-cash flow from operations (P/CFO) ratio etc. Important point is the relatives have to be computed for the peer group of companies to find the average relationship between the base value and market price. After obtaining the average relationship through relative or multiple, the company finds it calculated market price by applying the average relative to its base value.

The steps involved to find value per share based on market approach:

1. Market capitalisation of each of the peer group of companies is related to any fundamental element of that company (called base value such as Profits, Cash Flows, Net assets, Sales). The ratio obtained is called relative or multiple.
2. To decide what will be the base value on which multiple will be applied. More than one multiple is usually considered in practice.
3. To compute the average of the multiples of the peer group of companies (we call it as Comparator) for each base value.
4. To apply the average multiple (Comparator to a particular base value of the required company for valuation of its equity for that base. Then to find average of the different equity values based on different base values.
5. To divide average value of equity by the no. of shares in order to find value per share.

Market capitalisation is the product of market price of shares and the no. of shares outstanding. Thus, it represents market value of equity. In computation of relative we may find some popular ratios also such as Price Earnings ratio where base value is Earnings and Market to Book Value ratio where base value is Net Assets. But in all circumstances the base values are related to market value of equity.

Relative or multiple = Market Capitalisation/Base value. [where, alternative base values are EAT, EBIT, NOPAT, CF, FCFF, FCFE, Net Assets, Enterprise Value, Sales, or any other fundamental variable]

Illustration 13

X Ltd. has EPS ₹ 12 and no. of shares 1000. Its CF ₹ 15000 and Sales ₹ 80000. Find value per share of X Ltd. based on the data of similar other companies as provided below:

Companies	PAT (₹)	CF (₹)	Sales (₹)	MC (₹)
A	20,000	25,000	1,20,000	1,50,000
B	16,000	20,000	1,40,000	1,75,000
C	25,000	32,000	1,60,000	2,00,000
D	18,000	24,000	1,44,000	1,92,000

Solution:

PAT of X Ltd. = EPS × No. of shares = 12 × 1000 = 12000

For the 4 companies in the peer group Relatives are computed as MC/ Base Value

For PAT as base value M1 is the multiple.

For CF as base value M2 is the multiple.

For Sales as base value M3 is the multiple.

Comparator is the average value of the multiples for the 4 companies.

Value of equity of X for each base = Base Value of X × Comparator

					Multiples		
Companies	**PAT (₹)**	**CF (₹)**	**Sales (₹)**	**MC (₹)**	**M1 = MC/ PAT**	**M2=MC/CF**	**M3 = MC/ Sales**
A	20000	25000	120000	150000	7.5	6	1.25
B	16000	20000	140000	175000	10.9375	8.75	1.25
C	25000	32000	160000	200000	8	6.25	1.25
D	18000	24000	144000	192000	10.66667	8	1.333333
				Comparator	9.276042	7.25	1.270833
			Base of X		PAT	CF	Sales
			Base Value of X ₹		12000	15000	80000
			Value of equity of X ₹		111312.5	108750	101666.7
			No. of equity shares		1000	1000	1000
Value per share based on Base value ₹					111.3125	108.75	101.6667
Average Value per share of X ₹				107.243056			

Solved Case Study(s)

1. Your client is willing to acquire a stake in equity of Desert Ltd. and asks you to find the value per share giving equal importance to the future free cash flows, the net asset value of the business and market price of the shares in peer group. Accordingly, you collected following data about the company:

   (a) EPS is ₹ 3.20

   (b) FCFF for the last year was ₹40 lakhs. Management expects 4% growth pa for the foreseeable future.

   (c) Debt capital amounts to ₹66 lakhs.

   (d) WACC is 14% and Ke is 17%.

   (e) Number of equity shares outstanding is 10 lakhs.

   (f) Net asset value of the business excluding goodwill is ₹300 lakhs.

   (g) The peer group consists of 3 companies with P/E ratios of 11, 12 and 13.

   (h) It earns super profit of ₹ 6 lakhs for forthcoming 5 years only. You calculated the present value of annuity for 5 years is 3.43 at 14% rate of discounting and 3.2 at 17% rate of discounting.

Solution:

A. Value of share based on income approach using DCF method:

FCFF1 = FCFF0 × (1 + 0.04)	= ₹41.6 lakhs
V0 = FCFF1/(WACC – g) = 4.16/(0.14 – 0.04)	= ₹ 416 lakhs
Value of equity = V0 - Debt Capital = 416 – 66	= ₹350 lakhs
Value per share = Value of equity/Number of equity shares = 350/10	= ₹35

B. Value of share based on market approach using EPS as the value driver:

Comparator = Average of P/E of the peer group = (11+12+13)/3	= 12
Value per share = EPS × comparator = 3.2 × 12	= ₹ 38.4

C. Value of share based on net asset approach:

Net asset excluding goodwill	= ₹ 300 lakhs
Goodwill measured at present value of super profit of 5 years purchase = 3.43 × 6	= ₹20.60 lakhs
Value of business = ₹300 + ₹20.60	= ₹320.6
Value per share = ₹320.6/10	= ₹32.06

D. Value per share giving equal importance to A, B and C = (35 + 38.4 + 32.06)/3 = ₹35.15

2. Light Ltd. is contemplating to acquire an equity stake in Twilight Ltd. and requires to know the intrinsic value of its shares on (a) 01-04-2020; (b) 01-04-2021 and (c) 01-04-2022.

   The following data of Twilight Ltd. are available: (₹ ' 000)

Year	2019-20	2020-21	2021-22	2022-23
Actual/projected EBIT	800	900	1000	1,100
Interest	80	80	100	100
Depreciation	100	120	125	130
Increase in Current Assets	95	110	100	120
Increase in Current Liabilities	15	20	30	40
Capital Expenditure	140	150	160	170
Debt Capital at the end of the year	4,000	4,000	5,000	5,000
Number of equity shares outstanding = 100000; WACC = 10%; Cost of equity = 15%; Effective tax rate = 25%; FCFF is expected to grow at (I) 0% and at (II)3% p.a. for infinite time from the year 2023-24				

Solution: (₹'000)

Year	2019-20	2020-21	2021-22	2022-23
NOPAT	600	675	750	825
Cash Flow	780	885	945	1035
FCFF	640	735	785	865
DCF at 01-04-2020		668	649	
DCF at 01-04-2021			714	
Terminal Value at zero growth			8,650	
Terminal Value at 3% growth			12357	

(₹'000)

Value of	Business		Equity		Share	
	Zero growth	3% growth	Zero growth	3% growth	Zero growth	3% growth
(a) as at 01-04-2020	8466[p]	11529	4466	7529	44.66	75.29
(b) as at 01-04-2021	8577[q]	11947	4577	7947	45.77	79.47
(c) as at 01-04-2022	8650[r]	12357	4450	8157	44.50	81.57

p = 668 +649 + 8650/(1+.10)^2

q = 714 + 8650/(1+.10)^1

r = 8650

Value of Equity = Value of Business – Debt Capital

Value per share = Value of equity/ Number of equity shares

Note: Past FCFF, Interest and Ke are not relevant.

Exercise

A. Theoritical Questions:

- **Multiple Choice Questions**

1. The major three approaches to valuation of shares are:
   a. Income Approach
   b. Net Assets Approach
   c. Market Approach
   d. All of the above

2. The major bases of asset valuation for a going concern:
   a. Book Value
   b. Net Replacement Value
   c. Net Realisable Value
   d. All of the above

3. The Income approach for Valuation of Shares includes the models/Techniques:
   a. Discounted Cash Flow
   b. Dividend Discount Model
   c. Maintainable Profits Basis
   d. All of the above

4. Some of the methods of Goodwill Valuation are
   a. Capitalisation method
   b. Super profits method
   c. Average Maintainable Profits method
   d. All of the above

5. The ways of determining the value of goodwill using the capitalisation approach

   a. Capitalisation of Average Profits

   b. Capitalisation of Super Profits

   c. Both a and b

   d. Capitalisation of Average Future maintainable profit

Answer:

1.	2.	3.	4.	5.
d.	d.	d.	d.	c.

Fill in the Blanks

1. Every firm in an industry is expected to earn a normal rate of return. If a particular firm of the industry manages to earn a rate of return that happens to be more than the normal industry rate of return, then such a firm is said to be earning __________.

2. _________ refers to a series of continuous cash flows (either cash inflows or cash outflows) of equal amount that occur in every period, over a specified period of time.

3. ____________ refers to the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the external liabilities.

4. The phrase ________________ refers to the expected number of future years for which the firm is expected to earn the average profit from the year of purchase.

5. __________ represents the capacity of the business to earn excess profit for a period of time over normal profit.

Answer:

1.	super profits	2.	Annuity
3.	Net Assets	4.	Number of Years of Purchase
5.	Goodwill		

Short Essay Type Questions

1. State some of the most important purposes of Share Valuation.
2. Enumerate the different factors that affect the valuation of shares.
3. Explain in brief the different variables which influence the valuation of goodwill under 'Super Profit method'.

Essay Type Questions

1. Under Income Approach how is the value of a business measured using different methods or techniques? Explain. Examine whether capitalisation of income is an application of valuation under income approach.
2. Explain different methods of goodwill valuation. Do you think valuation of goodwill is required to find value per share under (i) income approach; (ii) net asset approach; and (iii) market approach.

B. Numerical Questions:

Comprehensive Numerical Problems

1.

Year	2018	2019	2020	2021
CF (₹ in Lakhs)	500	600	700	800

(a) Find value of the business on 01-01-2021, if CF remains constant from 2021 to infinity, given that WACC = 10%.

(b) Find value of the business on 01-01-2020 if CF grows at 4% pa from 2022 to infinity, given that WACC = 10%.

(c) Find value of the business on 01-01-2019 if CF remains constant from 2021 to infinity, given that WACC = 10%.

2.

Data provided for forthcoming Year 1	₹ in Lakh
EBIT	800
Depreciation	160
Capex	200
Interest	300
Increase in non-cash working capital	100
Debt Capital at year 0	3000
Debt repaid during year 1	500
Debt issued during year 1	600

Further information:

Tax rate = t	25%
WACC	10%
No of equity shares	6000000

Find:

(a) NOPAT;

(b) CF;

(c) FCFF;

(d) FCFE;

(e) Value of business based on constant (i) CF; (ii) FCFF; (iii) FCFE

(f) Value of business when growth rate is 5% based on (i) CF; (ii) FCFF; (iii) FCFE

(g) Value per share based on FCFF when constant growth rate is 5%.

(h) Value per share based on FCFE when constant growth rate is 5%.

3. The following abridged Balance Sheet as on 31st March, 2021 pertains to K Ltd. (₹ in Lakh)

Liabilities	(₹)	Assets	(₹)
Share Capital :		Goodwill, at cost	600
100 lakh Equity shares of ₹10 each, fully paid up	1,000	Other Fixed Assets	9,030
60 lakh Equity shares of ₹10 each, ₹8 paid up	480	Current Assets	3,000
50 lakh Equity shares of ₹5 each, fully paid-up	250	Loans and Advances	900
Reserves and Surplus	4,000		
Secured Loans	5,000		
Current Liabilities	2,000		
Provisions	800		
	13,530		13,530

You are required to calculate the following for each one of three categories of equity shares appearing in the above-mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Net Assets;

(ii) Value per share on the basis of dividend yield.

Normal rate of dividend in the concerned industryis12%, whereas K Ltd. has been paying 15% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2021 the company has earned ₹1,740 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of ₹10 of a Company in the same industry is ₹1.8.

3. AB Ltd, earned profits during the past 5 years as follows:

Year	20 × 1	20 × 2	20 × 3	20 × 4	20 × 5
Profits (₹)	30,000	36,000	40,000	44,000	50,000

Determine the value of goodwill at the end of 20x5 in each of the following independent cases:

Case (a): It was decided to value the Goodwill on the basis of 2 years' purchase of average profit of last five years.

Case (b): It was decided to value the Goodwill on the basis of 4 years' purchase of average profit of last five years after giving weights of 1, 2, 3, 6 and 8 to the profits chronologically.

Case (c): It was decided to value the Goodwill on the basis of 3 years' purchase of weighted average profit of last five years giving maximum weightage to the recent results.

Case (d): It was decided to value the Goodwill on the basis of 3 years' annuity of expected annual profits of ₹ 50,000 at 10% rate of discounting.

Case (e): It was decided to value the Goodwill on the basis of 4 years' purchase of super profits, normal rate of return is 10%. Average capital employed is ₹ 4,00,000. Future maintainable profit is the simple average profit of last five years.

Case (f): It was decided to value the Goodwill on the basis of capitalization of super profits, capitalization rate is 10%. Average capital employed is ₹ 4,00,000. Future maintainable profit is ₹ 50,000.

Case (g): It was decided to value the Goodwill on the basis of 2½ years' purchase of simple average profit of last five years. In this regard the following were observed:

(i) an abnormal loss of ₹ 1,000 was charged against the profit of 20x3;

(ii) Profit of 20x4 included a non-recurring receipt of ₹ 2,000.

(iii) closing stock of 2015 was over-valued by ₹ 3,000.

4. The following is the Balance Sheet (extract) of Z Ltd. as on 31st March, 2021:

Balance Sheet **(₹ in Lakh)**

Equity and Liabilities	(₹)	Assets	(₹)
3,00,000 Equity shares of ₹10 each fully paid	30,00,000	Building	20,00,000
12% Redeemable preference shares of ₹100 each fully paid		Plant & Machinery	22,00,000
	19,00,000	Furniture	10,00,000
General Reserve	15,00,000	Investments	16,00,000
Profit & Loss A/c	3,00,000	Stock	12,00,000
Secured Loan	10,00,000	Debtors	20,00,000
Creditors	27,00,000	Bank Balance	4,00,000
	1,04,00,000		1,04,00,000

Additional Information:

(i) PPE are worth 10% more than book value. Stock is overvalued by ₹2,00,000. Debtors are to be reduced by ₹80,000. Trade investments, which constitute 10% of the total investments are to be valued at 20% below cost.

(ii) Trade investments were purchased on 01.04.2020. 50% of non-trade investments were purchased on 01.04.2019 and the rest on 01.04.2020. Non-trade investments yielded 15% return on cost.

(iii) In 2019-2020 Furniture with a book value of ₹1,00,000 was sold for ₹50,000. This loss should be treated as non- recurring or extraordinary item for the purpose of calculating adjusted average profit.

(iv) In 2018-2019 new machinery costing ₹2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) Return on capital employed is 18% in similar businesses.

(vi) Profits of last four years are as under:

Year	₹ in Lakhs
2017-2018	13,00,000
2018-2019	14,00,000
2019-2020	17,00,000
2020-2021	20,00,000

(vii) It is assumed that preference dividend has been paid till date.

(viii) Depreciation on the overall increased value of PPE (worth 10% more than book value) need not be considered. Depreciation on the additional value of only plant and machinery to be considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.

Compute Goodwill at three years purchase of super profits based on simple average profits of last four years.

Accounting of Financial Instruments

3

SLOB Mapped against the Module

To obtain in-depth knowledge on accounting and reporting of financial information for different types of corporate entities engaged in activities across certain sectors based on specified Ind ASs.

Module Learning Objectives

- To provide reasonable knowledge in regard accounting and reporting of financial instruments in an Ind AS environment
- To develop skill in application of reasonable knowledge in recognition, measurement, presentation and disclosure of financial instruments

Accounting of Financial Instruments

3

The following three Indian Accounting Standards are relevant for recognition, measurement and disclosure of financial instruments:

Financial instruments: Presentation (Ind AS 32)

Financial instruments: Disclosure (Ind AS 107)

Financial instruments (Ind AS 109)

Financial Instruments are classified as:

(i) Financial assets,

(ii) Financial liabilities and

(iii) Equity instruments.

Ind AS 32 prescribes the requirements for presentation of financial instruments and Ind AS 107 prescribes about disclosure of financial instruments.

Ind As 109 deals with recognition and measurement of financial instruments and hedge accounting.

As per Ind AS 32 in financial statements financial instruments are presented as financial assets or as financial liabilities or equities.

Objectives of the standard:

The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

(I) Financial assets are:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(a) a contract that will or may be settled in the entity's own equity instruments and is:

(iii) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's

own equity instruments; or

(iv) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments

(II) A financial liability is any liability that is:

(a) a contractual obligation :

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity;

or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

(III) An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) The instrument includes no contractual obligation:

i. to deliver cash or another financial asset to another entity; or

ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

i. a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

ii. a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. Ordinarily it satisfies the conditions of being classified as financial liabilities. Where it entitles the holder a pro rata share of the entity's net assets on liquidation it is classified as equity.

Ind AS 109: Financial Instruments

Objective:

The objective of this Standard is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

It classifies the financial assets and financial liabilities into three categories for recognition and measurement:

(i) Measured at fair value through Other Comprehensive Income (OCI).

Conditions for being classified as (FV through OCI)--

(a) Objectives of holding financial asset are both to collect contractual cash flows and to sell financial assets.

(b) Contractual cash flows solely consists of payment of principal and interest on the principal amount outstanding on specified dates.

(ii) Measured at amortized cost.

If the objective of holding financial asset does not include collection of cash flows by selling of financial assets, such financial assets are classified as 'amortized cost.''

(iii) Measured at fair value through P & L

If a financial asset is not classified as amortised cost or an FV through OCI it is measured at fair value through P & L. Simple case **for example,** if investment in equity of any other company where there is no contractual cash flows for interest or principal.

Ind AS 107: Financial Instruments: Disclosures

Objective:

The objective of this Indian Accounting Standard (Ind AS) is to require entities to provide disclosures in their financial statements that enable users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The principles in this Ind AS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in Ind AS 32, Financial Instruments: Presentation, and Ind AS 109, Financial Instruments.

An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

The carrying amounts of each of the following categories, as specified in Ind AS 109, shall be disclosed either in the balance sheet or in the notes:

(a) financial assets measured at fair value through profit or loss,

(b) financial liabilities at fair value through profit or loss

(c) financial assets measured at amortised cost.

(d) financial liabilities measured at amortised cost.

(e) financial assets measured at fair value through other comprehensive income.

Illustration 1

G Ltd. issued 6% Debenture of total ₹ 10,00,000 on 01.04.2017 repayable on 31. 03.2022. The debenture holders have right to receive equity shares of face value of ₹ 4,00,000 at maturity as alternative to repayment in cash. The required rate of return is 10%. How the transaction will be recognised, measured and presented in 2017-2018?

Solution:

Debentures were issued with embedded derivative of option to convert them into shares. Equity is recognised and measured at the value of the embedded option. Liability is recognised at the present value of future cash flows.

Workings:

Present Value of Liability

Year	Cash Flows (₹)	Discounting Rate	DCF (₹)
1	60,000	0.909	54,545
2	60,000	0.826	49,587
3	60,000	0.751	45,079
4	60,000	0.603	40,981
5	10,60,000		6,58,177
Total			**8,48,369**

Equity will be recognised and presented as Option to acquire shares under other equity in balance sheet measured at the difference between issue price and the present value of liability. Equity = ₹10,00,000 – ₹8,48,369 = ₹1,51,631.

Finance cost recognised and presented in statement of P & L = 10% × ₹8,48,369 = ₹ 84,837.

Financial liabilities will be recognised and presented as debenture in balance sheet measured at present value of future cash flows discounted at 10% pa. plus accrued interest = ₹ 8,48,369 + ₹84,837 – ₹60,000 = ₹ 8,73,206.

[At maturity if conversion into shares are opted] **Dr.** **Cr.**

Particulars		(₹)	(₹)
Debenture A/c	Dr.	10,00,000	
To, Equity Share Capital A/c			4,00,000
To, Security Premium A/c			6,00,000

Illustration 2

X ltd. Granted a loan to Y ltd amounting to ₹ 40 lakhs repayable in 2 years at ₹ 46 lakhs. However, due to economic recession after 1 year the repayable amount has been revised at ₹ 44 lakhs. Effective annual interest rate for such a loan is determined at 6% pa. The loan processing cost was ₹ 2 lakhs. X Ltd's accountant suggested to

(i) Charge processing cost to the first year profit and loss A/c.

(ii) To credit ₹ 4 Lakhs as interest income in the second year profit and loss a/c.

(iii) To carry loan a/c in the first year balance sheet at ₹ 40 lakhs. Your advice is solicited.

Solution:

(i) Processing cost should be added to the carrying value of the loan (i.e. ₹40 Lakhs +₹ 2 Lakhs = ₹ 42 lakhs), and not be charged to P & L.

(ii) In year 1 interest should be credited to P & L at 6% in ₹ 42 lakhs = ₹ 2.52 lakhs.

(iii) The Carrying Amount of the loan at the end of year 1 = ₹ 42 lakhs + ₹ 2.52 lakhs = ₹44.52 lakhs. But since the Repayable Amount at the end of year 2 is revised at ₹ 44 lakhs, the recoverable amount at the end of year 1 is the present value = ₹44 lakh/1.06 = ₹ 41.51 (approx) lakhs.

Thus the carrying amount shall be brought down to ₹ 41.51 lakhs only, the difference being impairment loss under Ind AS 36 ₹(44.52 – 41.51) Lakhs = ₹ 3.01 Lakh to be charged to Profit and Loss Statement.

In year 2, interest shall be credited to Profit and Loss Statement ₹ (41.51 × 6) ÷ 2.49 lakh and the carrying amount of loan = ₹ 41.51 Lakhs + ₹ 2.49 Lakhs = ₹ 44 Lakhs that should be repaid at the end of year 2.

Solved Case Study(s)

Case 1

Dew Ltd. issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of ₹1,000 per bond, giving total proceeds of ₹20,00,000. Interest is payable annually at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 25000 ordinary shares of ₹ 10. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent. The holders of the Debentures elected to convert the Debentures into Equity at maturity. Pass journal entries in the books of Dew Ltd.

Solution:

- The liability component is measured first, and the difference between the proceeds of the debenture issue and the fair value of the liability is assigned to the equity component.
- The present value of the liability component is calculated using a discount rate of 9 per cent, the market interest rate for similar bonds having no conversion rights, as shown below.

Year	Interest and Principal (₹)	DCF at 9% (₹)
1	1,20,000	1,10,092
2	1,20,000	1,01,002
3	1,20,000	92,662
Present value of the interest		3,03,755
Present value of the principal		
4	20,00,000	15,44,367
Liability component		18,48,122
Proceeds of the Deb issue		20,00,000
Equity component		1,51,878

Date	Payment 6% coupon (₹)	Interest at 9% (₹)	Increase in liability (₹)	Total Debenture liability (₹)
01-04-2019				18,48,122
31-03-2020	1,20,000	1,66,331	46,331	18,94,453
31-04-2021	1,20,000	1,70,501	50,501	19,44,954
31-03-2022	1,20,000	1,75,046	55,046	20,00,000

Journal

Date	Particulars		Dr. (₹)	Cr. (₹)
01-04-2019	Bank	Dr.	20,00,000	
	To, Convertible Debenture (liability)			18,48,122
	To, Convertible Debenture (Equity component)			1,51,878
31-03-2020	Interest Expense	Dr.	1,66,331	
	To, Bank			1,20,000
	To, Convertible Debenture (liability)			46,331
31-04-2021	Interest Expense	Dr.	1,70,501	
	To, Bank			1,20,000
	To, Convertible Debenture (liability)			50501
31-03-2022	Interest Expense	Dr.	1,75,046	
	To, Bank			1,20,000
	To, Convertible Debenture (liability)			55,046
31-03-2022	Convertible Debenture (liability)	Dr.	20,00,000	
	Convertible Debenture (Equity component)	Dr.	1,51,878	
	To, Equity Share Capital			2,50,000
	To, Securities Premium			19,01,878

Case 2

Hill Ltd. issues 4-year 2000 2% redeemable cumulative preference shares of ₹ 1000 at par to its parent Mountain Ltd. on 01-04-2018. Market rate of interest is 12%. Show journal entries in the books of Mountain Ltd. for all the years.

Solution:

Mountain Ltd. pays ₹ 1000 per preference share at issue and receives ₹ 20 dividend annually and ₹ 1000 at maturity, while market rate of interest is 12% amounting to ₹120 annually. The present value of dividends and maturity value of the preference shares at the discounting rate of 12% constitute the loan component of the investment and the excess consideration paid is accounted as equity component of the investment.

Initial recognition:

Year	Dividend and Principal	DCF at 12% (₹)
1	40,000	35,714
2	40,000	31,888
3	40,000	28,471

Year	Dividend and Principal	DCF at 12% (₹)
4	40,000	25,421
Present value of the Dividend		1,21,494
Present value of the maturity value		
5	20,00,000	12,71,036
	Loan component	13,92,530
	Investment	20,00,000
	Equity component	6,07,470

Subsequently, loan component of the investment will be carried at amortised cost as follows:

Year	Receipts @ 2% (₹)	Interest@12% (₹)	Increase in Loan (₹)	Carrying amount (₹)
0				13,92,530
1	40,000	1,67,104	1,27,104	15,19,634
2	40,000	1,82,356	1,42,356	16,61,990
3	40,000	1,99,439	1,59,439	18,21,429
4	40,000	2,18,571	1,78,571	20,00,000

Journal **Dr.** **Cr.**

Date	Particulars		(₹)	(₹)
01-04-2018	Investment (Equity portion)	Dr.	6,07,470	
	Loan Receivable	Dr.	13,92,530	
	To, Bank			20,00,000
31-03-2019	Loan Receivable	Dr.	1,27,104	
	Bank	Dr.	40,000	
	To, Interest Income			1,67,104
31-04-2020	Loan Receivable	Dr.	1,42,356	
	Bank	Dr.	40,000	
	To, Interest Income			1,82,356
31-03-2021	Loan Receivable	Dr.	1,59,439	
	Bank	Dr.	40,000	
	To, Interest Income			1,99,439

Date	Particulars		(₹)	(₹)
31-03-2022	Loan Receivable	Dr.	1,78,571	
	Bank	Dr.	40,000	
	To, Interest Income			2,18,571
31-03-2022	Bank	Dr.	20,00,000	
	To, Loan Receivable			20,00,000

Exercise

A. Theoritical Questions:

Mutiple Choice Questions

1. The Indian Accounting Standards relevant for recognition, measurement and disclosure of financial instruments are

   a. Financial instruments: Presentation (Ind AS 32)

   b. Financial instruments: Disclosure (Ind AS 107)

   c. Financial instruments: (Ind AS 109)

   d. All of the above

2. Financial assets are

   a. cash

   b. an equity instrument of another entity

   c. a contractual right

   d. All of the above

3. Ind AS 109: Financial Instruments classifies the financial assets and financial liabilities into the following categories for recognition and measurement

   a. Measured at fair value thought OCI

   b. Measured at amortized cost

   c. Measured at fair value through P & L

   d. All of the above

4. Ind As 109 deals with

   a. recognition and measurement of financial instruments and hedge accounting

   b. presentation of financial instruments

   c. disclosure of financial instruments

   d. None of the above

5. An ____________ is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities

   a. equity instrument

   b. puttable instrument

   c. financial instrument

   d. None of the above

Answer:

1.	2.	3.	4.	5.
D	D	D	A	A

- **Fill in the Blanks**

1. A ____________ is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

1. As per _______ in financial statements financial instruments are presented as financial assets or as financial liabilities or equities.

2. If the objective of holding financial asset does not include collection of cash flows by selling of financial assets, such financial assets are classified as _________.

3. If a financial asset is not classified as amortised cost or an FV through OCI it is measured at ________ through P & L.

4. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an ______________.

Answer:

1.	puttable instrument	2.	Ind AS 32
3.	amortized cost	4.	fair value
5.	arm's length transaction		

Short Essay Type Questions

1. Define Financial Asset as per Ind AS 32.

2. Briefly explain Puttable Instrument.

3. Classify the financial assets and financial liabilities into three categories for recognition and measurement under Ind AS 109.

4. Mention the categories whose carrying amount shall be disclosed either in the balance sheet or in the notes as per Ind AS 107.

5. Define Equity Instrument. Mention the conditions to be met to be classified as Equity Instrument.

B. Numerical Questions:

Comprehensive Numerical Problems

1. G Ltd. issued 8% Debenture of total ₹ 20,00,000 on 01.04.2020 repayable on 31.03.2025. The debenture holders have right to receive equity shares of face value of ₹ 12,00,000 at maturity as alternative to repayment in cash. The required rate of return is 10%. How the transaction will be recognised, measured and presented in 2020-2021?

2. X Ltd. Granted a loan to Y Ltd. amounting to ₹ 60 lakhs repayable in 2 years at ₹70 lakhs. However, due to economic recession after 1 year the repayable amount has been revised at ₹ 68 lakhs. Effective annual interest rate for such a loan is determined at 6% pa. The loan processing cost was ₹ 3 lakhs. X Ltd.'s accountant suggested to

   (i) Charge processing cost to the first-year Profit and Loss A/c.

   (ii) To credit ₹ 8 Lakhs as interest income in the second-year Profit and Loss A/c.

   (iii) To carry Loan A/c in the first year balance sheet at ₹ 60 lakhs.

Your advice is solicited.

NBFCs – Provisioning Norms, Accounting and Reporting

4

SLOB Mapped against the Module

To expose students to the financial reporting of NBFCs, to government accounting, and to XBRL.

Module Learning Objectives

- To keep students updated about presentation of financial statements and disclosures of relevant information with due exposure to
- The norms of the RBI, and
- The relevant schedules of the Companies Act, 2013

NBFCs – Provisioning Norms, Accounting and Reporting

4

The financial sector in any economy consists of several intermediaries, which include the banks, investment intermediaries (viz. mutual funds, hedge funds, pension funds etc.), risk transfer entities (i.e. the insurance companies), information and analysis providers (viz. rating agencies, financial advisers, etc), investment banks, portfolio managers. All the above-mentioned financial intermediaries, other than the banks, are broadly referredto as Non-Banking Financial Institutions.

Non-Banking Financial Companies (NBFCs), forms an integral part of Indian financial system, providing various financial services. In recent times, activities of NBFCs have undergone variety of changes through financial innovation. NBFC initially gets incorporated under Indian Companies Act, 2013 and later on obtains Certificate of Incorporation from RBI.

Non-Banking Financial Company (NBFC) – Concept

- Non-Banking Finance Company (NBFC) is a financial institution which does not meet the legal definition of bank but carries the similar activities to that of bank like lending and making investments i.e. such an institution does not hold a banking license.
- As per Sec. 45I(f) of RBI Act, 1934, a non-banking financial company" means:
  - (i) a financial institution which is a company;
  - (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
  - (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.
- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 which is engaged in the business of:
  - loans and advances,
  - acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature,
  - leasing,
  - hire-purchase,
  - insurance business,
  - chit business.

Note: IND AS is applicable to NBFCs on and from 1.4.2018.

However, such a company but does not include any institution whose principal business is that of:

- agriculture activity,
- industrial activity,
- purchase or sale of any goods (other than securities), or providing any services, and
- sale/ purchase/ construction of immovable property.

- Moreover, a non-banking institution which is a company and has principal business of receiving deposits, under any scheme or arrangement, in one lump sum or in installments, by way of contributions or in any other manner, is also a non-banking financial company (called a **Residuary non-banking company**).

Classification of Non- Banking Financial Companies (NBFCs)

NBFCs can be classified on the following bases:

[A] On the basis of Liability Structure

On the basis of liability structure, the NBFCs can be divided into two categories: NBFCs accepting public deposits (referred to as NBFCs-D), and NBFCs not raising public deposits (referred to as NBFCs-ND).

1. **Deposit taking NBFCs (referred to as NBFCs-D):** These NBFCs are subject to the requirements of Capital adequacy norms, Liquid assets maintenance norms, Exposure norms (including restrictions on exposure to investments in land, building and unquoted shares), Asset Liability Management (ALM) discipline and reporting requirements.
2. **Non-Deposit taking NBFCs (referred to as NBFCs-ND):** Till 2006 NBFCs-ND were subject to minimal regulations. However, since 2007, NBFCs-ND with assets of ₹ 100 crores and above are being classified as **Systemically Important Non-Deposit taking NBFCs (NBFCs-ND-SI)**.

Presently, in the light of the overall increase in the growth of the NBFC sector, the threshold for defining systemic significance for NBFCs-ND (non-deposit taking NBFCs) has been revised. Accordingly, the NBFCs-ND-SI will henceforth be those NBFCs-ND which have asset size of ₹500 crore and above as per the last audited balance sheet.

Thus, now the NBFCs-ND shall be categorized into two broad categories in accordance with the revised threshold limit for systemic significance:

- NBFCs-ND (those with assets of less than ₹ 500 crore) and
- NBFCs-ND-SI (those with assets of ₹ 500 crore and above).

The prudential regulations, such as capital adequacy requirements and exposure norms along with reporting requirements, have been made applicable to the NBFCs-ND-SIs. The Asset Liability-Management (ALM) reporting and disclosure norms have also been made applicable to them at different points of time.

NB: NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the above two categories i.e. NBFCs-ND and NBFCs- ND-SI. For this purpose, Statutory Auditors would be required to certify the asset size of all the NBFCs in the Group.

[B] On the basis of nature of primary activities performed

On this basis, the NBFCs can be classified into the following categories:

1. **Asset Finance company** is a company which carries on as its principal business the financing of physical assets supporting productive/economic and general purpose assets.

2. **Leasing company** is a company which carries on as its principal business, the business of leasing of equipments or the financing of such activity.
3. **Investment company** means any company which carries on as its principle business the acquisition of securities.
4. **Loan company** means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
5. **Infrastructure finance company** is a company which carries on as its principle business, the financing of the acquisition or construction of infrastructure facilities of various kinds.
6. **Infrastructure Debt Fund** is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects.
7. **Venture capital company** means any company which carries on as its principle business the providing of start-up capital to new business ventures.
8. **NBFC-Factor** is a non-deposit taking NBFC engaged in the principal business of factoring.
9. **NBFC- Non-Operative Financial Holding Company (NOFHC)** is financial institution through which promoter / promoter groups will be permitted to set up a new bank .It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

Regulatory Approach for NBFCs

- **NBFCs-ND Regulatory Approach (Asset size < ₹ 500 Crore):**

  The regulatory approach in respect of NBFCs-ND with an asset size of less than ₹ 500 crore will be as under:

  (i) No Regulations for No Deposits and No Customer Interface: They shall not be subjected to any regulation either prudential or conduct of business regulations if they have not accessed any public funds and do not have a customer interface.

  (ii) Conduct of business regulations if have Customer Interface: Those having customer interface will be subjected only to conduct of business regulations if they are not accessing public funds.

  (iii) Prudential Regulations for Public Deposits: Those accepting public funds will be subjected to only limited prudential regulations if they have no customer interface.

  (iv) Both Regulations for Deposits and Customer Interface: Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

  (v) Compulsory Compliance of Sec. 45-IA: Irrespective of whichever category the NBFC falls in, registration under Section 45 IA of the RBI Act will be mandatory.

- **NBFCs-ND Regulatory Approach (Asset size > ₹ 500 Crores):**

  All NBFCs-ND with assets of ₹ 500 crores and above shall have to comply with prudential regulations as applicable to NBFCs-ND-SI even if they have not accessed public funds.

  However, the NBFCs-ND having assets size of ₹ 500 crores and more shall comply with conduct of business regulations only if customer interface exists.

Mandatory Requirements of Minimum Net Owned Fund by NBFC:

- In terms of Section 45 IA of the RBI Act, 1934, no NBFC can commence or carry on business of a non-banking financial institution without having a Net Owned Funds (NOF) of ₹ 25 lakhs.
- Thereafter, the requirement of NOF has been increased to ₹200 lakhs for all new companies w.e.f. April 21. 1999 vide RBI Notification No. DNBS.132 CGM (VSNM) - 99 dated April 21, 1999.
- But now all NBFCs are compulsorily required to attain a minimum Net Owned Fund (NOF) of ₹ 2 crore by the end of March 2017 as per the milestones given below:
  - ₹ 1 crore by the end of March 2016
  - ₹ 2 crore by the end of March 2017
- Consequently, the companies that were already in existence even before April 21. 1999 have to attain the above minimum NOF in addition to the new companies applying for grant of COR to commence business of an NBFC on and after November 10, 2014.
- In other words, it shall be mandatory for all NBFCs to attain a minimum NOF of ₹ 100 lakh by the end of March 2016 and ₹ 200 lakh by the end of March 2017.

NB: All NBFCs, the NOF of which currently falls below ₹ 200 lakh shall submit a statutory auditor's certificate certifying compliance to the revised levels at the end of each of the two financial years as given above.

If any NBFC fails to achieve the prescribed ceiling within the stipulated time period, the Bank will initiate the process for cancellation of COR against such NBFCs.

Getting Rating to Accept or Renew Public Deposits for NBFC:

In accordance with the revised regulatory framework for NBFCs, all unrated Asset Finance Company (AFC) had to get an investment grade by March 31, 2016 otherwise they would not be allowed to renew existing or accept fresh deposits thereafter. Moreover, the limit for acceptance of deposits for rated AFCs has also been reduced from 4 times to 1.5 times of NOF.

Meanwhile i.e. till March 31, 2016, the unrated AFCs or those with a sub-investment grade rating can only renew existing deposits on maturity but not allowed to accept fresh deposits till they obtain an investment grade rating.

Earlier to this amendment, the unrated AFC having NOF of ₹ 25 lakh or more and maintaining capital adequacy ratio of not less than 15% were allowed to accept or renew public deposits 1.5 times of its NOF subject to ₹10 crore as per extant NBFCs Acceptance of Public Deposit (Reserve Bank) Directions, 1998.

Prudential Norms for NBFCs

The Reserve Bank of India has issued detailed directions on prudential norms, vide

- Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007,
- Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 and
- Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. Applicable regulations vary based on the deposit acceptance or systemic importance of the NBFC.

The directions inter alia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for

NBFCs predominantly engaged in business of lending against gold jewellery, besides others. Deposit accepting NBFCs have also to comply with the statutory liquidity requirements.

Enhanced prudential regulations shall be made applicable to NBFCs wherever public funds are accepted and conduct of business regulations will be made applicable wherever customer interface is involved.

The term 'Public Funds' includes:

(a) Funds raised directly or indirectly through public deposits;

(b) Commercial papers;

(c) Debentures;

(d) Inter-corporate deposits; and

(e) Bank finance.

However, the term Public Funds does not includes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue.

Application of Prudential Regulation for NBFCs

- **Prudential Regulations for NBFCs-ND (Assets size < ₹ 500 crores):**

  The NBFCs-ND with asset size of less than ₹ 500 crores shall be:

  (A) Exempted from the requirement of maintaining CRAR;

  (B) Exempted from complying with Credit Concentration Norms: and

  (C) Maintain a leverage ratio (Total Outside Liabilities Owned Funds) of 7 to link Asset Growth with the Capital.

- **Prudential Regulations for NBFCs-ND-SI (Asset size > ₹ 500 Crore) and all NBFCs-D:**

  Tier 1 Capital:

  All NBFCs-ND which have an asset size of ₹ 500 crore and above and all NBFCs-D shall maintain minimum Tier 1 Capital of 10%. The compliance to the revised Tier 1 capital will be phased in as follows:

  - 8.5% by end of March 2016.
  - 10% by end of March 2017.

Asset Classification for NBFCs

Every non-banking financial company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely:

(i) Standard assets;

(ii) Sub-standard assets;

(iii) Doubtful assets; and

(iv) Loss assets.

Standard Asset:

Standard Asset means the asset in respect of which, no default in repayment of principal or payment of interestis perceived and which does not disclose any problem nor carry more than normal risk attached to the business.

Sub-standard Asset:

- As per the "Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015, a Sub-standard asset means:

  (a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;

  (b) an asset where the terms of the agreement regarding interest and/ or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms: Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 27 of these Directions.

  NB: The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the upgradation.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Sub-standard asset means:

  (a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;

  Provided that the period 'not exceeding 18 months' stipulated in this sub-clause shall be 'not exceeding 16 months' for the financial year ending March 31, 2016; 'not exceeding 14 months' for the financial year ending March 31, 2017; and 'not exceeding 12 months' for the financial year ending March 31, 2018 and thereafter.

  (b) an asset where the terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms: Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 27 of these Directions.

Doubtful Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Doubtful asset means:

  (a) a term loan, or

  (b) a lease asset, or

  (c) a hire purchase asset, or

  (d) any other asset, which remains a sub- standard asset for a period exceeding 18 months.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Doubtful asset means:

  (a) a term loan, or

  (b) a lease asset, or

  (c) a hire purchase asset, or

  (d) any other asset, which remains a sub-standard asset for a period 'exceeding 18 months' for the financial year ended March 31, 2015; 'exceeding 16 months' for the financial year ended March 31, 2016; 'exceeding 14 months' for the financial year ending March 31, 2017 and 'exceeding 12 months' for the financial year ending March 31, 2018 and thereafter.

Loss Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Loss asset means:

(a) an asset which has been identified as loss asset by the non-banking financial company or its internal or external auditor or by the Reserve Bank of India during the inspection of the non-banking financial company, to the extent it is not written off by the non-banking financial company; and

(b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Loss asset means:

(a) an asset which has been identified as loss asset by the non-banking financial company or its internal or external auditor or by the Reserve Bank of India during the inspection of the non-banking financial company, to the extent it is not written off by the non-banking financial company; and

(b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non availability of security or due to any fraudulent act or omission on the part of the borrower.

Non-performing Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a non-performing asset (NPA) means:

(a) an asset, in respect of which, interest has remained overdue for a period of six months or more;

(b) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;

(c) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;

(d) a bill which remains overdue for a period of six months or more;

(e) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/ advances, which facility remained overdue for a period of six months or more;

(f) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more;

(g) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;

(h) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/ beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a non-performing asset (NPA) means:

(i) an asset, in respect of which, interest has remained overdue for a period of six months or more;

(ii) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;

(iii) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;

(iv) a bill which remains overdue for a period of six months or more;

(v) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances, which facility remained overdue for a period of six months or more;

(vi) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more; Provided that the period of 'six months or more' stipulated in sub-clauses (a) to (f) shall be 'five months or more' for the financial year ending March 31, 2016; 'four months or more' for the financial year ending March 31, 2017 and 'three months or more', for the financial year ending March 31, 2018 and thereafter.

(vii) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;

Provided that the period of 'twelve months or more' stipulated in this sub-clause shall be 'nine months or more' for the financial year ending March 31, 2016; 'six months or more' for the financial year ending March 31, 2017; and 'three months or more' for the financial year ending March 31, 2018 and thereafter.

(viii) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery.

Harmonisation of Asset Classification for NBFCs

In the interest of harmonisation, the asset classification norms for NBFCs-ND-SI and NBFCs-D are being brought in line with that of banks, in a phased manner, as provided below:

(1) Non-Performing Asset (NPA):

(A) Lease Rental and Hire-Purchase Assets:

(i) Overdue for 9 Months as on 31st March 2016: Lease Rental and Hire-Purchase Assets shall become NPA if they become overdue for 9 months (currently 12 months) for the financial year ending March 31,2016;

(ii) Overdue for 6 Months as on 31st March 2017: Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 6 months for the financial year ending March 31. 2017; and

(iii) Overdue for 3 Months as on 31st March 2018 and Onwards: Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

(B) Assets other than 'Lease Rental and Hire-Purchase Assets':

(i) Overdue for 5 Months as on 31st March 2016: Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if they become overdue for 5 months for the financial year ending March 31, 2016;

(ii) Overdue for 4 Months as on 31st March 2017: Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 4 months for the financial year ending March 31. 2017; and

(iii) Overdue for 3 Months as on 31st March 2018 and Onwards: Assets other than Lease Rental and Hire- Purchase Assets shall become NPA if overdue for 3 months for the financial year ending March 31. 2018 and thereafter.

(2) Sub-Standard Assets:

For all loan and hire-purchase and lease assets, sub-standard asset would mean:

(i) NPA upto 16 Months on 31/03/2016: An asset that has been classified as NPA for a period not exceeding 16 months (currently 18 months) for the financial year ending March 31. 2016;

(ii) NPA upto 14 Months on 31/03/2017: An asset that has been classified as NPA for a period not exceeding 14 months for the financial year ending March 31, 2017; and

(iii) NPA upto 12 Months on 31/03/2018: An asset that has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

(3) Doubtful Asset

For all loan and hire-purchase and lease assets, doubtful asset would mean:

(i) Sub-Standard Asset for 16 Months on March 31, 2016: An asset that has remained sub-standard for a period exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016

(ii) Sub-Standard Asset for 14 Months on March 31, 2017: An asset that has remained sub-standard for a period exceeding 14 months for the financial year ending March 31, 2017; and

(iii) Sub-Standard Asset for 12 Months on March 31, 2018 and thereafter: An asset that has remained sub- standard for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

Accounting Guidelines for NBFCs

The issues related to accounting include Income Recognition criteria, Accounting of Investments, asset classification and provisioning requirements. These have been provided in details in the RBI Directions, namely "Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015" and "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015".

RBI has prescribed that Income recognition should be based on recognised accounting principles, however Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these Directions as "ICAI" shall be followed in so far as they are not inconsistent with any of these Directions.

Income Recognition

- The income recognition of NBFCs, irrespective of their categorisation, shall be based on recognised accounting principles.
- Income including interest/ discount/ hire charges/ lease rentals or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.
- Income like interest /discount /any other charges on NPAs shall be recognised only when actually realised, RBI also requires that income recognised before asset becoming NPA should be reversed in the financial year in which such asset becomes NPA.
- The NBFCs are required to recognise income from dividends on shares of corporate bodies and units of mutual funds on cash basis, unless the company has declared the dividend in AGM and right of the company to receive the same has been established, in such cases, it can be recognized on accrual basis.
- Income from bonds and debentures of corporate bodies and from government securities/bonds may be taken into account on accrual basis provided it is paid regularly and is not in arrears.
- Income on securities of corporate bodies or public sector undertakings may be taken into account on accrual

basis provided the payment of interest and repayment of the security has been guaranteed by Central Government.

Principles for accounting of Investments

- Investing is one of the core activities of NBFCs, hence RBI requires the Board of Directors to Frame investment policy of the company and implement the same.
- The investments in securities shall be classified into current and long term, at the time of making each investment;
- The Board of the company should include in the investment policy the criteria for classification of investments into current and long-term.
- The investments need to be classified into current or long term at the time of making each investment.
- There can be no inter-class transfer of investments on ad hoc basis later on. Inter class transfer, if warranted, should be done at the beginning of half year, on April 1 or October 1, and with the approval of the Board.
- The investments shall be transferred scrip-wise, from current to long-term or vice-versa, at book value or market value, whichever is lower;
- The depreciation, if any, in each scrip shall be fully provided for and appreciation, if any, shall be ignored. Moreover, the depreciation in one scrip shall not be set off against appreciation in another scrip, at the time of such inter-class transfer, even in respect of the scrips of the same category.

Valuation of Investments

- The directions also specifies various valuation guidelines in respect of Quoted and Unquoted current investments leaving the Long term Investments to be valued as per ICAI Accounting Standards.

  It requires **Quoted current investments** to be grouped into specified categories, viz. (i) equity shares, (ii) preference shares, (iii) debentures and bonds, (iv) Government securities including treasury bills, (v) units of mutual fund, and (vi) others.
- The valuation of each specified category is to be done at aggregate cost or aggregate market value whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.
- **Unquoted equity shares in the nature of current investments** shall be valued at cost or break-up value, whichever is lower. However, the RBI Directions has prescribed that fair value for the break-up value of the shares may be replaced, if considered necessary. "Breakup value" means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one rupee only.
- **Unquoted preference shares in the nature of current investments** shall be valued at cost or face value, whichever is lower.
- **Investments in unquoted Government securities or Government guaranteed bonds** shall be valued at carrying cost.

- **Unquoted investments in the units of mutual funds in the nature of current investments** shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.
- **Commercial papers** shall be valued at carrying cost.
- **A long term investment** shall be valued in accordance with the Accounting Standard issued by ICAI.
- **Explanation: Unquoted debentures** shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

Transactions in Government Securities

Every non-banking financial company shall undertake transactions in Government securities through its CSGL account or its demat account: Provided that no non-banking financial company shall undertake any transaction in government security in physical form through any broker.

Preparation of Balance Sheet and Profit and Loss Account

- Every non-banking financial company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a non-banking financial company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.
- Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the non-banking financial company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date. Every non-banking financial company shall finalise its balance sheet within a period of 3 months from the date to which it pertains.
- Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 2013, the particulars in the schedule as set out in Division III of Schedule III.

Disclosures in the Balance Sheet

- The directions specify certain disclosure requirements in the balance sheet.
- Disclosure of provisions created without netting them from the income or against the value of assets. The provisions shall be distinctly indicated under separate heads of account as (i) Provisions for bad and doubtful debts; and (ii) Provisions for depreciation in investments.
- Provisions shall not be appropriated from the general provisions and loss reserves held. Provisions shall be debited to the profit and loss account.
- The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against the provisions.
- Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 2013, the particulars in the schedule as set out in Division III of Schedule III as amended on and w.w.f. 01-04-2021.
- The following disclosure requirements are applicable only to systemically important (Asset Size more than ₹ 500 crores) non-deposit taking non-banking financial company:
  - Capital to Risk Assets Ratio (CRAR);
    - Exposure to real estate sector, both direct and indirect; and
    - Maturity pattern of assets and liabilities."

The formats for the above disclosures are also specified by RBI.

- Ministry of Corporate Affairs vide Notification dated 11 October 2018 made amendments in Schedule III inserting Division III for NBFC whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rule, 2015. Further amendment made to Schedule III for NBFC vide Notification dated 24 March 2021 to be effective on and from 01 April 2021.

Division III provides a format of the Balance Sheet and Statement of Profit and Loss and sets out the minimum requirements of disclosure.

- Balance sheet items are to be classified as Financial and Non-financial and are allowed to be arranged in order of liquidity. Specific disclosure is required for derivative financial instruments and subordinated liabilities. Separate disclosure is required for Receivables which have significant increase in Credit Risk and that are Credit Impaired. Receivables and Loans are classified as follows:

Receivables and Loans shall be sub-classified as:

For trade receivables outstanding, following ageing schedule shall be given:

Trade Receivables aging schedule **(Amount in ₹)**

Particulars	Outstanding for following periods from due date of payment					Total
	Less than 6 months	6 months -1 year	1-2 years	2-3 years	More than 3 years	
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – which have significant increase in credit risk						
(iii) Undisputed Trade Receivables – credit impaired						
(iv) Disputed Trade Receivables – considered good						
(v) Disputed Trade Receivables – which have significant increase in credit risk						
(vi) Disputed Trade Receivables – credit impaired						

Loans sub-classified as:

	(Current Year)						(Previous Year)					
	Amortised cost	At Fair Value			Sub Total	Total	Amortised cost	At Fair Value			Sub Total	Total
		Through Other Comprehensive Income	Through profit or loss	Designated at fair value through profit or loss				Through Other Comprehensive Income	Through profit or loss	Designated at fair value through profit or loss		
	(1)	(2)	(3)	(4)	(5 = 2 + 3 + 4)	(6 = 1 + 5)	(7)	(8)	(9)	(10)	(11 = 8 + 9 + 10)	(12 = 7 + 11)
Loans												
(A) (i) Bills Purchased and Bills Discounted												
(ii) Loans repayable on Demand												
(iii) Term Loans												
(iv) Leasing												
(v) Factoring												
(vi) Others (to be specified)												
Total (A) - Gross												
Less: Impairment loss allowance												
Total (A) - Net												
(B) (i) Secured by tangible assets												

(ii) Secured by intangible assets												
(iii) Covered by Bank/ Government Guarantees												
(iii) Covered by Bank/ Government Guarantees												
(iv) Unsecured												
Total (B) - Gross												
Less: Impairment loss allowance												
Total (B) - Net												
(C) (I) Loans in India												
(i) Public Sector												
(ii) Others (to be specified)												
Total (C) - Gross												
Less: Impairment loss allowance												
Total (C) (I)-Net												
(C) (II) Loans outside India												
Less: Impairment loss allowance												
Total (C) (II)- Net												
Total C (I) and C(II)												

An NBFC shall disclose the following in the Notes under the head ‘Loans’:

(i) Bills purchased and bills discounted

(ii) Loans repayable on demand

(iii) lerm Loans

(iv) Leasing

(v) factoring

(vi) Others

- NBFCs are specially required to disclose Statutory Reserve in Other Reserve as part of Other Equity. Additional disclosure should be made for the conditions or restrictions for distribution from Statutory Reserve.
- Items of Revenue from Operations and Other Comprehensive Income are to be disclosed on the face of the statement of profit and loss instead of as parts of notes. In addition to disclosure of all material items in financial statements, a note for every item of Other Income or Other Expenditure should be given if it exceeds 1% of the total income.

The format of Balance Sheet and Statement of Profit and Loss of the NBFC as per Division III is shown below.

Part I: Balance sheet

Assets

Financial assets

(a) Cash and cash equivalents

(b) Bank Balance other than included in (a) above

(c) Derivative financial instruments

(d) Receivables

  (I) Trade Receivables

  (II) Other Receivables

(e) 1oans

(f) Investments

(g) Other Financial assets (to be specified)

Non -financial assets

(a) Inventories

(b) Current Tax Assets (Net)

(c) Deferred Tax Assets (Net)

(d) Investment Property

(e) Biological assets other than bearer plants

(f) Property, Plant and Equipment

(g) Capital work-in-progress

(h) Intangible assets under development

(i) Goodwill

(j) Other Intangible assets

(k) Other non-financial assets (to be specified)

Total Assets

Liabilities and Equity

Liabilities

Financial Liabilities

(a) Derivative financial instruments

(b) Payables

(I) Trade Payables

(i) total outstanding dues of micro enterprises and small enterprises

(ii) total outstanding dues of creditors other than micro enterprises and small enterprises

(II) Other Payables

(i) total outstanding dues of micro enterprises and small enterprises

(ii) total outstanding dues of creditors other than micro enterprises and small enterprises

(c) Debt Securities

(d) Borrowings (Other than Debt Securities)

(e) Deposits

(f) Subordinated Liabilities

(g) Other financial liabilities (to be specified)

Non-financial Liabilities

(a) Current tax liabilities (Net)

(b) Provisions

(c) Deferred tax liabilities (Net)

(d) Other non-financial liabilities (to be specified)

Equity

(a) Equity Share capital

(b) Other Equity

Total Liabilities and Equity

Part II - Statement of Profit and Loss Revenue from Operations

(i) Interest Income

(ii) Dividend Income

(iii) Rental Income

(iv) Fees and commission Income

(v) Net gain on fair value changes

(vi) Net gain on derecognition of financial instruments under amortised cost category

(vii) Sale of products(including Excise Duty)

(viii) Sale of services

(ix) Others (to be specified)

(I) Total Revenue from operations

(II) Other Income (to be specified)

(III) Total Income (l+ll)

Expenses

(i) Finance Costs

(ii) Fees and commission expense

(iii) Net loss on fair value changes

(iv) Net loss on derecognition of financial instruments under amortised cost category

(v) Impairment on financial instruments

(vi) Cost of materials consumed

(vii) Purchases of Stock -in -trade

(viii) Changes in Inventories of finished goods, stock -in - trade and work -in - progress

(ix) Fmployee Benefits Expenses

(x) [Depreciation , amortization and impairment

(xi) Others expenses (to be specified)

(IV) Total Expenses (IV)

(V) Profit / (loss) betore exceptional items and tax (III - IV)

(VI) Exceptional items

(VII) Profit/(loss) before tax (V -VI)

(VIII) Tax Expense:

(1) Current Tax

(2) Deferred Tax

(IX) Profit / (loss) for the period from continuing operations (VII -VIII)

(X) Profit/floss) from discontinued operations

(XI) Tax Expense of discontinued operations

(XII) Profit/(loss) from discontinued operations(After tax) (X -XI)

(XIII) Profit/(loss) for the period (IX+XII)

(XIV) Other Comprehensive Income

(A) (i) Items that will not be reclassified to profit or loss (specify items and amounts)

(ii) Income tax relating to items that will not be reclassified to profit or loss

Subtotal (A)

(B) (i) Items that will be reclassified to profit or loss (specify items and amounts)

(ii) Income tax relating to items that will be reclassified to profit or loss

Subtotal (B)

Other Comprehensive Income (A + B)

(XV) Total Comprehensive Income for the period (XIII+XIV) (Comprising Profit (Loss) and other Comprehensive) Income for the period)

(XVI) Earnings per equity share (for continuing operations)

- Basic (₹)
- Diluted (₹)

(XVII) Earnings per equity share (for discontinued operations)

- Basic (₹)
- Diluted (₹)

(XVIII) Earnings per equity share (for continuing and discontinued operations)

- Basic (₹)
- Diluted (₹)

Students may refer to the Notification of the MCA at: https://www.mca.gov.in/Ministry/pdf/ScheduleIIIAmendmentNotification_24032021.pdf

Provision Requirements for NBFCs as RBI Regulations

[A] Provision against sub-standard assets, doubtful assets and loss assets

Every NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, makeprovision against sub-standard assets, doubtful assets and loss assets as provided hereunder:

1. On loans, advances and other credit facilities including bills purchased and discounted

Loss Assets	The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for;
Doubtful Assets	(a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the non-banking financial company has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis;

	(b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. Estimated realisable value of the outstanding) shall be made on the following basis:	
	Period for which the asset has been considered as doubtful:	**Percent of provision**
	- Up to one year	20
	- One to three years	30
	- More than three years	50
Sub-standard assets	A general provision of 10 per cent of total outstanding shall be made	

2. On Lease and Hire Purchase assets

As per the RBI Directions, the provisioning requirements in respect of hire purchase and leased assets shall be as under:

- In respect of hire purchase assets, the total dues (overdue and future instalments taken together) as reduced by: (a) the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges: and (b) the depreciated value of the underlying asset, shall be provided for.

  Explanation: For the purpose of this paragraph, (1) the depreciated value of the asset shall be notionally computed as the original cost of the asset to be reduced by depreciation at the rate of twenty per cent per annum on a straight line method; and (2) in the case of second hand asset, the original cost shall be the actual cost incurred for acquisition of such second hand asset.

- Additional provision for hire purchase and leased assets: In respect of such assets, additional provision shall be made as under:

(a) Where hire charges or lease rentals are overdue upto 12 months	Nil
(b) Where hire charges or lease rentals are overdue for more than 12 months but upto 24 months	10 per cent of the net book value
(c) Where hire charges or lease rentals are overdue for more than 24 months but upto 36 months	40 per cent of the net book value
(d) Where hire charges or lease rentals are overdue for more than 36 months but upto 48 months	70 per cent of the net book value
(e) Where hire charges or lease rentals are overdue for more than 48 months	100 per cent of the net book value

► On expiry of a period of 12 months after the due date of the last instalment of hire purchase/ leasedasset, the entire net book value shall be fully provided for.

Notes:

1. The amount of caution money/ margin money or security deposits kept by the borrower with the non-banking financial company in pursuance of the hire purchase agreement may be deducted against the provisions stipulated under clause (i) above, if not already taken into account while arriving at the equated monthly instalments under the agreement. The value of any other security available in pursuance

to the hire purchase agreement may be deducted only against the provisions stipulated under clause (ii) above.

2. The amount of security deposits kept by the borrower with the non-banking financial company in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the provisions stipulated under clause (ii) above.
3. It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances including the depreciated book value of the leased asset under reference after adjusting the balance, if any, in the lease adjustment account. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.An asset which has been renegotiated or rescheduled as referred to in paragraph (2) (1) (xxv) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.
4. The balance sheet to be prepared by the NBFC may be in accordance with the provisions contained in subparagraph (2) of paragraph 11.
5. All financial leases written on or after April 1, 2001 attract the provisioning requirements as applicable to hire purchase assets.
6. In case of NBFC-MFIs, if the advance covered by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

[B] Provision against Standard Assets

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", every Non-Banking Financial Company shall make provision for standard assets at 0.25 percent of the outstanding, which shall not be reckoned for arriving at net NPAs.
- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", every Non-Banking Financial Company shall make provisions for standard assets at 0.25 per cent by the end of March 2015; 0.30 per cent by the end of March 2016; 0.35 per cent by the end of March 2017 and 0.40 per cent by the end of March 2018 and thereafter, of the outstanding, which shall not be reckoned for arriving at net NPAs. Thus, the provision for standard assets for NBFCs-ND-SI and for all NBFCs-D has now been increased to 0.40% . The compliance to the revised norm will be phased in as given below:
  - 0.30% by the end of March 2016
  - 0.35% by the end of March 2017
  - 0.40% by the end of March 2018
- The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.

Illustration 1

While closing its books of accounts on 31stMarch, a NBFC has its advances classified as follows-

Particulars	₹ Lakhs	Particulars	₹ Lakhs

Standard Assets	8,400	Unsecured Portion of Doubtful Debts	87
Sub-Standard Assets	910	Loss Assets	24
Secured Portions of Doubtful Debts:			
- Up to one year	160		
- One year to three years	70		
- more than three years	20		

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	8,400	0.40	33.6
Sub- Standard Assets	910	10%	91
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32
- 1 year to 2 years	70	30%	21
- more than three years	20	50%	10
Unsecured Portions of Doubtful Assets	87	100%	87
Loss Assets	24	100%	24
Total			**298.6**

Note: Percentage of provision for Standard Asset is 0.25 as per Non-Banking Financial Company - Non Systemicaliy Important Non-Deposit taking Company.

Illustration 2

While closing its books of account on March 31 of a financial year, a Non-banking Finance company has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	16,800
Standard Assets	1,340
Secured Positions of Doubtful Debts:	
- Up to one year	320
- one year to three years	90
- more than three years	30
Unsecured Portions of Doubtful debts	97

Particulars	₹ Lakhs
Loss Assets	48

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	16,800	0.40	67.2
Sub Standard Assets	1,340	10%	134
Secured Portion of Doubtful Debts:			
- Up to one year	320	20%	64
- 1 year to 2 years	90	30%	27
- more than 3 years	30	50%	15
Unsecured Portion of Doubtful debts	97	100%	97
Loss Assets	48	100%	48
Total			**452.4**

Illustration 3

While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	10,000
Sub Standard Assets	1,000
Secured Positions of Doubtful Debts:	
- Up to one year	160
- one year to three years	70
- more than three years	20
Unsecured Portions of Doubtful debts	90
Loss Assets	30

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	10.000	0.40	40
Sub-Standard Assets	1,000	10%	100
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32
- 1 year to 2 years	70	30%	21
- more than three years	20	50%	10
Unsecured Portions of Doubtful Assets	90	100%	90
Loss Assets	30	100%	30
Total			**323**

Illustration 4

Samvedan Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase) business. It provides you with the following information regarding major hire purchase deals as on 31.3.19. few machines were sold on hire-purchase basis. The hire purchase price was set as ₹ 100 lakhs as against cash price of ₹ 80 lakhs. The amount was payable as ₹ 20 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.3.20, but could not collect the second installment which was due on 31.3.21. the company was finalizing accounts for the year ending 31.3.21. till 15.5.21, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10.42%.

Required:

(i) What should be the principal outstanding on 1.4.20? Should the company recognise finance charge for the year 2020-21 as income?

(ii) What should be the net book value of assets as on 31.3.21 so far Samvedan Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

(iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

Solution:

(i) Since, the hire-purchaser paid the first installment due of 31.3.20, the notional principal outstanding on 01.04.2020 was ₹ 50.25 lakhs. [WN: I]

In the year ended 31.3.21, the installment due of ₹ 16 lakhs has not been received. However, it was due on 31.3.21 i.e. on the Balance Sheet date, and therefore, it will be classified as Standard Asset. Samvedan Ltd. will recognise ₹ 5.24 lakhs as interest income included in that due installment.

(ii) The net book value of the assets as on 31.3.2020

Particulars	₹ Lakhs
Overdue installment	16
Installments not due (₹ 16 lakhs × 3)	48

Particulars	₹ Lakhs
	64
Less: finance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
	55.49
Less: Provision as per NBFC prudential norms	7.49
∴ Net Book Value of assets for Samvedan Ltd.	48.00

(iii) Amount of Provision

Particulars	₹ Lakhs
Overdue installment	16
Installments not due (₹ 16 lakhs × 3)	48
	64
Less: finance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
	55.49
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20%)	48
Provision as per NBFC prudential norms	7.49

Since, the installment of ₹ 16 lakhs not paid, was due on 31.03.2016 only, the asset is classified as standard asset. therefore, no additional provision has been made for it.

Workings:

It is necessary to segregate the installments into principal outstanding and interest components by using IRR @10.42%

Time	Opening outstanding amount (a)	Cash flow (b)	Interest @ 10.42% (c) = (a) × 10.42%	Principal repayment (d) = (b) – (c)	Closing outstanding (e) = (a) – (d)
31.3.19	80	20	—	20	60
31.3.20	60	16	6.25	9.75	50.25
31.3.21	50.25	16	5.24	10.76	39.49
31.3.22	39.49	16	4.11	11.89	27.6
31.3.23	27.6	16	2.88	13.12	14.48
31.3.24	14.48	16	1.52	14.48	0

Solved Case Study(s)

1. Water Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase) business. It provides you with the following information regarding major hire purchase deals as on 31.3.18. few machines were sold on hire-purchase basis. The hp price was set as ₹ 200 lakhs as against cash price of ₹ 160 lakhs. The amount was payable as ₹ 20 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.3.19, but could not collect the second installment which was due on 31.3.20. the company was finalizing accounts for the year ending 31.3.20. till 15.5.20, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 11.32%.

   Required:

   What should be the principal outstanding on 1.4.19? Should the company recognise finance charge for the year 2019-20 as income?

   What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

   What should be the net book value of assets as on 31.3.20 so far Water Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

   Solution:

   Cash Price ₹ 160 lakhs

   HP Price ₹ 200 lakhs

   Down Payment ₹ 20 lakhs

   Annual Installment (200 – 20)/5 = 36

   (i) Since, the hire-purchaser paid the first installment due of 31.3.19, the notional principal outstanding on 01.04.2019 was ₹ 116.61lakhs. [WN: I]

   In the year ended 31.3.20, the installment due of ₹ 36 lakhs has not been received. However, it was due on 31.3.20 i.e. on the Balance Sheet date, and therefore, it will be classified as Standard Asset. Water Ltd. will recognise Rs. 12.61 lakhs as interest income included in that due installment as this should be treated as finance charge.

   (ii) Amount of Provision

Particulars	₹ Lakhs
Overdue installment	36
Installments not due (₹ 36 lakhs × 3)	108
	144
Less: Finance charge not matured and not credited to P/L A/c [8.21+5.70 + 2.97]	(16.89)
	127.11
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20%= 160 – 2 × 160/5 = 96)	96
Provision as per NBFC prudential norms	31.11

   Since, the installment of ₹ 36 lakhs not paid, was due on 31.03.2020 only, the asset is classified as standard asset. therefore, no additional provision has been made for it.

(iii) The net book value of the assets as on 31.3.2020

Particulars	₹ Lakhs
Overdue installment	36
Installments not due (₹ 36 lakhs × 3)	108
	144
Less: Finance charge not matured and not credited to P/L A/c [8.21+5.70 + 2.97]	(16.89)
	127.11
Less: Provision as per NBFC prudential norms	31.11
Net Book Value of assets for Water Ltd.	96.00

Working Note 1:

It is necessary to segregate the installments into principal outstanding and interest components by using IRR @9%

Time	Opening outstanding amount	Cash flow	Interest @ 9% (c) = (a) × 9%	Principal repayment (d) = (b) – (c)	Closing outstanding (e) = (a) – (d)
	(a)	(b)			
31.3.18	160	20	—	20	140
31.3.19	140	36	12.61	23.39	116.61
31.3.20	116.61	36	10.50	25.50	91.11
31.3.21	91.11	36	8.21	27.79	63.32
31.3.22	63.32	36	5.70	30.30	33.03
31.3.23	33.03	36	2.97	33.03	0.00

2. While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	40,000
Sub Standard Assets	4,000
Secured Positions of Doubtful Debts:	
- Up to one year	1000
- one year to three years	600
- more than three years	200
Unsecured Portions of Doubtful debts	160
Loss Assets	120

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	40,000	0.4	160
Sub-Standard Assets	4,000	10%	400
Secured Portions of Doubtful Debts:			
- Up to one year	1,000	20%	200
- 1 year to 2 years	600	30%	180
- more than three years	200	50%	100
Unsecured Portions of Doubtful Assets	160	100%	160
Loss Assets	120	100%	120
Total			1320

Exercise

A. Theoritical Questions:

Multiple Choice Questions

1. IND AS is applicable to NBFCs on and from

   a. 1.4.2016

   b. 1.4.2017

   c. 1.4.2015

   d. 1.4.2018

2. As per Sec. 45I(f)of RBI Act, 1934, a non-banking financial company means

   a. a financial institution which is a company

   b. a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner

   c. such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify

   d. All of the above

3. The term 'Public Funds' includes

   a. Debentures

   b. Funds raised directly or indirectly through public deposits

   c. Bank finance

   d. All of the above

4. As per Prudential Regulations for NBFCs-ND, the NBFCs-ND with asset size of less than ₹ 500 crores shall be

   a. Exempted from the requirement of maintaining CRAR

   b. Exempted from complying with Credit Concentration Norms

c. Maintain a leverage ratio (Total Outside Liabilities Owned Funds) of 7 to link Asset Growth with the Capital

d. All of the above

5. Non-Performing Asset (NPA) in case of Lease Rental and Hire-Purchase Assets if

a. Overdue for 9 Months as on 31st March 2016

b. Overdue for 6 Months as on 31st March 2017

c. Overdue for 3 Months as on 31st March 2018 and Onwards

d. All of the above

Answer:

1.	2.	3.	4.	5.
d.	d.	d.	d.	d.

- **Fill in the blanks:**

1. Commercial papers shall be valued at _________.

2. The provision towards standard assets need not be netted from gross advances but shall be shown separately as ____________________ in the balance sheet.

3. In addition to disclosure of all material items in financial statements, a note for every item of Other Income or Other Expenditure should be given if it exceeds __% of the total income.

4. Balance sheet items are to be classified as Financial and Non-financial and are allowed to be arranged in order of _______.

5. All NBFCs-ND which have an asset size of ₹500 crore and above and all NBFCs-D shall maintain minimum Tier 1 Capital of ___.

Answer:

1.	carrying cost	2.	Contingent Provisions against Standard Assets
3.	1%	4.	liquidity
5.	10%		

Short Essay Type Questions

1. Define a Non-Banking Financial Company as per RBI Act, 1934.
2. Explain the classification of Non- Banking Financial Companies (NBFCs).
3. Explain Derecognition under Ind AS 16: Property, Plant and Equipment (PPE).
4. Classify the Regulatory Approaches for NBFCs.
5. Enumerate the Mandatory Requirements of Minimum Net Owned Fund by NBFC.
6. Write Short Notes on the following:
   a. Standard assets
   b. Sub-standard assets
   c. Doubtful assets
   d. Loss assets

Essay type questions

1. How an NBFC will classify its Loans and Advances and create provisions for each class of assets?
2. How is interest and dividend income are recognized in accounting of NBFCs? How is income from NPA recognized?

B. Numerical Questions

Comprehensive Numerical Problems

1. While closing its books of accounts on 31stMarch, a NBFC has its advances classified as follows-

Particulars	₹ in Lakhs	Particulars	₹ in Lakhs
Standard Assets	6,800	Unsecured Portion of Doubtful Debts	80
Sub-Standard Assets	750	Loss Assets	30
Secured Portions of Doubtful Debts:			
- Up to one year	130		
- One year to three years	50		
- more than three years	25		

Calculate the amount of provision which must be made against the advances.

2. Lake Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase) business. It provides you with the following information regarding major hire purchase deals as on 31.03.2019. Few machines were sold on hire-purchase basis. The hire purchase price was set as ₹ 80 lakhs as against cash price of ₹ 65 lakhs. The amount was payable as ₹ 10 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.03.2020, but could not collect the second installment which was due on 31.03.2021. The company was finalizing accounts for the year ending 31.03.2021. Till the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10%.

   Required:

   (a) What should be the principal outstanding on 1.4.20? Should the company recognise finance charge for the year 2020-21 as income?

   (b) What should be the net book value of assets as on 31.3.16 so far Lake Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

   (c) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

Section-C

Accounting for Business Combination and Restructuring (In Compliance with Ind ASs)

Accounting for Business Combinations and Restructuring

5

This Module Includes

5.1 **Introduction**

5.2 **Accounting for Business Combination (Basic Level) with Simple Examples**

5.3 **Absorptions, Amalgamations, External Reconstruction**

5.4 **Detailed Discussion on Business Combination**

5.5 **A Business Combination Achieved in Stages**

5.6 **Reverse Acquisition**

5.7 **Purchase of Shares from/Sale to Non-controlling Interest not Resulting in Loss of Control of the Acquirer**

5.8 **Sale of Holding resulting in Loss of Control of the Acquirer over the Acquiree**

5.9 **Business Combination under Common Control (Appendix C of Ind AS 103)**

5.10 **Disclosures**

5.11 **Difference between Ind AS 103 and AS 14**

5.12 **Internal Reconstruction (Capital Reduction).**

Accounting for Business Combinations and Restructuring

SLOB Mapped against the Module

To acquire in-depth knowledge on accounting and reporting of different modes of business combinations including other complications associated in Ind AS environment.

Module Learning Objectives

- To provide updated knowledge about accounting and reporting of transactions in the nature of investments leading to
  - Acquiring control of other entities
  - Absorption, amalgamation and external reconstruction
- To provide in-depth knowledge about accounting of internal reconstruction
- To develop adequate application skill for accounting of business combination in Ind AS environment

Introduction

5.1

In Ind AS 103 Business Combination is dealt with. Two new terms are used in Ind AS 103, Business Combination and Business Combination under Common Control. All the events and arrangements meant by the extant and popular terms such as mergers, acquisitions, absorptions, amalgamations, external reconstruction, de-merger and reverse merger are now accommodated within these two new terms. Only events and arrangements meant by extant and popular terms like internal reconstruction, financial restructuring or capital reduction are continuing with the same terminology as Ind AS has not intervened on such events.

In fact, the economic events or transactions that were accounted under accounting of absorption, amalgamation and external reconstruction continue to exist and continue to be accounted under Business Combination as per Ind AS 103, Further, Ind As 103 on Business combination expands the scope of accounting to transaction or other event in which an acquirer obtains control of one or more businesses, when the legal entity of the acquiree continues to exist.

Accounting of Business Combination (Ind AS 103) [at basic level]

5.2

Objective of Ind AS 103: The objective of this Indian Accounting Standard (Ind AS) is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. To accomplish that, this Ind AS establishes principles and requirements for how the acquirer: (a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; (b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase1 ; and (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

A business combination is a transaction or other event in which an acquirer obtains **control** of one or more businesses.

Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also **business combinations** as that term is used in this Ind AS.

Acquiree is the business or businesses that the acquirer obtains control of in a business combination
Acquirer is the entity that obtains control of the acquiree

When after business combination, acquiree continues to exist, it is to be recorded in the books of the acquirer in two sets, one for consolidated accounts and the other for its separate financial statements i.e., for its stand -alone accounts.

When after business combination, acquiree ceases to exist, it is to be recorded in the books of the acquirer in one set only, in its stand-alone accounts (it is also called individual set).

Thus, when the Acquirer acquires controlling shares of the Acquiree, no accounting is required in the books of the Acquiree but in the books of the acquirer, accounting is required in two sets of accounts:

(I) In stand-alone set as stated below:

(Note: there is no application of Ind AS 103, rather, Ind AS 109 is applicable) Dr. Cr.

Particulars	(₹)	(₹)
Investment in shares in the Acquiree Dr.	xxxx	
To, Consideration		xxxx

(II) In consolidated set, Acquisition Method of Ind AS 103 is applied.

Accordingly, the acquirer in its financial statements recognizes and measures:

Recognizes		Measures
(a)	the identifiable assets acquired, and	at their fair values at the acquisition date
	the identifiable liabilities assumed	
	and any non-controlling interest (NCI) in the acquiree	at its fair value at the acquisition date, or
		at the non-controlling interest's proportionate share in fair value of the acquiree's identifiable net assets
(b)	the goodwill acquired in the business combination (A – B) or a gain from a bargain purchase (B – A)	A = Fair value of consideration transferred + Recognized amount of any NCI in acquiree + Fair value of (if any) previously held equity interest in the acquiree
		B = Net of acquisition-date amounts of the identifiable assets acquired and liabilities assumed.
(c)	The investor may have previously-held equity interest in acquiree (investee). Then, previously held investment in acquiree has to be cancelled.	at fair value at the date of acquisition.

- Acquisition date is the date on which the acquirer obtains control of the acquired.
- Non-controlling Interest is the equity in a subsidiary (acquiree) not attributable, directly or idrectly, to a parent (acquirer)

Thus, entries in the books of the acquirer are made like the following: Dr. Cr.

Particulars		(₹)	(₹)
Identified Assets of Acquiree	Dr.	xxxx	
Goodwill (if any)	Dr.	xxxx	
To, Consideration			xxxx
To, Identified Liabilities			xxxx
To, Non-controlling Interest			xxxx
To, Previously-held equity interest in Acquiree			xxxx
To, Gain from a bargain purchase (if any)			xxxx

Next, we may take up some numerical examples under Ind AS 103 for accounting under Acquisition Method of Ind AS 103 in consolidated set and also in separate set.

Illustration 1(a) (Take over)

A Ltd. takes over B Ltd. for ₹ 12,60,000. Fair Value (FV) of B's net assets at time of acquisition amounts ₹ 11,80,000.

Required:

Calculate Goodwill.

Journal Entries in the books of A Ltd.

Solution:

It is a business combination to be accounted under Ind AS 103. Here, B Ltd. is the Acquiree and A Ltd. is the Acquirer. The Acquiree ceases to exist after the takeover. In (individual set) the books of A Ltd., the Acquirer, net assets of B Ltd., the Acquiree, will be recognized and measured at fair value and the consideration will be settled at fair value. The excess of consideration over net assets will be recognized as Goodwill.

Purchase consideration ₹ 12,60,000

Fair Value of Net Assets ₹11,80,000

Goodwill = Consideration – Net Assets = ₹ (12,60,000 – 11,80,000) = ₹80,000

Journal (in Individual set of accounts)

Particulars		Dr. (₹)	Cr. (₹)
Net Assets A/c	Dr.	11,80,000	
Goodwill A/c	Dr.	80,000	
To, Consideration A/c			12,60,000

In books of B

All Accounts would be closed through Realisation Account.

Illustration 1(b) (100% subsidiary)

A Ltd. acquires 100% shares of B Ltd. for ₹ 12,60,000. Fair Value (FV) of B Ltd.'s net assets at time of acquisition amounts ₹ 11,80,000. Required:

1. Calculate Goodwill.
2. Journal Entries in the books of A Ltd. and B Ltd.

Solution:

Here, B Ltd. is 100% subsidiary and its legal separate existence is continued. It is a business combination to be accounted under Ind AS 103. Here, B Ltd. is the Acquiree and A Ltd. is the Acquirer. In the books (consolidated set) of A Ltd., the Acquirer, net assets of B Ltd., the Acquiree, will be recognized and measured at fair value and the consideration will be settled at fair value. The excess of consideration over net assets will be recognized as Goodwill. At the same time in the stand-alone set of A Ltd. (Separate set), Investment in Subsidiary will be recognized as per Ind AS 109 and Ind AS 103 will not apply.

Purchase consideration ₹ 12,60,000

Fair Value of Net Assets ₹11,80,000

Goodwill = Consideration – Net Assets = ₹ (12,60,000 – 11,80,000) = ₹80,000

Journal (in consolidated set of accounts)

Particulars		Dr. (₹)	Cr. (₹)
Net Assets A/c	Dr.	11,80,000	
Goodwill A/c	Dr.	80,000	
To, Consideration A/c			12,60,000

Journal entry (in Individual set of accounts)

Particulars		Dr. (₹)	Cr. (₹)
Investment in B Ltd. A/c	Dr.	12,60,000	
To, Consideration A/c			12,60,000

In books of B No accounting.

Illustation 1(c) (Non-controlling Interest at fair value)

A Ltd. acquires 80% shares of B Ltd. for ₹12,80,000. Fair Value (FV) of B Ltd.'s net assets at time of acquisition amounts ₹ 14,80,000. Non-Controlling Interests are recognized at fair value.

Required:

1. Calculate Goodwill.
2. Journal Entries in the books of A Ltd. and B Ltd.

Solution:

Here, B Ltd. is 80% subsidiary of A Ltd. and its legal separate existence is continued after acquisition of control. It is a business combination to be accounted under Ind AS 103. Here, B Ltd. is the Acquiree and A Ltd. is the Acquirer. In the books (consolidated set) of A Ltd., the Acquirer, net assets of B Ltd., the Acquiree, will be recognized and measured at fair value and the consideration will be settled at fair value. For the 20% interests of the other shareholders, Non-Controlling Interests (NCI) will be recognized at fair value as stated in the problem. The excess of aggregate of consideration and NCI over net assets will be recognized as Goodwill. At the same time in the stand-alone set of A Ltd. (Separate set), Investment in Subsidiary will be recognized as per Ind AS 109 and Ind AS 103 will not apply.

Purchase consideration ₹ 12,80,000

Fair Value of Net Assets ₹14,80,000

NCI = Purchase consideration X (Share of NCI/Share of holding by the Acquirer)

= ₹12,80,000 × (20/80)

= ₹ 3,20,000

Goodwill = Consideration + NCI – Net Assets

= ₹ (12,80,000 + 3,20,000 – 14,80,000)

= ₹ 1,20,000

Journal (in consolidated set of accounts)

Particulars		Dr. (₹)	Cr. (₹)
Net Assets A/c	Dr.	14,80,000	
Goodwill A/c	Dr.	1,20,000	
To, Consideration A/c			12,80,000
To, NCI A/c			3,20,000

Journal (in Individual set of accounts)

Particulars		Dr. (₹)	Cr. (₹)
Investment in B Ltd. A/c	Dr.	12,80,000	
To, Consideration A/c			12,80,000

In books of B Ltd. No accounting.

Illustration 2(a) (Take over)

On March 31, 2021, P Ltd acquired Q Ltd. by issue of 3,00,000 equity shares (₹ 10) that were trading at ₹ 16 on March 31.

The summarized Balance Sheets of the companies as at March 31, 2021 (before acquisition): [Amount in ₹]

	(Book Value)		(Market Value)	
	P Ltd.	Q Ltd.	P Ltd.	Q Ltd.
Net Assets	80,00,000	42,00,000	110,00,0000	45,00,000
Equity Sh. Cap	60,00,000	25,00,000		
Other Equity	20,00,000	17,00,000		

Show acquisition journal entry under Ind AS 103 and summarized balance sheet after business combination. Also show the necessary accounting in the books of the Acquiree.

Solution:

Purchase consideration (at fair value) = 3,00,000×₹16 = ₹ 48,00,000; FV of Net Assets ₹ 45,00,000

Goodwill = Consideration – Net Assets = ₹ (48,00,000 – 45,00,000) = ₹ 3,00,000.

Journal (individual set of P Ltd.)

Particulars		Dr. (₹)	Cr. (₹)
Net Assets A/c	Dr.	45,00,000	
Goodwill A/c	Dr.	3,00,000	
To, Consideration A/c			48,00,000
Consideration A/c	Dr.	48,00,000	
To, Equity Share Capital A/c			30,00,000
To, Security Premium A/c			18,00,000

Summarized Individual Balance sheet of K Ltd. as at March 31 (Post-acquisition)

Workings:

	(₹)	(₹)
Net Assets:		
Carrying amount of Acquirer P Ltd.	80,00,000	
Fair Value of Acquiree Q Ltd.	45,00,000	
		125,00,000
Goodwill		3,00,000
Total Net Assets		1,28,00,000
Equity:		
Equity Share Capital		
Existing	60,00,000	
Issue for consideration	30,00,000	
		90,00,000
Other Equity:		
Carrying amount	20,00,000	
Security Premium (on issue of shares)	18,00,000	
		38,00,000
Total Equity		**1,28,00,000**

No consolidated or separate set is required.

In books of Q:

accounts are closed through Realisation Account

Particulars		Dr. (₹)	Cr. (₹)
Realisation A/c	Dr.	42,00,000	
To, Net Assets A/c			42,00,000
Equity Shares in K Ltd. A/c	Dr.	48,00,000	
To, Realisation A/c			48,00,000
Realisation A/c	Dr.	6,00,000	
To, Equity Shareholders' A/c			6,00,000

Particulars		(₹)	(₹)
Equity Share Capital A/c	Dr.	25,00,000	
Other Equity A/c	Dr.	17,00,000	
To, Equity Shareholders' A/c			42,00,000
Equity Shareholders' A/c	Dr.	48,00,000	
To, equity Shares in K Ltd.			48,00,000

Dr. **Realisation Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
Net Assets A/c	42,00,000	Equity Shares in P A/c	48,00,000
Equity Shareholders' A/c	6,00,000		
	48,00,000		48,00,000

Dr. **Equity Shareholders' Account** **Cr.**

Particulars	(₹)	Particulars	(₹)
Equity Shares in P Ltd. A/c	48,00,000	Equity Share Capital A/c	25,00,000
		Other Equity A/c	17,00,000
		Realisation A/c	6,00,000
	48,00,000		**48,00,000**

Now, what changes take place in accounting in the books of the Acquirer and the Acquiree if the following changes take place:

a. P Ltd acquired 100% shares of Q Ltd.

b. P Ltd acquired 80% shares of Q Ltd.

[for guidance you may also follow the solutions in illustration 1(b) and 1(c)]

Illustration 2(b) (100% Subsidiary)

On March 31, 2021, P Ltd acquired 100% shares of Q Ltd. P Ltd. issued 3,00,000 equity shares (₹ 10) that were trading at ₹ 16 on March 31.

The summarized Balance Sheets of the companies as at March 31, 2021 (before acquisition): (Amount in ₹)

Partclars	(Book Value)		(Market Value)	
	P Ltd.	Q Ltd.	P Ltd	Q Ltd
Net Assets	80,00,000	42,00,000	110,00,0000	45,00,000
Equity Sh. Cap	60,00,000	25,00,000		
Other Equity	20,00,000	17,00,000		

Show acquisition journal entry under Ind AS 103 and summarized balance sheet after business combination. Also show the necessary accounting in the books of the Acquiree.

Solution:

Purchase consideration (at fair value) = 3,00,000 ×₹16 = ₹ 48,00,000; FV of Net Assets ₹ 45,00,000

Goodwill = Consideration – Net Assets = ₹ (48,00,000 – 45,00,000) = ₹ 3,00,000

Journal (in Consolidated set of P Ltd.) **Dr.** **Cr.**

Particulars		(₹)	(₹)
Net Assets A/c	Dr.	45,00,000	
Goodwill A/c	Dr.	3,00,000	
To, Consideration A/c			48,00,000
Consideration A/c	Dr.	48,00,000	
To, Equity Share Capital A/c			30,00,000
To, Security Premium A/c			18,00,000

Summarized Consolidated Balance sheet of P Ltd. and its subsidiary Q Ltd.as at March 31 (post cquisition)

Particulars	(₹)	(₹)
Net Assets:		
Carrying amount of Acquirer P	80,00,000	
Fair Value of Acquiree Q	45,00,000	
		1,25,00,000
Goodwill		3,00,000
Total Net Assets		1,28,00,000
Equity:		
Equity Share Capital		
Existing	60,00,000	
Issue for consideration	30,00,000	
		90,00,000
Other Equity:		
Carrying amount	20,00,000	
Security Premium (on issue of shares)	18,00,000	
		38,00,000
Total Equity		**1,28,00,000**

Journal (Separate set of P Ltd.)

Particulars		Dr. (₹)	Cr. (₹)
Investment in Shares of Q Ltd. A/c	Dr.	48,00,000	
To, Equity Share Capital A/c			30,00,000
To, Security Premium A/c			18,00,000

Summarized Separate Balance sheet of P Ltd. as at March 31 (post acquisition)

Particulars	(₹)	(₹)
Net Assets:		
Carrying amount of Acquirer K	80,00,000	
Investment in Shares of L	48,00,000	
		1,28,00,000
Total Net Assets		1,28,00,000
Equity:		
Equity Share Capital		
Existing	60,00,000	
Issue for consideration	30,00,000	
		90,00,000
Other Equity:		
Carrying amount	20,00,000	
Security Premium (on issue of shares)	18,00,000	
		38,00,000
Total Equity		**1,28,00,000**

In books of P Ltd. No entry

Illustration 4 (NCI at fair value)

Z Ltd. acquired a 60% interest in P Ltd. on January 1, 2021. Z paid ₹960 Lakhs in cash for their interest in P Ltd. The fair value of P Ltd.'s assets is ₹2,400 Lakhs, and the fair value of its liabilities is ₹900 Lakhs. Provide the journal entry for the acquisition using Ind AS, assuming that Z Ltd. does not wish to report the NCI at fair value.

Show acquisition journal entry under Ind AS 103.

Solution:

Workings:

(i) FV of Net Assets = ₹(2400 – 900) Lakhs = ₹1,500 Lakhs

(ii) Share of Parent in Acquireer = 60% and Share of Non-controlling Interest in Acquiree = 100% – 60% = 40%

NCI (at proportionate net asset value) = 40%×₹1500 Lakhs = ₹600 Lakhs

(iii) Goodwill = A – B = ₹(960 + 600) Lakhs – ₹1500 Lakhs = ₹60 Lakhs [where, A = Consideration + NCI, and B = Net Assets]

Journal for consolidation: **Dr.** **Cr.**

Particulars		₹ ₹ in Lakhs	₹ ₹ in Lakhs
Assets A/c	Dr.	2,400	
Goodwill A/c [W.N. iii]	Dr.	60	
To, Consideration A/c			960
To, Acquired liabilities A/c			900
To, Non-controlling interests A/c [W.N. ii]			600
Consideration A/c	Dr.	960	
To, Cash			960

Illustration 5 (Gain on bargain purchase)

On 1 January 2021 M Ltd. acquires 80 per cent of the equity interests of P Ltd. by issue of equity shares of paid-up value of ₹100 Lakhs (market value ₹ 240 Lakhs). The identifiable assets are measured at ₹ 380 Lakhs and the liabilities assumed are measured at ₹ 60 Lakhs. Non-controlling Interest is measured at proportionate net asset value. Pass journal.

Solution: [₹ ₹ in lakhs]

Working Note 1: Amount of the identifiable net assets acquired ₹(380 – 60) = 320

Working Note 2: Non-controlling Interest = ₹320 × 20% = 64

Working Note 3: Gain on Bargain Purchase = B – A = ₹320 – ₹ (240 + 64) = 16

M Ltd. would record its acquisition of control of P Ltd. in its consolidated financial statements as follows:

Journal for Consolidation **Dr.** **Cr.**

Particulars		₹ ₹ in Lakhs	₹ ₹ in Lakhs
Identifiable Assets Acquired A/c	Dr.	380	
To, Consideration A/c			240
To, Liabilities assumed A/c			60
To, Non-controlling Interest in P Ltd. A/c			64
To, Gain on the Bargain Purchase A/c			16

Note: The gain on bargain purchase will be recognised in other comprehensive income and accumulated in other equity as capital reserve.

Absorptions, Amalgamations, External Reconstruction

5.3

We shall discuss about how Absorption, Amalgamation and External Reconstruction where the vendor company ceases to exist are treated based on Ind AS 103 and Ind AS 103 Appendix C.

For Absorption, Amalgamation and External Reconstruction, no consolidated set of accounts is required even for companies complying with Ind AS. The Acquirer company will account for the transactions following Ind AS 103 and Ind AS 103 Appendix C for preparing individual (stand-alone) financial statements.

Now let us see how the events like Absorption, Amalgamation and External Reconstruction are treated under Ind AS 103 with the help of illustrations.

Illustration 6 (Absorption)

On March 31, 201X, A Ltd absorbed B Ltd. A Ltd. issued 60,000 equity shares (₹10 par value) that were trading at ₹25 on March 31. The book value of B's net assets was ₹12,00,000, Equity Share Capital ₹ 5,00,000 and Other Equity ₹7,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at ₹13,00,000.

Show journal entries complying Ind AS.

Solution:

It is a business combination under Ind AS 103. Accounting in the books of A Ltd. is done under acquisition method. Net assets and consideration are recognized at fair value, and their difference is recognized as Goodwill/ Gain on Bargain Purchase.

Workings:

Consideration = 60000 × ₹25 = ₹15,00,000

Goodwill = ₹15,00,000 – ₹13,00,000 = ₹2,00,000

Journal Entries in books of A Ltd.: **Dr.** **Cr.**

Particulars		(₹)	(₹)
Net Assets A/c	Dr.	13,00,000	
Goodwill A/c	Dr.	2,00,000	
To, Consideration A/c			15,00,000
Consideration A/c	Dr.	15,00,000	
To, Equity Share Capital A/c			6,00,000
To, Security Premium A/c			9,00,000

Illustration 7 (Amalgamation)

On March 31, 201X, A Ltd and B Ltd. were amalgamated into C Ltd., control of the businesses lying with the same parties as before. C Ltd. issued 80,000 equity shares to A Ltd. and 75,000 equity shares to B Ltd. at the nominal value of ₹10 per share. The book value of A Ltd.'s net assets was ₹12,00,000, Equity Share Capital ₹ 5,00,000 and Other Equity ₹7,00,000 on March 31. The fair value of net assets of A Ltd. was assessed at ₹16,00,000. The book value of B Ltd.'s net assets was ₹10,00,000, Equity share capital ₹4,00,000 and Other Equity ₹6,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at ₹15,00,000.

Show journal entries complying Ind AS.

Solution:

It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C, where control lies with the same parties before and after the transaction.

Pooling of Interest method will be applied. Consideration is measured only at nominal value of shares. Difference of consideration and other equity carried, with net assets be recognized as Goodwill or Capital Reserve. Net assets and Other Equity of the transferee company will be carried at book value.

Workings:

Consideration to A Ltd.	= 80,000 × ₹10	= ₹	8,00,000
Consideration to B Ltd.	= 75,000 ×₹10	= ₹	7,50,000
Total Consideration		= ₹	15,50,000
Other Equity of A Ltd. and B Ltd.	= ₹7,00,000 + ₹6,00,000	= ₹	13,00,000
Total Net assets	= ₹12,00,000 + ₹10,00,000	= ₹	22,00,000
Goodwill	= ₹15,50,000 + ₹9,00,000	= ₹	6,50,000

Journal in books of C Ltd.

Particulars		Dr. (₹)	Cr. (₹)
Net Assets of A Ltd.A/c	Dr.	12,00,000	
Net Assets of B Ltd.A/c	Dr.	10,00,000	
Goodwill A/c	Dr.	6,50,000	
To, Consideration A/c (₹8,00,000 + ₹7,50,000)			15,50,000
To, Other Equity A/c (₹7,00,000 + ₹6,00,000)			13,00,000
Consideration A/c	Dr.	15,50,000	
To, Equity Share Capital A/c			15,50,000

Illustration 8 (External Reconstruction)

On March 31, 201X, A Ltd externally reconstructed into B Ltd. B Ltd. issued 80,000 equity shares at the nominal value of ₹ 10 per share. The book value of A Ltd.'s net assets was ₹12,00,000 on March 31. The fair value of net assets was assessed at ₹15,00,000.

Show journal entries complying Ind AS.

Solution:

It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C, where control lies with the same parties before and after the transaction.

Pooling of Interest method will be applied. Consideration is measured only at nominal value of shares, Difference of consideration and carried amount of Other Equity with the net assets will be recognized as Goodwill or Capital Reserve. Net assets and Other Equity of the transferee company will be carried at book value.

Workings:

Consideration = 80000 ×₹10 = ₹8,00,000

Goodwill = ₹8,00,000 +₹6,00,000 -₹12,00,000 = ₹2,00,000

Journal in books of B Ltd.:

Particulars		Dr. (₹)	Cr. (₹)
Net Assets A/c	Dr.	12,00,000	
Goodwill A/c	Dr.	2,00,000	
To, Consideration A/c			8,00000
To, Other Equity A/c			6,00,000
Consideration A/c	Dr.	8,00,000	
To, Equity Share Capital A/c			8,00,000

Detailed Discussion on Business Combination

5.4

In business combination control of the business of Acquiree is obtained by the Acquirer. Control of business can be obtained by

(a) acquiring assets and assuming liabilities (such assets and liabilities must constitute a business, otherwise it is not a business combination),

(b) by acquisition of shares, or

(c) by other legal process.

An entity shall account for each business combination by applying the acquisition method (similar to 'Purchase method' of AS 14).

Note: It does not include 'business combination under common control', which is accounted under 'Pooling of Interest' method under Appendix C of Ind AS 103.

Applying the acquisition method requires:

(a) identifying the acquirer;

(b) determining the acquisition date;

(c) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non- controlling interest in the acquiree; and

(d) recognising and measuring goodwill or a gain from a bargain purchase.

Identifying the Acquirer:

- For each Business combination one of the combining entities shall be identified as the acquirer.
- Acquirer is the entity that obtains control of business.
- The guidance in Ind AS 110 shall be used to identify the acquirer—the entity that obtains control of another entity, ie the acquiree.

  When it is not clear from Ind AS 110, the following factors should be considered under Ind AS 103 (Appendix B)

  B14 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

  B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests.

  Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

(a) the relative voting rights in the combined entity after the business combination —

The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.

(b) the existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest —

The acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.

(c) the composition of the governing body of the combined entity —

The acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.

(d) the composition of the senior management of the combined entity —

The acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.

(e) the terms of the exchange of equity interests —

The acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

B16 The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

B17 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–B17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.]

Determining the acquisition date: It is the date on which the acquirer obtains control of the acquiree i.e., legally transfers the consideration, acquires the assets and assumes the liability of the acquiree.

Consideration transferred should also be measured as per the requirement of this standard.

- The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the equity interests issued by the acquirer.
- The consideration transferred may include assets or liabilities of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a business of the acquirer). If so, the acquirer shall remeasure the transferred assets or liabilities to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in profit or loss.
- Further, any items that are not part of the business combination be accounted separately from business combination (example: acquisition related costs)
- Contingent consideration (Obligation by the acquirer to transfer additional assets or equity interest, if specified future events occur or conditions are met), if any, should also be measured at fair value at acquisition date.

Contingent liability: The acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. (Ind AS 37 do not apply)

In business combination there is no adjustment for unrealised profits in case of existence of inter-company holding of inventory. However, inter-company debts are fully set off. Inter-company investments in equity are not permitted vide section 19 of the Companies Act, 2013.

A Business Combination Achieved In Stages

5.5

An acquirer sometimes obtains control of an acquiree in which it already held an equity interest. For example, on 31 March 20X1, Entity A holds a 35 per cent non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity

This is a business combination achieved in stages or a step acquisition.

In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at the acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

Illustration 9

Entity A acquired 35 % of Entity B on 01-04-2019 for ₹ 35,000. On 31-03-2020, fair value of shares of Entity B is ₹ 42,000, thus ₹ 7,000 reported under OCI in 2019-20. On 01-07-2020 Entity A further acquired 40% stake in Entity B. Consideration paid is ₹ 60,000.

Entity A identifies the net assets of Entity B at fair value of ₹ 120,000 at the acquisition date, value 35% shares at ₹ 45,000. NCI is valued at proportionate net assets. Show workings and Journal entries.

Solution:

Entity A will make transfer to P&L Account

Particulars	(₹)
Gain on disposal of 35% investment ₹ (45,000 – 42,000)	3,000
Gain previously reported in OCI ₹ (42,000 - 35,000)	7,000
Total transfer to P & L Account	10,000

Entity A will measure goodwill as follows:

Particulars	(₹)
Fair Value of consideration given for controlling interest	60,000
Non-controlling interest (25% × ₹1,20,000)	30,000
Fair Value of previously-held interest	45,000
Total	1,35,000

Particulars	(₹)
Less: Fair value of net assets of acquire	1,20,000
Goodwill	15,000

Particulars		Dr. (₹)	Cr. (₹)
Investment A/c	Dr.	3,000	
OCI A/c	Dr.	7,000	
To, Profit and Loss A/c			10,000
Net Assets A/c	Dr.	1,20,000	
Goodwill A/c	Dr.	15,000	
To, Consideration A/c			60,000
To, Investment A/c			45,000
To, NCI A/c			30,000

Note: If an entity already has control of the acquiree (suppose, already held 60% of the equity and for further purchase of 30% there this is no step acquisition.)

Advanced level-I illustrations with explanations

Reverse Acquisition

5.6

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired. However, application of the guidance in paragraphs B13–B18 of Ind AS 103 results in identifying:

(a) the public entity as the acquiree for accounting purposes (the accounting acquiree); and

(b) the private entity as the acquirer for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in Ind AS103, including the requirement to recognise goodwill, apply.

Purchase of shares from/sale to Non-controlling Interest not resulting in loss of control of the acquirer

5.7

When there is an increase in parent's ownership interest by purchase of a part/full of non-controlling interest, it is Equity Transaction (transaction with owner in the capacity of owner). Any profit or loss on the transaction will be transferred to Other Equity of the Parent in consolidated accounting. Thus, the Acquirer shall debit NCI for acquisition of additional stake or credit NCI for sale of a part of holding, thereby not loosing control indeed. The difference between the NCI (debit/credit) and the payments received shall be accounted to Other Equity (debit for loss and credit for profit for the transaction). Goodwill will not be affected for the change of stake retaining control.

Illustration 10

On 01.04.2020 Gold Ltd. acquired 75% share of Coal Ltd. at ₹10,80,000, when the fair value of its net assets was 1000000. During 01.4.2020 to 31-3-2021 Coal Ltd made TCI ₹ 2,00,000. On 31.3.2021 Gold Ltd. (a) sold (b) purchased 15% holding to/from outsiders at ₹2,20,000. Pass journal entries for sale/purchase of partial holding retaining control. NCI is valued at (i) Proportionate net asset value; (ii) fair value.

Solution:

Workings:

(a) Sale of holding

Carrying amount of 15% holding 15% × ₹10,80,000 + 15% of TCI = ₹1,92,000

Sale price = ₹2,20,000

Gain credited to Other Equity = ₹2,20,000 – ₹1,92,000 = ₹28,000

Journal Entry **Dr.** **Cr.**

Particulars		(₹)	(₹)
Bank A/c	Dr.	2,20,000	
To, NCI			1,92,000
To, Other Equity			28,000

(b) Purchase of shares from outsiders

(i) NCI recognized at Proportionate net asset value

15% holding 15% × ₹(10,00,000 + 2,00,000) = ₹1,80,000

Purchase price = ₹2,20,000

Loss debited to Other Equity = ₹2,20,000 – ₹1,80,000 = ₹40,000

Journal **Dr.** **Cr.**

Particulars		(₹)	(₹)
NCI A/c	Dr.	1,80,000	
Other Equity A/c	Dr.	40,000	2,20,000
To, Bank A/c			

(ii) NCI recognized at fair value

Carrying amount of 15% holding = (15%/75%) × ₹10,80,000 + 15% of ₹2,00,000 (TCI) = ₹2,46,000

Purchase price = ₹2,20,000

Gain credited to Other Equity = ₹2,46,000 – ₹2,20,000 = ₹26,000

Journal Entry **Dr.** **Cr.**

Particulars		(₹)	(₹)
NCI A/c	Dr.	2,46,000	
To, Other Equity			26,000
To, Bank			2,20,000

5.8 Sale of Holding Resulting in Loss of Control of the Acquirer over the Acquiree

If a parent loses control of a subsidiary, it shall:

(a) derecognise:

   (i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and

   (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).

(b) recognise:

   (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control.

Advanced Level-I Illustrations with Explanations

Illustration 11 (Contingent consideration)

D Ltd. has acquired 100% of the equity of F Ltd. on March 31, 2021. The purchase consideration comprises of an immediate payment of ₹10 lakhs and two further payments of ₹1.21 lakhs if the Return on Equity exceeds 20% in each of the subsequent two financial years. A discount rate of 10% is used. Compute the value of total consideration at the acquisition date.

Solution:

Particulars	₹ ₹ in Lakhs
Immediate cash payment	10.00
Fair value of contingent consideration [1.21/1.1 +1.21/(1.1)^2]	2.10
Total purchase consideration	12.10

Illustration 12

C Ltd. acquires 60% share in D Ltd. for cash payment of ₹2,00,000. The fair value of non-controlling interest is ₹1,00,000. This amount was determined with reference of market price of D's ordinary shares before the acquisition date.

Calculate NCI and goodwill following:

(i) Fair Value approach

(ii) Proportionate shares of identified net asset in acquire approach

when on the acquisition date, the aggregate value of D's identifiable net assets is:

(a) ₹2,40,000;

(b) ₹ 3,30,000.

Solution:

Particulars	(ia) ₹	(ib) ₹	(iia)₹	(iib)₹
Consideration	2,00,000	2,00,000	2,00,000	2,00,000
NCI	1,00,000	1,00,000	96,000x	1,32,000y
Net assets	2,40,000	3,30,000	2,40,000	3,30,000
Goodwill (1+2-3)	60,000		56,000	2,000
Gain on Bargain Purchase (3-1-2)		30,000		

x - 40% × ₹2,40,000 = ₹96,000

y - 40% ×₹3,30,000 = ₹1,32,000

[Under Ind AS 103, Goodwill is not amortised but tested for annual impairment in accordance with Ind AS 36.]

Illustration 13 (Contingent Liability)

Z Ltd. acquired C Ltd. on April 1, 2021. For a lawsuit contingency C Ltd. has a present obligation as on April 1, 2021 and the fair value of the obligation can be reliably measured as ₹50,000. As of the acquisition date it is

not believed that an out flow of cash or other assets will be required to settle this matter. What amount should be recorded by Z Ltd. under Ind AS for this contingent liability of C Ltd.?

Solution:

Contingent liabilities of the Acquiree are recognized as of the acquisition date if there is a present obligation (even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, contrary to Ind AS 37) and the fair value of the obligation can be measured reliably. Hence, a liability of ₹50,000 would be recorded by Z.

Illustration 14

[A comprehensive problem: In this problem you will find P Ltd. acquired shares in S Ltd. having significant influence on S Ltd., its Associate (Ind AS 28 and Ind AS 27 are applicable). Next, P Ltd. acquired controlling shares in S Ltd., its subsidiary (Ind AS 103, Ind AS 27 and Ind AS 110 are applicable). Thereafter, P Ltd. acquired further shares in S Ltd. resulting in change of ownership of Parent and Non-Controlling Interest (NCI) but not in control over subsidiary (Ind AS 110 is applicable). In all the cases where Ind AS 27 is applied, Ind AS 109 is also referred to.]

P Ltd. acquired 25% shares of S Ltd. on 01.04.2019 in cash. P Ltd. further acquired on 01.04.2020 45% shares of B Ltd. payable by issue of 30000 shares of ₹ 10 (market price ₹15). On that date Debentures of S Ltd. were exchanged for 10% Debenture of P Ltd. A contingent consideration is also payable, fair value of which at 01.04.2020 was estimated at ₹45,000. P Ltd. paid transaction cost ₹20,000. Non-Controlling Interest is recognized at fair value.

The fair values of assets and liabilities of S Ltd. are stated below:

Fair Value	01.04.2019 (₹)	01.04.2020 (₹)	31.03.2021 (₹)
PPE	3,80,000	4,00,000	4,50,000
Current Assets	4,00,000	4,20,000	4,30,000
Creditors	30,000	36,000	40,000

On 31.03.2021 P Ltd. further purchased 20% shares in S Ltd. at ₹ 2,50,000 in cash. Profits made by S Ltd. during 2020-21 amounted to ₹80,000.

The abstracts of Balance Sheet of P Ltd. (consolidated with Associate S Ltd.) and S Ltd. (stand alone or individual) on 31.03.20 are given below: [Amount in ₹]

Particulars	P Ltd.	S Ltd.	Particulars	P Ltd.	S Ltd.
Equity Share Capital	4,60,000	2,50,000	PPE	1,80,000	1,60,000
Other Equity	3,70,000	3,00,000	Investment in 25% shares in S Ltd. (valued under equity method with share of post-acquisition profits ₹ 16,000)	2,30,000	
10% Debenture	90,000	10,000	Current Assets	5,60,000	4,40,000
Creditors	50,000	40,000			
Total	**9,70,000**	**6,00,000**	**Total**	**9,70,000**	**6,00,000**

i. Pass journal entries in the books of P Ltd. for acquisition of shares on 01.04.2019, on 01.04.2020 and on 31.03.2021 (both in consolidated and separate set of accounting).

ii. Show the Separate and Consolidated balance sheet as at 01.04.2020.

iii. Also measure the balance of NCI and Goodwill that would appear in the consolidated balance sheet and Investment in separate balance sheet of P Ltd. as at 31.03.2021.

Solution:

Note that the fair values of assets and liabilities of S Ltd. as on 01.04.2020 and 31.03.2022 are not relevant.

i. Journal in books of P Ltd.

Explanation 1:

On 01.04.2020: Acquisition of 25% shares having Significant Influence on Associate S Ltd.

Ind AS 28 is applicable. P Ltd. has to prepare Consolidated Balance Sheet measuring investment in associate under **Equity method** and Separate Balance Sheet measuring investment in securities at cost or as per Ind AS 109. Ind AS 27 requires preparation of Separate Financial Statements also.

Workings:

Calculation of Cost of Acquisition:

Particulars	(₹)
Investment in 25% shares in S Ltd. on 31.03.2021	2,30,000
Less: Post-acquisition Profits (01.04.2019 to 31.03.2021)	16,000
Cost of Acquisition at 01.04.2020	2,14,000

Journal both in Consolidated and Separate Set on 01.04.2020

Date	Particulars		Dr. (₹)	Cr. (₹)
01.04.2020	Investment in shares of S Ltd. A/c	Dr.	2,14,000	
	To, Cash A/c			2,14,000

However, on 31.03.2021 in Separate Set no entry is required.

But in Consolidated Set, following Journal Entry is passed:

Date	Particulars		Dr. (₹)	Cr. (₹)
31.03.2021	Investment in shares of S Ltd. A/c	Dr.	16,000	
	To, Profit and Loss A/c			16,000

Note: Thus, in Separate Balance Sheet of P Ltd. on 31.03.2021, Other Equity stood at ₹ 3,70,000 – ₹16,000 = ₹3,54,000.

Explanation 2:

On 01.04.2021: Further acquisition of 45% shares in S Ltd. It is acquisition in steps leading to having control of S Ltd with total holding of (25% + 45%) = 70% shares. At the acquisition date 01.04.2020 it is business combination

under Ind AS 103 to be accounted applying Acquisition method. P Ltd. is the Acquirer and S Ltd. is the Acquiree.

Debentures exchanged are not part of Purchase Consideration and Transaction cost is expensed in Statement of Profit & Loss of the Acquirer.

For accounting in Consolidated Set:

Working Note 1: Computation of Net Identified Assets at Fair Value as at 01.04.2021

Particulars	Fair Value (₹)
PPE	4,00,000
Current Assets	4,20,000
Less: Creditors	36,000
Less: Debenture	10,000
Net Identified Assets at fair value	7,74,000

Working Note 2: Calculation of Consideration (Payable to shareholders of the Acquiree)

Particulars	Fair Value (₹)
Issue of Shares (30,000 × ₹15)	4,50,000
Contingent Consideration (Fair Value)	45,000
Total Consideration	4,95,000

Working Note 3: Calculation of NCI

Share of NCI = 100 – 70 = 30%

NCI at Fair Value = (30/45) × ₹4,95,000 = ₹3,30,000

Working note 4: Calculation of Fair Value of previously held interest	(₹)
Fair Value for 25% interest (based on Fair Value of Consideration (25/45) × ₹4,95,000	2,75,000
Less: Carried Value	2,30,000
Profit on Revaluation through P&L	45,000 [a]

Working Note 5: Calculation of Goodwill	(₹)
Consideration	4,95,000
Fair value of previously held shares	2,75,000
NCI	3,30,000
Total	11,00,000

Less: Net Identified Assets at fair value	7,74,000
Goodwill	3,26,000

(a) Journal in Consolidated Accounting: Dr. Cr.

Date	Particulars		Dr. (₹)	Cr. (₹)
01.04.2020	Investment in shares of S Ltd. A/c	Dr.	45,000	
	To, P&L A/c			45,000
	(Revaluation profit)			
	PPE A/c	Dr.	4,00,000	
	Current Assets A/c	Dr.	4,20,000	
	Goodwill A/c	Dr.	3,26,000	
	To, Consideration A/c			4,95,000
	To, Creditors A/c			36,000
	To, 10% Debentures (issued by P Ltd.) A/c			10,000
	To, NCI A/c			3,30,000
	To, Investment in shares of S Ltd. A/c			2,75,000
	Consideration A/c	Dr.	4,95,000	
	To, Equity Share Capital A/c			3,00,000
	To, Securities Premium A/c			1,50,000
	To, Liability for Contingent Consideration A/c			45,000
	Transaction Cost A/c	Dr.	20,000	
	To, Cash A/c			20,000
	Profit and Loss A/c	Dr.	20,000	
	To, Transaction Cost A/c			20,000

(b) Journal for Separate Set of Accounting: Dr. Cr.

Particulars		Dr. (₹)	Cr. (₹)
Investment in Shares of S Ltd. A/c	Dr.	4,95,000	
Investment in Debentures of S Ltd. A/c	Dr.	10,000	
To, Equity Share Capital A/c			3,00,000
To, Security Premium A/c			1,50,000
To, Liability for Contingent Consideration A/c			45,000
To, 10% Debenture A/c			10,000
Transaction Cost A/	Dr.	20,000	
To, Cash A/c			20,000

Profit and Loss A/c (other equity)	Dr.	20,000 b	
To, Transaction Cost A/c			20,000

On 31.03.2021:

Explanation 3

Here is an increase in parent's ownership interest by purchase of a part of non-controlling interest. It is Equity Transaction (transaction with owner in the capacity of owner). Any profit or loss on the transaction will be transferred to Other Equity of the Parent in Consolidated Accounting.

Journal in Consolidated Set

Particulars		Dr. (₹)	Cr. (₹)
NCI A/c (20/30) × ₹3,30,000	Dr.	2,20,000	
Other Equity (Loss on acquisition) A/c	Dr.	30,000	
To, Cash A/c			2,50,000

Journal in Separate Set

Particulars		Dr. (₹)	Cr. (₹)
Investment in shares of S Ltd.A/c	Dr.	2,50,000	
To, Cash A/c			2,50,000

(II) Abstract of Separate balance sheet of P Ltd. and Consolidated Balance Sheet of the group as at 01.04.2021 (after business combination) (Amount in ₹)

Particulars	Working for Separate (₹)	Working for Consolidation (₹)	Separate (₹)	Consolidated (₹)
PPE	1,80,000	1,80,000 + 4,00,000	1,80,000	5,80,000
Investment	2,14,000 + 5,05,000		7,19,000	
Goodwill		Note 5		3,26,000
Current Assets	5,60,000 -20,000	5,60,000 + 4,20,000 - 20,000	5,40,000	9,60,000
Total			14,39,000	18,66,000
Equity Share Capital	4,60,000 + 3,00,000	4,60,000 + 3,00,000	7,60,000	7,60,000
Other Equity	3,54,000 $ + 1,50,000 – 20,000	3,70,000 + 1,50,000 (security premium) + 45,000a (investment revaluation) – 20,000b (transaction cost)	4,84,000	5,45,000
NCI		Note 2		3,30,000
12% Debenture		90,000 + 10,000	1,00,000	1,00,000

Particulars	Working for Separate (₹)	Working for Consolidation (₹)	Separate (₹)	Consolidated (₹)
Liability for contingent consideration			45,000	45,000
Trade Payables	50,000	50,000 + 36,000	50,000	86,000
Total			14,39,000	18,66,000

$ other equity in Separate Balance Sheet of P Ltd. excluding the 25% share of profits from S Ltd. on 31.03.2020 = ₹3,70,000 - ₹16,000 = ₹3,54,000.

(III) In Consolidated Set:

After purchase of another 20% share in S Ltd., NCI is reduced to 10% only.

NCI as at 31.03.2022 = (10/30) × balance at 31.03.2020 + 10% of profits of 2021-22 = ₹1,10,000 + (10/100) × ₹80,000 = ₹1,18,000;

Goodwill = ₹3,26,000 (continued at acquisition date value, unaffected by subsequent transaction)

In Separate Set:

Investment in shares of S Ltd. ₹ (7,19,000 + 2,50,000) = ₹ 9,69,000

Business Combination under Common Control (Appendix C of Ind AS 103)

5.9

If in a business combination all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory, it is a **business combination under common control**. Appendix C of Ind AS 103 deals with accounting for combination of entities or businesses under common control.

Common control business combinations will include transactions, such as transfer of subsidiaries or businesses, between entities within a group. The extent of non-controlling interests in each of the combining entities before and after the business combination is not relevant to determining whether the combination involves entities under common control. This is because a partially-owned subsidiary is nevertheless under the control of the parent entity.

Business combinations involving entities or businesses under common control shall be accounted for using the **pooling of interest method**. The pooling of interest method is considered to involve the following:

(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(ii) No adjustments are made to reflect fair values, or recognize any new assets or liabilities.

(iii) The equity share capital will be recorded at nominal value only. Consideration in excess of equity share capital will be recorded as goodwill (Capital reserve in case of deficiency).

(iv) The other equity of the transferor shall be carried by the transferee in the same form in which they appeared in the financial statements of the transferor.

Disclosure

5.10

An acquirer should disclose information that enables users to evaluate the nature and financial effect of business combinations that were affected. This information includes:

(a) the name and a description of the acquiree.

(b) the acquisition date.

(c) the percentage of voting equity interests acquired.

(d) the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.

(e) a qualitative description of the factors that make up the goodwill recognised.

(f) the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:

  (i) cash;

  (ii) other tangible or intangible assets, including a business or subsidiary of the acquirer;

  (iii) liabilities incurred; and

  (iv) equity interests of the acquirer

(g) information for contingent consideration arrangements

(h) information for each contingent liability recognised

(i) The amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable. If impracticable, fact must be disclosed.

Advanced Level II–Problems

Illustration 15: (Reverse Acquisition)

Suppose, Entity A acquires 80% shares of Entity B and satisfies the consideration by issue of three shares of Entity A for every share of Entity B. Market price of ₹10 share of Entity A is ₹25.

The summarized Balance Sheets:

Particulars	A (₹)	B (₹)
Net Assets	30,000	20,000
Equity	30,000	20,000

Particulars	A (₹)	B (₹)
No. of Equity Shares	1000	750

Is it a reverse acquisition?

Solution:

80% of 750 = 600 shares of Entity B are acquired and Entity A issues 600 × 3 = 1800 shares to Entity B. Now, shareholders of Entity A hold 1000 shares and shares holders of Entity B hold 1800 shares effectively, the group is controlled by Entity B. This is a case of reverse acquisition. In such case accounting will be done in books of Entity A, the legal acquirer, but it would be assumed that Entity B is the accounting acquirer and accordingly assets and liabilities of Entity A would be identified and effective consideration would be calculated.

In case of amalgamation also 'reverse acquisition' may take place when it is indicated that after Entity A and Entity B amalgamated into Entity C, shareholders of Entity B would control Entity C. Although Entity C is the legal acquirer, in the books recording will be done assuming that Entity B is the acquirer. Thus de facto acquirer is considered the accounting acquirer and de juri acquirer is the legal acquirer.

Now, I shall take up illustrations.

In illustration 1, it is application of pooling of interest method for a transaction of demerger indentified as business combination under common control as per Ind AS 103, Appendix C.

Illustration 16 (Reverse Acquisition)

Reverse Acquisition takes place as H Ltd. acquires 100% equity shares of S Ltd on 31.03.2021. From the following data pass journal entries and prepare consolidated and separate Balance Sheet in the books of H Ltd.

[₹ in Lakhs]

Particulars	H Ltd. (₹)	S Ltd. (₹)
Non-current Assets	2,000	3,000
Current Assets	1,000	1,000
Total	3,000	4,000
Equity Share Capital H: 100 shares; S: 80 shares	1,000	800
Other Equity	500	1,600
Non-current Liabilities	700	1,200
Current Liabilities	800	400
Total	3,000	4,000

H Ltd. and S Ltd. shares are quoted at ₹ 20 and ₹ 50 respectively on 31.03.2021. H Ltd. issues shares in exchange ratio based on quoted price. Fair Value of NC asset of H ₹2,400, S ₹3,200.

Solution:

I. It is a business combination. H Ltd. issues 2.5 shares for every one share of S Ltd. (50/20). Thus 200 shares (80 × 2.5) of H Ltd. are issued to owners of S Ltd., who become 2/3 rd owner of the group interest (200 out of total 300 shares, 100 shares belonging to the owners of H Ltd.). For accounting purpose, the subsidiary company S Ltd., (holding 2/3 rd of the group interest) the legal acquiree is considered as the accounting acquirer. It is a reverse acquisition. As 100% shares of S Ltd. are acquired there is no non-controlling interest.

II. Consideration transferred:

Of the group 100 shares are held by owners of H Ltd. and 200 shares are held by owners of S Ltd. Effective consideration from the view point of accounting acquirer S Ltd. is the fair value of 100 shares held by H = 20×₹100 = ₹2,000 , which is equivalent to 40 shares of S Ltd. at ₹ 50. In the consolidated set maintained by H Ltd., recording will be made as if S Ltd. is acquiring H Ltd. Thus, net assets of H Ltd. will be recognised at fair value and net assets and equity of S Ltd. will be recognised at carrying amount.

III. Goodwill:	(₹) in Lakhs
Net Assets of H identified ₹(2,400 + 1,000 - 700 - 800)	1,900
Consideration transferred	2,000
Goodwill ₹(2,000 – 1,500)	100

IV. Journal assuming S Ltd. as the Accounting acquirer : **Dr.** **Cr.**

Particulars		(₹ in Lakhs)	(₹ in Lakhs)
Non-Current Assets A/c	Dr.	2,400	
Current Assets A/c	Dr.	1,000	
Goodwill A/c	Dr.	100	
To, Non-current Liabilities A/c			700
To, Current Liabilities A/c			800
To, Consideration A/c			2,000
Consideration A/c	Dr.	2,000	
To, Equity Share Capital A/c			2,000

V. Consolidated Balance Sheet on 31-03-2021 (in books of H Ltd.) (₹ in Lakhs)

Particulars	Separate (₹)	Consolidated (Bk Value of S + FV of H Ltd.) (₹)
Non-current Assets	2,000	5,400
Goodwill		100
Financial asset – Investment	2,000	
Current Assets	1,000	2,000
Total	5,000	7,500

Particulars	Separate (₹)	Consolidated (Bk Value of S + FV of H Ltd.) (₹)
Equity Share Capital – 300 shares of H Ltd. (Carrying amount of S Ltd. + Issue by H Ltd. = 800 + 2000)	3,000	2,800
Other Equity	500	1,600
Non-Current Liabilities	700	1,900
Current Liabilities	800	1,200
Total	5,000	7,500

* Equity structure i.e. Number of shares reflects the legal parent H Ltd, although amount of equity is the carrying value of S plus purchase consideration by issue of shares.

[**Note:** There is mismatch between the number of shares and the Balance Sheet amount if nominal value is considered. This is maintained in the standard without any explanation.]

Illustration 17 (Amalgamation: Reverse acquisition)

DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31.03.2021 who issued requisite number of equity shares of ₹10 to take over the businesses of DA Ltd. and TA Ltd.. The abstract of balance sheets of the companies on 31.03.2021: (₹ in Lakhs)

Particulars	DA Ltd.	TA Ltd.
PPE	7,500	8,000
Financial Assets	800	500
Current Assets	4,700	6,500
Equity Share Capital	6,000	10,000
Other Equity	3,000	1,000
Borrowings	2,000	3,000
Current Liabilities	2,000	1,000

Fair value of the following items is given: (₹ in Lakhs)

Particulars	DA Ltd.	TA Ltd.
PPE	8,000	6,000
Current Assets	5,000	7,000
Fair Value of Business	7,500	15,000

However the control of DATA Ltd. is taken by the management of TA Ltd.

Show the merged balance sheet.

Solution:

TA Ltd. having the control over DATA Ltd., it is considered a reverse acquisition and in the merged balance sheet, assets and liabilities of TA Ltd. would be shown at carrying amount. (₹ in Lakhs)

	DA Ltd.	TA Ltd.
Fair Value of Business	7,500	15,000
Share of each company in the merged company	1/3	2/3

Fair value per share of TA Ltd. = ₹15,000/1000 = ₹15

Consideration payable by TA Ltd. to DA Ltd. is ₹ 7,500/15 = 500 lakh shares

Or, No. of shares held by TA Ltd. for 2/3 share in DATA Ltd. = 1000 lakh shares; no. of shares to be issued to DA for 1/3 share = 500.

Thus total consideration = 500 lakh shares of ₹ 10 each at ₹ 5 premium = ₹7,500. (₹ in Lakhs)

Particulars	Note	(₹)
Assets		
Non Current Assets		
PPE (8000 + 8000)		16,000
Financial Assets		1,300
Current Assets (5000 + 6500)		11,500
Total		28,800
Equity and Liabilities		
Equity		
Equity Share Capital 1500 (1000 + 500) lakh shares of ₹ 10		15,000
Other Equity	Note 1	5,800
Borrowings		5,000
Current Liabilities		3,000
Total		28,800

Note 1:

Particulars	₹
PPE	8,000
Financial Assets	800
Current Assets	5,000
	13,800

Particulars	₹
Borrowings	2,000
Current Liabilities	2,000
	4,000
Net Assets	9,800
Consideration	7,500
Gain on Bargain Purchase	2,300

Other Equity = Other Equity of TA + Gain on Bargain Purchase + security premium

= ₹(1,000+2,300+2,500) = ₹5,800

Illustration 18 (Demerger : Business Combination under Common Control)

Z Ltd has two divisions X and Y. On 31.03.2021 the division-wise extract of the balance sheet was:

(₹ in Crores)

	X	Y	Total
PPF	350	600	950
Prov. for Depr.	(300)	(400)	(700)
Current assets	300	400	700
	350	600	950
Equity share capital (₹ 10 per share)	50	—	50
Other Equity	250	(150)	100
Borrowing		360	360
Current Liabilities	50	390	440
	350	600	950

Q Ltd, a new company is formed to take over division Y by issue of 1 crore equity shares of ₹ 10 at a premium of ₹ 15 per share to (i) the shareholders of Z ltd (ii) to Z Ltd.

Pass journal entries and prepare balance sheet after reconstruction in the books of both Z Ltd and Q Ltd (a) based on (i) above and (b)) based on (ii) above.

Solution:

As the control of division Y was with the shareholders of Z Ltd before the demerger and after division Y is taken over by Q Ltd the control of Q Ltd is still lying with the same shareholders of Z Ltd, this is a transaction identified as business combination under common control, where the transferee is Q Ltd. and the transferor is Z Ltd. Pooling of interest is the method of accounting to be applied.

Z Ltd. shall close all its accounts for division Y and Q Ltd will record all the assets and liabilities at carrying amount (as in the books of the transferor). The equity share capital will be recorded at nominal value only. Consideration in

excess of equity share capital will be recorded as goodwill (Capital reserve in case of deficiency). The other equity shall be cancelled in the books of transferor and shall be carried by the transferee in the same form is which they appeared in the financial statements of the transferor.

In the given problem the consideration is settled by issue of equity shares at a premium. Under pooling of interest method of accounting, only nominal value will be considered (the accounting of both the transferor and transfers will remain unaffected for ignoring the share premium altogether).

(a) When shares are issued to shareholders of Z Ltd

Journal in the books of Z Ltd.

Particulars		Dr. (₹ in Crore)	Cr. (₹ in Crore)
Borrowing A/c	Dr.	360	
Current Liabilities A/c	Dr.	390	
Prevision for Depn. A/c	Dr.	400	
To, PPE A/c			600
To, Current Assets A/c			400
To, Other Equity A/c			150

(Assets liabilities and other equity are closed, and consideration 10 is not accounted being received by the shareholders directly)

Balance sheet of Z Ltd. after reconstructions (₹ in Crore)

	Note	Amount
Assets		
Non-current assets		
PPE		50
Current assets		300
Total		350
Equity and Liabilities		
Equity		
Equity share capital		50
Other Equity		250
Liabilities		
Current Liabilities		50
Total		350

Journal in books of Q Ltd

Particulars		Dr. (₹ in Crore)	Cr. (₹ in Crore)
PPE A/c	Dr.	200	
Current Assets A/c	Dr.	400	
Other Equity + A/c	Dr.	150	
Goodwill 1 A/c	Dr.	10	
To, Borrowing A/c			360
To, Current liabilities A/c			390
To, Consideration A/c			10
(+Other equity recognized)			
Consideration A/c	Dr.	10	
To, Equity Share Capital A/c			10

Balance Sheet of Q Ltd.

	Note	Amount (₹ in Crore)
Assets		
Non-current assets		
PPE		200
Goodwill1		10
Current Assets		400
Total		610
Equity and Liabilities		
Equity		
Equity share capital		10
Other Equity (*preserved in the same form of the transferor)		(150)
Liabilities		
Borrowings		360
Current Liabilities		390
Total		610

[1] Goodwill is the excess of the amount recorded as share capital issued over the share capital of the transferor. Here Y Division share capital is Zero. Hence, Goodwill = ₹(10 – 0) crore = ₹10 crore.

(b) For shares issued to Z Ltd

When shares issued by Q Ltd. are received by Z Ltd. in Z Ltd's accounts investment is recognized.

Journal of Z Ltd

Particulars		Dr. (₹ in Crore)	Cr. (₹ in Crore)
Borrowing A/c	Dr.	360	
Current Liabilities A/c	Dr.	390	
Prevision for Depn. A/c	Dr.	400	
Investment A/c	Dr.	10	600
To, PPE A/c			400
To, Current Assets A/c			150
To, Other Equity A/c			10*
To, Reconstruction A/c (Profit transferred to Other Equity)			

Z Ltd. Balance Sheet After Reconstructions

	Note	Amount (₹ in Crore)
Assets		
Non-current assets		
PPE		50
Financial asset-Investment		10
Current Assets		300
Total		360
Equity and Liabilities		
Equity		
Equity share capital		50
Other Equity (250 + 10*)		260
Liabilities		
Current Liabilities		50
Total		360

The recording in the books of Q Ltd will remain same as is (a).

Illustration 19: (Amalgamation: Business combination under common control)

DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31.03.2021 who issued requisite

number of equity shares of ₹ 10 to take over the businesses of DA and TA. The abstract of balance sheets of the companies on 31.03.2021: (₹ in Lakhs)

Particulars	DA Ltd.	TA Ltd.	DATA Ltd.
PPE	7,500	8,000	15,500
Financial Assets	800	500	1,300
Current Assets	4,700	6,500	11,200
Equity Share Capital	6,000	8,000	14,000
Other Equity	3,000	3,000	6,000
Borrowings	2,000	3,000	5,000
Current Liabilities	2,000	1,000	3,000

Pass journal entries in the books of DA, TA and DATA Ltd. and show balance sheet abstract after merger.

Solution:

The combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination. It is a business combination under common control, and pooling of interest method of accounting is be followed.

WN 1. Carrying amount after merger: (₹ ₹ in Lakhs)

Particulars	DA Ltd.	TA Ltd.	DATA Ltd.
PPE	7,500	8,000	15,500
Financial Assets	800	500	1,300
Current Assets	4,700	6,500	11,200
Equity Share Capital	6,000	8,000	14,000
Other Equity	3,000	3,000	6,000
Borrowings	2,000	3,000	5,000
Current Liabilities	2,000	1,000	3,000

WN 2. Purchase consideration: (₹ in Lakhs)

Particulars	DA Ltd.	TA Ltd.	DATA Ltd.
Equity Share Capital	6,000	8,000	14,000
Other Equity	3,000	3,000	6,000
Equity	9,000	11,000	20,000
Share	9/20	11/20	20/20

Particulars	DA Ltd.	TA Ltd.	DATA Ltd.
Purchase consideration	(9/20)×14,000 = 6,300	(11/20)×14,000 = 7,700	14,000

Journal in the books of transferor company DA Ltd. Dr. Cr.

Particulars		(₹)	(₹)
Current Liabilities A/c	Dr.	2,000	
Borrowings A/c	Dr.	2,000	
Realisation A/c	Dr.	9,000	
To, PEE A/c			7,500
To, Current Assets A/c			4,700
To, Financial Assets A/c			800
(Transferred to Realisation A/c)			
Shares in DATA Ltd. A/c	Dr.	6,300	
To, Realisation A/c			6,300
(Consideration)			
Equity Shareholders A/c	Dr.	2,700	
To, Realisation A/c			2,700
(Loss on Realisation)			
Equity Share Capital A/c	Dr.	6,000	
Other Equity A/c	Dr.	3,000	
To, Equity Shareholders A/c			9,000
Equity Shareholders A/c	Dr.	6,300	
To, Shares in DATA Ltd.A/c			6,300

Journal in the books of transferor company TA Ltd. Dr. Cr.

Particulars		(₹)	(₹)
Current Liabilities A/c	Dr.	1,000	
Borrowings A/c	Dr.	3,000	
Realisation A/c	Dr.	11,000	
To, PPE A/c			8,000
To, Current Assets A/c			6,500
To, Financial Assets A/c			500
(Transferred to Realisation A/c)			
Shares in DATA Ltd. A/c	Dr.	7,700	
To, Realisation A/c			7,700
(Consideration)			

Particulars		(₹)	(₹)
Equity Shareholders A/c	Dr.	3,300	
To, Realisation A/c			3,300
(Loss on Realisation)			
Equity Share Capital A/c	Dr.	8,000	
Other Equity A/c	Dr.	3,000	11,000
To, Equity Shareholders A/c			
Equity Shareholders A/c	Dr.	7,700	
To, Shares in DATA Ltd.A/c			7,700

In the books of Transferee company DATA Ltd.

Journal **Dr.** **Cr.**

Particulars		(₹)	(₹)
PPE A/c	Dr.	15,500	
Current Assets A/c	Dr.	11,200	
Financial Assets A/c	Dr.	1,300	
To, Consideration A/c			14,000
To, Borrowings A/c			5,000
To, Current Liabilities A/c			3,000
To, Other Equity*			6,000
Consideration A/c	Dr.	14,000	
To, Equity Share Capital A/c			14,000

Balance sheet abstract of DATA Ltd. as at 31.03.2021

Particulars	₹ ₹ in lakh
PPE	15,500
Financial Assets	1,300
Current Assets	11,200
Total	28,000
Equity Share Capital	14,000
Other Equity	6,000
Borrowings	5,000
Current Liabilities	3,000
Total	28,000

Chain Holding

Chain-holding refers to the transaction of business combination where a parent is acquiring control of its subsidiary (intermediate parent) which in turn is acquiring control of another company (sub-subsidiary). In separate set of accounts of the Acquirer (parent), there will be no additional treatment for chain holding. But in the consolidated set of accounts of the Acquirer net assets of the subsidiary (which is intermediate parent also) and the net assets of the sub-subsidiary are recognised at fair value. Also, the non-controlling interest of the subsidiary and the sub-subsidiary are recognised. An illustrative example is given below.

Illustration 20

Pass journal entries for business combination in the books of P Ltd. from the following particulars:

Summarised Balance Sheet as at 31-03-2021 **(₹ in Lakhs)**

	P	Q	R
PPE	400	500	320
Current Assets:			
Inventory	250	80	60
Trade Receivables	280	120	200
Bills Receivables		70	50
Cash and Bank	180	50	60
Total Assets	1110	820	690
Equity and Liabilities			
E. Share Cap (₹ 10)	450	500	300
Other Equity	260	160	120
Current Liabilities			
Trade Payables	300	300	200
Bills Payables	100	90	70
Total	1110	1050	690

P Ltd. acquired 80% shares of Q Ltd. at a consideration of 480 and Q Ltd. acquired 75% shares of R Ltd. at a consideration of 300 on 01-04-2021. NCI is measured at fair value.

Fair value as at acquisition: (₹ in lakhs)

	P	Q	R
PPE	700	600	400
Current Assets:			
Inventory	240	80	60

	P	Q	R
Trade Receivables	250	120	180
Bills Receivables		70	50
Current Liabilities			
Trade Payables	300	300	170
Bills Payables	100	90	70

Solution:

Workings:

I. Share of parent and NCI

Share of P in Q = 80% NCI in Q = 20%

Share of Q in R = 75%

Share of Group in R = 80%*75% = 60%

NCI in R = 40%

II. Net Assets on acquisition at fair value (₹ in lakhs)

	Q	R	Total
PPE	600	400	1000
Inventory	80	60	140
Trade Receivables	120	180	300
Cash and Bank	50	60	110
Bills Receivables	70	50	120
Total Assets	920	750	1670
Trade Payables	300	170	470
Bills Payables	90	70	160
Total Liabilities	390	240	630
Net Assets at fair value	530	510	1040

III. NCI at FV.

NCI of R	= [Consideration × (NCI share/Intermediate Parent Share)]	= 300 × 40% / 75%	= 160
NCI Q	= [Consideration × (NCI share/Parent Share)]	= 480 × 20% / 80%	= 120
Less: Included in NCI of R (20% of 300)		60	60
Total NCI			220

IV. Goodwill/ Bargain Purchase

	(₹)
a. Net Assets	1040
b. Consideration	480
c. NCI	220
Gain on Bargain Purchase [a – (b + c)]	340

Journal in consolidated set of P Ltd.

		Dr. (₹)	Cr. (₹)
PPE	Dr.	1,000	480
Inventory	Dr.	140	470
Trade Receivables	Dr.	300	160
Bills Receivables	Dr.	120	220
Cash and Bank	Dr.	110	340
To, Consideration			
To, Trade Payables			
To, Bills Payables			
To, NCI			
To, Capital Reserve (Gain on Bargain Purchase)			

In separate set:

		Dr.	Cr.
Investment in shares of Q Ltd	Dr.	480	
To, Consideration			480

Cross-Holding:

Cross--Holding appears only when subsidiary company have some shares in holding company.

However, according to the Companies Act, 2013 a subsidiary company cannot own shares in a parent company. Further, holding companies are also barred by the Companies Act, 2013 from allotting or transferring its shares to a subsidiary company.

The provisions relating to holding of shares by a subsidiary in parent company is mentioned in Section 19 of the Companies Act, 2013, as reproduced below:

No company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

Difference between Ind AS 103 and AS 14

5.11

Scope : Ind AS 103 has a wider scope than AS 14 [See para 6].

Method of accounting : Ind AS 103 prescribe acquisition method for every business combination unless it is a business combination under common control, whereas AS 14 states two methods of accounting: Pooling of interest method and Purchase method.

Recognition and measurement: Ind AS 103 recognises acquired identifiable assets liabilities and non-controlling interest at fair value. AS 14 allows choice of Book value, agreed value or FV.

Goodwill: Under Ind AS 103, Goodwill is not amortised but tested for annual impairment where as AS 14 require goodwill to be amortised over a period not exceeding 5 years.

Non Controlling Interest: Ind AS 103 provide for accounting of Non-Controlling Interest, AS 14 does not.

Recording for consolidated financial statements: It is provided in Ind AS 103, not in AS 14.

Common control transactions : Appendix C deals with accounting for common control transactions, which prescribes Pooling of interest method of accounting. AS 14 does not prescribe any common control transactions.

Contingent Consideration: Ind AS 103 recognises contingent consideration, AS 14 does not.

Reverse acquisitions: Ind AS 103 deals with reverse acquisitions, AS 14 does not.

Terms defined as per *appendix A of Ind AS 103*

Acquiree: The business or businesses that the **acquirer** obtains control of in a **business combination**.

Acquirer: The entity that obtains control of the **acquiree.**

Acquisition date: The date on which the **acquirer** obtains control of the **acquiree.**

Business combination: A transaction or other event in which an **acquirer** obtains control of one or more **businesses**. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also **business combinations** as that term is used in this Ind AS.

Contingent consideration

Usually, an obligation of the **acquirer** to transfer additional assets or **equity interests** to the former owners of an **acquiree** as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, *contingent consideration* also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

Equity interests: For the purposes of this Ind AS, *equity interests* is used broadly to mean ownership interests of investor-owned entities and owner, member or participant interests of **mutual entities**.

Fair value: *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See Ind AS 113.)

Goodwill: An asset representing the future economic benefits arising from other assets acquired in a **business combination** that are not individually identified and separately recognised.

Intangible asset: An **identifiable** non-monetary asset without physical substance.

Non-controlling interest: The equity in a subsidiary not attributable, directly or indirectly, to a parent.

Internal Reconstruction (Capital Reduction)

5.12

The Act does not prescribe the manner in which the reduction of capital is to be effected nor is there any limitation on the power of the Tribunal to confirm the reduction, except that it must be satisfied that every creditor of the company has either consented to the said reduction or they have been paid off or their interest has been secured.

Reduction of share capital may be effected in one of the following ways:

1. In respect of share capital not paid-up, extinguishing or reducing the liability on any of its shares. (For example, if the shares are of face value of INR 100 each of which INR 75 has been paid, the company may reduce them to INR 75 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of INR 25 per share); or
2. Cancel any paid-up share capital, which is lost, or is not represented by available assets. This may be done either with or without extinguishing or reducing liability on any of its shares (For example, if the shares of face value of INR 100 each fully paid-up is represented by INR 75 worth of assets. In such a case, reduction of share capital may be effected by cancelling INR 25 per share and writing off similar amount of assets); or
3. Pay off the paid-up share capital, which is in excess of the needs of the company. This may be achieved either with or without extinguishing or reducing liability on any of its shares. (For example, shares of face value of INR 100 each fully paid-up can be reduced to face value of INR 75 each by paying back INR 25 per share.)

   Paid-up share capital for the purpose of capital reduction would include securities premium and capital redemption reserve.

Steps:

(1) First of all, the total amounts to be written off should be ascertained. This would mean totalling up the debit balance of the Profit and Loss account, all fictitious assets like goodwill, preliminary expenses, discount on shares or debentures, any fall in value of assets, any increase in liabilities and arrears of dividends on cumulative preference shares. If the value of any share can be legitimately increased the amount of loss would then be reduced accordingly. The other way to get at the same figure would be to add up the present value as a going concern, of all the assets and deduct there from the amount of liabilities and also the arrears of dividend on cumulative preference shares. What is left is “net assets”. The share capital compared with net assets will show how much amount is to be written off.

(2) The question now arises as to who is to bear the loss. If the net assets are more than the preference share capital, it is obvious the whole of the loss will have to be borne by the equity shareholders. The nominal value of the equity shares should be reduced by a sufficient margin to cover the loss. If the net assets are not sufficient to cover the preference share capital (or if the net assets are just sufficient), the preference share holder will have to accept a sacrifice, although their sacrifice will be smaller than that of the equity shareholders. (Equity shareholders should not be completely wiped off). If the future earning power of the

company permits, the dividend rate should be increased so that, in terms of rupees, the dividend remains unchanged. Thus if 10.5% preference share of ₹100 are converted into preference share of ₹75 each, rate of dividend should be raised to 14%, if possible. In both cases, then the dividend will be ₹ 10.5 per share.

(3) Payment of arrears of dividend (question arises only in case of cumulative preference shares) in cash immediately may present difficulties. In such a case a good method is to issue deposit certificates. This is preferable to issuing shares because (a) it will not upset the voting power and (b) the certificate can be redeemed as soon as opportunity arises. The rate of interest need not be heavy, but of course, it will depend on the future earning capacity of the company.

(4) Debenture holders and other creditors are affected by the reconstruction scheme only if the total assets in the company are insufficient to cover even the liabilities (although they are concerned is necessary to any scheme that may be formulated). In such an eventuality, the creditors (including debenture holders) will have to accept sacrifice unless they think that by sending the company into liquidation we will be able to realize substantial portion of their claims. The shareholders, both preference and equity will have to accept a heavy reduction in the value of share but they cannot be expected to agree to complete wiping of the shares, in which case they will have no interest in keeping the company going. In short, the whole scheme should broadly depend upon the expected earning power and upon the position as it likely to obtain if the company is sent to liquidation.

Illustration 21 (Internal Reconstruction)

The following is the Balance Sheet as at 31st March, 2017 of Hopefull Ltd.

Liabilities	(₹)	Assets	(₹)
Share Capital:		Fixed Assets (including goodwill of ₹1,00,000)	11,80,000
8,500 Equity Shares of ₹100 each fully paid up	8,50,000	Investments	40,000
		Stock in Trade	2,75,000
4,000 Cumulative Preference Shares of ₹ 100 each fully paid up	4,00,000	Trade Debtors	1,50,000
		Bank Balances	65,000
Securities Premium	20,000		
General Reserve	60,000		
Trade Creditors	3,80,000		
	17,10,000		**17,10,000**

Contingent liability: Preference Dividends in arrears ₹ 60,000.

The Board of Directors of the company decided upon the following scheme of reconstructions, which was duly approved by all concerned and put into effect from 1st April, 2017.

(i) The Preference Shares are to be converted into 12% unsecured debentures of ₹ 100 each with regard to 70% of the dues (inducing arrears of dividends) and for the balance Equity Shares of ₹ 50 paid up would be issued. The authorized Capital of the company permitted the issue of additional shares.

(ii) Equity Shares would be reduced to share of ₹ 50 each paid up.

(iii) Since goodwill has no value, the same is to be written of the fully.

(iv) The market value of investments are to be reflected at ₹60,000.

(v) Obsolete items in Stock of ₹ 75,000 are to be written off. Bad Debts to the. extent of 5% of the tot debtors would be provided for. Fixed assets to be written down by ₹ 1,80,000.

The company carried on trading, for six months upto 30th September 2017, and made a net profit of ₹1,00,000 after writing off depreciation at 25% p.a. on the revised value of fixed assets. The half yearly working resulted in an increase of Sundry Debtors by ₹80,000, stock by ₹70,000 and Cash by ₹ 50,000.

You are required to show the Journal

Solution:

Books of Hopeful Ltd.

Journal

Particulars		Dr. (₹)	Cr. (₹)
Cumulative Preference Share Capital A/c	Dr.	4.00.000	
Capital Reduction A/c	Dr.	60,000	
To, Cumulative Preference Shareholders A/c			4,60,000
(Being Cumulative preference shares and Preference Shareholders A/c)			
Cumulative Preference Shareholders A/c	Dr.	4,60,000	
To, 12% Unsecured Debentures A/c			3,22,000
To, Equity Share Capital A/c			1,18,000
(Being the issue of 12% Unsecured Debentures and 2,760 Equity Shares of ₹ 100 each issued as ₹ 50 paid up)			
Equity Share Capital A/c	Dr.	4,25,000	
To, Capital Reduction A/c			4,25,000
(Being the entry for reducing every share of ₹ 100 each as ₹ 50 fully paid up, 8,500 Equity shares)			
Investments A/c	Dr.	20,000	
Capital Reduction A/c (Balancing figure)	Dr.	3,42,500	
To, Goodwill A/c			1,00,000
To, Stock A/c			75,000
To, Fixed Assets A/c			1,80,000
To, Provision for Doubtful Debts A/c			7,500
(Being the change in value of assets)			
Capital Reduction A/c	Dr.	22,500	
To, Capital Reserve A/c			22,500
(Being transfer of Capital Reduction A/c balance to Capital Reserve)			

Balance Sheet of Hopeful Ltd.

as at 30.09.2021

Particulars	Note No.	₹ (in Lakh)
I. Assets		

Particulars	Note No.	₹ (in Lakh)
Non Current Assets		
PPE	3	7,87,500
Other Non Current Assets		60,000
2. Current Assets		6,07,500
Total		14,55,000
II. Equity and Liabilities		
1. Equity		
(a) Equity Share Capital	1	5,63,000
(b) Other Equity	2	2,02,500
2. Non Current Liabilities		
12% Unsecured Debenture		3,22,000
Current Liabilities		3,67,500
Total		14,55,000

		(₹)	(₹)
Note - 1:	Equity Share Capital As on 30th September 2021		
	Authorized, issued subscribed and paid up capital 11,260 equity shares of ₹50 each		5,63,000
Note - 2:	Other Equity As on 30th September 20121		
	Securities Premium		20,000
	Capital Reserve		22,500
	General Reserve		60,000
	Profit and Loss A/c		1,00,000
	Total		2,02,500
Note - 3:	PPE As on 30th September 2021		
	PPE	9,00,000	
	Less: Depreciation	1,12,500	7,87,500
Note - 4:	Current Assets As on 30th September 2021		
	Stock in trade	(2,75,000-75,000 + 70,000)	2,70,000
	Trade Receivables	2,300,00	
	Less: Provision for doubtful debt	7,500	2,22,500
	Cash and Bank Balance		1,15,000
Total			**6,07,500**

Solved Case Study(s)

Case 1

On 01.04.2021 the summarised balance sheets of Satellite Ltd. and Planet Ltd. are provided as: (₹'000)

	Satellite Ltd.		Planet Ltd.
	B/S (₹)	Fair Value (₹)	B/S (₹)
Equity Share Capital (₹ 10)	8,000		12000
Other Equity	6,000		4000
Borrowings	2,000	2,050	3000
Trade Payables	2,500	2,400	2000
Property, Plant and Equipment	9,000	10000	12000
Investment Property	5,000	7000	1000
Investments	1,000		3500
Current Assets	3,500	3200	4500
Contingent Liabilities	800	750	

Market price of equity shares of Planet Ltd. and Satellite Ltd. are ₹ 16 and ₹ 15 respectively on the day. On the basis of the above data, you are required to make the necessary accounting for the following cases.

Planet Ltd. takes over Satellite Ltd. and purchase consideration is settled by issue of

1050000 equity shares. Pass journal entries in the books of both the companies and re-draft the balance sheet of Planet Ltd. after the business combination.

Solution:

WN 1. Net Assets of Satellite Ltd. at fair value: (₹'000)

	(₹)	(₹)
Property, Plant and Equipment	10,000	
Investment Property	7,000	
Investments	1,000	
Current Assets	3,200	
Total Assets		21,200
Borrowings	2,050	
Trade Payables	2,400	
Liabilities (Recognised)	750	
Total Liabilities		5,200
Net assets		16,000

In the books of Planet Ltd.

Journal (₹'000)

Date	Particulars		Dr.	Cr.
01.04.2021	Property, Plant and Equipment	Dr.	10,000	
	Investment Property	Dr.	4,000	
	Investments	Dr.	4,000	
	Current Assets	Dr.	3,200	
	Goodwill	Dr.	800	
	To, Borrowings			2,050
	To, Trade Payables			2,400
	To, Liabilities (Contingent liabilities recognised)			750
	To, Equity Share Capital (₹10)			10,500
	To, Security Premium (₹ 6)			6,300

Summarised Balance sheet as at 01.04.2021 (after take over) (₹'000)

	Workings (₹)	(₹)
Property, Plant and Equipment	12,000 + 10,000	22,000
Goodwill		800
Investment Property	4,000 + 4,000	8,000
Investments	3,500 + 1,000	4,500
Current Assets	4,500 + 3,200	7,700
Total Assets		43,000
Equity Share Capital	12,000 + 10,500	22,500
Other Equity	4,000 + 6,300	10,300
Borrowings	3,000 + 2,050	5,050
Trade Payables	2,000 + 2,400	4,400
Liabilities (contingent recognised)		750
Total of equity and liabilities		43,000

In the books of Satellite Ltd.

Journal Dr. Cr. (₹'000)

Date	Particulars		(₹)	(₹)
	Realisation A/c	Dr.	18,500	
	To, Property, Plant and Equipment A/c			9,000
	To, Investment Property A/c			5,000
	To, Investments A/c			1,000
	To, Current Assets A/c			3,500

Date	Particulars		(₹)	(₹)
	Equity Shares in Planet Ltd.	Dr.	16,800	
	Borrowings	Dr.	2,000	
	Trade Payables	Dr.	2,500	
	To, Realisation A/c			21,300
	Realisation A/c	Dr.	2,800	
	To, Equity Shareholders A/c			2,800
	Equity Share Capital A/c	Dr.	8,000	
	Other Equity	Dr.	6,000	
	To, Equity Shareholders A/c			14,000
	Equity Shareholders A/c	Dr.	16,800	
	To, Equity Shares in Planet Ltd.			16,800

Case 2

Planet Ltd. and Satellite Ltd. are amalgamated into Solar Ltd. control of which retained with the same parties as before. Solar Ltd. issues 1050000 shares and 1250000 shares to take over the businesses of Satellite Ltd. and Planet Ltd. respectively. Pass journal entries and draft balance sheet in the books of the Solar Ltd.

Solution:

It is a business combination under common control and pooling of interest method of accounting is followed in the books of the transferee.

In the books of Solar Ltd.

Journal **Dr.** **Cr. (₹ '000)**

Date	Particulars		Dr.	Cr.
	Property, Plant and Equipment	Dr.	21,000	
	Investment Property	Dr.	6,000	
	Investments	Dr.	4,500	
	Current Assets	Dr.	8,000	
	Goodwill (10,500 + 12,500 – 8,000 -12,000)	Dr.	3,000	
	To, Borrowings			5,000
	To, Trade Payables			4,500
	To, Other Equity (6,000 + 4,000)			10,000
	To, Equity Share Capital			23,000

Summarised Balance sheet as at 01.04.2021 (after amalgamation) **(₹ '000)**

		(₹)
Property, Plant and Equipment	12,000 + 9,000	21,000

Goodwill		3,000
Investment Property	1,000 + 5,000	6,000
Investments	3,500 + 1,000	4,500
Current Assets	4,500 + 3,500	8,000
Total Assets		42,500
Equity Share Capital	12,500 + 10,500	23,000
Other Equity	4,000 + 6,000	10,000
Borrowings	3,000 + 2,000	5,000
Trade Payables	2,000 + 2,500	4,500
Total of equity and liabilities		42,500
Note: Contingent Liabilities	800	

Case 3

Planet Ltd. and Satellite Ltd. are amalgamated into Solar Ltd. control of which remained with the management of Planet Ltd. Solar Ltd. issues 1050000 shares and 1250000 shares to take over the businesses of Satellite Ltd. and Planet Ltd. respectively.

Solution:

It is a case of Reverse Acquisition. Legal acquiree is the accounting acquirer. Planet Ltd. being accounting acquirer, its assets and liabilities will be recognised at carrying amount.

In the books of Solar Ltd.

Journal **Dr.** **Cr. (₹ '000)**

Date	Particulars		(₹)	(₹)
	Property, Plant and Equipment	Dr.	22000	
	Investment Property	Dr.	8000	
	Investments	Dr.	4500	
	Current Assets	Dr.	7700	
	Goodwill	Dr.	800	
	To Borrowings			5050
	To Trade Payables			4400
	To Liabilities (Contingent liabilities recognised)			750
	To Equity Share Capital (12000 + 10500)			22500
	To Other Equity [4000 + 6300]			10300

Effective consideration: Issue of 1050000 shares of ₹ 16 to Satellite Ltd.= 16800000; Equity Share Capital (₹ '000) 10500 and Security Premium (₹ '000) 6300.

Net Assets of Satellite Ltd. = (₹ '000) 16000

Goodwill (₹ ‘000) = 16800 – 16000 = 800

Equity Share Capital of Solar Ltd. = Equity Share Capital of Planet Ltd. (₹ ‘000) 12000 + Equity Shares issued to Satellite Ltd. (₹ ‘000) 10500 = (₹ ‘000) 22500. [although number of shares should be 1250000 + 1050000 = 2300000 of ₹ 10]

Other Equity of Solar Ltd. = Other Equity of Planet Ltd. ₹ 4000 + Security Premium in Purchase Consideration ₹ 6300.

Summarised Balance sheet of Solar Ltd. as at 01-04-2021 (after reverse acquisition) (₹ ’000)

	Carrying amount of Planet Ltd. + Fair value of Satellite Ltd.	(₹)
Property, Plant and Equipment	12000 + 10000	22000
Goodwill (a)		800
Investment Property	1000 + 7000	8000
Investments	3500 + 1000	4500
Current Assets	4500 + 3200	7700
Total Assets		43000
Equity Share Capital [23000 shares] (b)	12000 + 10500	22500
Other Equity (c)	4000 + 6300	10300
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (Contingent liabilities recognised)		750
Total of equity and liabilities		43000

Case 4

Planet Ltd. acquires 25% stake in Satellite Ltd. having significant influence and purchase consideration is settled by issue of 160000 equity shares. During 2021-22 Satellite Ltd. earns profit (₹ ‘000) 2000 and Other Comprehensive Income (₹ ‘000) 1200. Pass journal entries in the books of Planet Ltd. at acquisition and on 31-03-2022.

Solution:

It is a case of investment in Associate. Equity method is followed as per Ind AS 28.

Journal:

Journal in Consolidated and Separate Set at acquisition

Dr. Cr. (₹ ’000)

Date	Particulars		(₹)	(₹)
01-04-2021	Investments in Associate	Dr.	2560	
	To Equity Share Capital (₹ 10)			1600
	To Security Premium (₹ 6)			960

Journal in Consolidated Set at subsequent reporting date (₹ '000)

Date	Particulars		(₹)	(₹)
31-03-2022	Investments in Associate	Dr.	800	
	To Statement of Profit and Loss			500
	To Other Comprehensive Income			300

Journal in Separate Set at subsequent reporting date: No entry

Case 5

Planet Ltd. acquires 75% stake in Satellite Ltd. on 01-04-2021 and purchase consideration is settled by issue of 800000 equity shares. Non-Controlling Interest is measured at proportionate net Asset value. Pass journal entries in the books of Planet Ltd. at acquisition and re-draft balance sheets at acquisition.

Solution:

It is a case of business combination as per Ind AS 103. There will be two sets of accounting in the books of the Acquirer.

Consolidated set in the books of Planet Ltd. (Amount in ₹ '000)

Purchase Consideration = 800000 shares of ₹ 16 = 12800

WN 1. Net Assets of Satellite Ltd. at fair value = ₹ 16000

WN 2. Non-Controlling Interest (NCI) = 25% of Net Assets = 25% × 16000 = 4000

WN 3. Goodwill = Purchase Consideration + NCI – Net Assets = 12800 + 4000 – 16000 = 800

Journal **Dr.** **Cr. (Rs.'000)**

Date	Particulars		(₹)	(₹)
01-04-2021	Property, Plant and Equipment	Dr.	10000	
	Investment Property	Dr.	7000	
	Investments	Dr.	1000	
	Current Assets	Dr.	3200	
	Goodwill [WN 3]	Dr.	800	
	To, Borrowings			2050
	To, Trade Payables			2400
	To, Liabilities (Contingent liabilities recognised)			750
	To, Non-Controlling Interest (WN 2)			4000
	To, Equity Share Capital (₹ 10)			8000
	To, Security Premium (₹ 6)			4800

Summarised Consolidated Balance sheet as at 01-04-2021 (after acquisition) (₹ '000)

	Workings	(₹)
Property, Plant and Equipment	12000 + 10000	22000

	Workings	(₹)
Goodwill		800
Investment Property	1000 + 7000	8000
Investments	3500 + 1000	4500
Current Assets	4500 + 3200	7700
Total Assets		43000
Equity Share Capital	12000 + 8000	20000
Other Equity	4000 + 4800	8800
Non-Controlling Interest		4000
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (contingent recognised)		750
Total of equity and liabilities		43000

Separate set in the books of Planet Ltd.

Journal **Dr.** **Cr. (₹ '000)**

Date	Particulars		(₹)	(₹)
01-04-2021	Investments in Subsidiary	Dr.	12800	
	To Equity Share Capital (₹ 10)			8000
	To Security Premium (₹ 6)			4800

On 01-04-2021 the summarised separate balance sheets of Planet Ltd. (post acquisition) (₹ '000)

	Planet Ltd.
Property, Plant and Equipment	12000
Investment Property	1000
Investment in Subsidiary	12800
Investments	3500
Current Assets	4500
Total Assets	33800
Equity Share Capital (Rs. 10)	20000
Other Equity	8800
Borrowings	3000
Trade Payables	2000
Total of Equity and Liabilities	33800

Case 6

Planet Ltd. acquires 45% stake in Satellite Ltd. and purchase consideration is settled by issue of 540000 equity shares. The investment in the balance sheet of Planet Ltd. shows the cost of previously held 30% interest in Satellite Ltd. Non-Controlling Interest is measured at fair value. Pass journal entries in the books of Planet Ltd. at acquisition and re-draft balance sheets at acquisition in consolidated set only.

It is a case of business combination as per Ind AS 103.

Consolidated set in the books of Planet Ltd. (Amount in ₹ '000)

WN 1. Purchase Consideration = 450000 shares of ₹16 = 7200

WN 2. Fair Value of previously held Interest = (30%/45%) × 7200 = 4800

WN 3. Net Assets of Satellite Ltd. at fair value = 16000

WN 4. Non-Controlling Interest (NCI) = (25%/45%) × 7200 = 4000

WN 5. Gain on Bargain Purchase = Net Assets - Purchase Consideration - NCI – fair value of previously held interest = 16000 – [7200 + 3200 + 4800] = 800

Journal Dr. Cr. (₹'000)

Date	Particulars		(₹)	(₹)
01-04-2021	Investments (previously held interest)	Dr.	1300	
	To Statement of Profit and Loss (Revalued)			1300
01-04-2021	Property, Plant and Equipment	Dr.	10000	
	Investment Property	Dr.	7000	
	Investments	Dr.	1000	
	Current Assets	Dr.	3200	
	To Borrowings			2050
	To Trade Payables			2400
	To Liabilities (Contingent liabilities recognised)			750
	To Non-Controlling Interest (WN 4)			4000
	To Gain on Bargain Purchase [WN 5]			800
	To Equity Share Capital (Rs. 10)			4500
	To Security Premium (Rs. 6)			2700
	To Investment (previously held interest)			4800

Summarised Consolidated Balance sheet as at 01-04-2021 (after acquisition) **(₹ '000)**

	Workings	(₹)
Property, Plant and Equipment	12000 + 10000	22000
Investment Property	1000 + 7000	8000
Investments	1000	1000

	Workings	(₹)
Current Assets	4500 + 3200	7700
Total Assets		38700
Equity Share Capital	12000 + 4500	16500
Other Equity	4000 + 2700 + 1300	8000
Non-Controlling Interest	WN 4	4000
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (contingent recognised)		750
Total of equity and liabilities		38700

Case 7

Satellite Ltd. acquires 75% stake in Planet Ltd. by issue of shares in the ratio based on the market prices. In consequence, Planet Ltd. becomes the accounting acquirer. Non-Controlling Interest is measured at fair value. Pass journal entries in the books of Planet Ltd. at acquisition and re-draft balance sheets at acquisition.

Solution:

Exchange Ratio 16 shares of Satellite for every 15 shares of Planet. Number of shares to be issued by Satellite = 16 × 1200000/15 = 1280000

Existing shares of Satellite = 800000;

In the group owners of Planet holds controlling interest

It is a case of Reverse Acquisition, where Planet, the legal acquiree is the Accounting Acquirer.

Effective purchase consideration = number of shares of Accounting Acquiree × mkt price = 800000 × 15 = (₹'000) 12000

In the consolidated accounts of the group Satellite's assets and liabilities will be recognised at fair value and Planet's assets and liabilities will be recognised at carrying amount.

Consolidated Equity = Carrying amount of Equity of Planet + Purchase consideration (issue by Satellite) = 16000 + 12000 = (₹ '000) 28000

Non-controlling interest = 25% of Planet = 25% × 1200000 × 16 = (₹'000) 4800

Goodwill = Purchase consideration + NCI – Net Assets = 12000 + 4800 – 16000 = 800

Date	Particulars		Dr. (₹)	Cr. (₹)
01-04-2021	Property, Plant and Equipment	Dr.	10000	
	Investment Property	Dr.	7000	
	Investments	Dr.	1000	
	Current Assets	Dr.	3200	

Date	Particulars		(₹)	(₹)
	Goodwill [WN d]	Dr.	800	
	To Borrowings			2050
	To Trade Payables			2400
	To Liabilities (Contingent liabilities recognised)			750
	To Non-Controlling Interest (WN c)			4800
	To Equity Share Capital (1280000 shares)			12000

Summarised Consolidated Balance sheet as at 01-04-2021 (after acquisition) **(₹ '000)**

	Workings	(₹)
Property, Plant and Equipment	12000 + 10000	22000
Goodwill		800
Investment Property	1000 + 7000	8000
Investments	3500 +1000	4500
Current Assets	4500 + 3200	7700
Total Assets		43000
Equity Share Capital (1200000 + 1280000 shares)	12000 + 12000	24000
Other Equity	4000	4000
Non-Controlling Interest	WN 4	4800
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (contingent recognised)		750
Total of equity and liabilities		43000

Exercise

A. Theoritical Questions:

Multiple Choice Questions

1. As per Ind AS 103, accounting and reporting for business combination is done under
   A. Acquisition Method
   B. Purchase method
   C. Pooling of interest method
   D. None of the above

2. As per Ind AS 103, while accounting and reporting for business combination goodwill is calculated as
   A. Consideration + Non controlling Interest – Net assets
   B. Consideration - Non controlling Interest + Net assets
   C. Consideration - Non controlling Interest – Net assets
   D. Consideration + Non controlling Interest + Net assets

3. How is non-controlling interest shown in the financial statements of the acquirer at the time of a business combination under Ind AS 103.
   A. It is shown as a liability
   B. It is shown as an item under equity
   C. It is not shown in balance sheet
   D. Non-controlling interest is not recognised.

4. At what value is non-controlling interest recorded in the books of the Acquiree at the time of a business combination transaction under Ind AS 103?
   A. It is recognised at fair value only
   B. It is recognised at proportionate fair value of identified net assets only
   C. It is not recognised at all
   D. It is recognised either at fair value or at proportionate fair value of identified net assets.

5. As per Ind AS 103, while accounting and reporting for business combination goodwill is calculated as
   A. Consideration + Non controlling Interest + Fair value of previously held interest in the Acquiree – Net assets
   B. Consideration + Non controlling Interest - Fair value of previously held interest in the Acquiree – Net assets
   C. Consideration - Non controlling Interest + Fair value of previously held interest in the Acquiree – Net assets
   D. Consideration - Non controlling Interest - Fair value of previously held interest in the Acquiree – Net assets

6. Transactions sometimes referred to as ________ or ________ are also business combinations as that term is used in this Ind AS.
   A. True Mergers, Mergers of Equals
   B. Business Combination, Business Combination under Common Control

C. Internal reconstruction, Financial restructuring

D. None of the above

7. Ind AS 103 has a wider scope than ______

A. AS 15

B. AS 14

C. AS 16

D. AS 13

8. If a parent loses control of a subsidiary, it shall derecognise

A. the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost

B. the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them)

C. the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control

D. Both A. and B.

9. In business combination, control of business can be obtained by

A. acquiring assets and assuming liabilities (such assets and liabilities must constitute a business, otherwise it is not a business combination)

B. by acquisition of shares

C. by other legal process

D. All of the above

10. When after business combination, acquiree ceases to exist, it is to be recorded in the books of the ___________in one set only, in its stand-alone accounts

A. acquirer

B. acquiree

C. both A. and B.

D. either A. or B.

11. As per Ind AS 103, accounting and reporting for business combination is done under

A. Acquisition Method

B. Purchase method

C. Pooling of interest method

D. None of the above

12. As per Ind AS 103 Appendix C, accounting and reporting for business combination under common control is done under

A. Acquisition Method

B. Purchase method

C. Pooling of interest method

D. None of the above

13. As per Ind AS 103, while accounting and reporting for business combination goodwill is calculated as
    A. Consideration + Non controlling Interest – Net assets
    B. Consideration - Non controlling Interest + Net assets
    C. Consideration - Non controlling Interest – Net assets
    D. Consideration + Non controlling Interest + Net assets

Answer:

1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.
C	A	B	D	A	A	B	D	D	A	A	C	A

Fill in the Blanks

1. __________ is the business or businesses that the acquirer obtains control of in a business combination.
2. A ____________ occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes.
3. Business combinations involving entities or businesses under common control shall be accounted for using the ___________ method.
4. ______________ refers to the transaction of business combination where a parent is acquiring control of its subsidiary (intermediate parent) which in turn is acquiring control of another company (sub-subsidiary).
5. _____________ is the equity in a subsidiary (acquiree) not attributable, directly or indirectly, to a parent (acquirer).

Answer:

1.	Acquiree	**2.**	reverse acquisition
3.	pooling of interest	**4.**	Chain holding
5.	Non-controlling Interest		

Short Essay Type Questions

1. Briefly explain the concept of Reverse Acquisition.
2. Define Business combination under common control as per Appendix C of Ind AS 103.
3. State the differences between Ind AS 103 and AS 14.
4. Explain Internal Reconstruction. List the ways in which reduction of share capital may be effected.
5. List the disclosures an acquirer should disclose that enables users to evaluate the nature and financial effect of business combinations that were affected.
6. Define Contingent consideration.
7. Explain Chain Holding.

8. During sale of holding resulting in loss of control of the acquirer over the acquiree, if a parent loses control of a subsidiary, what shall it derecognize and recognize?

9. When is an asset identifiable?

Essay type questions:

1. Discuss in detail how accounting will be made complying the requirements of Indian Accounting Standards in the books of the company which acquires additional shares of its own subsidiary.

2. Discuss in detail how accounting will be made complying the requirements of Indian Accounting Standards in the books of the transferee company for business combination under common control.

B. Numerical Questions:

Multiple Choice Questions

1. A Ltd. acquires 80% of B Ltd. for ₹ 12,80,000 paid by equity at par. Fair Value (FV) of B's net assets at time of acquisition amounts ₹ 9,00,000. NCI is measured at proportionate net asset. The value of goodwill will be:

   A. ₹ 3,00,000

   B. ₹ 3,80,000

   C. ₹ 4,50,000

   D. ₹ 5,60,000

2. Q Ltd. acquired a 60% interest in R Ltd. on January 1, 2021. Q Ltd. paid ₹ 900 Lakhs in cash for their interest in R Ltd. The fair value of R Ltd.'s assets is ₹ 2,000 Lakhs, and the fair value of its liabilities is ₹ 1,000 Lakhs.

   (i) If NCI is valued at proportionate net asset, value of Goodwill:

   A. ₹ 300 lakhs

   B. ₹ 250 lakhs

   C. ₹ 400 lakhs

   D. ₹ 350 lakhs

   (ii) If NCI is valued at fair value, goodwill amounts to:

   A. ₹ 300 lakhs

   B. ₹ 250 lakhs

   C. ₹ 500 lakhs

   D. ₹ 350 lakhs

3. A Ltd. acquires 80% of B Ltd. for ₹ 10,00,000 paid by equity at par. Fair Value (FV) of B's net assets at time of acquisition amounts ₹ 9,00,000. The value of goodwill based on NCI valued at proportionate fair value of identified net asset will be:

   A. ₹ 3,00,000

   B. ₹ 2,80,000

   C. ₹ 4,50,000

   D. ₹ 5,00,000

4. On 1 January 2021 A Ltd. acquires 80 per cent of the equity interests of B Ltd in exchange of cash of ₹ 600 lakhs. The identifiable assets are measured at ₹ 925 lakh and the liabilities assumed are measured at ₹150 lakh. The fair value of the 20 per cent non-controlling interest in P is ₹ 90 lakhs. The gain on bargain purchase will be -

   A. ₹ 90 lakhs

   B. ₹ 85 lakhs

   C. ₹ 105 lakhs

   D. ₹ 75 lakhs

5. X has acquired 100% of the equity of Y on March 31, 2018. The purchase consideration comprises of an immediate payment of ₹ 50 lakhs and three further payments of ₹ 2.5 lakhs if the Return on Equity exceeds 20% in each of the subsequent three financial years. A risk adjusted discount rate of 20% is used. Compute the value of total consideration at the acquisition date.

   A. ₹ 50 lakhs

   B. ₹ 55.266 lakhs

   C. ₹ 55 lakhs

   D. ₹ 57.5 laks

6. Q Ltd. acquired a 75% interest in R Ltd. on January 1, 2021. Q Ltd. paid ₹ 900 Lakhs in cash for their interest in R Ltd. The fair value of R Ltd.'s assets is ₹ 2,000 Lakhs, and the fair value of its liabilities is ₹ 920 Lakhs. NCI valued at Fair Value and at Proportionate Value are:

   A. ₹ 300 lakhs and ₹ 360 lakhs

   B. ₹ 225 lakhs and ₹ 270 lakhs.

   C. ₹ 300 lakhs and ₹ 270 lakhs.

   D. ₹ 225 lakhs and ₹ 360 lakhs.

7. On 1 January 2021 A Ltd. acquires 80 per cent of the equity interests of B Ltd for ₹560 lakh. The identifiable assets are measured at ₹ 960 lakh and the liabilities assumed are measured at ₹160 lakh. The non controlling interest in B Ltd. is measured at fair value. The gain on bargain purchase will be

   A. ₹ 90 lakh

   B. ₹ 100 lakh

   C. ₹ 55 lakh

   D. ₹ 75 lakh

8. P Ltd. acquires 3/4th equity shares of Q Ltd. at consideration of ₹ 24,00,000 payable by issue of equity shares of ₹ 10 (market price ₹ 30) and exchanges of Debentures of Q by P's own Debenture ₹ 2,00,000. Net assets of Q amounts to ₹ 27,00,000 at fair value. NCI is measured at fair value. Transaction cost borne by P is ₹ 25,000. Ind AS 103 is applicable.

   (i) In separate set of accounting

   A. Investment is debit by ₹ 24,00,000.

   B. Investment is debit by ₹ 26,00,000.

   C. Net asset is debit by ₹ 27,00,000.

   D. Non-controlling interest is recognised at ₹ 8,00,000

(ii) In consolidated set of accounting

A. Investment is debit by ₹ 24,00,000.

B. Investment is debit by ₹ 26,00,000.

C. Net asset is debit by ₹ 27,00,000.

D. Goodwill is recognised at ₹ 8,00,000.

(iii) In consolidated set of accounting

A. Equity is credit by ₹ 26,00,000.

B. Purchase consideration is ₹ 26,25,000.

C. Goodwill is debit by ₹ 7,00,000.

D. Non-controlling interest is recognised at ₹ 8,00,000.

(iv) In consolidated set of accounting

A. Other Equity is credit by ₹ 24,00,000.

B. Investment is debit by ₹ 26,00,000.

C. Goodwill is debit by ₹ 5,00,000.

D. Non-controlling interest is recognised at ₹ 7,00,000.

(v) In consolidated set of accounting

A. Equity share capital is credit by ₹ 8,00,000.

B. Purchase consideration is ₹ 26,00,000.

C. Goodwill is debit by ₹ 3,75,000.

D. Non-controlling interest is recognised at ₹6,75,000.

(vi) In consolidated set of accounting

A. Other Equity is credit by ₹ 15,75,000.

B. Purchase consideration is ₹ 24,25,000.

C. Goodwill is debit by ₹ 3,75,000.

D. Non-controlling interest is recognised at ₹6,75,000.

(vii) In consolidated set of accounting

A. Equity is credit by ₹ 16,00,000.

B. Purchase consideration is ₹ 24,00,000.

C. Goodwill is debit by ₹ 3,75,000.

D. Non-controlling interest is recognised at ₹6,75,000.

9. X Ltd. acquires 20% shares of B Ltd. on 01.04.2021. X Ltd. further acquires on 01.04.2021, 60% shares of B Ltd. at a consideration of ₹3,60,000 in cash and by issue of 10000 shares of ₹ 10 (market price ₹15). Debentures of B Ltd. are exchanged for 12% Debenture of X Ltd. A contingent consideration is also payable, fair value of which at the date of acquisition is estimated at ₹ 60,000. X Ltd. pays transaction cost ₹ 20,000. Non-Controlling Interest is recognized at fair value. The fair values of assets and liabilities of B Ltd. are stated below:

	Fair Value (₹)
PPE	3,00,000
Current Assets	4,20,000
Creditors	38,000

The abstracts of consolidated balance sheet of X Ltd. and individual balance sheet of B Ltd. on 31.03.20X2 are given below: [Amount in Rupees]

Particulars	X Ltd.	B Ltd.	Particulars	X Ltd.	B Ltd.
Equity Share Capital	4,60,000	2,50,000	PPE	1,80,000	1,60,000
Other Equity	2,70,000	3,00,000	Investment in 20% shares in B Ltd. (valued under equity method with share of post-acquisition profits ₹20,000)	2,00,000	
12% Debenture	60,000	10,000	Current Assets	4,60,000	4,40,000
Creditors	50,000	40,000			
Total	**8,40,000**	**6,00,000**	**Total**	**8,40,000**	**6,00,000**

Choose the correct alternative.

(i) Identified net assets at fair value is

A. ₹ 7,58,000

B. ₹ 6,82,000

C. ₹ 6,72,000

D. None of the above

(ii) Purchase consideration is

A. ₹ 3,60,000

B. ₹ 4,60,000

C. ₹ 5,10,000

D. ₹ 5,70,000

(iii) Fair value of previously held interest

A. ₹ 1,80,000

B. ₹ 1,90,000

C. ₹ 1,60,000

D. None of the above

(iv) Non-controlling interest is recognised at

A. ₹ 1,34,800

B. ₹ 1,90,000

C. ₹ 72,000

D. None of the above

(v) Goodwill is recognised at

A. ₹ 88,000

B. ₹ 2,78,000

C.₹ 1,56,000

D. None of the abov

(vi) Revaluation profit (loss) on Preouly held interest

A. ₹ 30,000

B. ₹ (10,000)

C. ₹ 20,000

D. None of the above

(vii) Consolidated other equity at acquisition is

A. ₹ 2,70,000

B. ₹ 3,20,000

C. ₹ 2,90,000

D. ₹ 3,00,000.

(viii) Investment in the separate balance sheet of X Ltd:

A. ₹ 7,50,000

B. ₹ 6,80,000

C. ₹ 7,60,000

D. None of the above

Answer:

1.	D
2. (i)	A. [Consideration = ₹900 Lakhs; Net assets = ₹(2,000 -1,000) Lakhs = ₹1,000 Lakhs; NCI = 40%×₹1,000 Lakhs = ₹400 lakhs; Goodwill = Consideration + NCI – Net assets = ₹(900 + 400 – 1000) Lakhs = ₹300 Lakhs] ;
2. (ii)	C. [NCI at Fair Value = (40%/60%)×Consideration = ₹600 Lakhs; Goodwill = ₹(900 + 600) Lakhs – ₹1,000 Lakhs = ₹500 Lakhs]
3.	B [NCI = 20%×₹9,00,000 = ₹1,80,000; Goodwill = ₹10,00,000 + ₹1,80,000 – ₹9,00,000 = ₹2,80,000]
4.	B [Net assets = ₹(925 – 150) Lakhs = ₹775 lakhs; Gain on bargain purchase = ₹775 Lakhs – ₹(600+90) lakhs = ₹85 Lakhs];
5.	B [Contingent Consideration = ₹2.5 Lakhs × (PV of 3 year annuity at 20%) = 2.5× 2.106481 = ₹5.266 Lakhs; Total Consideration = ₹(50 + 5.266) Lakhs = ₹55.266 Lakhs];
6.	C [NCI at FV = (25%/75%)× ₹900 Lakhs = ₹300 Lakhs; NCI at Proportionate Value = 25%×Net Assets = ₹270 Lakhs];
7.	B [₹(960 – 160) Lakhs – (20/80)×₹560 Lakhs – ₹560 Lakhs = ₹100 Lakhs];
8.	[Hints: Consideration is ₹ 24,00,000 only. Debenture exchange is reflected in net assets. Transaction cost is expensed. Purchase consideration is the amount payable to shareholders of Q and issue of debenture in exchange of Q's debentures is not part of purchase consideration. It is a liability identified. In separate set of accounting, it is included in Investment, Investment in shares ₹ 24,00,000 plus investment in Debentures ₹ 2,00,000 NCI = (1/3)×₹24,00,000 = ₹8,00,000; Goodwill = ₹24,00,000 +₹ 8,00,000 – ₹27,00,000 = ₹5,00,000; Equity Share Capital issued = ₹24,00,000×(10/30) = ₹8,00,000; Other Equity (security premium – transaction cost) = ₹24,00,000×(20/30) – ₹25,000 = ₹15,75,000] (i) B ; (ii) C; (iii) D; (iv) C;(v) A; (vi) A;(vii) B.
9.	[Hints: Identified net assets at fair value = ₹3,00,000 + ₹4,20,000 – ₹38,000 – ₹10,000 (Debenture exchanged) = ₹6,72,000; Consideration = ₹3,60,000 +₹10,000×15 + ₹60,000 = ₹5,70,000; NCI = (20/60)×₹5,70,000 = ₹1,90,000 Goodwill = Consideration + NCI + Previously held interest – Net Assets = ₹5,70,000 +₹1,90,000 +₹1,90,000 – ₹6,72,000 = ₹2,78,000; Consolidated other equity =₹2,70,000 + ₹50,000 (Security premium) – ₹20,000 (transaction cost) - ₹10,000 (Revaluation loss on previously held interest = ₹1,90,000 - ₹2,00,000) = ₹2,90,000; Investment in separate balance sheet = Previously held investment at cost + Consideration + investment in debentures = (₹2,00,000 – ₹20,000) + ₹5,70,000 + ₹10,000 (Debenture) = ₹7,60,000] (i) C ; (ii) D ;(iii) B ; (iv) B; (v) A; (vi) B; (vii) C; (viii) C.

Comprehensive Numerical Problems

1. Pass journal entries along with necessary workings in the books of A Ltd. (both in consolidated set and separate set as necessary) for the following events:

   (a) A Ltd. takes over B Ltd. for ₹ 15,00,000. Fair Value (FV) of B's net assets at time of acquisition amounts to ₹ 13,80,000. Purchase consideration paid by issue of 100000 equity shares of ₹ 10.

   (b) A Ltd. acquires 100% shares of B Ltd. for ₹ 15,00,000. Fair Value (FV) of B's net assets at time of acquisition amounts to ₹ 13,80,000. Purchase consideration paid by issue of 100000 equity shares of ₹ 10.

   (c) A Ltd. acquires 80% shares of B Ltd. for ₹ 12,80,000. Fair Value (FV) of B's net assets at time of acquisition amounts to ₹ 13,80,000. Purchase consideration paid by issue of 100000 equity shares of ₹ 10. Recognise non-controlling interest at proportionate net asset value.

   (d) A Ltd. acquires 80% shares of B Ltd. for ₹ 12,80,000. Fair Value (FV) of B's net assets at time of acquisition amounts to ₹ 13,80,000. Purchase consideration paid by issue of 100000 equity shares of ₹ 10. Recognise non-controlling interest at fair value.

   (e) A Ltd. acquires 40% shares of B Ltd. for ₹ 6,40,000. A Ltd. has previously held interest in B ltd with holding of 35% shares at a cost of ₹ 5,00,000. Fair Value (FV) of B's net assets at time of acquisition amounts to ₹ 13,80,000. Purchase consideration paid by issue of 40000 equity shares of ₹ 10. Recognise non-controlling interest at proportionate net asset value.

   (f) A Ltd. acquires 80% shares of B Ltd. for ₹ 12,80,000. Fair Value (FV) of B's net assets at time of acquisition amounts to ₹ 13,80,000. Purchase consideration paid by issue of 100000 equity shares of ₹ 10 plus additional amount of ₹ 3,00,000 payable at the end of 3rd year contingent upon B's earning average 20% ROI in 3 years, fair value of which is estimated at ₹ 1,20,000 at acquisition date. Recognise non-controlling interest at proportionate net asset value.

   (g) A Ltd. acquires 40% shares of B Ltd. for ₹ 6,40,000. A Ltd. has previously held interest in B ltd with holding of 35% shares at a cost of ₹ 5,00,000. Purchase consideration paid by issue of 40000 equity shares of ₹ 10 plus additional amount of ₹ 3,00,000 payable at the end of 3rd year contingent upon B's earning average 20% ROI in 3 years, fair value of which is estimated at ₹ 1,20,000 at acquisition date. Recognise non-controlling interest at proportionate net asset value. The balance sheet and other data of B Ltd. are summarized below:

(₹)

Particulars	B/S Value	Fair value
PPE	9,00,000	11,00,000
Current Assets	6,00,000	5,80,000
Total Assets	15,00,000	16,80,000
Equity Share Capital	6,00,000	
Other Equity	5,00,000	
Borrowings	2,50,000	2,60,000
Current Liabilities	1,50,000	1,40,000

A Ltd. paid cost of acquisition ₹ 20,000.

2. On March 31, 201X, A Ltd and B Ltd. were amalgamated into C Ltd., control of the businesses lying with the same parties as before. C Ltd. issued 1,00,000 equity shares to A Ltd. and 60,000 equity shares to B Ltd. at the nominal value of ₹10 per share. The book value of A Ltd.'s net assets was ₹15,00,000, Equity Share Capital ₹ 8,00,000 and Other Equity ₹7,00,000 on March 31. The fair value of net assets of A Ltd. was assessed at ₹18,00,000. The book value of B Ltd.'s net assets was ₹7,00,000, Equity share capital ₹4,00,000 and Other Equity ₹3,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at ₹10,00,000.

   Show journal entries complying with Ind AS.

3. On March 31, 201X, A Ltd with equity share capital of ₹ 7,00,000 was externally reconstructed into B Ltd. B Ltd. issued 100,000 equity shares at the nominal value of ₹ 10 per share. The book value of A Ltd.'s net assets was ₹13,00,000 on March 31. The fair value of net assets was assessed at ₹15,00,000.

   Show journal entries complying with Ind AS.

4. P Ltd. acquired 80% shares of Q Ltd. at a consideration of ₹ 640 Lakhs and Q Ltd. acquired 75% shares of R Ltd. at a consideration of ₹ 450 Lakhs on 01.04.2021. NCI is measured at fair value. Fair value of net assets of Q ₹ 750 Lakhs and of R ₹ 600 Lakhs. Pass journal entries for business combination in the books of P Ltd. complying with Ind AS.

5. H Ltd. acquires 100% equity shares of S Ltd on 31.03.2021. From the following data pass journal entries in separate and consolidated set of H Ltd. H Ltd. and S Ltd. shares are quoted at ₹ 20 and ₹ 50 respectively on 31.03.2021. H Ltd. issues shares in exchange ratio based on quoted price. Fair Value of Net asset of H ₹2,500, S ₹2,800. Other information:

Balances as at 31.03.2021	H (₹)	S (₹)
Equity Share Capital H: 100 shares; S: 60 shares	1000	600
Other Equity	500	1600

Section-D

Consolidated Financial Statements and Separate Financial Statements (In Compliance with Ind ASs)

Consolidated Financial Statements and Separate Financial Statements

6

This Module Includes

6.1 Introduction to Consolidation

6.2 Concept of Significant Influence, Joint Control and Control as per Ind AS

6.3 Consolidation Procedure for Investment in Associates, Joint Ventures and Subsidiaries

6.4 Measurement of Fair Value of Net Assets, Non-controlling Interest, Goodwill/ Gain on Bargain Purchase, Consolidated Other Equity (including Measurement of Investments under Equity Method)

6.5 Accounting and Reporting in Consolidated Financial Statements and in Separate Financial Statements at Acquisition Date - Introductory Examples.

6.6 Consolidated Financial Statements and Separate Financial Statements at Subsequent Reporting Date - Introductory Examples.

6.7 Consolidated and Separate Financial Statements of Group Entities - Advanced Level Discussion and Examples (including Inter-company Investments, Chain Holding, Crossholding and Other Relevant Matters)

6.8 Accounting and Reporting of Joint Operation.

6.9 Disclosures

Consolidated Financial Statements and Separate Financial Statements

SLOB Mapped against the Module

To develop detail understanding on preparation of consolidated and separate financial statements by companies having significant influence on, joint control or control of other entities in an Ind AS environment.

Module Learning Objectives

- To provide in-depth and updated knowledge about accounting of the group consisting of the Investor and its associate or its joint venture or its subsidiary.
- To develop application skill of preparing consolidated financial statements and separate financial statements in compliance with relevant Ind ASs for the group

Introduction to Consolidation 6.1

A group consists of a parent and its subsidiaries. A parent is an entity that controls one or more entities. A subsidiary is an entity that is controlled by another entity.

Purchase of equity shares is the most common way by which an investor company (parent) acquires control in the investee company (called subsidiary).

Accounting for consolidated financial statements (as per Ind AS 110) is made at the reporting date by combining assets and liabilities of parent and subsidiaries, measuring non-controlling interest [Ind AS 110] and recognizing goodwill [Ind AS 103].

Ind AS 103 states that the acquirer obtaining control over acquiree, recognises and measures in its consolidated financial statements (i) the identifiable assets acquired, the liabilities assumed at Fair Value and (ii) any non-controlling interest in the acquiree at Fair Value or at Proportionate Value and (iii) the goodwill acquired in the business combination or a gain on bargain purchase. In the consolidated financial statements on the date of acquisition they would be incorporated accordingly.

However, for subsequent reporting of consolidated financial statements the post-acquisition changes in assets and liabilities and the post-acquisition profits shared by NCI and Other Equity should also be considered but no change should be made to Goodwill/Gain on Bargain Purchase.

Thus, it appears that a parent has to report consolidated financial statements based on Ind AS 103 and Ind AS 110 and investor company prepares consolidated financial statements for investment in Associate or in Joint Venture. However, for any arrangement of Joint Operation no consolidation of financial statements is required. The reporting of joint operation is dealt in Ind AS 111. The disclosure requirements for holding interest in other entity are dealt in Ind AS 112.

Concept of Significant Influence, Joint Control and Control as per Ind AS

6.2

Consolidated financial statements are required to be prepared by an Ind AS complied company if it holds shares in the investee company

- Entailing 20% or more voting rights having significant influence over the investee company (called Associate as per Ind AS 28).
- Entailing joint control over the investee company (called a Joint Venture as per Ind AS 28)
- Entailing control over investee company (called subsidiary company as per Ind AS 110).

No consolidation is required otherwise (i.e., for holding shares in investee not falling under above three clauses) and the investor company prepares only individual/standalone financial statements.

Ind AS 27 requires that when consolidated financial statements are prepared the investor company shall also prepare individual/standalone financial statements, which are named as separate financial statements.In the separate financial statements of the investor company investment account is recognised for holding shares in the investee company (whether it is an associate, joint venture, subsidiary). It is measured at cost or as per Ind AS 109 (at fair value through profit or loss)

Consolidated financial statements are required to be prepared as per Ind AS 28 under Equity Method when investor company has significant influence or joint control over the investee company (associate or joint venture). Under Equity Method of consolidation, no assets or liabilities of the investee is recognised, rather investment account is recognised at cost plus share of investor in post-acquisition profits (both profit or loss and other comprehensive income, strictly spea) in the investee.

When investor company has control over the investee company (subsidiary) consolidated financial statements are required to be prepared as per Ind AS 110 by recognising assets, liabilities, non-controlling interest on the reporting date, but recognising goodwill or gains from bargain purchase at the acquisition date as per Ind AS 103. Share of post-acquisition profits in the subsidiary company is divided to Other Equity of parent for the share of parent and to Non-Controlling Interest for their share. No investment account is recognised for holding shares in the subsidiary.

Here, the relevant Ind ASs are briefly presented.

Ind AS 27: Separate Financial Statements

1. **Introduction:** A company shall prepare financial statements for every financial year as required by law. A parent company in a group of companies shall prepare consolidated financial statements as per Ind AS 110, and further it shall prepare separate financial statements as per Ind AS 27. A company having investments in associates or joint ventures prepares financial statements using equity method of accounting as per Ind AS 28; in addition, it shall also prepare separate financial statements as per Ind AS 27.

Thus a company presenting consolidation or applying equity method shall in addition present separate financial statements. A company exempted from consolidation or from applying equity method may prepare separate financial statements as its only financial statements.

2. **Objective:** The objective of this Standard is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

3. **Scope:** This Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by law, to present separate financial statements.

4. **Definition:** Separate financial statements are those presented by a parent (i.e an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or at a value based on Ind AS 109.

5. When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:

   (a) at cost, or

   (b) in accordance with Ind AS 109.

6. An entity shall recognise a dividend from a subsidiary, a joint venture or an associate in profit or loss in its separate financial statements when its right to receive the dividend is established.

7. An entity shall apply all applicable Ind ASs when providing disclosures in its separate financial statements.

8. In case of exemption from consolidation or use of equity method, the entity shall disclose

   (i) that the financial statements are separate financial statements

   (ii) that the exemption is used and

   (iii) a list with details of investments in subsidiaries, joint ventures and associates.

Ind AS 28: Investments in Associates and Joint Ventures

1. **Objective:** The objective of this Standard is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures..

2. **Scope:** This Standard shall be applied by all entities having investments in associates and joint ventures.

3. **Definitions:**

   (i) An associate is an entity over which the investor has significant influence.

   (ii) Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

   (iii) If an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power (or currently exercisable potential voting rights) of the investee, it is presumed that the entity has significant influence.

   (iv) A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

   (v) A joint arrangement is an arrangement of which two or more parties have joint control.

   (vi) Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

   (vii) The equity method is a method of accounting whereby the investment is initially recognised at cost and

adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

4. **Application of equity method:** An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method.

5. An entity shall discontinue the use of the equity method from the date when its investee is no more an associate or a joint venture.

6. An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with Ind AS 27.

Ind AS 110 Consolidated Financial Statements

The objective of this Indian Accounting Standard (Ind AS) is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

To meet the objective Ind AS 110:

(a) requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements;

(b) defines the principle of control, and establishes control as the basis for consolidation;

(c) sets out how to apply the principle of control to identify whether an investor control an investee and therefore must consolidate the investee;

(d) sets out the accounting requirements for the preparation of consolidated financial statements; and

(e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

However, a parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with Ind ASs.

An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Thus, 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.

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the investee's returns. Power arises from rights. Sometimes, power can be assessed straightforward from the voting rights through shareholdings. In other cases, the assessment will be more complex when power results from one or more contractual arrangements.

If another entity (including government, court, administrator, receiver, liquidator or regulator) has existing rights to direct the relevant activities, the investor does not have power over the investee even if it holds more than half of the voting rights in the investee.

Case 1

An investor acquires 45 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Has investor power over the investee?

Solution:

In this case, on the basis of the absolute size of its holding and the relative size and arrangements of the other shareholdings, it appears that the investor has a sufficiently dominant voting interest to conclude that the investor has power over the investee.

Case 2

Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. Has A power over the investee?

Solution:

In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power. Additional evidences are needed to be considered for concluding whether A has power over the investee. If it is not clear, that the investor has power, the investor does not control the investee.

Case 3

Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. Has A power over the investee?

Solution:

In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power. However, investor A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the investee.

Case 4

Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. Has A power over the investee?

Solution:

In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient

to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.

If a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.

(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.

A parent shall determine whether it is an investment entity. An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity shall not consolidate its subsidiaries or apply Ind AS 103 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

Consolidation Procedure for Investment in Associates, Joint Ventures and Subsidiaries

6.3

Consolidated financial statements are required to be prepared as per Ind AS 28 under Equity Method when investor company has significant influence or joint control over the investee company (associate or joint venture). Under Equity Method of consolidation, no assets or liabilities of the investee is recognised, rather investment account is recognised at cost plus share of investor in post-acquisition profits (both profit or loss and other comprehensive income) in the investee.

When investor company has control over the investee company (subsidiary) consolidated financial statements are required to be prepared on the reporting date as per Ind AS 110:

- by combining the book value of assets and liabilities of parent with the fair value of assets and liabilities of the subsidiary plus post-acquisition changes in their book value,
- by recognising non-controlling interest at acquisition date value plus post-acquisition share in total comprehensive income of the subsidiary,
- by recognising goodwill or gains from bargain purchase at acquisition date as per Ind AS 103 and
- by recognising parent's share in post-acquisition profits of the subsidiary company in the consolidated Other Equity.
- No investment account is recognised for holding shares in the subsidiary.

Measurement of Fair value of Net Assets, Non-controlling Interest, Goodwill/ Gain on Bargain Purchase, Consolidated Other Equity (including Measurement of Investments under Equity Method)

6.4

Ind AS 103 states that the acquirer obtaining control over acquiree, recognises and measures in its consolidated financial statements at the acquisition date

(i) the identifiable assets acquired, the liabilities assumed at Fair Value and

(ii) any non-controlling interest in the acquiree at Fair Value or at Proportionate Value and

(iii) the goodwill acquired in the business combination or a gain on bargain purchase.

However, for consolidation at subsequent reporting date, the post-acquisition changes in assets and liabilities of the subsidiary and corresponding change in Other equity and NCI for post-acquisition total comprehensive income of the subsidiary should also be considered but no change should be made to Goodwill/Gain on Bargain Purchase.

At the time of acquisition of shares in Subsidiary company (S) identified assets and liabilities of S are recorded in the consolidated accounts at fair value. Subsequently the non-current items (assets and liabilities) of S are carried in the consolidated balance sheet at acquisition date fair value plus subsequent change in book value. However, for current items the revaluation profit or loss on the acquisition date (difference between fair value and book value) is reverted through post acquisition retained earnings, and thus the book values of parent and subsidiaries are combined for consolidation. [# Suppose that unsold stocks of S on acquisition date had carrying amount ₹1,000 and Fair Value ₹1,200. After one year, on the reporting date, stock (assumed) being fully sold at ₹1,300, S's post acquisition profits amounting to ₹300 ₹(1,300 – 1,000) should be reduced by ₹200 for consolidation as this ₹200 has already been considered as revaluation profit at the time of acquisition.

In subsequent CBS (Consolidated Balance Sheet), Non-Controlling Interest (NCI) is measured at value at acquisition (as per Ind AS 103) + share of NCI in post-acquisition profits (total comprehensive income). Note that NCI as per Ind AS 103 can be measured at Fair Value or at proportionate value of net assets identified. The parent's share in post-acquisition profits in subsidiary is added to the consolidated other equity.

In subsequent CBS (Consolidated Balance Sheet) Goodwill/Gain on bargain purchase is recorded at acquisition date value as per Ind AS 103; ie., Consideration + NCI + Fair value of previously held interest (if any) - Fair Value of net assets identified at acquisition.

For finding NCI and Goodwill, the fair value of net assets can alternatively be represented by the Equity plus revaluation profit/loss, (i.e, Share Capital plus Other Equity plus revaluation profits/losses arising from the difference between carrying amount and fair value of net assets).

Equity plus revaluation profit/loss = Net Assets identified at fair value. But for consolidation on subsequent date the share of NCI in post-acquisition profit or loss of the subsidiary must be added to NCI at acquisition date value. [Illustration 2 suggested]. When dividend is declared by the subsidiary company it appears as a deduction from Profit and Loss of subsidiary and as a current liability in subsidiary's balance sheet. In the books of the parent company the dividend receivable is shown as current asset and credited to Profit and Loss (if it is from post-

acquisition profit) or Investment a/c (if it is from pre-acquisition profits). If pre-acquisition dividend is wrongly credited to parent's Profit and Loss, both Investment a/c and parent's Profit and Loss are reduced by the share of parent in pre-acquisition dividend. But it is important to keep in mind that this treatment is done in the separate financial statements only.

When Ind AS 103 is followed, purchase consideration at the acquisition date is added with NCI and Fair value of previously held equity interest and from the total fair value of net assets identified is subtracted for finding the goodwill to be recognized. This goodwill recognized at acquisition date is not adjusted afterwards for any declaration of dividend by the subsidiary, even if it is from pre-acquisition profits. It is not required also. As dividends from pre-acquisition profits are already included in the acquisition date fair value of net assets, it is no more required to be deducted separately from Purchase consideration again. Thus, it is clear that for calculating goodwill in the consolidation of accounts pre-acquisition dividends need not be subtracted from Investment (Purchase consideration).

Accounting and Reporting in Consolidated Financial Statements and in Separate Financial Statements at Acquisition Date- Introductory Examples

6.5

When a company purchases less than 20% shares of another company the transaction is recorded in the books of investor company as:

Particulars		Dr. (₹)	Cr. (₹)
Investment A/c	Dr.	xxxx	
To, Bank / Equity A/c			xxxx

Investment A/c will appear in the Individual Balance Sheet of Investor company.

When a company purchases 20% or more shares of another company, having significant influence in the investee (called Associate), the transaction is recorded in the books of investor company as:

Particulars		**Dr.** (₹)	**Cr.** (₹)
Investment A/c	Dr.	xxxx	
To, Bank / Equity A/c			xxxx

Investment a/c will appear in the Separate and also in the Consolidated Balance Sheet of investor company. In the subsequent years in Separate Balance Sheet Investment A/c will be carried at cost or as per Ind AS 109.

However, in consolidated accounts, Investment A/c shall be valued under Equity Method. If in subsequent years Investee Company's Net Assets change (assume, increase) by Profit or Loss and by other comprehensive income, following Journal Entry shall be passed in the consolidated accounts of the investor company:

Particulars		**Dr.** (₹)	**Cr.** (₹)
Investment A/c	Dr.	xxxx	
(share of investor in change of net assets of investee)			xxxx
To, Profit and Loss A/c (share of Profit /Loss)			
To, OCI A/c (share of OCI)			

Thus, in consolidated Balance Sheet Investment A/c shall appear at cost plus share of investor company in change of Net Assets of the investee and Other Equity will increase by share of P/L and OCI of the investee.

This is the required accounting for investment in Associates as per Ind AS 28 and 27. The same accounting is done for investment in Joint Venture, where the investor has joint control.

But when by purchase of shares investor company acquires control of investee company (NOT Joint control), the investee becomes subsidiary and investor is parent. For such transaction, at the acquisition date accounting shall be made in the Consolidated Accounts of the parent and also in the separate accounts of parent.

In the Separate Accounts the following entry shall be made: **Dr.** **Cr.**

Particulars	(₹)	(₹)
Investment A/c Dr.	xxxx	
To, Bank / Equity A/c		xxxx

In the subsequent years in Separate Balance Sheet Investment A/c will be carried at cost or as per Ind AS 109.

However, in Consolidated Accounts following entry will be passed under acquisition method of Ind AS 103:

Dr. **Cr.**

Particulars	(₹)	(₹)
Assets A/c (of subsidiary identified at Fair Value) Dr.	xxxx	
Goodwill A/c (Balancing figure) Dr.		xxxx
To, Consideration A/c		
To, Liabilities A/c (of subsidiary identified at Fair Value)		
To, Previously held Interest A/c (at fair value)		
To, Non-Controlling Interest A/c		
(at fair value or at proportionate net asset value)		
To, Gain on bargain purchase A/c (balancing figure)		

Thus, at acquisition, the assets and liabilities of parent at carrying amount are combined with the fair value of assets and liabilities of subsidiary for preparation of Consolidated Balance Sheet. Goodwill is shown under non-current assets or Gain on bargain purchase is shown under (consolidated) Other Equity. Non-Controlling Interest is also shown below Other Equity.

If subsequently, parent purchases additional shares in subsidiary, NCI is reduced proportionately to its carrying amount and the following entry is passed: **Dr.** **Cr.**

Particulars	(₹)	(₹)
NCI A/c (at proportionate carrying amount) Dr.	xxxx	
To, Bank / Equity A/c		xxxx

Difference, if any, between proportionate carrying amount of NCI and consideration for additional stake is debited or credited to Other Equity.

If subsequently some shares of subsidiary is sold retaining control of parent: **Dr.** **Cr.**

Particulars	(₹)	(₹)
Bank A/c Dr.	xxxx	
To, NCI A/c (at proportionate carrying amount)		xxxx

Difference, if any, between proportionate carrying amount of NCI and sale value of shares is debited or credited to Other Equity.

Thus we see that preparation of Consolidated Balance Sheet under Ind AS 110 at the acquisition date is simply incorporating the entries of business combination with the Balance Sheet items of parent. However, for subsequent periods, post-acquisition changes (say, increase) in carrying amount of Net Assets of subsidiary (same as change in Other Equity, equity share capital is assumed to remain unchanged) have to be taken into consideration. In consolidated accounts change in net assets of subsidiary (say, increase) is given effect (to consolidated assets and liabilities) and Other Equity increases by parent's share and NCI increases by NCI share.

Thus, we see that post acquisition change in other equity of subsidiary is divided to parent and NCI in the ratio of their respective shares. Consolidated other equity is the sum total of parent's other equity and share of parent in subsidiary's post-acquisition change in other equity. Goodwill is measured at acquisition date under Ind AS 103. Even if subsidiary pays dividend subsequently (whether out of pre-acquisition or post acquisition profits) there will be no change in Goodwill. NCI in subsequent Consolidated Balance Sheet is the sum total of NCI at acquisition and NCI's share in post-acquisition change in other equity of subsidiary. However on the reporting date any dividend (whether out of pre-acquisition or post acquisition profits) payable by subsidiary shall, to the extent of NCI's share, be subtracted from NCI to be shown as a separate liability.

Illustration 1

Company P Ltd. (a listed company) acquires 20% shares (entitling 20% voting power and significant influence) in company Q Ltd. on 1.4.2020 at a cost of ₹ 46,000, paid by cash. During the financial year 2020-2021, Q made profits of ₹ 20,000 and other comprehensive income of ₹ 10,000.

(a) Whether for the investment in shares of Q, P requires preparation of consolidated financial statements and separate financial statements?

(b) Pass the journal entries in books of P at the time of acquisition.

(c) Show the relevant accounting treatment at the end of the year in (i) consolidated and (ii) separate financial statements of P.

Solution:

(a) P Ltd. requires preparation of consolidated financial statements because it has investment in Associate Q Ltd. Ind AS 28 requires that accounting for investment in associate and in joint venture should be made under equity method in the consolidated financial statement. Q is an Associate because P has significant influence in Q by virtue of its 20% voting power through holding of 20% shares in Q.

Ind AS 28 also requires P the investor company to prepare separate financial statement as per Ind AS 27.

(b) **Journal** **Dr.** **Cr.**

Particulars		(₹)	(₹)
Investment A/c	Dr.	46,000	
To, Cash A/c			46,000

(c) There will be two sets of accounting at the end the year, one for consolidated accounts and the other for separate financial statements.

(i) For consolidated accounts Ind AS 28 requires the recognition of investment by equity method.

At the year end in consolidated accounts of P Ltd., adjustments are made to the Investment and income accounts as per equity method:

Working Note:

Change in investee's net assets = ₹20,000 + ₹10,000 = ₹30,000;

Share of P = 20% of ₹30,000 = ₹6,000.

Investor's Profit or loss includes 20% of ₹20,000 = ₹4,000 and

other comprehensive income includes 20% of ₹10,000 = ₹2,000.

(ii) At the year end for the separate financial statements of P Investment is valued at cost at ₹ 46,000 or at a value as per Ind AS 109.

Illustration 2 A

X Ltd. acquired 20% shares of B Ltd. on 01.04.20X1. X Ltd. further acquired on 01.04.20x2 60% shares of B Ltd. at a consideration of ₹3,60,000 in cash and by issue of 10000 shares of ₹ 10 (market price ₹15). Debentures of B Ltd. were exchanged for 12% Debenture of X Ltd. A contingent consideration was also payable, fair value of which at the date of acquisition was estimated at ₹ 60,000. X Ltd. paid transaction cost ₹20,000. The fair value of shares previously held in B Ltd. amounts to ₹ 1,10,000. The fair values of assets and liabilities of B Ltd. are stated below:

	Fair Value ₹
PPE	3,00,000
Current Assets	4,20,000
Creditors	36,000

The abstracts of consolidated balance sheet of A and individual balance sheet of B on 31-03-20X2 are given below: [Amount in ₹]

Prepare summarised Separate and Consolidated balance sheet as at 1-04-20X2.

Solution:

Working note 1: Net Identified Assets at fair value

Particulars	Fair Value (₹)
PPE	3,00,000
Current Assets	4,20,000
Less Creditors	36,000
Less Debenture	10,000
Net Identified Assets at fair value	6,74,000

Working note 2: Consideration [Debentures exchanged are separately considered and Transaction cost is expensed through P&L of Acquirer.]

Particulars	(₹)
Cash Payment	3,60,000
Issue of shares	1,50,000

Particulars	(₹)
Contingent Consideration	60,000
Consideration	5,70,000

Working note 3: Fair value of previously held interest

Particulars	(₹)
Carried value	1,00,000
Fair Value for 20% interest (based on fair value of NCI)	1,10,000
Profit on Revaluation through P&L	10,000a

Working note 4: NCI

Non-Controlling Interest is recognized at Fair value of ₹ 1,10,000

Working note 5: Goodwill

Particulars	(₹)
Consideration	5,70,000
Fair value of previously held shares	1,10,000
NCI	1,10,000
Total	7,90,000
Net Identified Assets at fair value	6,74,000
Goodwill	1,16,000

Working note 6: Journal for consolidated accounting: **Dr.** **Cr.**

Particulars		Dr. (₹)	Cr. (₹)
Investment A/c	Dr.	10,000	
To, Profit and Loss A/c			10,000
PPE A/c	Dr.	3,00,000	
Current Assets A/c	Dr.	4,20,000	
Goodwill A/c	Dr.	1,16,000	
To, Consideration A/c			5,70,000
To, Creditors A/c			36,000
To, 12% Debentures A/c			10,000
To, NCI A/c			1,10,000
To, Investment A/c			1,10,000

Particulars		(₹)	(₹)
Consideration A/c	Dr.	5,70,000	
To, Equity Share Capital A/c			1,00,000
To, Security Premium A/c			50,000
To, Cash A/c			3,60,000
To, Liability for Contingent Consideration A/c			60,000
Transaction Cost A/c	Dr.	20,000	
To, Cash A/c			20,000
Profit and Loss A/C	Dr.	20,000	
To, Transaction Cost A/c			20,000

Working note 7: Journal for separate accounting: **Dr.** **Cr.**

Particulars		(₹)	(₹)
Investment A/c	Dr.	5,80,000	
To, Equity Share Capital A/c			1,00,000
To, Security Premium A/c			50,000
To, Cash A/c			3,60,000
To, Liability for Contingent Consideration A/c			60,000
To, 12% Debenture A/c			10,000
Transaction Cost A/c	Dr.	20,000	
To, Cash A/c			20,000
Profit and Loss A/C	Dr.	20,000 b	
To, Transaction Cost			20,000

Summarised Separate Balance Sheet of X Ltd. and Consolidated Balance Sheet of the Group as at 01.04.20X2

(Amount in ₹)

Particulars	Working for consolidation	Working for Separate	Separate	Consolidated
PPE	1,80,000+3,00,000	1,80,000	1,80,000	4,80,000
Investment		1,00,000+5,80,000	6,80,000	
Goodwill	Note 5			1,16,000
Current Assets	6,60,000+4,20,000-3,60,000-20,000	6,60,000-30,000-20,000	2,80,000	7,00,000
Total			11,40,000	12,96,000
Equity Share Capital	4,60,000+1,00,000		5,60,000	5,60,000

Particulars	Working for consolidation	Working for Separate	Separate	Consolidated
Other Equity	3,70,000 + 50,000 + 10,000a – 20,000b (transaction cost)	3,70,000+50,000-20,000	4,00,000	4,10,000
NCI	Note 4			1,10,000
12% Debenture	60,000+10,000		70,000	70,000
Liability for contingent consideration			60,000	60,000
Trade Payables	50,000+36,000	50,000	50,000	86,000
Total			11,40,000	12,86,000

Note 1:

In the above problem regarding the carried amount of the old investment of 20 % interest in B Ltd. the question was silent whether it is at cost or at equity method value. In the solution to avoid complication it is assumed that both cost and equity method value are same. On the contrary if we change Investment in B Ltd. on the Balance sheet of X Ltd on 31.03.20X2 as below, the solution will be different.

Illustration 2 B

In problem 2A Investment in B Ltd. carried at amount of ₹.100000 is valued under equity method with share of post-acquisition profits in Associate ₹. 15000. Show separate balance sheet on 31-03-20X2 and on 01-04-20X2.

Solution:

Working note 1: Fair value of previously held interest:

Particulars	(₹)
Carried value (Equity Method)	1,00,000
Fair Value for 20% interest (based on fair value of NCI)	1,10,000
Profit on Revaluation through P&L	10,000[a]

Post-acquisition share of profit and loss in Associate ₹15,000c

Cost of Investment = ₹1,00,000 – ₹15,000 = ₹ 85,000

Working note 2:

For Separate financial statements Other Equity of X Ltd. is consolidated Other Equity less the post-acquisition profits of ₹ 15,000 c .

Separate balance sheet of X Ltd. as at 31.03.20X2 is as below.

Liabilities	(₹)	Assets	(₹)
Equity Share Capital	4,60,000	PPE	1,80,000

Liabilities	(₹)	Assets	(₹)
Other Equity ₹(3,70,000-15,000 c)	3,55,000	Investment in 20% shares in B Ltd. ₹(1,00,000-15,000 c)	85,000
12% Debenture	60,000	Current Assets	6,60,000
Creditors	50,000		
Total	9,25,000	Total	9,25,000

Summarised Separate Balance Sheet of X Ltd. and Consolidated Balance Sheet of the Group as at 01.04.20X2

(Amount in ₹)

Particulars	Working for consolidation	Working for Separate	Separate	Consolidated
PPE	1,80,000+3,00,000	1,80,000	1,80,000	4,80,000
Investment		85,000+5,80,000	6,65,000	
Goodwill	Note 5			1,16,000
Current Assets	6,60,000+4,20,000-3,60,000-20,000	6,60,000-30,000-20,000	2,80,000	7,00,000
Total			**11,25,000**	**12,96,000**
Equity Share Capital	4,60,000+1,00,000		5,60,000	5,60,000
Other Equity	3,55,000 + 50,000 + 10,000[a] – 20,000[b] (transaction cost)	3,55,000+50,000-20,000	385000	4,10,000
NCI	Note 4			1,10,000
12% Debenture	60,000+10,000		70,000	70,000
Liability for contingent consideration			60,000	60,000
Trade Payables	50,000+36,000	50,000	50,000	86,000
Total			**11,25,000**	**12,86,000**

Illustration 2C

In problem 2A Investment in B Ltd. carried at amount of ₹1,00,000 is valued under equity method with share of post-acquisition profits in B Ltd. (Associate) ₹ 16,000 and share of post-acquisition OCI in B Ltd. (Associate) ₹ 8,000. Show separate balance sheet on 31.03.20X2 and on 01.04.20X2.

Solution:

Working note 1: Fair value of previously held interest:

Particulars	(₹)
Carried value (Equity Method)	1,00,000

Particulars	(₹)
Fair Value for 20% interest (based on fair value of NCI)	1,10,000
Profit on Revaluation through P&L	10,000[a]

Post-acquisition share of profit and loss in Associate ₹16,000[d]

Post-acquisition share of OCI in Associate ₹ 8,000[d]

Cost of Investment = ₹(1,00,000 – 16,000 – 8,000) = ₹ 76,000

Working note 2: For Separate financial statements Other Equity of X Ltd. is consolidated other equity less the post-acquisition profits of ₹ 24,000 [d] (₹16,000 +₹8,000)

Separate balance sheet of X Ltd. as at 31.03.20X2 is as below.

Separate balance sheet of X Ltd. as at 01-04-20X2:

Particulars	Working for Separate (₹)	Separate (₹)
PPE	1,80,000	1,80,000
Investment	76,000 + 5,80,000	6,56,000
Goodwill		
Current Assets	6,60,000 - 30,000 - 20,000	2,80,000
Total		11,16,000
Equity Share Capital		5,60,000
Other Equity	3,46,000 + 50,000-20,000	3,76,000
NCI		
12% Debenture		70,000
Liability for contingent consideration		60,000
Trade Payables	50,000	50,000
Total		11,16,000

Consolidated accounting is changed as follows:

Additional entry in (i) Dr. Cr.

Particulars		(₹)	(₹)
OCI A/c	Dr.	8,000	
To, Profit and Loss A/c (Transfer)			8,000

Corresponding changes in statement of Change in equity should be made but other equity total will not be affected.

There will be no other change in consolidated accounts. Thus, summarized consolidated balance sheet of the group remained unchanged in 2A, 2B and 2C.

Illustration 2D

In continuation of the original problem 2A above, on 01.04.20X3, X Ltd. sold 5% interest in B Ltd. at a price of ₹ 54,000 in cash (the NCI share of profit during 20X2-X3 was ₹10,000). On 01.04.20X4 X Ltd. purchased 25% interest in B Ltd. at a price of ₹ 1,50,000 in cash (the NCI share of profit during 20X3-X4 was ₹12,000). Show the journal entries in separate set of accounting and in consolidated set of accounting.

In Separate set: **Dr.** **Cr.**

Particulars		(₹)	(₹)
On 01.04.20X3			
Cash A/c	Dr.	54,000	
To, Investment A/c [(5/80) × ₹6,80,000][1]			42,500
To, P&L A/c			11,500
On 01-04-20X4			
Investment A/c	Dr.	1,50,000	
To, Cash A/c			1,50,000

[1] On 01.04.20X2 Investments(80%) were valued at ₹ 6,80,000. For sale of 5% interest Investment is credited by (5/80) × ₹6,80,000.

In consolidated set: **Dr.** **Cr.**

Particulars		(₹)	(₹)
On 01.04.20X3			
Cash A/c	Dr.	54,000	
To, NCI A/c [(5/20)× ₹(1,10000+10,000)][2]			30,000
To, Other Equity A/c			24,000
On 01-04-20X4			
NCI A/c (₹1,50,000+₹12,000)[3]	Dr.	1,62,000	
To, Other Equity A/c			12,000
To, Cash A/c			1,50,000

[2] On 01.04.20X2 NCI value was ₹ 1,10,000. Share of NCI for profits during 20X2-20X3 was ₹ 10,000. On 01.04.20X3 NCI (20%) is valued at ₹1,10,000 + ₹10,000 = ₹ 1,20,000. For sale of 5% shares in B Ltd. NCI is increased (credited) by (5/20)× ₹1,20,000 = ₹ 30,000.

[3] On 01.04.20X3 NCI value was ₹ (1,20,000 + 30,000) = ₹1,50,000. Share of NCI for profits during 20X3-20X4 was ₹ 12,000. On 01.04.20X4 NCI (25%) is valued at ₹(1,50,000+12,000) = ₹1,62,000. For purchase of 25% interest in B Ltd. NCI is decreased (debited) by (25/25) × ₹1,62,000 = ₹ 1,62,000.

[2] On 01.04.20X2 NCI value was ₹ 1,10,000. Share of NCI for profits during 20X2-20X3 was ₹ 50,000×20% = ₹ 10,000. On 01-04-20X3 NCI (20%) is valued at ₹1,10,000+₹10,000 = ₹ 1,20,000. For sale of 5% shares in B Ltd. NCI is increased (credited) by (5/20)× ₹1,20,000 = ₹ 30,000.

[3] On 01.04.20X3 NCI value was ₹1,20,000 + ₹30,000 = ₹1,50,000. Share of NCI for profits during 20X3-20X4 was ₹48,000×25% = ₹ 12,000. On 01.04.20X4 NCI (25%) is valued at ₹1,50,000 + ₹12,000 = ₹ 1,62,000. For purchase of 25% interest in B Ltd. NCI is decreased (debited) by (25/25)×₹1,62,000 = ₹ 1,62,000.

Consolidated Financial Statements and Separate Financial Statements at Subsequent Reporting Date- Introductory Examples

6.6

Let us take an illustrative problem.

Company P Ltd. acquires 80% shares of company S Ltd. on 1.4.2020 by issue of equity shares of ₹ 10 each at a premium of ₹30. The financial data of the companies at 31.3.2020 are stated below. Non-Controlling Interest is valued at fair value. (₹ in Lakhs).

Particulars	On 31-3-17			On 31-3-18	
	P Ltd.	S Lyd.	FV of S Ltd.	P Ltd.	S Ltd.
PPE	720	480	700	800	560
Investment in S				640	
Current Assets (CA)	450	350	300	500	360
Equity	500	300		1240	360
Noncurrent Liability	350	300	310	320	320
Current Liability	320	230	200	380	240

Pass entries for business combination under acquisition method and show consolidated and separate balance sheet abstract on 31.03.2020 and on 31.03.2021.

Solution: **(₹ in Lakhs)**

WN 1. Purchase Consideration is ₹640 (Paid Up ₹10: premium ₹30; Equity Share Capital ₹160 and Security Premium ₹480)

WN 2. Fair Value of Net Identified Assets

	FV of S Ltd. (₹)
PPE	700
Current Assets (CA)	300
Noncurrent Liability	(310)
Current Liability	(200)
Net Assets	490

WN 3: NCI at fair value = 20%/80% × ₹640 = ₹160

WN 4. Goodwill = Consideration + NCI – Net Assets = ₹(640 + 160 – 490) = ₹310

Journal for business combination

Particulars		Dr. (₹)	Cr. (₹)
On 01.04.20X3			
PPE A/c	Dr.	700	
Current Assets A/c	Dr.	300	
Goodwill A/c (WN 4)	Dr.	310	
To, Non-Current Liabilities A/c			310
To, Current Liability A/c			200
To, Purchase Consideration A/c			640
To, NCI A/c (WN 3)			160
Purchase Consideration A/c	Dr.	640	
To, Equity Share Capital A/c			160
To, Security Premium A/c			480

Consolidated Balance Sheet (abstract) of P Ltd. and S Ltd. at 01.04.2020

Particulars	(₹)	Consolidated (₹)	Separate (₹)
PPE	720+700	1,420	720
Goodwill		310	
Investment			640
CA	450+300	750	450
Total Assets		**2,480**	**1,810**
Equity	500+640	1,140	1,140
NCI		160	-
Noncurrent Liability	350+310	660	350
Current Liability	320+200	520	320
Total of Equity and Liability		2,480	

WN 5: Other Equity of S

Particulars	(₹)
Balance on 31-03-18	360
Less: Balance on 31-03-17	300
Increase	60
Revaluation loss of Current assets	50

Particulars	(₹)
Revaluation profit of Current liabilities	30
Net Loss	20
Revaluation net loss reverted	20
Post acquisition change in Other Equity	80
P's share	64
NCI	16

WN 6: Consolidated equity = ₹1,240 + 64 = ₹1,304

WN 7: NCI on 31.03.2021= ₹160 + ₹16 = ₹176

Consolidated Balance Sheet (abstract) of P and S at 31.3.2021

Particulars	(₹)	Consolidated (₹)	Separate (₹)
PPE	800 + 560 + 220 (Rev)	1,580	800
Goodwill		310	
Investment			640
CA	500 + 360	860	500
Total Assets		**2,750**	**1,940**
Equity		1,304	1,240
NCI		176	
Noncurrent Liability	320 + 320 + 10 (Rev)	650	320
Current Liability	380 + 240	620	380
Total of Equity and Liability		**2,750**	**1,940**

Illustration 3

Company P Ltd. (a listed company) acquires 60% shares in company Q Ltd. on 01.04.17 at a cost of (₹ in Lakhs) 138, paid by issue of shares of ₹ 10 at par. The abstract of balance sheets of Q (along with fair values at the acquisition date) and P at the beginning and at the end of the year are as follows: (₹ in Lakhs)

Particulars	Q Ltd.			P Ltd.	
	1-4-2021 Book Value	1-4-2021 Fair Value	31-3-2022 Book Value	1-4-2021	31-3-2022
PPE	175	200	190	276	300
Investment in Q				138	138

Particulars	Q Ltd.			P Ltd.	
	1-4-2021 Book Value	1-4-2021 Fair Value	31-3-2022 Book Value	1-4-2021	31-3-2022
Other Non-current Financial Assets	80	60	70	100	120
Inventories	45	48	50	68	80
Total assets	300		310	582	638
Equity Share Capital	130		130	338	338
Other Equity	80		90	120	150
Borrowings	60	60	64	80	100
Trade Payables	30	28	26	44	50
Total of Equity and Liabilities	300		310	582	638

Prepare consolidated balance sheet of P Ltd on 31.3.2022 based on Ind AS 110. Solution:

Abstract of Consolidated balance sheet of P Ltd. and its subsidiary Q Ltd. as at 31.3.22 (₹ in Lakhs)

Particulars	Working	(₹)
Assets:		
PPE	300+215[X]	515
Goodwill		10#
Financial Assets	120+50[Z]	170
Inventories	80+50[Y]	130
Total Assets		**825**
Equity and Liabilities :		
Equity Share Capital		338
Other Equity		153$
NCI		94&
Liabilities:		
Borrowings	100+64	164
Trade Payables	50+26	76
Total of Equity and Liabilities		**825**

Working Notes:

1. Net Assets of Q Ltd. at Fair value (₹ in Lakhs)

Items	on 1.4.21 at Book Value	On 1.4.21 at Fair Value	Profit for Reversal of change in current items	Change in book value post acquisition
PPE	175	200		190-175 = 15
Inventories	45	48	-3	50-45 = 5
Non-current Financial Assets	80	60		70-80 = -10
Total assets	**300**	**Total = 308**		
Equity Share Capital	130			
Other Equity	80			90-80 = 10[k]
Borrowings	60	60		64-60 = 4
Trade Payables	30	28	-2	
Total of Equity and Liabilities	**300**	**Total = 88**		
Net Assets at Fair value		**220**		

2. NCI at acquisition:

   Fair Value of Consideration transferred = ₹138;

   NCI recognized at Fair Value: 40%× ₹138/60% = ₹92@;

   [Alternative solution: @NCI can be measured at proportionate share of identifiable net assets = 40% × ₹220 = ₹88; in that case NCI will be less by 4 and Goodwill also less by 4]

3. #: Goowill = Consideration + NCI – Fair Value of Identifiable Net Assets = ₹138 + ₹92 – ₹220 = ₹10.

4. Balance Sheet data of Q Ltd. (₹ in Lakhs)

Particulars	1	2	3	4
	1.4.2021 Fair Value	Reversal of change in Current items to Retained Earnings	Change in Bk Value carried to subsequent B/S	Adjusted B/S On 31.3.18 (1+2+3)
PPE	200	-	+15	215[x]
Inventories	48	-3[p]	5	50[Y]
Financial Assets	60		-10	50[Z]
Borrowings	60		4	64
Trade Payables	(28)	-2[q]		(30)

1. Post-acquisition total comprehensive income of Q = $10^{k} – 3^{p} – 2^{q}$ = 5;
2. NCI at reporting date: &:

   NCI at the time of acquisition (@) = ₹92;

   Share of NCI in post-acquisition TCI= 40% × 5 = ₹2; Total NCI at the year end = ₹92 + ₹2 = ₹94
3. Other Equity of P at the end of the year = ₹150;

   Share of post-acquisition Total comprehensive income of Q = 60% × 5 = 3;

   Other equity consolidated = ₹150 + ₹3 = ₹153. $

Illustration 4

Company P Ltd. (P) acquires 80% shares of company S Ltd. (S) on 1.10.2020 by issue of equity shares at total Fair Value of ₹440 Lakhs, total paid up value ₹100 Lakhs. Non-Controlling Interest (NCI) should be measured at proportionate Net Assets. The total comprehensive income of P and S in the year ending on 31.3.2021 amounted to ₹120 Lakhs and ₹140 Lakhs respectively. The extracts from balance sheets at book values and at fair values at the date of acquisition and at 31.03.2021 are stated below. (₹ in Lakhs)

Particulars	On 1.10.2020			On 31.3.2021	
	P	S	FV of S	P	S
PPE	680	440	700	720	500
Investment in Shares of Q				440	
Current Assets	420	360	320	500	400
Total Assets	1,100	800		1,660	900
Current Liability	300	200	200	340	220
Noncurrent Liability	300	300	300	320	310
Total Liabilities	600	500		660	530
Net assets at Fair Value			520		

Equity structure of the companies: (₹ in Lakhs)

	P Ltd.		S Ltd.	
	On 01.04.2020	On 31.03.2021	On 01.04.2020	On 31.03.2021
Equity Share Capital	200	300^{x}	100	100
Other Equity	240	700^{x}	130	270

Prepare CBS on 01.10.2020 and on 31.03.2021.

Solution:

Working Notes: (₹ in Lakhs)

1. Analysis of profits of S:	Pre-acquisition	Post-acquisition
Other Equity on 01.04.2020	130	
Revaluation Profit/Loss ₹(260-40) Lakhs	220	
Profits during the year ₹140 Lakhs		
50%× ₹140 Lakhs pre and 50% post	70	70
Revaluation loss on Current Asset reverted		40[z]
Other Equity on 01.10.2017	**420**	**110**
Share of P 80%		88[@]
Share of NCI 20%		22[@]

2. Net Assets of S at Fair Value represented by Equity Share Capital + Pre-acquisition Profits (Other Equity at acquisition):

   Equity Share Capital ₹ 100 Lakhs

   Other Equity on 01.10.2020 ₹ 420 Lakhs

   Net Assets ₹ 520 Lakhs

3. NCI at acquisition = 20% × 520 = 104[$]

4. Goodwill = Purchase Consideration + NCI – Net Assets = ₹ (440 + 104 – 520) = ₹ 24 Lakhs[#]

Consolidated Balance Sheet of P Ltd. and its subsidiary S Ltd as on 01.10.2020

Particulars	Workings	(₹ in Lakhs)
PPE	680 + 700	1,380
Goodwill		24#
Current Assets	420 + 320	740
Total Assets		**2,144**
Equity Share Capital	(200 + 100)	300
Other Equity on 01.10.2020	(240 + 60 + 340)	640
NCI		104[$]
Noncurrent Liability	300+300	600
Current Liability	300+200	500
Total of Equity and Liabilities		**2,144**

Consolidated Balance Sheet of P Ltd. and its subsidiary S Ltd. as on 31.03.2021

Particulars	Workings	(₹ in Lakhs)
PPE	720 + 500 + 260	1,480
Goodwill		24[#]
Current Assets	500 + 400 - 40 + 40[z]	900
Total Assets		**2,404**
Equity Share Capital		300[x]
Other Equity	700 [x] + 88[@]	788
NCI	104[$] + 22[@]	126
Noncurrent Liability	320 + 310	630
Current Liability	340 + 220	560
Total of Equity and Liabilities		**2,404**

Illustration 5

D Co. Ltd acquired 60% shares of G Co. Ltd. on 1st October 2020. The Retained Earnings balance of G on 01.04.2020 was ₹ 5,000. G declared dividend for 2020-2021 ₹ 6,000 (accounted in books of G but not accounted in books of D).

The abstracts from balance sheets of D and G as at 31.03.2021 are: (Amount in ₹)

Particulars	D		G	
PPE		60,000		30,000
Investments: Shares in G		24,000		
Current Assets		20,000		16,000
Total Assets		1,04,000		46,000
Equity Shares		50,000		25,000
Other Equity (Retained Earnings)		25,000		11,000
Current Liabilities		29,000		10,000
Total of Equity and Liabilities		1,04,000		46,000

Required: Separate and Consolidated Balance sheet as at 31.03.2021

Solution: **(Amount in ₹)**

WN 1: Share of parent and NCI in subsidiary: Share of D = 60%

NCI = 40%

WN 2: Pre-acquisition profits of G:

Particulars	(₹)	Pre (₹)	Post (₹)
Retained Earnings on 01.04.2020			5,000
Retained Earnings on 31.03.2021	11,000		
Add: dividend declared	6,000		
Earnings before dividend	17,000		
Less: Opening balance	5,000		
Profits during the year	12,000	6,000	6,000
		11,000	6,000

Acquisition being made in the mid of the year profits during the year is divided equally between Pre and Post. Share of NCI in post-acquisition profits = ₹6,000×40% = ₹2,400

WN 3 : FV of net assets identified as at 01.10.2020:

Particulars	(₹)
Equity Shares	25,000
Pre-acquisition Profits	11,000
Book Value of Net Assets as at 01.10.2020	26,000
It is assumed that Fair value is same as Book value.	
Thus fair value of Net Assets identified = ₹36,000	
WN 4: Goodwill:	
Purchase consideration (investment)	24,000
NCI (FV) at acquisition (40/60) × ₹24,000	16,000
Total	40,000
Less: Net Assets identified (WN 3)	36,000
Goodwill	4,000
WN 5: NCI at acquisition	16,000
Add: share of Post-acquisition profit 40% × ₹6,000	2,400 (WN 2)
Less: Dividends payable to NCI 40% × ₹6,000	2,400 (to be shown as current liability)
NCI at reporting date	16,000
WN 6: Consolidated other equity:	
Other equity of D	25,000

Particulars	(₹)
Share of post-acquisition profit of G (60% × ₹6,000)	3,600

Consolidated Balance Sheet as at 31.03.2021

Assets	Separate	Consolidated	
Non-current Assets			
PPE	60,000	60,000 + 30,000	90,000
Investment (24000-1800)	22,200		
Goodwill (WN 4)			4,000
Current Assets (20000+3600)	23600	20,000 + 16,000	36,000
Total	**1,05,800**		**1,30,000**
Equity and Liabilities			
Equity			
Equity Share Capital	50,000		50,000
Consolidated Other Equity (WN 6)	26,800		28,600
NCI (WN 5)			16,000
Current Liabilities (WN 7)	29,000	29000 + 6400	35,400
Total	1,05,800		1,30,000

Illustration 6

Company P Ltd. (a listed company) invests in shares of company Q Ltd. on 01.04.2020 at a cost of ₹ 66,000, paid by cash. During the financial year 2020-2021, Q made profits of ₹ 20000 and other comprehensive income of ₹ 10,000. The following alternative scenarios are presented:

I. Investment entails 25% voting power and significant influence over Q.

II. P does have joint control of Q, a joint venture.

III. Investment entails significant influence over Q, which is a Joint Venture and P does not have joint control of Q.

IV. P does not have significant influence over Q.

V. P does not have joint control of or significant influence over Q, which is a joint venture. For each of the cases I, II , III, IV and V:

(a) State whether for the investment in shares of Q, P requires preparation of consolidated financial state ments and separate financial statements.

(b) Pass the journal entries in books of P at the time of purchase of shares.

(c) Show the relevant accounting treatment at the end of the year for

(i) consolidated financial statements,

(ii) separate financial statements and

(iii) Individual financial statements of P.

Solution:

(a) In cases I, II and III, P Ltd. requires preparation of consolidated financial statements for its investment in Q Ltd.

In case I, Q is an Associate because P has significant influence in Q by virtue of its 25% voting power. In case II, Q is a joint venture in which P has joint control.

In case III, Q is a joint venture in which P does not have joint control, but has significant influence. For each of the above cases, Ind AS 28 requires that accounting for investment in associate or in joint venture (having joint control or significant influence) should be made under equity method in the consolidated financial statement.

Ind AS 28 also requires P the investor company to prepare separate financial statement as per Ind AS 27. For cases IV and V, P requires preparation of Individual financial statements.

(b) Journal Entry on 01.04.2020 for cases I, II and III for both Consolidated and separate financial statements:

Particulars		**Dr. (₹)**	**Cr. (₹)**
Investment A/c	Dr.	66,000	
To, Cash A/c			66,000

Journal Entry for cases IV and V: As per Ind AS 109 for Individual financial statements. At initial measurement:

Particulars		**Dr. (₹)**	**Cr. (₹)**
Investment A/c	Dr.	66,000	
To, Cash A/c			66,000

(c) Journal Entry on 31-03-2018 for cases I, II and III:

There will be two sets of accounting at the end the year, one (i) for consolidated accounts and the other (ii) for separate financial statements.

(i) For consolidated accounts Ind AS 28 requires the recognition of investment by equity method.

Particulars	**Dr. (₹)**	**Cr. (₹)**
Investment A/c	7,500	
To Profit and Loss A/c		5,000
To Other Comprehensive Income A/c		2,500

Working Note: Change in investee's Net Assets = ₹20,000 +₹10,000 = ₹30,000;

Share of P = 25% of ₹30,000 = ₹7500.

Investor's Profit or loss includes 25% of ₹20,000 = ₹5,000 and other comprehensive income includes 25% of ₹10,000 = ₹2,500.

(ii) At the yearend for the separate financial statements of P, Investment is valued at cost at ₹ 66,000 or at a value as per Ind AS 109.

Note: There will be no individual financial statement of P for cases I, II and III.

For cases IV and V: Investment shall be valued as per Ind AS 109 in Individual financial statements. There will be no consolidated and no separate financial statement

Illustration 7

The financial data of the companies P and S at 31.03.2020 and at 31.03.2021 are stated below. (₹ in Lakhs)

Particulars	On 31.03.2020		On 31-3-2021	
	S (Individual B/S) (₹)	Fair Value of S (₹)	P (Separate B/S) (₹)	S (Individual B/S) (₹)
PPE	480	700	750	500
Investment in S (60% shares acquired on 01.04.2020 by issue of Equity)			480	
CA	350	300	540	400
			1,770	900
Equity	300		1,070	360
Non-current Liability	300	310	360	330
Current Liability	230	200	340	210

Prepare Consolidated Balance Sheet.

Solution: (₹ in Lakhs)

WN 1: Purchase consideration = 480

WN 2: Fair value of net identified assets at the date of acquisition:

	Fair Value of S (₹)	Revaluation profits (loss)	
		Non-Current (₹)	Current (₹)
PPE	700	220	
CA	300		(50)
Noncurrent Liability	310	(10)	
Current Liability	200		30
Net assets	490		(20)

WN 3: Post-acquisition TCI of S:

Particulars	(₹ in Lakhs)
Equity on 31.03.2021	360

Particulars	(₹ in Lakhs)
Less Equity on 31.03.2020	300
TCI Post-Acquisition (assumed no fresh issue of shares)	60
Add: Reversal of Revaluation loss on Current items#	20
Adjusted Post-acquisition TCI	80
Share of Parent (60% × ₹80)	48
Share of NCI (40% × ₹80)	32

Revaluation profit (loss) on current items at acquisition date is reverted against post acquisition profits (loss) of subsidiary

WN 4: NCI at proportionate net assets at acquisition date = 40% × 490 = 196

Particulars	(₹ in Lakhs)
Add: Share of NCI in post-acquisition TCI	32
NCI at reporting date	228

WN 5: Goodwill = Consideration + NCI at acquisition – Net Assets = 480 + 196 – 490 = 186

WN 6: Consolidated Equity:

Particulars	(₹ in Lakhs)
Equity of P	1,070
Share of P in Post-acquisition TCI of S	48
Consolidated Equity	1,118

Consolidated Balance Sheet of P and S on 31.03.2021 (₹ in Lakhs)

	Book Value	Adjustment on non-current items (FV – BV)	Consolidated
PPE	750 + 500	+220	1,470
Goodwill		WN 5	186
CA	540 + 400	[revaluation loss 50]$	940
Total Assets			**2,596**
Equity		WN 6	1,118
NCI		WN 4	228
Noncurrent Liability	360 + 330	+10	700
Current Liability	340 + 210	[revaluation gain 30]$	550
Total of Equity and Liability			**2,596**

$ Net revaluation loss on current items ₹(50-30) Lakhs = ₹20 Lakhs is not adjusted in consolidated value, rather it is reverted to Retained earnings and TCI of S is increased.

Illustration 8

Company Sky Ltd. (a listed company) acquires 60% shares in company Cloud Ltd. on 01.04.2020 at a cost of ₹1,50,000, paid by issue of shares of ₹ 10 (Market Price ₹ 25). The abstract of balance sheets of Cloud (along with fair values at the acquisition date) and Sky at the end of the year 2019-2020 and 2020- 2021 are as follows:

Particulars	Cloud (₹Lakhs)			Sky (₹Lakhs)	
	31.03.2020 Book Value	31.03.2020 Fair Value	31.03.2021 Book Value	31.03.2020	31.03.2021
PPE	1,94,000	2,10,000	2,06,000	2,80,000	3,00,000
Investment in Q					1,50,000
Inventories	45,000	54,000	58,000	74,000	80,000
Financial Assets	88,000	50,000	98,000	1,00,000	1,20,000
Total Assets	**3,27,000**		**3,62,000**	**4,54,000**	**6,50,000**
Equity Share Capital	1,50,000		1,50,000	2,00,000	2,60,000
Other Equity	87,000		1,17,000	1,20,000	2,40,000
Borrowings	60,000	60,000	64,000	90,000	1,00,000
Trade Payables	30,000	25,000	31,000	44,000	50,000
Total	**3,27,000**		**3,62,000**	**4,54,000**	**6,50,000**

(a) Pass journal entries in consolidated accounts of P and show consolidated balance sheet on 1.04.2020 based on Ind AS 103 and Ind AS 110 and separate balance sheet of P on 1.04.2020 based on Ind AS 27.

(b) Prepare consolidated balance sheet of P on 31.03.2021 based on Ind AS 110.

Solution:

Working Note 1: Assets and liabilities of Cloud recognized at Fair value. (₹ Lakhs)

Particulars	01.04.2020 Fair Value
PPE	2,10,000
Inventories	54,000
Financial Assets	50,000
Total	3,14,000
Borrowings	60,000
Trade Payables	25,000
Total	85,000

Particulars	01.04.2020 Fair Value
Net Assets at fair value	2,29,000$

(a) Journal entries in books of Sky:

Particulars		Dr. (₹)	Cr. (₹)
PPE A/c	Dr.	2,10,000	
Inventories A/c	Dr.	54,000	
Financial Assets A/c	Dr.	50,000	
Goodwill A/c (balancing Figure #)	Dr.	21000	
To, Consideration			1,50,000
To, NCI @ A/c			1,00,000
To, Borrowings A/c			60,000
To, Trade Payables A/c			25,000
Consideration A/c	Dr.	1,50,000	
To Equity Share Capital A/c [(10/25) × ₹1,50,000]			60,000
To Security Premium A/c (Other Equity) [(15/25) × ₹1,50,000]			90,000

[Working Notes:

@ NCI recognized at Fair Value: 40% × ₹1,50,000/60% = ₹1,00,000;

Goodwill = Consideration + NCI – Fair Value of Identifiable Net Assets = ₹1,50,000 + ₹1,00,000@ – ₹2,29,000$ = ₹21,000.

Alternative solution: @ NCI can be measured at proportionate share of identifiable net assets = 40% × ₹2,29,000 = ₹91,600.

Balance sheet (abstracts) of Sky and Cloud as at 01.04.2017 (based on Ind AS 103, Ind AS 110 and Ind AS 27)

(₹ Lakhs)

Particulars	Cloud (Fair Value)	Sky	
		Separate	Consolidated
PPE	2,10,000	2,80,000	4,90,000
Goodwill			21000
Investment in Cloud		1,50,000	
Inventories	54,000	74,000	1,28,000
Financial Assets	50,000	1,00,000	1,50,000
Total assets		6,04,000	7,89,000

Particulars	Cloud (Fair Value)	Sky	
		Separate	Consolidated
Equity Share Capital		2,60,000	2,60,000
Other Equity [1,20,000 + 90,000]		2,10,000	2,10,000
NCI			1,00,000
Borrowings	60,000	90,000	1,50,000
Trade Payables	25,000	44,000	69,000
Total of Equity and Liabilities		6,04,000	7,89,000

(b) Working Note 1: Adjustment to Balance sheet data of Cloud (₹ Lakhs)

Particulars	1	2	3	4	5	6
	31.03.17 Book Value	01.04.17 Fair Value	Revaluation Profit (loss) of current items	Reversal of change in Current items to Retained Earnings	Change in Bk Value carried to subsequent B/S	Adj. B/S on 31.03.18
PPE	1,94,000	2,10,000		-	12,000	2,22,000[x]
Financial Assets	88,000	50,000			10,000	60,000[Z]
Inventories	45,000	54,000	+9,000	-9,000	13,000	58,000[Y]
Borrowings	60,000	60,000	-	-	4,000	64,000
Trade Payables	30,000	25,000	+5,000	-5,000	1,000	31,000
Total				-14,000		

Working Note 2: #: Goodwill is recognised in (a) above.

Working Note 3: NCI at the year-end NCI at the time of acquisition = ₹1,00,000

Post-acquisition total comprehensive income of Cloud = ₹1,17,000 – ₹87,000 – ₹14,000 = ₹16,000;

Share of NCI = 40% ×16,000 = 6,400;

Total NCI at the year-end = ₹1,00,000 + ₹6,400 = ₹1,06,400.

Working Note 4: $: Other Equity Consolidated Other Equity of Sky Ltd. at the end of the year = ₹2,40,000;

Share of post-acquisition Total comprehensive income of Cloud Ltd. = 60%×₹16,000 =₹9,600;

Other Equity Consolidated = ₹2,40,000 + ₹9,600 = ₹2,49,600.

Abstract of Separate of Sky and Consolidated balance sheet of the group as at 31.03.18 (₹ Lakhs)

Particulars	Adjusted value of Cloud	Sky (Separate balance sheet)	Consolidated Balance Sheet
PPE	2,22,000[X]	3,00,000	5,22,000
Goodwill			21,000[#]
Investment in Q		1,50,000	
Financial Assets	60,000[Z]	1,20,000	1,80,000
Inventories	58,000[Y]	80,000	1,38,000
Total Assets	3,34,000	6,50,000	8,61,000
Equity Share Capital		2,60,000	2,60,000
Other Equity		2,40,000	2,49,600[$]
NCI			1,06,400[&]
Borrowings	64,000	1,00,000	1,64,000
Trade Payables	31,000	50,000	81,000
Total of Equity and Liabilities	3,65,000	6,50,000	8,61,000

Illustration 9

X Ltd. acquires 80% of equity of Y Ltd. on 31.03.20x5 at cost of ₹110 Lakhs, when the Equity Share Capital and Other Equity of Y Ltd. were ₹40 Lakhs and ₹80 Lakhs respectively. For the years ending on 31.03.20x6 and 31.03.20x7, Y Ltd accounted Total Comprehensive Income of (₹15 Lakhs) and ₹25 Lakhs. Recognise NCI at Proportionate Net Asset Mesure. X Ltd's share in post-acquisition profits of Y Ltd. and Goodwill to be shown in CFS of X Ltd. at the end of the years. The revaluation profit/loss for the difference between Fair Value and carrying amount of Assets and Liabilities of Y Ltd. at acquisition date and the abstracts of separate balance sheet of X Ltd. and individual balance sheet of Y Ltd. as at 31.03.20x8 are as follows: (₹ Lakhs)

	Revaluation profit (+)/ loss (-) at acquisition	X at 31.03.20x8	Y at 31.03.20x8
Non-Current Assets	+ 25	480	240
Investment in shares of Y at cost		110	
Current Assets	- 15	310	160
Total Assets		900	400
Equity Share Capital		200	40
Other Equity		300	120
Non-Current Liabilities	- 10	300	140
Current Liabilities	+ 5	100	100
Total Equities and Liabilities	+ 5	900	400

Prepare the consolidated balance sheet at 31-03-20X8.

Solution:

Workings:

At the end of the years	31.03.20x5	31.03.20x6	31.03.20x7	31.03.20x8
TCI		**(15)**	**25**	**120 -90 = 30**
Other Equity of Y Ltd.	80	85 -15 = 65	65+25 = 90	120
Net Asset at Balance Sheet value = Equity Share Capital + Other Equity	40+80 = 120			
Revaluation Profit/loss at acquisition	5			
Net Assets at Fair Value at acquisition	125			
Revaluation profit/loss on current items reverted in next year (reversal)		+10		
Adjusted TCI (L)		-15+10 = -5	25	30
(Adjusted) Net Assets = Opening Net Assets + Adj. TCI (M)		125 - 5 = 120	120+5 = 145	145+30 = 175
Consideration (Investment at cost)	110			
a. NCI = Net Asset (M) × 20%	25	24	29	35
b. Goodwill = Consideration + NCI – Net Assets at acquisition	10			
X Ltd's share in post-acquisition profits = 80% × Adj TCI (L) (P)	-	(4)	20	24
Other Equity of X at 31-03-20X8				300
Add: Share of post-acquisition profits of Y		- 4 +20+24		40
c. Consolidated other equity				340

	Workings	Consolidated
Non-Current Assets	480 + 240 + 25 (revaluation profit)	745
Goodwill	b	10
Current Assets	310 + 160	470
Total Assets	900	1,225
Equity Share Capital	200	200
Other Equity	c	340
NCI	a	35

	Workings	Consolidated
Non-Current Liabilities	300 + 140 + 10 (revaluation loss)	450
Current Liabilities	100 + 100	200
Total		1,225

Illustration 10

P acquires 60% shares in Q on 01.10. 2020 at ₹30,000. Q makes profits 20000 in the year 2020-21 and declared dividend 9000. NCI is valued at proportionate net assets. Abstracts of Separate Balance Sheet of P (Dividend from subsidiary not accounted) and Individual Balance Sheet of Q as at 31-03- 2021: **(₹ Lakhs)**

	P	Q
PPE	50,000	30,000
Investment in shares of Q at cost	30,000	
Current Assets	20,000	28,000
	1,00,000	58,000
Equity Share Capital (₹10)	60,000	25,000
Other Equity	25,000	15,000
Current Liabilities		
Trade Payables	15,000	9,000
Dividend Payable		9,000
	1,00,000	58,000

Show Consolidated Balance Sheet and Separate Balance Sheet of P.

Solution:

Working Notes:

1. Analysis of profits of Q:

   Opening P/L = Other Equity at the end + Dividend – Profits for the year

   = ₹(15,000 + 9,000 - 20,000) = ₹4,000

2. Net Assets identified on acquisition in the mid of the year, represented by Value of Equity of Q

   = ₹25,000 + Pre acquisition profits (Opening P/L + 50% of yearly profit)

   = ₹(25,000 + 4,000 + 10,000) = ₹39,000 (A)

3. Goodwill = B + C - A = ₹(15,600 + 30,000 – 39,000) = ₹6,600

   Where: A = ₹39,000

   B NCI = 40% × ₹39,000 = ₹15,₹600

   C Consideration = Investment in shares of Q = ₹30,000.

4. NCI at the reporting date

   = NCI at acquisition + Share of NCI in post-acquisition profits of Q – Dividend payable to NCI

   = ₹15,600 + 40% × ₹10,000 (50% of yearly profit) - 40% × 9000 (dividend payable to be shown separately)

   = ₹15,600 + ₹4,000 – ₹3,600 = ₹16,000.

5. Consolidated Other Equity = P's Other Equity + Share from Post acquisition profits of Q

   = ₹25,000 + 60% × ₹10,000 = ₹31,000

6. Separate Other Equity = ₹25,000 + ₹ 2,700 (post-acquisition profits) = ₹27,700 (₹ in Lakhs)

	In P's Book	
	Separate	Consolidated
Goodwill (3)		6,600
PPE = ₹(50,000 + 30,000)	50,000	80,000
Investment in shares of Q ₹(30,000 – 2,700 Pre-acquisition Dividend)	27,300	
Current Assets ₹(20,000 + 5,400 Dividend Receivable)	25,400	48,000#
	1,02,700	1,34,600
Equity Shares	60,000	60,000
Other Equity (5)	27,700	31,000
NCI (4)		16,000
Current Liabilities		
Trade Payables	15,000	24,000
Dividend Payable (to NCI)		3,600
	1,02,700	1,34,600

(20000 + 28000 = 48000); In Consolidated balance sheet Inter-company dividend is set off and does not appear.

Illustration 11

On 01.04.2020 BB Ltd. acquired 90% share of CM Ltd. at ₹10,80,000, when the fair value of its Net Assets was 1000000. During 01.04.2020 to 31.03.21 CM Ltd made TCI ₹2,00,000. On that date BM sold 15% holding to outsiders at 220000. Pass journal entries for sale of partial holding retaining control.

Solution:

Workings:

Net Assets on 31.03.2021 = ₹10,00,000 + ₹2,00,000 (TCI) = ₹12,00,000

Carrying amount of 15% holding sold ie. NCI recognized (assumed at proportionate net asset)

= 15% ×₹12,00,000 = ₹1,80,000

Sale Price = ₹2,20,000

Gain credited to Other Equity = ₹2,20,000 – ₹1,80,000 = ₹40,000

Journal: **Dr.** **₹Cr.**

Particulars		(₹)	(₹)
Bank A/c	Dr.	2,20,000	
To, NCI A/c			1,80,000
To, Other Equity A/c			40,000

Alternative:

NCI assumed to be recognized at fair value:

Carrying amount of 15% holding sold ie. NCI recognized (at fair value) = 15% × ₹10,80,000 + 15% of ₹2,00,000 (TCI) = ₹1,92,000

Sale price = ₹2,20,000

Gain credited to Other Equity = ₹2,20,000 – ₹1,92,000 = ₹28,000

Journal: **Dr.** **Cr.**

Particulars		(₹)	(₹)
Bank A/c	Dr.	2,20,000	
To, NCI A/c			1,92,000
To, Other Equity A/c			28,000

Consolidated and Separate Financial Statements of Group Entities-Advanced Level Discussion and Examples (Including Inter-Company Investments, Chain Holding, Cross Holding and Other Relevant Matters)

6.7

Illustration 12

Prepare Consolidated Balance Sheet (CBS) of a group of P Ltd., Q Ltd. and R Ltd. for which the abstracts of Balance sheets on 31.03.2021 are given below. (₹ in Lakhs)

Particulars	P	Q	R
PPE	400	500	320
Investment in Q (80%)	480		
Investment in R (75%)		300	
Current Assets:			
Inventory	250	80	60
Trade Receivables	280	120	200
Bills Receivables	70		50
Cash and Bank	180	50	60
Total Assets	1660	1050	690
Equity and Liabilities			
Equity Share Cap (₹ 10)	600	500	300
Other Equity	460	160	120
Current Liabilities			
Trade Payables	500	250	200
Dividend Payable		50	
Bills Payables	100	90	70
Total	1660	1050	690

Control was acquired on 01.10.2020 when fair value of PPE was in excess of carrying amount by Q: 50 and R: 30. On 01.04.2020 the balances of Other Equity were Q : 100 and R : 50 NCI is measured at fair value.

Inventory of Q included 16 purchased from R at cost plus 33.33%.

Bills Receivables of R includes 30 from P and Bills Receivables of R includes 40 from Q.

Solution:

Consolidated Balance sheet of the group as at 31-03-2021 (₹ in Lakhs)

Assets	Workings (₹)	(₹)
Non-Current:		
PPE	400 + 500 + 320 + 50 + 30	1,300
Current Assets:		
Inventory	250 + 80 + 60 - 4	386
Trade Receivables	280 + 120 + 200	600
Bills Receivables	70 + 50 - 30 - 40	50
Cash and Bank	180 + 50 + 60	290
Total Assets		**2,626**
Equity and Liabilities		
Equity Share Cap		600
Other Equity	Note 2	641
NCI of Q	Note 3	61
NCI of R	Note 2	174
Current Liabilities		
Trade Payables	500+250+200	950
Dividend Payable		10
Bills Payables	100+90+70-30-40	190
Total		**2,626**

Workings:

I. Share of parent and NCI Share of P in Q = 80% Share of Q in R = 75%

Share of Group in R = 80% × 75% = 60% NCI in R = 40%

II. Analysis of Profits (₹ in Lakhs)

Particulars	P	Q	R
Other Equity at the yearend + dividend payable	460	210	120
Other Equity at the beginning		100	50
Profits during the year		110	70
Pre-acquisition upto 30.09.2020		55	35
Post-acquisition Profits		55	35

Particulars	P	Q	R
Share from Q = 80% × ₹55	44		
Share from R = 60% × ₹35	21		
	525		
Less Unrealised Profits in inter-company Inventory = 16 × 1/4	4		
Other Equity	521		

III. Net Assets on acquisition

Particulars	Q (₹)	R (₹)
Share Cap	500	300
Other Equity on 01.04.2020	100	50
Revaluation	50	30
Add Profits	55	35
Net Assets	705	415

IV. NCI on 01-10-2020

Consideration × (NCI Share/Parent Share)	Q (₹)	R (₹)
NCI - Q = 480 × 20%/80%	120	
NCI - R = 300 × 40%/75%		160

Note 1: Goodwill/ Bargain Purchase

Particulars		Q (₹)	R (₹)	Consolidated (₹)
Net Assets	a	705	415	
Consideration	b	480	240$	
NCI on acquisition at fair value	c	120	160	
Gains on bargain Purchase	a- (b + c)	105	15	
Net amount to Other Equity				120

$ 80% × ₹300

Note 2: Consolidated Other Equity = Other Equity (II) + Net Gains on Bargain Purchase

= (₹521+ ₹120) Lakhs = ₹641 lakhs

Note 3: NCI on 31.03.2021

Particulars	Q (₹)	R (₹)
NCI on acquisition	120	160

Particulars	Q (₹)	R (₹)
Post acquisition profit = Q: 55 × 20%; R: ₹35 × 40%	11	14
Less: NCI share in investment in R = 20% × ₹300	-60	
Less; Dividend payable	-10	
NCI on Reporting date	61	174

Consolidated Balance Sheet: Treatment of Dividend

For the companies where Ind AS is applied, preparation of consolidated financial statements is based on Ind AS 103 and Ind AS 110.

When dividend is declared by the subsidiary company it appears as a deduction from Profit and Loss of subsidiary and as a current liability in subsidiary's balance sheet. In the books of the parent company the dividend receivable is shown as current asset and credited to Profit and Loss (if it is from post-acquisition profit) or Investment a/c (if it is from pre-acquisition profits). If pre-acquisition dividend is wrongly credited to parent's Profit and Loss, both Investment a/c and parent's Profit and Loss are reduced by the share of parent in pre-acquisition dividend. But it is important to keep in mind that this treatment is done in the separate financial statements only.

When Ind AS 103 is followed, purchase consideration at the acquisition date is added with NCI and Fair value of previously held equity interest and from the total fair value of net assets identified is subtracted for finding the goodwill to be recognized. This goodwill recognized at acquisition date is not adjusted afterwards for any declaration of dividend by the subsidiary, even if it is from pre-acquisition profits. It is not required also. As dividends from pre-acquisition profits were already included in the acquisition date fair value of net assets, it is no more required to be deducted separately from Purchase consideration again. Thus, it is clear that for calculating goodwill in the consolidation of accounts pre-acquisition dividends need not be subtracted from Investment (Purchase consideration). One illustrative example is given below.

Illustration 13

D Co. Ltd acquired 60% shares of G Co. Ltd. on 1st October 2020. The Retained Earnings balance of G on 1-4-2020 was ₹ 5,000. G declared dividend for 2020-21 ₹ 6000 (accounted in books of G but not accounted in books of D).

The abstracts from balance sheets of D and G as at 31-03-2021 are: (Amount in ₹)

Particulars	D (₹)		G (₹)	
PPE		60,000		30,000
Investments: shares in G		24,000		
Current Assets		20,000		16,000
Total Assets		1,04,000		46,000
Equity Shares		50,000		25,000
Other Equity (Retained Earnings)		25,000		11,000

Particulars	D (₹)	G (₹)
Current Liabilities	29,000	10,000
Total Equity and Liabilities	1,04,000	46,000

Required: Consolidated Balance sheet as at 31-03-2021

Solution: (Amount in ₹)

WN 1: Share of parent and NCI in subsidiary:

Share of D = 60%

NCI = 40%

Required: Consolidated Balance sheet as at 31.03.2021

WN 2: Pre-acquisition profits of G:

Particulars	(₹)	Pre (₹)	Post (₹)
Retained Earnings on 01.04.2020		5,000	
Retained Earnings on 31.03.2021	11,000		
Add: dividend declared	6,000		
Earnings before dividend	17,000		
Less: Opening balance	5,000		
Profits during the year	12,000	6,000	6,000
		11,000	6,000

Acquisition being made in the mid of the year profits during the year is divided equally between Pre and Post.

Share of NCI in post-acquisition profits = ₹ 6,000 × 40% = ₹2,400

WN 3: FV of net assets identified as at 01.10.2020:

Particulars	(₹)
Equity Shares	25,000
Pre-acquisition profits	11,000
Book Value of Net Assets as at 01.10.2020	36,000

It is assumed that Fair value is same as Book value.

Thus Fair Value of Net Assets identified = ₹36,000

WN 4: Goodwill:

Particulars	(₹)
Purchase consideration (investment)	24,000
NCI (FV) at acquisition (40/60)× ₹24,000	16,000
Total	40,000
Less: Net Assets identified (WN 3)	36,000
Goodwill	4,000

WN 5:

Particulars	(₹)
NCI at acquisition	16,000
Add: share of Post-acquisition profit 40% × ₹6,000	2,400 (W.N. 2)
Less: Dividends payable to NCI 40% × ₹6,000 (to be shown as current liability)	2,400
NCI at reporting date	16,000

WN 6: Consolidated other equity:

Particulars	(₹)
Other equity of D	25,000
Share of post-acquisition profit of G (60% × ₹6,000)	3,600
	28,600

WN 7: Current liabilities of G:

Particulars	(₹)
Balance as per B/S	10,000
Less: Dividend payable (included in CL)	6,000
Other current liabilities	4,000
Dividend payable to NCI 40% × ₹6,000	2,400
	6,400

Consolidated Balance Sheet as at 31-03-2021

Particulars	(₹)	(₹)
Assets		
Non-current assets		
PPE	60,000 + 30,000	90,000
Goodwill (WN 4)		4,000
Current assets	20,000 +16,000	36,00
Total		1,30,000
Equity and Liabilities		
Equity Share Capital		50,000
Consolidated Other Equity (WN 6)		28,600
NCI (WN 5)		16,000
Current Liabilities (WN 7)	29,000 + 6,400	35,400
Total		**1,30,000**

Accounting and Reporting of Joint Operation

6.8

Ind AS 111: Joint Arrangements

1. Meaning of Joint Arrangement: A joint arrangement is an arrangement of which two or more parties have joint control.

   [An arrangement can be a joint arrangement even though not all of its parties have joint control of the arrangement. Note, at least two of all the parties must have joint control.]

2. Scope: This Ind AS shall be applied by all entities that are a party to a joint arrangement.

   [whether or not it has joint control]

3. Objectives:

   a. The objective of Ind AS 111 is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (ie joint arrangements).

   b. To meet the objective this Ind AS defines joint control and requires an entity that is a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations and to account for those rights and obligations in accordance with that type of joint arrangement.

4. Characteristics of Joint Arrangement: A joint arrangement has the following characteristics:

   (a) The parties are bound by a contractual arrangement.

   (b) The contractual arrangement gives two or more of those parties joint control of the arrangement.

5. Meaning of Joint Control: Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.[At least two of all the parties must have shared control as joint operators or joint venturers.]

6. Type of Joint Arrangement: An entity shall determine the type of joint arrangement in which it is involved. A joint arrangement is either a joint operation or a joint venture.

   The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement.

   A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

   A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

Illustration 14

Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent

ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity. In such a case, the assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement and the joint arrangement is classified as Joint Venture.

However, if parties modify the features of the corporation through their contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion, such contractual modifications to the features of a corporation can cause the joint arrangement to be a Joint Operation.

7. Financial statements of parties to a joint arrangement classified as Joint operations:

   A. A joint operator shall recognise in relation to its interest in a joint operation:

      (a) its assets, including its share of any assets held jointly;

      (b) its liabilities, including its share of any liabilities incurred jointly;

      (c) its revenue from the sale of its share of the output arising from the joint operation;

      (d) its share of the revenue from the sale of the output by the joint operation; and

      (e) its expenses, including its share of any expenses incurred jointly.

   B. A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation.

8. Financial statements of parties to a joint arrangement classified as Joint venture:

   a. A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS 28, Investments in Associates and Joint Ventures, unless the entity is exempted from applying the equity method as specified in that standard.

   b. A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with Ind AS 109, Financial Instruments, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with Ind AS 28.

9. Separate financial statements:

   A. In its separate financial statements, a joint operator or joint venturer shall account for its interest in:

      (a) a joint operation in accordance with paragraph 7;

      (b) a joint venture in accordance with paragraph 10 of Ind AS 27, Separate Financial Statements.

   B. In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:

      (a) a joint operation in accordance with paragraph 23;

      (b) a joint venture in accordance with Ind AS 109, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 10 of Ind AS 27.

Disclosures

6.9

Ind AS 112: Disclosure of Interests in Other Entities

1. Objective:

A. The objective of this Standard is to require an entity to disclose information that enables users of its financial statements to evaluate:

(a) the nature of, and risks associated with, its interests in other entities; and

(b) the effects of those interests on its financial position, financial performance and cash flows.

B. To meet the objective in para A, an entity shall disclose:

(a) the significant judgements and assumptions it has made in determining:

(i) the nature of its interest in another entity or arrangement;

(ii) the type of joint arrangement in which it has an interest

(iii) that it meets the definition of an investment entity, if applicable; and

(b) information about its interests in:

(i) subsidiaries;

(ii) arrangements and associates; and

(iii) structured entities that are not controlled by the entity (unconsolidated structured entities).

C. If the disclosures required by this Ind AS, together with disclosures required by other Ind ASs, do not meet the objective in para A, an entity shall disclose whatever additional information is necessary to meet that objective.

2. Scope:

A. This Ind AS shall be applied by an entity that has an interest in any of the following:

(a) subsidiaries

(b) joint arrangements (ie joint operations or joint ventures)

(c) associates

(d) unconsolidated structured entities.

B. This Ind AS does not apply to:

(a) post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19, Employee Benefits, applies.

(b) an entity's separate financial statements to which Ind AS 27, Separate Financial Statements, applies. However, if an entity has interests in unconsolidated structured entities and prepares separate financial statements as its only financial statements, it shall apply the requirements of this standard when preparing those separate financial statements.

(c) an interest held by an entity that participates in, but does not have joint control of, a joint arrange ment unless that interest results in significant influence over the arrangement or is an inter est in a structured entity.

(d) an interest in another entity that is accounted for in accordance with Ind AS 109, Financial Instruments. However, an entity shall apply this Ind AS:

(i) when that interest is an interest in an associate or a joint venture that, in accordance with Ind AS 28, Investments in Associates and Joint Ventures, is measured at fair value through profit or loss; or

(ii) when that interest is an interest in an unconsolidated structured entity.

3 to 9: Disclosure

3. **About significant judgements and assumptions:** An entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

(a) that it has control of another entity, ie an investee as described in paragraphs 5 and 6 of Ind AS 110, Consolidated Financial Statements;

(b) that it has joint control of an arrangement or significant influence over another entity; and

(c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

4. **Example of significant judgements and assumptions:**

An entity shall disclose, for example, significant judgements and assumptions made in determining that:

(a) it does not control another entity even though it holds more than half of the voting rights of the other entity.

(b) it controls another entity even though it holds less than half of the voting rights of the other entity.

(c) it is an agent or a principal.

(d) it does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity.

(e) it has significant influence even though it holds less than 20 per cent of the voting rights of another entity.

5. **About investment entity status:**

When a parent determines that it is an investment entity in accordance with paragraph 27 of Ind AS 110, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity. If the investment entity does not have one or more of the typical characteristics of an investment entity (see paragraph 28 of Ind AS 110), it shall disclose its reasons for concluding that it is nevertheless an investment entity.

6. **About change of status:**

When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:

(a) the total fair value, as of the date of change of status, of the subsidiaries that cease to be consolidated;

(b) the total gain or loss, if any, calculated in accordance with paragraph B101 of Ind AS 110; and

(c) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

7. About interests in subsidiaries:

A. An entity shall disclose information that enables users of its consolidated financial statements

(a) to understand:

(i) the composition of the group; and

(ii) the interest that non-controlling interests have in the group's activities and cash flows; and

(b) to evaluate:

(i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;

(ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;

(iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control; and

(iv) the consequences of losing control of a subsidiary during the reporting period.

B. About difference of dates:

When the financial statements of a subsidiary used in the preparation of consolidated financial statements are as of a date or for a period that is different from that of the consolidated financial statements, an entity shall disclose:

(a) the date of the end of the reporting period of the financial statements of that subsidiary; and

(b) the reason for using a different date or period.

C. About non-controlling interests:

An entity shall disclose for each of its subsidiaries that have non-controlling interests that are material to the reporting entity:

(i) the name of the subsidiary.

(ii) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary.

(iii) the proportion of ownership interests held by non-controlling interests.

(iv) the proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held.

(v) the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.

(vi) accumulated non-controlling interests of the subsidiary at the end of the reporting period.

(vii) summarised financial information about the subsidiary.

D. About nature and extent of significant restrictions:

An entity shall disclose:

(a) significant restrictions (eg statutory, contractual and regulatory restrictions) on its ability to access or use the assets and settle the liabilities of the group, such as:

(i) those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group.

(ii) guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group.

(b) the nature and extent to which protective rights of non-controlling interests can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary before settling its own liabilities, or approval of non-controlling interests is required either to access the assets or to settle the liabilities of a subsidiary).

(c) the carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

8. About Interests in joint arrangements and associates:

An entity shall disclose information that enables users of its financial statements to evaluate:

(a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates; and

(b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

9. About interests in unconsolidated structured entities:

An entity shall disclose information that enables users of its financial statements:

(a) to understand the nature and extent of its interests in unconsolidated structured entities; and

(b) to evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities.

Solved Case Study(s)

Case 1

On 01.04.2021 the summarised balance sheets of Satellite Ltd. and Planet Ltd. are provided as: (₹'000)

	Satellite Ltd.		Planet Ltd.
	B/S (₹)	Fair Value (₹)	B/S (₹)
Equity Share Capital (₹ 10)	8,000		12000
Other Equity	6,000		4000
Borrowings	2,000	2,050	3000
Trade Payables	2,500	2,400	2000
Property, Plant and Equipment	9,000	10000	12000
Investment Property	5,000	7000	1000
Investments	1,000		3500
Current Assets	3,500	3200	4500
Contingent Liabilities	800	750	

Market price of equity shares of Planet Ltd. and Satellite Ltd. are ₹ 16 and ₹ 15 respectively on the day. On the basis of the above data, you are required to make the necessary accounting for the following cases.

Planet Ltd. takes over Satellite Ltd. and purchase consideration is settled by issue of

1050000 equity shares. Pass journal entries in the books of both the companies and re-draft the balance sheet of Planet Ltd. after the business combination.

Solution:

WN 1. Net Assets of Satellite Ltd. at fair value: (₹'000)

	(₹)	(₹)
Property, Plant and Equipment	10,000	
Investment Property	7,000	
Investments	1,000	
Current Assets	3,200	
Total Assets		21,200
Borrowings	2,050	
Trade Payables	2,400	
Liabilities (Recognised)	750	
Total Liabilities		5,200
Net assets		16,000

In the books of Planet Ltd.

Journal **(₹'000)**

Date	Particulars		Dr.	Cr.
01.04.2021	Property, Plant and Equipment	Dr.	10,000	
	Investment Property	Dr.	4,000	
	Investments	Dr.	4,000	
	Current Assets	Dr.	3,200	
	Goodwill	Dr.	800	
	To Borrowings			2,050
	To Trade Payables			2,400
	To Liabilities (Contingent liabilities recognised)			750
	To Equity Share Capital (₹10)			10,500
	To Security Premium (₹ 6)			6,300

Summarised Balance sheet as at 01.04.2021 (after take over) (₹'000)

	Workings (₹)	Amount (₹)
Property, Plant and Equipment	12,000 + 10,000	22,000
Goodwill		800

	Workings (₹)	Amount (₹)
Investment Property	4,000 + 4,000	8,000
Investments	3,500 + 1,000	4,500
Current Assets	4,500 + 3,200	7,700
Total Assets		43,000
Equity Share Capital	12,000 + 10,500	22,500
Other Equity	4,000 + 6,300	10,300
Borrowings	3,000 + 2,050	5,050
Trade Payables	2,000 + 2,400	4,400
Liabilities (contingent recognised)		750
Total of equity and liabilities		43,000

In the books of Satellite Ltd.

Journal **(₹'000)**

Date	Particulars		Dr. (₹)	Cr. (₹)
	Realisation A/c	Dr.	18,500	
	To, Property, Plant and Equipment A/c			9,000
	To, Investment Property A/c			5,000
	To, Investments A/c			1,000
	To, Current Assets A/c			3,500
	Equity Shares in Planet Ltd.	Dr.	16,800	
	Borrowings	Dr.	2,000	
	Trade Payables	Dr.	2,500	
	To Realisation A/c			21,300
	Realisation A/c	Dr.	2,800	
	To Equity Shareholders A/c			2,800
	Equity Share Capital A/c	Dr.	8,000	
	Other Equity	Dr.	6,000	
	To Equity Shareholders A/c			14,000
	Equity Shareholders A/c	Dr.	16,800	
	To Equity Shares in Planet Ltd.			16,800

Case 2

Planet Ltd. and Satellite Ltd. are amalgamated into Solar Ltd. control of which retained with the same parties as before. Solar Ltd. issues 1050000 shares and 1250000 shares to take over the businesses of Satellite Ltd. and Planet Ltd. respectively. Pass journal entries and draft balance sheet in the books of the Solar Ltd.

Solution:

It is a business combination under common control and pooling of interest method of accounting is followed in the books of the transferee.

In the books of Solar Ltd.

Journal (₹ '000)

Date	Particulars		Dr.	Cr.
	Property, Plant and Equipment	Dr.	21,000	
	Investment Property	Dr.	6,000	
	Investments	Dr.	4,500	
	Current Assets	Dr.	8,000	
	Goodwill (10,500 + 12,500 – 8,000 -12,000)	Dr.	3,000	
	To Borrowings			5,000
	To Trade Payables			4,500
	To Other Equity (6,000 + 4,000)			10,000
	To Equity Share Capital			23,000

Summarised Balance sheet as at 01.04.2021 (after amalgamation) (₹ '000)

		Amount (₹)
Property, Plant and Equipment	12,000 + 9,000	21,000
Goodwill		3,000
Investment Property	1,000 + 5,000	6,000
Investments	3,500 + 1,000	4,500
Current Assets	4,500 + 3,500	8,000
Total Assets		42,500
Equity Share Capital	12,500 + 10,500	23,000
Other Equity	4,000 + 6,000	10,000
Borrowings	3,000 + 2,000	5,000
Trade Payables	2,000 + 2,500	4,500
Total of equity and liabilities		42,500
Note: Contingent Liabilities	800	

Case 3

Planet Ltd. and Satellite Ltd. are amalgamated into Solar Ltd. control of which remained with the management of Planet Ltd. Solar Ltd. issues 1050000 shares and 1250000 shares to take over the businesses of Satellite Ltd. and Planet Ltd. respectively.

Solution:

It is a case of Reverse Acquisition. Legal acquiree is the accounting acquirer. Planet Ltd. being accounting acquirer, its assets and liabilities will be recognised at carrying amount.

In the books of Solar Ltd.

Journal **(₹ '000)**

Date	Particulars		Dr.	Cr.
	Property, Plant and Equipment	Dr.	22000	
	Investment Property	Dr.	8000	
	Investments	Dr.	4500	
	Current Assets	Dr.		
	Goodwill	Dr.	7700	
	To Borrowings		800	5050
	To Trade Payables			4400
	To Liabilities (Contingent liabilities recognised)			750
	To Equity Share Capital (12000 + 10500)			22500
	To Other Equity [4000 + 6300]			10300

Effective consideration: Issue of 1050000 shares of ₹ 16 to Satellite Ltd.= 16800000; Equity Share Capital (₹ '000)10500 and Security Premium (₹ '000)6300.

Net Assets of Satellite Ltd. = (₹ '000) 16000

(a) Goodwill (₹ '000) = 16800 – 16000 = 800

(b) Equity Share Capital of Solar Ltd. = Equity Share Capital of Planet Ltd. (₹ '000) 12000 + Equity Shares issued to Satellite Ltd. (₹ '000) 10500 = (₹ '000) 22500. [although number of shares should be 1250000 + 1050000 = 2300000 of ₹ 10]

(c) Other Equity of Solar Ltd. = Other Equity of Planet Ltd. ₹ 4000 + Security Premium in Purchase Consideration ₹ 6300.

Summarised Balance sheet of Solar Ltd. as at 01-04-2021 (after reverse acquisition) **(₹ '000)**

	Carrying amount of Planet Ltd. + Fair value of Satellite Ltd.	Amount (₹)
Property, Plant and Equipment	12000 + 10000	22000
Goodwill (a)		800
Investment Property	1000 + 7000	8000
Investments	3500 + 1000	4500
Current Assets	4500 + 3200	7700
Total Assets		43000

	Carrying amount of Planet Ltd. + Fair value of Satellite Ltd.	Amount (₹)
Equity Share Capital [23000 shares] (b)	12000 + 10500	22500
Other Equity (c)	4000 + 6300	10300
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (Contingent liabilities recognised)		750
Total of equity and liabilities		43000

Case 4

Planet Ltd. acquires 25% stake in Satellite Ltd. having significant influence and purchase consideration is settled by issue of 160000 equity shares. During 2021-22 Satellite Ltd. earns profit (₹ '000) 2000 and Other Comprehensive Income (₹ '000) 1200. Pass journal entries in the books of Planet Ltd. at acquisition and on 31-03-2022.

Solution:

It is a case of investment in Associate. Equity method is followed as per Ind AS 28.

Journal:

Journal in Consolidated and Separate Set at acquisition **(₹ '000)**

Date	Particulars	Dr. (₹)	Cr. (₹)
01-04-2021	Investments in Associate Dr.	2560	
	To Equity Share Capital (₹ 10)		1600
	To Security Premium (₹ 6)		960

Journal in Consolidated Set at subsequent reporting date **(₹'000)**

Date	Particulars	Dr. (₹)	Cr. (₹)
31-03-2022	Investments in Associate Dr.	800	
	To Statement of Profit and Loss		500
	To Other Comprehensive Income		300

Journal in Separate Set at subsequent reporting date: No entry

Case 5

Planet Ltd. acquires 75% stake in Satellite Ltd. on 01-04-2021 and purchase consideration is settled by issue of 800000 equity shares. Non-Controlling Interest is measured at proportionate net Asset value. Pass journal entries in the books of Planet Ltd. at acquisition and re-draft balance sheets at acquisition.

Solution:

It is a case of business combination as per Ind AS 103. There will be two sets of accounting in the books of the Acquirer.

Consolidated set in the books of Planet Ltd.	(₹ in '000)
Purchase Consideration = 800000 shares of ₹ 16 =	12800
WN 1. Net Assets of Satellite Ltd. at fair value =	16000
WN 2. Non-Controlling Interest (NCI) = 25% of Net Assets = 25% × 16000 =	4000
WN 3. Goodwill = Purchase Consideration + NCI – Net Assets = 12800 + 4000 – 16000 =	800

Journal **(₹ '000)**

Date	Particulars		Dr. (₹)	Cr. (₹)
01-04-2021	Property, Plant and Equipment	Dr.	10000	
	Investment Property	Dr.	7000	
	Investments	Dr.	1000	
	Current Assets	Dr.	3200	
	Goodwill [WN 3]	Dr.	800	
	To Borrowings			2050
	To Trade Payables			2400
	To Liabilities (Contingent liabilities recognised)			750
	To Non-Controlling Interest (WN 2)			4000
	To Equity Share Capital (₹ 10)			8000
	To Security Premium (₹ 6)			4800

Summarised Consolidated Balance sheet as at 01-04-2021 (after acquisition) **(₹ '000)**

	Workings	Amount (₹)
Property, Plant and Equipment	12000 + 10000	22000
Goodwill		800
Investment Property	1000 + 7000	8000
Investments	3500 + 1000	4500
Current Assets	4500 + 3200	7700
Total Assets		43000
Equity Share Capital	12000 + 8000	20000
Other Equity	4000 + 4800	8800
Non-Controlling Interest		4000
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (contingent recognised)		750
Total of equity and liabilities		43000

Separate set in the books of Planet Ltd.

Journal (₹ '000)

Date	Particulars		Dr. (₹)	Cr. (₹)
01-04-2021	Investments in Subsidiary	Dr.	12800	
	To Equity Share Capital (₹ 10)			8000
	To Security Premium (₹ 6)			4800

On 01-04-2021 the summarised separate balance sheets of Planet Ltd. (post acquisition) (₹ '000)

	Planet Ltd. (₹)
Property, Plant and Equipment	12000
Investment Property	1000
Investment in Subsidiary	12800
Investments	3500
Current Assets	4500
Total Assets	33800
Equity Share Capital (Rs. 10)	20000
Other Equity	8800
Borrowings	3000
Trade Payables	2000
Total of Equity and Liabilities	33800

Case 6

Planet Ltd. acquires 45% stake in Satellite Ltd. and purchase consideration is settled by issue of 540000 equity shares. The investment in the balance sheet of Planet Ltd. shows the cost of previously held 30% interest in Satellite Ltd. Non-Controlling Interest is measured at fair value. Pass journal entries in the books of Planet Ltd. at acquisition and re-draft balance sheets at acquisition in consolidated set only.

It is a case of business combination as per Ind AS 103.

Consolidated set in the books of Planet Ltd. (₹ in '000)

WN 1. Purchase Consideration = 450000 shares of ₹ 16 = 7200

WN 2. Fair Value of previously held Interest = (30%/45%) × 7200 = 4800

WN 3. Net Assets of Satellite Ltd. at fair value = 16000

WN 4. Non-Controlling Interest (NCI) = (25%/45%)×7200 = 4000

WN 5. Gain on Bargain Purchase = Net Assets - Purchase Consideration - NCI – fair value of previously held interest = 16000 – [7200 + 3200 + 4800] = 800

Journal (₹ '000)

Date	Particulars		Dr. (₹)	Cr. (₹)
01-04-2021	Investments (previously held interest)	Dr.	1300	
	To Statement of Profit and Loss (Revalued)			1300
01-04-2021	Property, Plant and Equipment	Dr.	10000	
	Investment Property	Dr.	7000	
	Investments	Dr.	1000	
	Current Assets	Dr.	3200	
	To Borrowings			2050
	To Trade Payables			2400
	To Liabilities (Contingent liabilities recognised)			750
	To Non-Controlling Interest (WN 4)			4000
	To Gain on Bargain Purchase [WN 5]			800
	To Equity Share Capital (₹ 10)			4500
	To Security Premium (₹ 6)			2700
	To Investment (previously held interest			4800

Summarised Consolidated Balance sheet as at 01-04-2021 (after acquisition) (₹ '000)

	Workings	Amount
Property, Plant and Equipment	12000 + 10000	22000
Investment Property	1000 + 7000	8000
Investments	1000	1000
Current Assets	4500 + 3200	7700
Total Assets		38700
Equity Share Capital	12000 + 4500	16500
Other Equity	4000 + 2700 + 1300	8000
Non-Controlling Interest	WN 4	4000
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (contingent recognised)		750
Total of equity and liabilities		38700

Case 7

Satellite Ltd. acquires 75% stake in Planet Ltd. by issue of shares in the ratio based on the market prices. In consequence, Planet Ltd. becomes the accounting acquirer. Non-Controlling Interest is measured at fair value. Pass journal entries in the books of Planet Ltd. at acquisition and re-draft balance sheets at acquisition.

Solution:

Exchange Ratio 16 shares of Satellite for every 15 shares of Planet. Number of shares to be issued by Satellite = 16 × 1200000/15 = 1280000

Existing shares of Satellite = 800000;

In the group owners of Planet holds controlling interest

It is a case of Reverse Acquisition, where Planet, the legal acquiree is the Accounting Acquirer.

(a) Effective purchase consideration = number of shares of Accounting Acquiree × mkt price = 800000 × 15 = (₹’000) 12000

In the consolidated accounts of the group Satellite’s assets and liabilities will be recognised at fair value and Planet’s assets and liabilities will be recognised at carrying amount.

(b) Consolidated Equity = Carrying amount of Equity of Planet + Purchase consideration (issue by Satellite) = 16000 + 12000 = (₹ ’000) 28000

(c) Non-controlling interest = 25% of Planet = 25% × 1200000 × 16 = (₹’000) 4800

(d) Goodwill = Purchase consideration + NCI – Net Assets = 12000 + 4800 – 16000 = 800

Date	Particulars		Dr. (₹)	Cr. (₹)
01-04-2021	Property, Plant and Equipment	Dr.	10000	
	Investment Property	Dr.	7000	
	Investments	Dr.	1000	
	Current Assets	Dr.	3200	
	Goodwill [WN d]	Dr.	800	
	To Borrowings			2050
	To Trade Payables			2400
	To Liabilities (Contingent liabilities recognised)			750
	To Non-Controlling Interest (WN c)			4800
	To Equity Share Capital (1280000 shares)			12000

Summarised Consolidated Balance sheet as at 01-04-2021 (after acquisition) **(₹ ’000)**

	Workings	Amount (₹)
Property, Plant and Equipment	12000 + 10000	22000
Goodwill		800
Investment Property	1000 + 7000	8000

	Workings	Amount (₹)
Investments	3500 +1000	4500
Current Assets	4500 + 3200	7700
Total Assets		43000
Equity Share Capital (1200000 + 1280000 shares)	12000 + 12000	24000
Other Equity	4000	4000
Non-Controlling Interest	WN 4	4800
Borrowings	3000 + 2050	5050
Trade Payables	2000 + 2400	4400
Liabilities (contingent recognised)		750
Total of equity and liabilities		43000

Exercise

A. Theoritical Questions:

Multiple Choice Questions

1. Consolidated financial statements are required to be prepared by an Ind AS complied company if it holds shares in the investee company

   a. entailing 20% or more voting rights having significant influence over the investee company (called Associate as per Ind AS 28)

   b. entailing joint control over the investee company (called a Joint Venture as per Ind AS 28)

   c. entailing control over investee company (called subsidiary company as per Ind AS 110)

   d. All of the above

2. ___________ requires that when consolidated financial statements are prepared the investor company shall also prepare individual/standalone financial statements, which are named as separate financial statements.

   a. Ind AS 27

   b. Ind AS 28

   c. Ind AS 110

   d. Ind AS 112

3. An investment entity is an entity that

   a. obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services

   b. commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both

   c. measures and evaluates the performance of substantially all of its investments on a fair value basis

   d. All of the above

4. Ind AS 103 states that the acquirer obtaining control over acquiree, recognises and measures in its consolidated financial statements at the acquisition date

a. the identifiable assets acquired, the liabilities assumed at Fair Value

b. any non-controlling interest in the acquiree at Fair Value or at Proportionate Value

c. the goodwill acquired in the business combination or a gain on bargain purchase

d. All of the above

5. As per Ind AS 112: Disclosure of Interests in Other Entities, an entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions) in determining

   a. that it has control of another entity, i.e. an investee as described in paragraphs 5 and 6 of Ind AS 110, Consolidated Consolidated Financial Statements

   b. that it has joint control of an arrangement or significant influence over another entity

   c. the type of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle

   d. All of the above

Answer:

1.	2.	3.	4.	5.
d.	a.	d.	d.	d.

Fill in the Blanks

1. _____________ is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

2. A ____________ is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

3. ____________ is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

4. The ___________ is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investors share of the investees net assets.

5. An _________ is an entity over which the investor has significant influence.

Answer:

1.	**Joint control**	2.	**joint operation**
3.	**Significant influence**	4.	**equity method**
5.	**associate**		

Short Essay Type Questions

1. Explain the different types of Joint Arrangement.

2. Describe the objectives of Ind AS 112: Disclosure of Interests in Other Entities.

3. Enumerate the Consolidation procedure for investment in Associates, Joint Ventures and Subsidiaries.

4. State the conditions when a parent company need not present consolidated financial statements.

5. Under Consolidated Balance Sheet, define the treatment of Dividend.

6. Write a short note on:

   a. Ind AS 111: Joint Arrangements

   b. Ind AS 112: Disclosure of Interests in Other Entities

7. Under Ind AS 112: Disclosure of Interests in Other Entities, state few examples of significant judgements and assumptions made.

8. State the details to be disclosed by the entity for each of its subsidiaries that have non-controlling interests that are material to the reporting entity.

Essay Type Questions

1. When is an investor is assessed as a parent?

2. What is the objective of the Indian Accounting Standard 110 and what are the requirements of the Standard to meet the objectives?

3. When a parent does not need to prepare consolidated financial statements?

4. What is an investment entity? What accounting procedure is required acquiring control of another entity as per Indian Accounting Standards if the parent is an investment entity?

5. What accounting is required when a parent loses control of a subsidiary?

6. What is the procedure of accounting for consolidation in case of investment in Associate, Joint Venture and subsidiary?

B. Numerical Questions:

⊙ Comprehensive Numerical Problems

1. P Ltd. acquires 80% shares of S Ltd. by issue of 48000 shares of ₹ 10 (Mkt price ₹ 25) on 01.04.2021.

   (A) Relevant data of P Ltd. and S Ltd. are as follows: (₹)

As at 01-04.2021 before acquisition	S Ltd.		P Ltd.
	Book Value BV	Fair Value FV	Book Value BV
PPE	7,00,000	10,00,000	12,00,000
Current Assets	3,00,000	2,80,000	6,00,000
Total	10,00,000	12,80,000	18,00,000
Equity Share Capital	3,00,000		6,00,000
Other Equity	2,40,000		4,00,000
Non-Current Liabilities	2,00,000	2,00,000	5,00,000
Current Liabilities	2,60,000	2,50,000	3,00,000
Total	10,00,000		18,00,000

Prepare Separate and Consolidated balance sheet of P Ltd. and its subsidiary S Ltd. as at 01-04-2021.

(a) Consider NCI at fair value.;

(b) Consider NCI at proportionate net asset value.

(B) Additional data after one year:

As at 31-03-2022	S Ltd.	P Ltd. Stand alone
	Book Value	Book Value
PPE	7,50,000	13,00,000
Investment		12,00,000
Current Assets	3,60,000	6,60,000
Total	11,10,000	31,60,000

As at 31-03-2022	S Ltd.	P Ltd. Stand alone
	Book Value	Book Value
Equity Share Capital	3,00,000	10,80,000
Other Equity	2,70,000	11,70,000
Non-Current Liabilities	2,40,000	5,60,000
Current Liabilities	3,00,000	3,50,000
Total	11,10,000	31,60,000

Prepare Separate and Consolidated balance sheet of P Ltd. and its subsidiary S Ltd. as at 31.03.2022. Consider NCI at proportionate net asset value.

2. Pass journal entries and state about the requirements with reference to the Indian Accounting Standards for the following:

X Ltd. acquires 20000 equity shares in Y Ltd on 01.01.2020 by issue of 10000 equity shares of ₹ 10 each (market value ₹ 24). Net Assets of Y are ₹ 2,30,000.

(a) By the investment in shares of Y, X acquires less than 20% of Y's voting power.

(b) By the investment in shares of Y, X acquires more than 20% of Y's voting power.

(c) By the investment in shares of Y, X acquires joint control of Y.

(d) By the investment in shares of Y, X acquires 80% of Y's voting power, ie control of Y.

3. Company P Ltd. acquires 80% shares of company S Ltd. on 1.04.2019 by issue of equity shares of ₹ 10 each at a premium of ₹15. The financial data of the companies at 31.03.2019 are stated below. Non-Controlling Interest is valued at fair value. (₹ in Lakhs).

Particulars	On 31.03.19			On 31.03.2020	
	P	S	FV of S	P	S
PPE	900	600	700	1000	700
Investment in S				750	
CA	600	400	360	500	450
Equity	800	500		1650	600
Noncurrent Liability	350	300	310	320	320
Current Liability	350	200	200	380	230

S Ltd. paid dividend 100 for the year ended on 31.03.2019 in the financial year 2019-2020.

S Ltd. purchased goods from P Ltd. on credit 60, the debt remaining outstanding and the goods remaining entirely unsold as at 31.03.2020. P Ltd. sold goods at 33.33% profits on cost.

Pass entries for business combination under acquisition method and show consolidated and separate balance sheet abstract on 31.03.19 and on 31.03.20.

4. P Ltd. acquires 75% of equity of A Ltd. on 31.03.2019 at cost of ₹120 Lakhs, when the Equity Share Capital and Other Equity of Atlanta Ltd. were ₹40 Lakhs and ₹60 Lakhs respectively. For the years ending on 31.03.2020 and 31.03.2021, A Ltd. accounted Total Comprehensive Income of ₹(20) Lakhs and ₹ 30 Lakhs. Find NCI (Proportionate Net Asset Method), P Ltd's share in post-acquisition profits of A Ltd. and Goodwill to be shown in CFS of P Ltd. at the end of the years. The revaluation profit/loss for the difference between fair value and carrying amount of assets and liabilities of A Ltd. at acquisition date and the abstracts of Separate Balance Sheet of P Ltd. and individual balance sheet of A Ltd. as at 31032022 are as follows:

(₹ in Lakhs)

Particulars	Revaluation profit (+) / loss (-)	Pacific at 31.03.2022	Atlanta at 31.03.2022
Non-Current Assets	40	500	260
Investment in shares of Atlanta		120	
Current Assets	(10)	300	150
Total Assets		920	410
Equity Share Capital		200	40
Other Equity		320	110
Non-Current Liabilities	(16)	300	160
Current Liabilities	6	100	100
Total	5	900	410

Prepare the consolidated balance sheet in books of X Ltd.

5. When does a parent not require to present consolidated financial statements?

6. G Ltd. acquired 60% shares of S Ltd. on 1st October 2021. The Retained Earnings balance of S Ltd. on 1.04.2021 was ₹ 30,000 and fair value of PPE of S Ltd. on 01.10.2021 was ₹ 15,000 higher than the book value. S Ltd. declared dividend for 2021-2022 ₹ 20,000 in November, 2021 (accounted in books of S Ltd. but not accounted in books of G Ltd).

The abstracts from balance sheets of G Ltd and Star Ltd. as at 31.03.2022 are: (₹)

	G Ltd.		S Ltd.	
PPE		60,000		40,000
Investments: shares in Star Ltd.		24,000		
Current Assets		20,000		27,000
Total Assets		1,04,000		67,000
Equity Shares		50,000		25,000
Other Equity (Retained Earnings)		25,000		32,000
Current Liabilities		29,000		10,000
Total Equity and Liabilities		1,04,000		67,000

Required: In books of G Ltd consolidated and separate Balance Sheet as at 31.03.2022.

Section-E

Recent Developments in Financial Reporting

Recent Developments in Financial Reporting

7

This Module Includes

7.1 4P Bottom Line Reporting

7.2 Sustainability Reporting and Global Reporting Initiative

7.3 Business Responsibility and Sustainability Report

7.4 Integrated Reporting

7.5 Corporate Social Responsibility Reporting in India

7.6 Environmental, Social and Governance (ESG)

7.7 Human Resource Reporting

7.8 Value Added Statement

7.9 Economic Value Added and Market Value Added

7.10 Reporting through XBRL (eXtensible Business Reporting Language)

7.11 Quarterly Earnings Call Management

Recent Developments in Financial Reporting

SLOB Mapped against the Module

To expose students to the contemporary research and developments on corporate financial reporting from the viewpoint of all the stakeholders in global context beyond the boundary of Ind AS.

Module Learning Objectives

- To provide a basket of all other reporting formats relevant for all the stakeholders
- To expose the students to the role of accounting in recognizing responsibility and accountability of the entity towards the planet earth and towards the society.
- To update the knowledge base of the students to the new dimensions of financial and non-financial reporting in the changing technological, ecological, social and spiritual environment.

Introduction

7

Financial Reporting of corporate entities are regulated by the laws of the country and guided by the GAAP of the country and by the adopted or converged IFRS. These are general purpose financial reporting focused primarily to serve the interest of the shareholders and other investors. In addition to these mandatory financial reporting there are many other formats of reporting relevant for all the stakeholders including investors. The status of these other formats of reporting is mostly voluntary and informal barring a few exceptions. In this module the basket contains the following reporting formats, contents of which are partly overlapping:

- 4P Bottom Line Reporting
- Sustainability Reporting and GRI
- Business Responsibility Reporting
- Integrated Reporting
- CSR Reporting in India
- Environmental, Social and Governance (ESG)
- Human Resource Reporting
- Value Added Statement
- Economic Value Added and Market Value Added
- Reporting through XBRL (eXtensible Business Reporting Language)
- Quarterly Earnings Call Management

4P Bottom Line Reporting

7.1

4P Bottom Line or Quadruple bottom line (QBL) reporting is an extension of 3P bottom line or triple bottom line (TPL) reporting.

The phrase "triple bottom line" was first coined in 1994 by John Elkington, the founder of a British consultancy called 'Sustain Ability'. He further articulated the concept in his 1997 book 'Cannibals with Forks: The Triple Bottom Line of 21st Century Business'.

The concept of 'Triple bottom line 'incorporates two technical terminologies – 'Triple' and 'Bottom Line'. We first understand these two for better understanding of the concept of Triple bottom line reporting.

- **Bottom Line:** In traditional accounting and common parlance, the "bottom line" refers to either the "operating result", which is usually recorded at the very last line (or, bottom) of the income statement. Over the last few decades, environmentalists and advocates of social justice have been challenged to introduce a broader concept of 'bottom line' into public consciousness by introducing full cost accounting.
- **Quadruple:** The Quadruple bottom line concept requires an organisation to measure and report on four dimensions viz. social, environmental, economic/ financial and spiritual performance of the organisation.

For example, a leather tanning firm may report a financial profit, but their output may cause adverse health effect, and pollute the nearby water reserves; and the government may end up spending the taxpayer money on health care and environmental clean-up. Now the question that arises in the mind of the proponents of full-cost accounting is 'How do we perform a full societal cost benefit analysis?' in this respect, the 4P bottom line adds three more "bottom lines", namely, people (social) and planet (environmental/ecological) and purpose (spiritual) concerns.

Thus, the concept of '4P bottom line' consists of four dimensions, namely 'social equity', 'economic', 'environmental' and 'spiritual' factors. In other words, the quadruple bottom line (QBL) consists of three Ps: profit, people, planet and purpose. It aims to measure the financial, social, environmental and spiritual performance of the corporation over a period of time. At its core, 4P bottom line thinking ties the social and environmental impact of an organization's activities to its economic performance. Thus, it is also referred to as "QBL," "4PBL," "People, Planet, Profit and Purpose".

Concept of 4P Bottom Line Reporting

Quadruple bottom line reporting (QBLR) expands the traditional reporting framework to take into account social and environmental and spiritual performance in addition to financial performance. The concept of 4P bottom line reporting states that reporting should incorporate the social, environmental, financial and spiritual performance of an organization.

QBL reporting refers to the publication of economic, environmental and social and spiritual information in an integrated manner that reflects activities and outcomes across these three dimensions of a company's performance. They are discussed hereunder:

- The first bottom line happens to be the bottom line of the "income statement" (which is the traditional measure of operating result).
- The second bottom line is that of an organisation's "people account" (a measure in some shape or form of how socially responsible an organisation has been throughout its operations); and
- The third bottom line is that of the organisation's "planet account" (which measures how environmentally responsible the company has been).
- The fourth bottom line lifts business activities to a sacred form. The fourth bottom line is measured by how much more loving, understanding, happy, joyful, in touch with their destiny, deeper relationship or partnership with god or higher powers the person has become, while performing their business responsibilities. And as these qualities are acquired they are infused back into one's own business activities.

The fourth bottom line relate business with happiness of stakeholders. That is when the question of why one is doing business becomes relevant.

The first bottom line deals with the what. "What do I get?" is usually measured by money. The second and third bottom lines deal with whether one is doing business without hurting people and the environment. The Fourth Bottom Line has to do with why. With the fourth bottom line, commerce/business becomes a spiritual path. The concept introduces the fourth bottom line as being a way to utilize core business principles to factor in compassion, for example by being compassionate to the customers and hence developing value for the business in an altruistic way.

The benefits emerging from 4P bottom line reporting are discussed hereunder:

- **Enhancement of reputation and brand:** Corporate reputation is a function of the way in which a company is perceived by its stakeholders. Effective communication with stakeholders on one or more of the environmental, social, and economic dimensions can play an important role in managing stakeholder perceptions and, in doing so, protect and enhance corporate reputation.
- **Securing a social license to operate:** A 'license to operate' is not a piece of paper, but informal community and stakeholder support for an organisation's operations. Business is increasingly recognising the link between ongoing business success and its 'license to operate', especially in the resources sector. Communication with stakeholders is often critical to securing and maintaining a 'license to operate'. Communities and stakeholders generally, are likely to be more supportive of companies that communicate openly and honestly about their management and performance in relation to environmental, social and economic factors.
- **Attraction and retention of high calibre employees:** Existing and prospective employees have expectations about corporate environmental, social and economic behaviour, and include such factors in their decisions regarding working for an organisation.. The publication of TBL-related information can play a role in positioning an employer as an 'employer of choice' which can enhance employee loyalty, reduce staff turnover and increase a company's ability to attract high quality employees.
- **Improved access to investor market:** A growing number of investors are including environmental and social factors within their decision-making processes. The growth in socially responsible investment and shareholder activism is evidence of this. Responding to investor requirements through the publication of TBL-related information is a way of ensuring that the company is aligning its communication with this stakeholder group, and therefore enhancing its attractiveness to this segment of the investment market.
- **Establish position as a preferred supplier:** Obtaining a differentiated position in the market place is one way to establish the status of preferred supplier. Effectively communicating with stakeholder groups on environmental, social and economic issues is central to obtaining a differentiated position in the market place.

- **Reduced risk profile:** There is an expanding body of evidence to suggest that performance in respect of economic, social and environmental factors has the capacity to affect the views of market participants about a company's exposure to, and management of risk. TBL reporting enables a company to demonstrate its commitment to effectively managing such factors and to communicate its performance in these areas. A communication policy that addresses these issues can play an important role in the company's overall risk management strategy.
- **Identification of potential cost savings:** TBL reporting often involves the collection, collation and analysis of data on resource and materials usage, and the assessment of business processes. For example, this can enable a company to better identify opportunities for cost savings through more efficient use of resources and materials.
- **Increased scope for innovation:** The development of innovative products and services can be facilitated through the alignment of R&D activity with the expectations of stakeholders. The process of publishing TBL reporting provides a medium by which companies can engage with stakeholders and understand their priorities and concerns.
- **Aligning stakeholder needs with management focus:** External reporting of information focuses management attention on not only the integrity of the data but also the continuous improvement of the indicator being reported.
- **Creation of sound basis for stakeholder dialogue:** Publication of TBL reporting provides a powerful platform for engaging in dialogue with stakeholders. Understanding stakeholder requirements and alignment of business performance with such requirements is fundamental to business success. TBL reporting demonstrates to stakeholders the company's commitment to managing all of its impacts, and, in doing so, establishes a sound basis for stakeholder dialogue to take place.
- **Altruism and happiness of the stakeholders:** The 4th P 'Purpose' makes business contribute to one's spirituality by serving a unique purpose in addition to financial, social, and environmental returns.

Usually, in making a business profitable and making it adhere to social and environmental responsibilities, one forgets to ask, why is one doing this in the first place?

Does the company contribute in any way to stakeholders' happiness, align with their values and beliefs, or assist towards their personal growth?

In addition to the benefits obtained through superior relationships with key stakeholder groups, the decision to be publicly accountable for spiritual, environmental and social performance is often recognised as a powerful driver of internal behavioural change. The availability of relevant information on economic, environmental and social performance that previously may not have been collected and evaluated in a readily understood manner may enable executives to identify and focus attention on specific aspects of corporate performance where improvement is required.

Prerequisites of implementation of QBL Reporting

QBL reporting would be of little relevance to the reporting company or its stakeholders if it is not **aligned to the company's overall business strategy**. A decision to move to full TBL reporting should not be taken lightly. It must have **senior management endorsement and commitment**, as it may have major resource implications, and a half- hearted approach is likely to be worse than not adopting it all.

Strategy for implementation

Critical issues for consideration in the development and implementation of TBL reporting include:

- clear definition of the role of QBL reporting in driving strategic business objectives;

- establishment of the resource and cost requirements;
- awareness of associated legal implications; and
- understanding the risks involved in publishing QBL information.

Key Challenges for Implementation

The key challenges for implementation of QBL reporting framework are:

- Awareness of relevant issues associated with QBL reporting;
- Understanding stakeholder requirements;
- Aligning QBL reporting with objectives and risks; and
- Determining and measuring performance indicators.

A number of options, ranging from the inclusion of minimal QBL-related information within statutory porting through to the publication of a full QBL report, are available to companies considering QBL reporting.

In choosing an appropriate path forward, companies are likely to take into account various factors including:

- the overall strategic objectives;
- current capacity to report;
- prioritization of stakeholder requirements; and
- the reporting activities within the industry sector.

Sustainability Reporting and Global Reporting Initiative

7.2

In the modern era, sustainability has often been considered as a goal of every kind of organisation, be it business, non-profit organisation or government. Sustainability is a balancing act where business decisions take into account the impact they may have on the various aspects of sustainability including the economic viability of the business. Sustainability usually makes us think about carbon footprints, greenhouse gases and ecosystems. This is the environmental aspect of sustainability. Moreover, two additional aspects are generally recognised as contributing to sustainability: spiritual factors, economic factors and social factors. Together these three pillars of sustainability are often referred to as '***People – Planet – Profit***'. In this scenario, the four forms of sustainability that are considered by the organisations are:

- **Social sustainability** activities focus on maintaining mutually beneficial relationships with employees, customers and the community. These activities often have benefits in terms of positive profile and customer and community support.
- **Environmental sustainability** activities focus on the impact of resource usage, hazardous substances, waste and emissions on the physical environment. These activities may have a direct benefit for a business by reducing costs.
- **Economic sustainability** activities focus on business efficiency, productivity and profit.

The growth of this broader "world sustainability" viewpoint can be seen in the number of companies that have begun reporting on more than just financial operations. Large corporations such as Weyerhaeuser Company, The Boeing Company, PricewaterhouseCoopers, The Procter & Gamble Company, Sony Corporation, and Toyota Motor Corporation, have joined with many others to create the World Business Council for Sustainable Development (WBCSD).

Sustainability Reporting is defined as "an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development. Through this process, an organization identifies its significant impacts on the economy, the environment, and/or society and discloses them in accordance with a globally accepted standard." (GRI, 2018a, p. 3)

Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. (Brundtland 1987)

It suggests that sustainability reporting should recognize the interdependence of economic, social and environmental factors; and the importance of inter-generational timescales.

Corporate sustainability reporting helps companies:

- assess and manage their sustainability impacts,
- report their contributions to sustainable development and
- integrate sustainability into their business strategies.

- identify and manage sustainability risks,
- improve governance, and
- enhance reputation.

The Global Reporting Initiative (GRI)

The Global Reporting Initiative (GRI) is considered "the best-known framework for voluntary reporting of environmental and social performance by business and other organizations worldwide." (Szejnwald Brown, H., 2011). Guidance and standards of Global Reporting Initiative (GRI) are the most widely used framework of sustainability reporting. As per GRI "materiality" is a key principle for reporting. Materiality is achieved when a report covers topics, which "can reasonably be considered important for reflecting the organization's economic, environmental, and social impacts, or influencing the decisions of stakeholders."

Benefits of Sustainability Reporting

Internal benefits for companies and organizations can include:

- Increased understanding of risks and opportunities
- Enhanced link between financial and non-financial performance
- More focus on long term management strategy and policy, and business plans
- Streamlining processes, reducing costs and improving efficiency
- Benchmarking and assessing sustainability performance with respect to laws, norms, codes, performance standards, and voluntary initiatives

External benefits of sustainability reporting can include:

- Mitigating – or reversing – negative environmental, social and governance impacts
- Improving reputation and brand loyalty
- Enhanced perception on organisation's value

Sustainability reporting does also have the potential to deliver financial returns and related competitiveness benefits. It contributes to positive results in both financial and non-financial areas including reputation and brand, human resources, and risk management, good governance, business climate, supply chain, social and environmental matters.

Business Responsibility and Sustainability Report

7.3

In 2012, the Securities Exchange Board of India (SEBI) passed a circular amongst the top 100 companiesbased on market capitalisation, making it mandatory for firms to report their environmental, social and governance initiatives. This report, Business Responsibility Report (BRR), has to be filed as part of their annual reports based on nine principles of National Voluntary Guidelines (NVG). At the time of introduction, only the top-100 BSE-listed firms were required to present BRRs as part of annual reports. In 2016, after signing a memorandum of understanding (MoU) with Global Reporting Initiative, the mandate was extended to top-500 BSE listed companies.

These nine principles aim to cover all aspects which hold significant importance in business operations and sustainability. The principles complement the guidelines and further act as a pathway for flexible and quality reporting standards.

The context and regulatory requirements of Business Responsibility Report

At a time and age when enterprises are increasingly seen as critical components of the social system, they are accountable not merely to their shareholders from a revenue and profitability perspective but also to the larger society which is also its stakeholder. Hence, adoption of responsible business practices in the interest of the social set–up and the environment are as vital as their financial and operational performance. This is all the more relevant for listed entities which, considering the fact that they have accessed funds from the public, have an element of public interest involved, and are obligated to make exhaustive continuous disclosures on a regular basis. Ministry of Corporate Affairs, Government of India, in July 2011, came out with the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business'. These guidelines contain comprehensive principles to be adopted by companies as part of their business practices and a structured business responsibility reporting format requiring certain specified disclosures, demonstrating the steps taken by companies to implement the said principles. SEBI had introduced requirements with respect to BRR vide circular No. CIR/CFD/DIL/8/2012 dated August 13, 2012.

As per clause (f) of sub regulation (2) of regulation 34 of Listing Regulations, the annual report shall contain a business responsibility report describing the initiatives taken by the listed entity from an environmental, social and governance perspective, in the format as specified by the Board. Accordingly, listed entities shall be guided by the format as per Annexure I.

Certain key principles to assess the fulfillment of listed entities and a description of the core elements under these principles are detailed at Annexure II.

Those listed entities which have been submitting sustainability reports to overseas regulatory agencies/ stakeholders based on internationally accepted reporting frameworks need not prepare a separate report for the purpose of these guidelines but only furnish the same to their stakeholders along with a mapping of the principles contained in these guidelines to the disclosures made in their sustainability reports. [SEBI Circular No. CIR/CFD/ CMD/10/2015 dated November 04, 2015]

Suggested Format For Business Responsibility Report

There are five sections (A, B, C, D and E) in the suggested format. [ANNEXURE I to SEBI Circular]

Section A: General information about the company

Section B: Financial details of the company

1. Paid up Capital (INR)
2. Total Turnover (INR)
3. Total profit after taxes (INR)
4. Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%)
5. List of activities in which expenditure in 4 above has been incurred:

Section C: Other details

1. Does the Company have any Subsidiary Company/ Companies?
2. Do the Subsidiary Company/Companies participate in the BR Initiatives of the parent company? If yes, then indicate the number of such subsidiary company(s)
3. Do any other entity/entities (e.g. suppliers, distributors etc.) that the Company does business with, participate in the BR initiatives of the Company? If yes, then indicate the percentage of such entity/entities? [Less than 30%, 30- 60%, More than 60%]

Section D: BR information

1. Details of Director/Directors responsible for BR
2. Principle-wise (as per NVGs) BR Policy/policies

Section E: Principle-wise performance

Nine Principles to Assess Compliance With Environmental,

Social and Governance Norms as per National Voluntary Guidelines (NVG) [ANNEXURE II to SEBI Circular]

Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability

1. Businesses should develop governance structures, procedures and practices that ensure ethical conduct at all levels; and promote the adoption of this principle across its value chain. Businesses should communicate transparently and assure access to information about their decisions that impact relevant stakeholders.
2. Businesses should not engage in practices that are abusive, corrupt, or anti-competition.
3. Businesses should truthfully discharge their responsibility on financial and other mandatory disclosures.
4. Businesses should report on the status of their adoption of these Guidelines as suggested in the reporting framework in this document.
5. Businesses should avoid complicity with the actions of any third party that violates any of the principles contained in these Guidelines.

Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle.

1. Businesses should assure safety and optimal resource use over the life-cycle of the product –from design to disposal –and ensure that everyone connected with it-designers, producers, value chain members, customers and recyclers are aware of their responsibilities.

2. Businesses should raise the consumer's awareness of their rights through education, product labelling, appropriate and helpful marketing communication, full details of contents and composition and promotion of safe usage and disposal of their products and services.
3. In designing the product, businesses should ensure that the manufacturing processes and technologies required to produce it are resource efficient and sustainable.
4. Businesses should regularly review and improve upon the process of new technology development, deployment and commercialization, incorporating social, ethical, and environmental considerations.
5. Businesses should recognize and respect the rights of people who may be owners of traditional knowledge, and other forms of intellectual property.
6. Businesses should recognize that over-consumption results in unsustainable exploitation of our planet's resources, and should therefore promote sustainable consumption, including recycling of resources.

Principle 3: Businesses should promote the wellbeing of all employees

1. Businesses should respect the right to freedom of association, participation, collective bargaining, and provide access to appropriate grievance Redressal mechanisms.
2. Businesses should provide and maintain equal opportunities at the time of recruitment as well as during the course of employment irrespective of caste, creed, gender, race, religion, disability or sexual orientation.
3. Businesses should not use child labour, forced labour or any form of involuntary labour, paid or unpaid.
4. Businesses should take cognizance of the work-life balance of its employees, especially that of women.
5. Businesses should provide facilities for the wellbeing of its employees including those with special needs. They should ensure timely payment of fair living wages to meet basic needs and economic security of the employees.
6. Businesses should provide a workplace environment that is safe, hygienic humane, and which upholds the dignity of the employees. Business should communicate this provision to their employees and train them on a regular basis.
7. Businesses should ensure continuous skill and competence upgrading of all employees by providing access to necessary learning opportunities, on an equal and non-discriminatory basis. They should promote employee morale and career development through enlightened human resource interventions.
8. Businesses should create systems and practices to ensure a harassment free workplace where employees feel safe and secure in discharging their responsibilities.

Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

1. Businesses should systematically identify their stakeholders, understand their concerns, define purpose and scope of engagement, and commit to engaging with them.
2. Businesses should acknowledge, assume responsibility and be transparent about the impact of their policies, decisions, product & services and associated operations on the stakeholders.
3. Businesses should give special attention to stakeholders in areas that are underdeveloped.
4. Businesses should resolve differences with stakeholders in a just, fair and equitable Manner.

Principle 5: Businesses should respect and promote human rights

1. Businesses should understand the human rights content of the Constitution of India, national laws and policies and the content of International Bill of Human Rights. Businesses should appreciate that human rights are inherent, universal, indivisible and interdependent in nature.

2. Businesses should integrate respect for human rights in management systems, in particular through assessing andmanaging human rights impacts of operations, and ensuring all individuals impacted by the business have access to grievance mechanisms.
3. Businesses should recognize and respect the human rights of all relevant stakeholders and groups within and beyond the workplace, including that of communities, consumers and vulnerable and marginalized groups.
4. Businesses should, within their sphere of influence, promote the awareness and realization of human rights across their value chain.
5. Businesses should not be complicit with human rights abuses by a third party.

Principle 6: Business should respect, protect, and make efforts to restore the Environment.

1. Businesses should utilize natural and manmade resources in an optimal and responsible manner and ensure the sustainability of resources by reducing, reusing, recycling and managing waste.
2. Businesses should take measures to check and prevent pollution. They should assess the environmental damage and bear the cost of pollution abatement with due regard to public interest.
3. Businesses should ensure that benefits arising out of access and commercialization of biological and other natural resources and associated traditional knowledge are shared equitably.
4. Businesses should continuously seek to improve their environmental performance by adopting cleaner production methods, promoting use of energy efficient and environment friendly technologies and use of renewable energy.
5. Businesses should develop Environment Management Systems (EMS) and contingency plans and processes that help them in preventing, mitigating and controlling environmental damages and disasters, which may be caused due to their operations or that of a member of its value chain.
6. Businesses should report their environmental performance, including the assessment of potential environmental risks associated with their operations, to the stakeholders in a fair and transparent manner.
7. Businesses should proactively persuade and support its value chain to adopt this principle.

Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner

1. Businesses, while pursuing policy advocacy, must ensure that their advocacy positions are consistent with the Principles and Core Elements contained in these Guidelines.
2. To the extent possible, businesses should utilize the trade and industry chambers and associations and other such collective platforms to undertake such policy advocacy.

Principle 8: Businesses should support inclusive growth and equitable development

1. Businesses should understand their impact on social and economic development, and respond through appropriate action to minimise the negative impacts.
2. Businesses should innovate and invest in products, technologies and processes that promote the wellbeing of society.
3. Businesses should make efforts to complement and support the development priorities at local and national levels, and assure appropriate resettlement and rehabilitation of communities who have been displaced owing to their business operations.
4. Businesses operating in regions that are underdeveloped should be especially sensitive to local concerns.

Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner

1. Businesses, while serving the needs of their customers, should take into account the overall well-being of the customers and that of society.
2. Businesses should ensure that they do not restrict the freedom of choice and free competition in any manner while designing, promoting and selling their products.
3. Businesses should disclose all information truthfully and factually, through labelling and other means, including the risks to the individual, to society and to the planet from the use of the products, so that the customers can exercise their freedom to consume in a responsible manner. Where required, businesses should also educate their customers on the safe and responsible usage of their products and services.
4. Businesses should promote and advertise their products in ways that do not mislead or confuse the consumers or violate any of the principles in these Guidelines.
5. Businesses should exercise due care and caution while providing goods and services that result in over exploitation of natural resources or lead to excessive conspicuous consumption.
6. Businesses should provide adequate grievance handling mechanisms to address customer concerns and feedback.

Integrated Reporting

7.4

Corporate Reporting has come a long way over the years. The multiple corporate reporting frameworks including corporate environmental reporting, corporate social responsibility reporting have evolved to report various corporate efforts to meet stakeholders' expectation. These efforts, though apparently seem independent, together create value for the organization. Unfortunately, none of reporting mechanism stated above effectively explain how such value is created and further enhanced (Sarkar, 2021)[1]. In this context, Integrated Reporting is increasingly gaining popularity.

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates, preserves or erodes value over time. However, an integrated report benefits all stakeholders interested in an organization's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers.

Definition of Integrated Report (IR)

As per the Integrated Reporting Framework issued by International Integrated Reporting Council[2] (IIRC), an integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation, preservation or erosion of value over the short, medium and long term. In other words, integrated report is the representation of the financial and non-financial performance of a company in a single report. IR provides non-financial data such as how the company performs on environmental, social and governance (ESG) parameters, how sustainability is embedded in the core business strategy etc.

Thus, IR aims to provide a more holistic form of reporting the value created by a business, by considering non-financial resources such as human, social and intellectual capitals as well as financial capital. This creates a shift in focus from meeting short-term financial goals, to developing a long-term business strategy, which not only makes a commitment to social and environmental issues, but also to sustainable businesses and society.

IR is more than just another corporate report; it is defined as a process, founded on integrated thinking, which results in a periodic integrated report high lighting value creation.

Objectives of Integrated Reporting

The survival of an organization depends on how successful it is in creating value for the financial capital providers in short, medium and long term (Sarkar, 2021). This value is, however, created through the interaction among various financial and non-financial resources (termed as 'capital' in the IR Framework issued by IIRC). Integrated Reporting helps an organization to communicate, in a clear way, how it is using its financial and non-

1 https://www.academia.edu/63886069/Implementing_Integrated_Reporting_in_India_Issues_and_Challenges

2 IIRC became a part of Value Reporting Framework (VRS) in June, 2021. VRS again was merged with IFRS Foundation w.e.f. July 1, 2022.

financial resources and relationships to create and sustain value in different time horizons (Sarkar, 2021). Thus, the objectives of integrated reporting are:

a. To improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.

b. To promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time.

c. To enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies.

d. To support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

Integrated reporting is consistent with all the developments in corporate reporting over time across the world. It has the potential to synthesise all of them and can accelerate these individual initiatives and provide impetus to greater innovation in corporate reporting.

It may be expected that over time integrated reporting will become the corporate reporting norm. Organisations will no longer produce numerous, disconnected and static communications. Integrated reporting will meet all the information needs of the stakeholders.

The Integrated Reporting Framework Issued by IIRC

Towards achieving a globally acceptable Integrated Reporting framework, IIRC issued the final Consultation Draft of the International Integrated Reporting Framework in April, 2013. The same had been launched as a global framework in December, 2013.

The basic purpose of <IR> Framework is to establish Guiding Principles and Content Elements that govern the overall content of an integrated report, and to explain the fundamental concepts that underpin them.

However, the Framework is principles-based rather than prescriptive in order to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs.

At the same time, the Framework also says that any communication claiming to be an integrated report and referencing the <IR> Framework should apply all the requirements identified in bold italic type unless:

a. The unavailability of reliable information or specific legal prohibitions results in an inability to disclose material information

b. Disclosure of material information would cause significant competitive harm.

Moreover, an integrated report should include a statement from those charged with governance that includes:

- An acknowledgement of their responsibility to ensure the integrity of the integrated report
- Their opinion or conclusion about whether, or the extent to which, the integrated report is presented in accordance with the <IR> Framework.

Where legal or regulatory requirements preclude a statement of responsibility from those charged with governance, this should be clearly stated.

The Value Creation Process[3]

At the core of any Integrated Report there is the Value Creation Process. It explains how an organization creates value over time by augmenting or improving a number of 'Capitals' through a systematic process using the organization's business model (Sarkar, 2021). The value and value creation have the following features:

a. Value has two interrelated aspects – value created, preserved or eroded for the organization itself and for Others (i.e., stakeholders and society at large).

b. Providers of financial capital are interested in the value an organization creates for itself. They are also interested in the value an organization creates for others when it affects the ability of the organization to create value for itself.

c. The ability of an organization to create value for itself is linked to the value it creates for others. This happens through a wide range of activities, interactions and relationships in addition to those, such as sales to customers, that are directly associated with changes in financial capital. When these interactions are material, they find a mention in the integrated report. This includes consideration to externalities (i.e., the costs or other effects on capitals not owned by the firm).

d. These externalities may be positive or negative and thus may ultimately increase or decrease value created for the organization; therefore, providers of financial capital need information about material externalities to assess their effects and allocate resources accordingly.

e. Because value is created over different time horizons and for different stakeholders through different capitals, it is unlikely to be created through the maximization of one capital while disregarding the others.

The value creation process as outlined in the <IR> Framework may be discussed as follows:

I. The Components: The components of the value creation process in the organisation are:

(a) The Capitals: The IIRC used the term "capitals" to denote various resources, with six capitals identified as: financial; manufactured; intellectual; human; social and relationship; and natural.

i. **Financial Capital:** It is broadly understood as the pool of funds available to an organization. This includes both debt and equity finance. This description of financial capital focuses on the source of funds, rather than its application which results in the acquisition of manufactured or other forms of capital.

ii. **Manufactured Capital:** It is seen as human-created, production-oriented equipment and tools. A distinction is drawn between inventory (as a short-term asset) and plant and equipment (tangible capital). Although the identification of these items is generally agreed, their accounting treatment, particularly in terms of valuation, depreciation and taxation, is more contentious.

iii. **Intellectual Capital:** It refers to organizational, knowledge-based intangibles, including intellectual property such as patent and copyrights and organisational capital such as tacit knowledge, systems, procedures and protocols.

iv. **Human Capital:** It includes people's competencies, capabilities and experience as well as their motivations to innovate.

v. **Social and Relationship Capital:** It refers to the institutions and the relationships within and

3 http://www.integratedreporting.org/wp-content/uploads/2022/08/IntegratedReportingFramework_081922.pdf

between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being. For example, shared norms, key stakeholder relationships, social license to operate etc.

vi. **Natural capital:** It includes all renewable and non-renewable environmental resources and processes that provide goods or services.

(b) **External Environment:** It includes various economic conditions, technological change, societal issues and environmental challenges, sets the context within which the organization operates.

(c) **Purpose, Mission and Vision:** This covers the entire organization and defines the objective and broad philosophy of the organization in specific terms.

(d) **Governance:** Those charged with governance are responsible for creating an appropriate oversight structure to support the ability of the organization to create value.

(e) **Risk and Opportunities:** An organization identifies risk and opportunities when it continuously monitors and analyses the forces of external environment in the context of its mission and vision.

(f) **Strategy and Resource Allocation:** This determines organization's long-term attitude towards management of risk and maximizing opportunities. Strategic objectives and processes are implemented through allocation of resources towards productive uses.

(g) **Performance:** An organization puts in place appropriate measures to monitor and evaluate its performance. This helps management taking proper decisions on different matters which have direct bearing on organization's performance.

(h) **Outlook:** Since the process of value creation is dynamic, it is necessary to review each and every component of the process as well as their interaction. Organization's focus on its outlook helps in revision and refinement of the above components and interactions.

(i) **Business Model:** At the core of value creating process is an organisation's business model which employs various capitals as inputs and converts them into output (product or services) through some well-defined business activities. Outputs and activities lead to outcomes in terms of effect on capital.

II. **The Process:** In the value creation process, an organization, at the very beginning, selects an appropriate business model. The selection of the model depends on a number of factors, such as, assessment of external forces, organization's long-term mission and vision, assessment of risks and opportunities arising out of external changes and organization's attitude towards handling the risks (or strategy). Thereafter, based on a well-defined resource allocation plan, the organization employs various capitals as inputs and converts them into outputs through a number of business activities. This leads to significant improvement in quantity and/ or quality of capitals (like profits improves financial capital, remuneration, career advancement programmes and training improves human capital, R&D improves intellectual capital, use of renewable energy sources improves natural capital, better process improves manufactured capital and after sale services, vendor development programmes and CSR activities improve social and relational capital) and thus create value. This process, however, is not static. Hence, the organization reviews all the components and relationships continuously based on its performance related information and outlook and initiates appropriate and timely changes either in the components or in the model to improve the value creation mechanism.

The following figure explains the process in pictorial form.

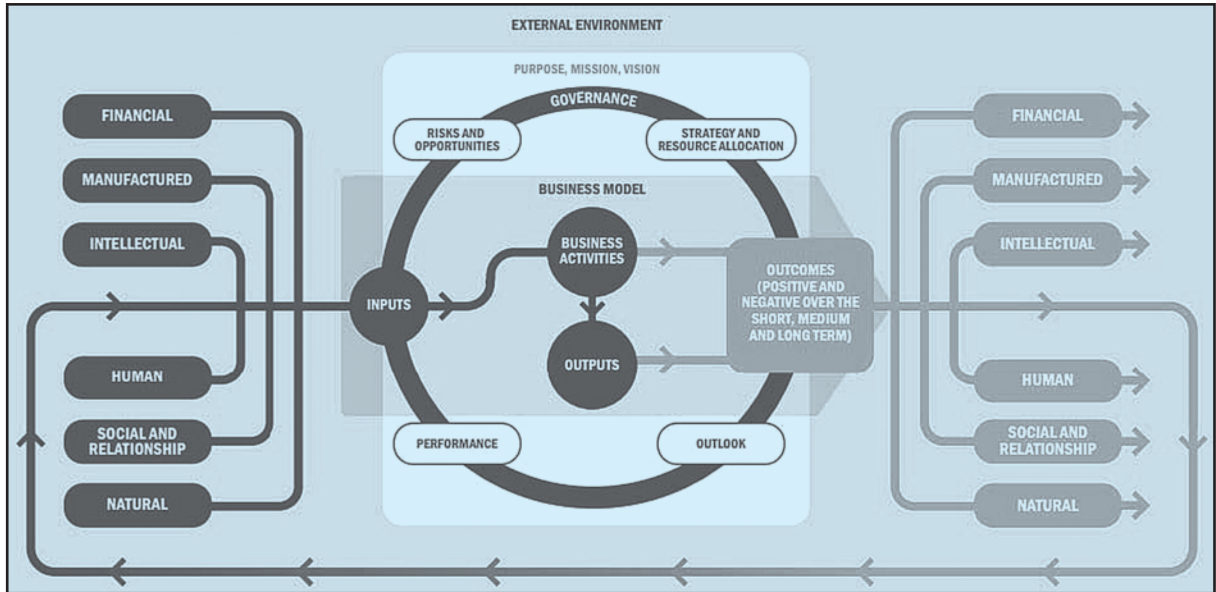

Figure 7.1: Value Creation, Preservation and Erosion over Time

The Integrated Report

Being a principle-based approach, integrated reporting allows much scope of adaptations to cater to the diversity among organisations across the world. Thus, to improve consistency and comparability, IIRC advocated certain (seven) guidelines while preparing and presenting integrated reports. These are:

a. Strategic focus and future orientation

b. Connectivity of information

c. Stakeholder relationships

d. Materiality

e. Conciseness

f. Reliability and completeness

g. Consistency and comparability

Judgement is needed in applying them, particularly when there is an apparent tension between them (e.g., between conciseness and completeness).

Integrated Reporting – The Global Trend

There is an increasing interest over Integrated Reporting worldwide. More than 2,500 businesses in 70+ countries have adopted integrated reporting. In early 2022, IFRS Foundation staff conducted a research project to determine where and how the Integrated Reporting Framework is being implemented worldwide. The findings of the study[4] shows that most integrated reports come from the Asia Pacific, Middle East and Africa, and Europe. Within the regions there are some countries that are leaders in adopting integrated reporting. For instance, Japanese

4 https://www.integratedreporting.org/news/the-growing-momentum-for-integrated-reporting-part-1/

companies make up a large portion of the sampled reports in the Asia Pacific region. Sector analysis[1] indicated that companies across all sectors are producing integrated reports (see the figure below). The majority of the reports in the study came from entities in the Infrastructure, Financials and Resource Transformation sectors. Further investigation showed that integrated reports are being produced in 71 out of the 77 industries based on the Sustainable Industry Classification System® (SICS®), demonstrating the widespread adoption of integrated reporting (Ref: The growing momentum for integrated reporting: Part 1).

Challenges to be Addressed for Implementing Integrated Reporting

Though widely accepted across the globe, integrated reporting is still to become the global corporate reporting language. This is because there exists a number of challenges that are to be addressed to improve its acceptability to all. These challenges include:

a. Issue of Assurance: Who will provide assurance to Integrated Reports?

b. Lack of Global Standards: There is no internationally acceptable standard for IR.

c. Lack of Acceptable Metrics: Measuring and quantifying non-financial metrics and then integrating them with financial performance are complex tasks due to non-availability of acceptable metrics.

Integrated Reporting in India

In India, the present corporate reporting practices are largely fragmented. Companies in India requires to produce multiple statutory reports as necessitated by various legislations including Companies Act, Accounting Standards and Stock Exchanges' Listing Agreement guidelines by SEBI. Financial reporting in form of financial statements, Management Discussion and Analysis, Director's Report, Board's Report such as Corporate Governance Report, Annual CSR Report are some of them. In addition, a company needs to incorporate, within its Annual Report, the auditor's report and Secretarial Audit Report also. Hence, corporate India still prepares multiple disintegrated reports. Accordingly Integrated Reporting has a great potential in India that can eliminate this multiple reporting requirements and overlapping of information by a single report (Sarkar, 2021).

Keeping this in mind the Securities and Exchange Board of India (SEBI) issued a circular no. SEBI/HO/CFD/ CMD/ CIR/P/2017/10 dated 6th February, 2017, to introduce Integrated Reporting on a voluntary basis for top 500 companies who are required to prepare Business Responsibility Report (BRR). Thus, in India, Integrated Reports are not yet mandatory. Still a fast-tracked adoption of Integrated Reporting <IR> can be seen with several organisations. As per the data published by AICL Communications, 75 companies from BSE 500 group, 23 Nifty 50 companies and 16 Sensex companies are currently publishing integrated reports. There are 66 full annual reports have been prepared as per the <IR> Framework. The combined market capitalisation of the companies adopting integrated reporting in India is more than $1 trillion.

Integrated Reporting is the future of corporate reporting in India and sooner or later it will be accepted by all. At present, India is inching towards the reporting ecosystem that will speed up the implementation of Integrated Reporting.

Corporate Social Responsibility Reporting in India

7.5

Concept of Corporate Social Responsibility

A business organisation is a part of the society. It procures its resources from the society and hence, in turn has responsibilities towards the wellbeing of the society. Corporate Social Responsibility (CSR) is the commitment of an organisation towards this responsibility of the society. In other words, it is a form of self-regulation that reflects a business's accountability and commitment to contribute to the well-being of communities and society through various environmental and social measures.

The World Business Council for Sustainable Development (WBCSD) defines Corporate Social Responsibility (CSR) as "the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large."

According to United Nations Industrial Development Organization (UNIDO), "Corporate social responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple-Bottom-Line- Approach"), while at the same time addressing the expectations of shareholders and stakeholders."

CSR plays a crucial role in a company's brand perception; attractiveness to customers, employees, and investors; talent retention; and overall business success.

Present Legislation on CSR in India

In India, traditionally, regulators' effort to bring CSR under the ambit of a well-defined regulatory structure was never whole hearted. The Companies Act, 2013 has only introduced the idea of CSR to the forefront.

The Legal Framework

The present legal framework on CSR in India comprises of –

(a) Section 135 of Companies Act 2013;

(b) Schedule VII of Companies Act 2013; and

(c) Companies (Corporate Social Responsibility Policy) Rules 2014.

Applicability of CSR Regulation

As per Section 135(1) read with Companies (Corporate Social Responsibility Policy) Rules 2014, every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during three immediately preceding financial years shall come under the ambit of CSR regulation and shall constitute a Corporate Social Responsibility

Committee of the Board consisting of three or more Directors[5], out of which at least one director shall be an independent director.

Role of CSR Committee

According to Section 135(3), the CSR Committee shall —

(a) formulate and recommend to Board

  (i). CSR Policy indicating the activities to be undertaken by the company in the areas or subject specified in Schedule VII;

  (ii). the amount of expenditure to be incurred on the above activities and

(b) monitor the CSR Policy of the company from time to time.

Role of the Board in CSR

The Board of the company shall have the following responsibilities:

a. The Board's report under sub-section (3) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee; [Section 135(2)]

b. Based on the recommendations of the CSR Committee, the Board shall approve the Corporate Social Responsibility Policy designed for the company, and disclose contents of such Policy in its report and also place it on the company's website; [Section 135(4)(a)]

c. The Board shall ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company; [Section 135(4)(b)]

d. The Board shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years (or during such immediately preceding financial years in case the company has not completed three years). [Section 135(5)]

Permissible CSR Activities

Activities may be included by the company in their CSR Policy as per Schedule VII of the Companies Act, 2013. Accordingly, Schedule VII suggests the following areas where CSR initiatives may be undertaken:

a. Eradicating extreme hunger and poverty;

b. Promotion of education;

c. Promoting gender equality and empowering women;

d. Reducing child mortality and improving maternal health;

e. Combating HIV, AIDS, malaria and other diseases;

f. Ensuring environmental sustainability;

g. Employment enhancing vocational skills;

h. Social business projects;

i. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

j. Such other matters as may be prescribed.

---

5 two or more directors for companies covered under Section 149.

Quantum of CSR Spending [Section 135 (5) and (6) read with Companies (CSR) Rules 2014]

While an eligible company needs to spend at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, amount overspent or remaining unspent shall be treated as follows:

a. If the company spends an amount in excess of the requirements, then it may set off such excess amount against the requirement to spend for three succeeding financial years. For this purpose, the excess amount available for set off shall not include the surplus arising out of the CSR activities and the Board of the company shall pass a resolution to that effect.

b. Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within thirty days from the end of the financial year to a special account (opened by the company in that behalf for that financial year in any scheduled bank) to be called the Unspent Corporate Social Responsibility Account.

   Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within thirty days from the date of completion of the third financial year.

c. Where the amount unspent is not related to any ongoing project, the amount shall be transferred to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

In addition to the above, the following points should also be considered:

a. The board shall ensure that the administrative overheads shall not exceed five percent of total CSR expenditure of the company for the financial year.

b. Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

Accounting for CSR Transactions

As per the provisions detailed in Section 135 of the Companies Act, 2013 and Companies (CSR) Rules, 2014, CSR expenditure incurred by a company is accounted as follows:

Transactions	Accounting Entries
For CSR expenditure incurred in cash	CSR Expenditure A/c ....Dr. To Cash / Bank A/c
For CSR expenditure incurred in kind	CSR Expenditure A/c ....Dr. To Purchase /Cost of goods consumed A/c
Unspent CSR expenditure [Section 135(5)] i.e., other than on ongoing project	CSR Expenditure A/c ....Dr. To Cash/Purchase/Cost of goods consumed (as applicable) To CSR to be Deposited in Fund A/c
Unspent CSR expenditure [Section 135(6)] i.e., on ongoing project	CSR Expenditure A/c ....Dr. To Cash/Purchase/Cost of goods consumed A/c (as applicable) To CSR to be Spent on Ongoing project A/c

Transactions	Accounting Entries
Excess spent CSR expenditure	CSR Expenditure A/c..Dr. CSR Pre-Spent A/c ....Dr. To Cash/Purchase/Cost of goods consumed A/c (as applicable)

Accordingly,

a. the amount of CSR expenditure shall be disclosed way of a note to the Statement of Profit and Loss.

b. for the unspent CSR expenditure, a provision for liability for the amount representing the extent to which the amount is to be transferred, needs to be recognized in the financial statements.

c. the excess amount spent would be allowed to be carried forward to next year and if the company decides to adjust such excess against future obligation, then to the extent of such excess, an asset will have to be recognized for the amount which is spent in excess of 2%.

d. if the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

CSR Reporting:

(1) The Board's Report of a company covered under these rules pertaining to any financial year shall include an annual report on CSR containing particulars specified in Annexure I or Annexure II, as applicable. As per Annexure I, the report shall include -

1. A brief outline of the company's CSR Policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR Policy and projects or programs.
2. The Composition of the CSR Committee.
3. Average net profit of the company for last three financial years
4. Prescribed CSR Expenditure (two per cent of the amount as in item 3 above)
5. Details of CSR spent during the financial year.

   (a) Total amount to be spent for the financial year;

   (b) Amount unspent, if any;

   (c) Manner in which the amount spent during the financial year.
6. In case the company has failed to spend the two per cent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

Annexure II provides a further detailed format and additional disclosure requirements such as –

(a) Surplus arising out of the CSR Projects or programmes or activities of the previous financial years;

(b) Amount required to be set-off for the financial year, if any;

(c) Amount spent in Administrative overheads;

(d) Amount spent on Impact Assessment, if applicable;

(e) Details of Unspent Corporate Social Responsibility amount for the preceding three Financial Years;

(f) Whether any capital assets have been created or acquired through Corporate Social Responsibility amount spent in the Financial Year;

(g) Reason for such failure.

Environmental, Social and Governance (ESG)

7.6

- **Concept of ESG Reporting**

In today's competitive world, corporate organizations with a transparent and fair image receive added attention from various stakeholders. Especially, investors are increasingly applying various nonfinancial factors as part of their analysis process to identify material risks and growth opportunities. In these process, corporates are being judged on three important aspects namely, economic, environmental and social aspects. Thus, ESG reporting has become immensely important. Each and every corporate house needs to disclose all the facts and figures relating to its contributions made towards the protection of environment and society as well as it should disclose all the essential economic information in front of the stakeholders. In a recent report, EY has stated that investors need clear and transparent ESG (Environmental, Social and Governance) disclosures founded on high-quality data and produced using robust and reliable processes and systems (EY – Global – Institutional Survey Report, 2020).

- **Importance of ESG Reporting**

ESG reporting refers to the disclosure of data covering the company's operations in three areas: environmental, social and corporate governance. The importance of ESG Reporting can be assessed based on the following five broad aspects:

a. ESG risks and opportunities have potential impact on shareholder's value.

b. Today, most of the investors wish to integrate the business with environment and society to generate sustainable profits in responsible manner.

c. ESG Reporting analyses how the business operations of the company impact the environment both directly as well as indirectly.

d. ESG Reporting analyses how a company manages relationships with its stakeholders, regardless of where it operates.

e. ESG reporting highlights on various dimensions of corporate governance.

Annual report, in spite of incorporating many mandatory reporting tools, often fails to identify the corporates' ESG performance. A separate ESG reporting can do a lot to meet this gap.

- **ESG Criteria**

ESG reporting requires identification and reporting information about the three criteria in a meaningful way. While, environmental criteria consider how a company performs as a steward of nature, social criteria examine how it manages relationships with employees, suppliers, customers, and the communities. Finally, governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights. Accordingly, the following criteria are largely used in this context.

(A) Environmental test criterion includes:

a. Conservation of the natural world
b. Climate change and carbon emissions
c. Air and water pollution
d. Biodiversity
e. Deforestation
f. Energy efficiency
g. Waste management
h. Water scarcity

(B) Social test criterion includes

a. Consideration of people & relationships
b. Customer satisfaction
c. Data protection and privacy
d. Gender and diversity
e. Employee engagement
f. Community relations
g. Human rights
h. Labor standards

(C) Governance test criteria includes consideration of:

a. Standards for running a company
b. Board composition
c. Audit committee structure
d. Bribery and corruption
e. Executive compensation
f. Lobbying
g. Political contributions
h. Whistle blower schemes

- **Evolution of ESG Reporting in India**

The effort to lay more emphasis on environmental and societal aspect of business was started way back in 2009. The journey of ESG reporting in India is quite fascinating.

Table – 1: Evolution of ESG Reporting in India

Year	Reporting Policies
2009	National Voluntary Guidelines (NVG) were issued by Ministry of Corporate Affairs (MCA) on Corporate Social Responsibility Reporting

Year	Reporting Policies
2012	Business Responsibility Report (BRR) - SEBI mandated top 100 listed companies by Market Capitalization to file BRR along with Annual Report based on NVG
2014	Corporate Social Responsibility (CSR) Reporting was mandated and rules came into force
2015	Filing BRR was extended to the top 500 listed companies by Market Capitalization
2017	SEBI Circular advised to file Integrated Report - may be adopted on a voluntary basis from FY 2017 -18 for top 500 listed companies by Market Capitalization
2019	National Guidelines on Responsible Business Conduct (NGRBC) were released in March 2019. It is a set of nine principles to guide the corporates for ESG reporting.
2019	SEBI extended the BRR requirement to the top 1000 listed companies by Market Capitalization from FY 2019-20
2021	SEBI issued circulars on Introduction of BRSR in May 10, 2021 (Pr. No. 18/2021) – Initiative towards ensuring investors' access to standardized disclosures on ESG Parameters

ESG Reporting through Business Responsibility and Sustainability Reporting

In India, no separate format has so far been promulgated for ESG reporting; rather the government is expecting to achieve the benefits of ESG reporting through BRSR. In the following table, various aspects of BRSR (for detail reference on different sections of BRSR, please refer to Module 7.3 of this study material) have been mapped against ESG disclosures.

Table – 2: Alignment of BRSR's KPIs with ESG Pillars

Environmental	Social	Governance
Energy and GHG Emissions	Employee Well-Being	Anti-corruption and anti-bribery policies
Solid Waste management	Health and Safety of Workers	Conflict Management Process
Water Consumption and Withdrawal	Trainings	Retention Policies
3R Practices	Human Rights	Remuneration Policies
Sustainable Sourcing	Social Impact Assessment	Stakeholder Engagement
Extended Producer Responsibility (EPR)	Gender Equality	
Life Cycle Assessments (LCA)	CSR Activities and details of beneficiaries	

Extinction Accounting: Should It Be a Part of Integrated Reporting and ESG Reporting?

Scientists declare that we have now entered the sixth mass extinction on planet earth, that they identify is a direct result of human – and corporate – activity. From insects to mammals, trees to flowers, species are going extinct at an unprecedented rate. The corporate world and society rely entirely on the healthy functioning of the ecosystem surrounding us. Hence, any imbalance in this ecosystem due to extinction of species is likely to hurt the society and the corporates as well. In this context, a new concept, extinction accounting is gaining popularity.

Extinction accounting may be described as "an attempt by companies to report on and evaluate the absence of specific species". Extinction accounting is intended as a means of reporting on biodiversity-related risks which creates an awareness of the importance of managing biodiversity loss (including the risk of extinction). In their path breaking article 'The emancipatory potential of extinction accounting: Exploring current practice in integrated reports', J.F. Atkins and W. Maroun have proposed a detail framework on extinction accounting[1].

Integrated thinking, at the heart of integrated reporting, merges social, environmental and economic factors into corporate strategic value creation throughout the whole organisation. Consequently, the contribution of companies to species extinctions cannot be excluded from integrated reports. As integrated reporting brings environmental and ecological outcomes into the heart of accounting, the ways in which species are affected by a company's activities, as well as steps companies are taking to prevent extinctions, must be included in integrated reports and also be a part of ESG reporting.

1 https://eprints.whiterose.ac.uk/126203/3/Final%20MS%2021%20December.pdf

Human Resource Reporting 7.7

Human Resources report is an analytical tool for displaying human resources-related facts, insights, and metrics to improve workforce performance, recruiting procedures, and other important HR operations.

By using HR-driven metrics, management can spot trends, identify inefficiencies, capitalise on strengths, and turn-around weaknesses.

Types of HR reports:

1. **Employee information reports**

   Employee Information Reports provide all information on employees' data factors, such as employee headcount, employee turnover rates, diversity, revenue per employee, employee satisfaction percentage, employee engagement percentage, and average employee tenure, etc.

2. **Recruitment reports**

   The following are some important metrics to track in recruitment reports:

   - Number of candidates evaluated in a period
   - Rate of offer declination
   - Reasons for offer rejection
   - Total number of interviews
   - Duration of the interview
   - Top channels for candidate sourcing
   - Active job postings by location, department, and other criteria
   - Candidates from the talent pool and their behaviour patterns

3. **Performance management reports**

   It's critical to keep track of employees' goals, skillsets, feedback, and other information. Performance reports provide a logical starting point for appraising staff.

   Performance reports can also show how each employee is doing in terms of meeting their objectives.

   The following are some of the parameters for measuring performance:

   - Employee evaluations
   - Time to productivity
   - The number of hours worked and revenue
   - Employee objectives and performance, as well as their improvements
   - Peer reviews, etc.

4. The finance team is in charge of majority of the compensation provided to employees. Payroll, on the other hand, is the responsibility of the HR department. To better understand compensation, keep track of salary reports, appraisal reports, paid time off reports, overtime compensation and dues reports, shift compensation, deductions, and financial reports based on each filter or criteria.

5. **Terminations Budget/Analysis**

   This report contains the list of all employees who have been terminated from employment within a defined date range.

6. **Equal employment opportunity reports**

   Equal employment opportunity is a pivotal concept for employees and employers alike. It ensures that the employment in an organization is not biased towards a specific gender, race or age group.

7. **Workplace Safety Reports**

   It includes Employee Grievance Reports, compensation reports and safety reports

Value Added Statement

7.8

- **Concept of Value Added**

'Value-Added' is a basic and important measurement to judge the performance of an enterprise. It indicates the net value or wealth created by the manufacturer during a specified period. No enterprise can survive or grow, if it fails to generate wealth. An enterprise may exist without making profit, but cannot survive without adding value. Value added is a more meaningful measure of corporate performance than conventional measures based on traditional financial accounting, and can be particularly useful for employee-oriented approach which will allow more fruitful discussions with employees and can be especially useful in productivity agreements. The value added concept attempts to neutralise the distinction between capital and labour by focussing on the creation of wealth i.e., the fund from which all payments to capital, labour and the government must come. It formally recognises this relationship by highlighting the two aspects of wealth creation and application. In this respect it is more alike to a funds flow statement than a conventional profit and loss account.

Value added can be particularly useful to management in comparing the performance of business within a group or comparing a company's performance with its industry as a whole. Financial reporting has traditionally concentrated on the needs of shareholders and creditors with a consequent focus upon profit to evaluate the success of a business enterprise. However, there is a growing recognition of the needs of the stakeholders, especially employees. Value added statements report the results of an enterprise in a way that recognises other stakeholders. The value added concept also aligns corporate financial reporting with 'National Income Accounting'. Value added is included in the computation of Gross Domestic Product (GDP).

- **Value Added Statement**

This is a financial statement that shows how much value (wealth) has been created by an enterprise through the utilisation of its capacity, capital, manpower, and other resources, and how it is then allocated among different stakeholders (employees, lenders, shareholders, government, etc.) within an accounting period. In other words, these are financial statements that show how a business creates value and distributes that wealth to diverse stakeholders. Employees, shareholders, the government, creditors, and the wealth retained in the enterprise are among the numerous stakeholders. A typical Value Added Statement has two parts – Creation /Generation of Value Added and Distribution of Value Added.

I. Creation or Generation of Value Added: This part of the value-added statement describes how the value is generated. Here, value added is shown as the excess of turnover plus income from services over the cost of bought-in material and cost of services. The term 'turnover' is defined as the gross sale of goods plus sales tax and duties minus the amount of rebates, returns, commission, discounts and goods used for self-consumption.

II. Application of Value Added: This part describes how the value added is shares by the three contributing members viz., (a) employees, (b) government and (c) providers of capital. The remainder of the value added is reinvested in the business in the form of depreciation and retained earnings.

The following is a general format of Value Added Statement.

Value Added Statement

For the year ended on ....

Particulars	(₹)	(₹)
Creation of Value Added		
(a) Sales (including sales tax and excise duty but net of rebate, commission, returns, discounts and goods for self-consumption)		
(b) Income from services (e.g., royalty, dividend and interest, rent received etc.)		
(c) Cost of bought-in materials (consumption of raw materials, consumables, packing materials, stationery, fuel and oil, electricity, repairs etc.)		
(d) Cost of bought-in services (e.g., audit fees, insurance, rent paid, travelling expenses, advertisement, postage and telegram, subscriptions, other expenses)		
Added Value Created [(a)+(b) –(c) – (d)]		
Distribution of Value Added		
(a) To Employees (e.g., wages and salaries, director's fees, contribution to P.F, ESI etc.)		
(b) To Government (e.g., duties and taxes)		
(c) To Providers of Capital (e.g., Interest and Dividend)		
(d) Retained Earnings (e.g., depreciation and retained profit)		
Disposal of Value Added [(a)+(b) +(c) + (d)]		

- **Uses of Value Added Statement**

Value added reporting is not only useful for external purposes but also for internal decision making and performance measurement The following are some of the uses of value added reporting:

a. Value added is an alternative performance measure to profit.

b. Useful productivity measures can be devised using corporate value added. For example,

   i. Value added per rupee of capital employed

   ii. Value added per rupee of sales

   iii. Value added per rupee of labour cost

   iv. Value added per employee

   v. Value added per labour hour or machine hour

c. Resource allocation decisions may be based upon value added.

d. The value added reporting is found useful by many companies for explaining company results to employees. One of the significant uses of the concept of value added is its incorporation in company incentive schemes or bonus schemes. The schemes work by establishing a base ratio of value added to payroll costs thereby creating a base index. If the index moves favourably in later periods, a bonus is payable to scheme members. There are two principal methods of using the base index to calculate bonus.

Consider the following illustration on preparation of Value Added Statement.

Illustration 1

The following are the balances in the account statements of X Ltd. for the year ended 31st March, 2005:

(₹ ‘000)

Particulars	(₹)
Turnover	4,600
Plant and machinery net	2,160
Loss on sale of machinery	150
Depreciation on plant and machinery	400
Dividends to ordinary shareholders	292
Debtors	390
Creditors	254
Total stock of all materials, WIP and finished goods:	
Opening stock	320
Closing stock	400
Raw materials purchased	1,250
Cash at bank	196
Printing and stationery	44
Auditor’s remuneration	56
Retained profits (opening balance)	1998
Retained profits for the year	576
Rent, rates and taxes	330
Other expenses	170
Ordinary share capital issued	3,000
Interest on/borrowings	80
Income-tax for the year	552
Wages and salaries	654
Employees state insurance	70
P.F. contribution	56

Prepare a Value Added Statement for the company for the year 2021-22.

Solution:

Value Added Statement

For the year ended on 31.03.2022

Particulars	(₹)	(₹)
Generation of Value Added		
Turnover		4,600
Add: Increase in Stock of raw materials, WIP and FG		80
		4,680
Less. Cost of bought-in materials and services		
Raw materials purchased	1,250	
Printing and Stationery	44	
Auditor's remuneration	56	
Rent, rates and taxes	330	
Other expenses	170	1,850
Total Value Added		2,830
Distribution of Value Added		
To Employees		
Wages and salaries	654	
Employees state insurance	70	
P.F. contribution	56	
		780
To Government		
Income-tax for the year		552
To Providers of Capital		
Interest on borrowings	80	
Dividends	292	
		372
Re-invested in Business		
Depreciation on plant and machinery		
Retained profit for the year	400	
	576	976
Loss on sale of machinery		150
Total Disposal of Added Value		2,830

Economic Value Added and Market Value Added

7.9

Economic Value Added (EVA) is a performance measure developed by Stern Stewart & Co. (now known as Stern Value Management) to find the true economic profit generated by a company.

It is also called "economic profit," and provides a measurement of a company's economic success (or failure) over a period of time.

Economic profit can be calculated by taking a company's net after-tax operating profit and subtracting from it the product of the company's invested capital multiplied by its percentage cost of capital.

Economic Value Added (EVA) is the measure of economic profits after charging both cost of debt and cost of equity capital.

EVA = NOPAT - (WACC × Invested Capital),

Where NOPAT = EBIT × (1 – t);

EBIT is Earnings Before Interest and Tax. t = tax rate = Tax expenses/EBT

EBT is Earnings Before Tax.

Weighted Average Cost of Capital (WACC) = We × Ke + Wd × Kd

We = weight of Equity in capital structure

Wd = weight of Debt in capital structure

Ke = Cost of Equity Capital

Kd = Cost of Debt Capital

For example, B Ltd. had 2021 net after-tax operating profits of ₹5,00,000 and invested capital of ₹50 lakhs at an average cost of 9%, then B Ltd.'s economic profit, EVA would be computed as ₹5,00,000 - (₹ 50 Lakhs × 9%) = ₹50,000.

This ₹50,000 represents an amount equal to 1% of B Ltd.'s invested capital, providing 1% real growth during the year.

Market Value Added

Market value added (MVA), on the other hand, is simply the difference between the current total market value of a company and the capital contributed by investors (including both shareholders and debtholders). It is typically used for companies that are larger and publicly-traded. MVA is not a performance metric like EVA but instead is a wealth metric, measuring the surplus value a company has generated in reflection of its future performance.

As a company performs well over time, investors will likely bid up to the prices of those shares in expectation of future earnings, causing the company's market value to rise. As this occurs, MVA measures the difference between the company's market value and the capital contributed by investors represents the excess price tag the market assigns to the company as a result of its expected future operating successes.

Reporting through XBRL (eXtensible Business Reporting Language)

7.10

XBRL stands for 'eXtensible Business Reporting Language'. XBRL is the open international standard for digital business reporting. It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet.

The basic idea behind XBRL is that instead of treating financial information as a block of text or numeric items, a unique electronically readable tag is attached to each individual financial term. It is not just the data or text that floats around, these individual items move along with an electronic tag. Thus, it is not just the 'content' but also the 'context' is being transmitted XBRL is the international standard for digital reporting of financial, performance, risk and compliance information, although it is also used for many other types of reporting. It offers major benefits to all those who have to create, transmit, use or analyse such business information.

It has been developed and refined over more than a decade ago and supports almost every kind of conceivable reporting. Moreover, it also provides a wide range of features that enhance the quality and consistency of reports, as well as their usability. It provides benefits in the preparation, analysis and communication of business information and is fast becoming an accepted reporting language across the globe.

The change from paper, PDF and HTML based reports to XBRL ones is a little bit like the change from film photography to digital photography, or from paper maps to digital maps. The new format allows you to do all the things that used to be possible, but also opens up a range of new capabilities because the information is clearly defined, platform-independent, testable and digital. Just like digital maps, digital business reports, in XBRL format,

simplify the way that people can use, share, analyse and add value to the data. Millions of XBRL documents are getting generated every year, replacing older, paper-based reports with more useful, more effective and more accurate digital versions. [Source: www.xbrl.org]

XBRL is today used for multiple purposes, some of which include:

- Accounting (individual transactions tagged with XBRL Global Ledger);
- Internal Reporting (for drafting of management reports);
- External Reporting (for drafting of financial statements, regulatory reports, corporate tax filings, statistical reports etc.)

Meaning of XBRL

XBRL is a language for the electronic communication of business and financial data which is revolutionising the business reporting around the world. The term XBRL includes four terminologies – Extensible, Business, Reporting and Language. These terms are briefly discussed hereunder:

(a) Extensible: This term implies that the user can extend the application of a particular business data beyond its original intended purpose. The major advantage in it is that the extended use can be determined even by

the users and not just the ones who merely prepare the business data. This is achieved by adding tags which are both human and machine readable – describing what the data is.

(b) Business: This platform is relevant to any type of business transaction. It is to be noted that XBRL focus is on describing the financial statements for all kinds of entities.

(c) Reporting: The intention behind promoting the use of XBRL is to have all companies report their financial statements in a consolidated manner using the specified formats.

(d) Language: XBRL is based on 'eXtensible Markup Language' (XML). It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet. It prescribes the manner in which the data can be "marked-up" or "tagged" to make it more meaningful to human readers as well as to computers-based system.

Definition of XBRL

As per **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015,** Extensible Business Reporting Language" (XBRL), means a standardised language for communication in electronic form to express, report or file financial information by the companies under the Act (i.e. Companies Act, 2013).

- **Important XBRL Related Concepts**

1. XML

XML stands for 'e**X**tensible **M**arkup **L**anguage'. It is a markup language for documents containing structured information. A markup language is a mechanism to identify structures in a document.

XML defines a set of rules for encoding documents in a format that is both human-readable and machine-readable. It is a textual data format with strong support (via Unicode) for different human languages.

There are hundreds and thousands of computers programming languages and one among them is XML. Also XML markup language has types of programming languages. There are nearly 200 types of XML markup languages, and XBRL happens to be one of them. XBRL is XML-based and therefore is expected to be widely available in software applications.

Hyper Text Mark-up Language (HTML) is a markup language for describing web documents. HTML is a cornerstone technology used to create web pages as well as to create user interfaces for mobile and web applications. However, this mark-up language suffered from certain limitations, they being – Limited number of Tags, forgiving Browsers, Browser developers may be tempted to add new tags that only work with their product, Cannot customize layout from client side, Product comparison to mention a few. These limitations of HTML gave birth to XML.

It was the World Wide Web Consortium (W3C) where XML group (originally known as the SGML Editorial Review Board) worked and invented XML. The work was started in 1996. On 10th February, 1998 XML version 1.0 recommendation was released.

2. Taxonomy

Taxonomies are the reporting-area specific hierarchical dictionaries used by the XBRL community. They define the specific tags that are used for individual items of data (such as "net profit"), their attributes and their interrelationships.

As per **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015**, taxonomy means in XBRL, an elechonic dictionary for reporting the business data as approved by the Central Govemment in respect of any documents or forms indicated in these rules.

Different taxonomies will be required for different business reporting purposes. Some national jurisdictions may need their own reporting taxonomies to reflect local accounting and other reporting regulations. Many different organisations, including regulators, specific industries or even companies, may require taxonomies or taxonomy extensions to cover their own specific business reporting needs.

Taxonomies which have been officially recognized by XBRL International are listed under 'Recognized Taxonomies'. Some of the recognized taxonomies are:

- India Banking GAAP Taxonomy 2010
- BRAZIL GAAP Commercial and Industrial Taxonomy
- Indonesia Stock Exchange (IDX) Taxonomy 2014
- Japan EDINET Taxonomy 2010
- Canadian Financial Reporting According to Canadian GAAP
- General Purpose Financial Reporting for Profit-Oriented Entities Chilean Laws
- Taxonomie Comptes Annuels (TCA) (France)
- US Governance, Risk and Compliance (GRC) Open Compliance and Ethics Group (OCEG) Taxonomy
- Tata Index for Sustainable Human Development Taxonomy
- MIX Microfinance Taxonomy
- RSC – CCI Scoreboard for Corporate Social Responsibility Taxonomy 2010

Myths Regarding XBRL

This section clarifies certain myths regarding XBRL. In other words, it is discussed what XBRL is not:

(a) **XBRL is not a set of Accounting Standards:** It needs to be clearly understood that XBRL does not represent a set of accounting standards, which remain the prerogative of the regulatory standards bodies. XBRL is merely a platform on which reporting standards content will reside and be represented.

(b) **XBRL is not a chart of accounts:** It is not a detailed universal chart of accounts. Formulation of a company's chart of accounts is an exercise conducted by its management with regard to its specific business intricacies. XBRL can facilitate the implementation of such structures through its ability to transport data between disparate software applications that might be used within an organizations operational structures.

(c) **XBRL is not a GAAP translator:** It does not provide a mechanism for facilitating a drilldown of existing GAAP information into lower levels of information that would be necessary for translating financial statements from one GAAP to another. The business-reporting document contains the same GAAP information, be it in an XBRL format or an MS word or PDF format.

(d) **XBRL is not a proprietary technology:** XBRL is freely licensed and available to the public.

(e) **XBRL is not a Transaction Protocol:** XBRL deals with business reporting information, not with data capture at the transaction level. It is designated to address issues related to generation and usage of information contained within business reports and begin at the accounting classification level.

Features of XBRL Reporting

1. **Clear Definitions**

XBRL allows the creation of reusable, authoritative definitions, called taxonomies, which capture the meaning contained in all of the reporting terms used in a business report, as well as the relationships between all of the terms. Taxonomies are developed by regulators, accounting standards setters, government agencies and

other groups that need to clearly define information that needs to be reported upon. XBRL doesn't limit what kind of information is defined: it's a language that can be used and extended as needed.

2. **Testable Business Rules**

   XBRL allows the creation of business rules that constrain what can be reported. Business rules can be logical or mathematical, or both. These business rules can be used to:

   - Prevent poor quality information being sent to a regulator or third party, by being run by the preparer while the report is in draft stage.
   - Prevent poor quality information being accepted by a regulator or third party, by being run at the point that the information is being received. Business reports that fail critical rules can be sent back to the preparer for review and resubmission.
   - Identifying or highlighting questionable information, allowing prompt follow up, correction or explanation.
   - Creation of ratios, aggregations and other kinds of value-added information, based on the fundamental data provided.

3. **Multi-lingual Support**

   XBRL allows concept definitions to be prepared in as many languages as necessary. Translations of definitions can also be added by third parties. This means that it's possible to display a range of reports in a different language to the one that they were prepared in, without any additional work. The XBRL community makes extensive use of this capability as it can automatically open up reports to different communities.

4. **Strong Software Support**

   XBRL is supported by a very wide range of software from vendors large and small, allowing a very wide range of stakeholders to work with the standard.

Benefits of XBRL Reporting

The benefits of reporting under XBRL over traditional form are:

1. **Automated Data Processing:** The use of XBRL offers major benefits to the preparers and users of business and financial information by enabling this data to be exchanged and processed automatically by the software. XBRL identification tags reduce and eliminate the need for the data entry operator to manually key data into the software.
2. **More accurate and efficient:** XBRL makes reporting more accurate and more efficient by using comprehensive definitions and accurate data tags. Such data tags allow the preparation, validation, publication, exchange, consumption and analysis of business information of all kinds.
3. **Data Review:** Organisations can use software to automatically validate data electronically received through XBRL. The software can help analyse the data and identify problems that accountants and auditors can examine.
4. **Improved reporting quality:** XBRL provides its users with increased data integrity and uniformity. It also allows for increased transparency of public owned companies' financial records for view by 'interested' parties.
5. **Interchangeable:** Information in reports prepared using the XBRL standard is interchangeable between different information systems in entirely different organisations. This allows for the exchange of business information across a reporting chain. The users who intend to report information, share information, publish information and allow straight through information processing rely on XBRL.

6. **Cost and time savings:** Currently all companies file their reports with regulators using formats like the Portable Document Format (PDF) which has its inherent limitations. Moreover, the costs of sending, receiving, storing, validating and auditing the financial records in this format are comparatively higher. XBRL reduces the involved time and also the cost.

7. **Tagging of transactions:** In addition to allowing the exchange of various business reports, XBRL has the capability to allow the tagging of transactions that can themselves be aggregated into XBRL reports. These transactional capabilities allow system-independent exchange and analysis of significant quantities of supporting data. XBRL allows unique tags to be associated with reported facts, which leads to the following advantages:

   - publishing of reports with the confidence that the information contained in them can be consumed and analysed accurately;
   - testing of the reports against a set of business and logical rules, in order to capture and avoid mistakes at their source;
   - using the information in the way that best suits the users' needs, including by using different languages, alternative currencies and in their preferred style
   - providing confidence to the users that the data provided to them conforms to a set of sophisticated pre-defined definitions.

User of XBRL

XBRL is the international standard for digital reporting. It offers benefits to all those who have to create, transmit, use or analyse such information. XBRL is used in many different ways, for many different purposes. The significant users of XBRL include:

1. **Companies:** Companies are required to provide relevant information to various stakeholders, and to accurately move information amongst them.

2. **Not-for-profit Organisations**: Several not-for-profit organisations, like universities, municipalities etc. opt for reporting under XBRL format.

3. **Accountants:** Accountants use XBRL in support of clients reporting requirements and are required to prepare and present financial statements using XBRL.

4. **Analysts:** Analysts that need to understand relative risk and performance.

5. **Investors:** Investors that need to compare potential investments and understand the underlying performance of existing investments.

6. **Regulatory Authorities:** The different regulatory authorities that use XBRL include:

   - **Financial regulators** that need significant amounts of complex performance and risk information about the institutions that they regulate.
   - **Securities regulators and stock exchanges** that need to analyse the performance and compliance of listed companies and securities, and need to ensure that this information is available to markets to consume and analyse.
   - **Business registrars** that need to receive and make publicly available a range of corporate data about private and public companies, including annual financial statements.

7. **Government agencies:** Government agencies that are in the process of simplifying the process of businesses reporting, reducing red tape (either by harmonising data definitions or consolidating reporting obligations, or both), or improving government reporting by standardising the way that consolidated or transactional reports are prepared.

8. **Tax authorities:** The tax authorities need financial statements and other compliance information from companies in order to process and review their corporate tax affairs.
9. **Statistical and monetary policy authorities:** These authorities that need financial performance information from many different organisations.
10. **Specialist Data Providers:** Specialist data providers that use published information for the purpose of creating comparisons, ratings and other value-added information products for various market participants.

XBRL International

XBRL is managed by **XBRL International Inc.(XII)**. XBRL International is a global not-for-profit consortium of approximately 600 companies and agencies worldwide working together to build the XBRL language, and promote and support its adoption. It is comprised of jurisdictions which represent countries, regions or international bodies and which focus on the progress of XBRL in their area. The number of established jurisdictions has grown from 7 to 22 over the years. Around 5 jurisdictions, including India are presently in the provisional stage.

It operates mainly through the XBRL Steering Committee and has over the years produced a variety of specifications and taxonomies for digitizing financial information in accordance with the accounting rules and other regulations prevailing in different countries. The consortium members meet periodically in international conferences and conduct committee work regularly throughout the week.

This collaborative effort began in 1998 and has produced a variety of specifications and taxonomies to support the goal of providing a standard, XML-based language for digitizing business reports in accordance with the rules of accounting in each country or with other reporting regimes such as banking regulation or performance benchmarking

Presently, XBRL is used around the world, in more than 60 countries.

XBRL in India

The XBRL global initiative is led by a non-profit organisation called XBRL International Inc. (XII), which has members from various agencies from more than 164 countries. In India, the Ministry of Corporate Affairs (MCA) has switched over its reporting format to XBRL for Annual Report and Cost Audit report filings. The Reserve Bank of India (RBI) hasalso moved to XBRL reporting for the Banking Industry while the Securities & Exchange Board of India (SEBI) hasmandated reporting by Mutual Funds though XBRL mode. The responsibilities of forming a XBRL national jurisdiction and the implementation of the standards for financial reporting in India have been entrusted to the Institute of Chartered Accountants of India (ICAI).

XBRL India

XBRL India is the Indian Jurisdiction of XBRL International. Its main objective is to promote and encourage the adoption of XBRL in India as the standard for electronic business reporting in India. XBRL India is working closely with regulators, stock exchanges and software companies for promotion of XBRL as a Standard Business Reporting Language. XBRL India is developing taxonomies for specific industries in consultation with the respective regulators viz. Insurance, Power and NBFCs.

Adoption of XBRL in India

XBRL adoption is widespread in India, with the Ministry of Corporate Affairs (annual report and cost audit reportfilings), the Reserve Bank of India and the Securities and Exchange Board (mutual funds) also having XBRL reportingmandates. The implementation and regulatory framework of XBRL in India is governed by these regulatory agencies.

[A] Adoption of XBRL by Ministry of Corporate Affairs (MCA)

The Ministry of Corporate Affairs (MCA) mandated submission of XBRL in 2011. It is a known fact that introducingnew systems requires some time for the market to adapt and settle and it is more challenging when the systemsitself undergo significant change before it has been well accepted. The journey of XBRL adoption by MCA bringsacross the experiences – initial startup, significant change and then stability.

Before the issuance of Companies Act, 2013

In India, the Ministry of Corporate Affairs (MCA) for the first time made it mandatory for certain class of companiesto file their Balance Sheets and Profit and Loss Account for the year 2010-11 onwards by using XBRL taxonomy by issuing Circular No. 16/2012 dated 6.7.2012. As per the **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011**, the following classes of companies were required to file the FinancialStatements in XBRL Form only from the year 2010-2011:

(i) All companies listed in India and their subsidiaries;

(ii) All companies having a paid up capital of ₹ 5 crore (₹ 50 million) and above; or

(iii) All companies having turnover of ₹ 100 crore (₹ 1 billion) or above, excluding power and banking companies,insurance companies, Non-Banking Financial Companies and overseas subsidiaries of these companies.

The circular also contained, by way of an annexure, a host of valuable information about XBRL in the form of Frequently Asked Questions (FAQs) about XBRL. As per the said circular, taxonomies for Indian companies are developed based on the requirements of Schedule VI of Companies Act, Accounting Standards, SEBI Listing requirements, etc. Taxonomies for manufacturing and service sector (referred as Commercial and Industrial, or C&I) and banking sector, is acknowledged by XBRL International. The Institute of Chartered Accountants of India (ICAI), the standards setting body developed taxonomy for Commercial and Industrial companies as per the provisions of Revised Schedule VI to the Companies Act, 1956. It has been developed as per the IFRS architecture 2011.

After the issuance of Companies Act, 2013

In exercise of the powers conferred by sections 469(1) and 469(2) read with section 398 of the Companies Act, 2013, and in supersession of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, except as respects things done or omitted to be done before such supersession, theCentral Government issued the **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015** on 09.09.2015.

Companies required to follow XBRL Reporting

The following class of companies shall file their financial statement and other documents under section 137 of the Companies Act, 2013, with the Registrar in e-form AOC-4 XBRL given in Annexure-l for the financial years commencing on or after April 1, 2014 using the XBRL taxonomy given in Annexure II, namely:

(i) all companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or

(ii) all companies having paid up capital of rupees five crore or above;

(iii) all companies having turnover of rupees hundred crore or above; or

(iv) all companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011.

Companies exempt from XBRL Reporting

As per the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 the following companies are exempt from XBRL filing of their financial statement and other documents:

(i) Banking companies

(ii) Insurance companies

(iii) Non-Banking Financial companies.

Power Sector Companies are excluded from exemption list vide Companies (Filing of Documents and Forms in Extensible Business Reporting Language), Amendment, Rules, 2017 Dated 6th November 2017. So all Power Sector companies are now required to file their financials and other documents as per XBRL Taxonomy.

XBRL & Filing of Cost Audit Report

A company required to furnish cost audit report and other documents to the Central Government under Section 148(6) of the Companies Act, 2013 and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure-III to the said Rule for the financial years on or after April 1, 2014 in e-Form CRA-4 specified under the Companies (Cost Records and Audit) Rules, 2014

[B] Adoption of XBRL by Reserve Bank of India (RBI)

The Reserve Bank of India (RBI), India's central bank, oversees a host of critical activities including monetary policy, bank supervision and foreign exchange management. RBI is internationally well regarded for its regulatory acumen that played a key role in the Indian financial sector remaining virtually unscathed during the Asian Financial Crisis and the ongoing international banking and credit crisis. Reserve Bank of India is responsible for implementing the XBRL standard for banks' reporting. RBI had opted for XBRL as the reporting technology for the Basel II reporting norms so as to capture quality information that can be reused across the regulatory functions. Within RBI, XBRL implementation is being regularly monitored by a High Level Steering Committee appointed by the Governor.

[C] Adoption of XBRL by Securities and Exchange Board of India (SEBI)

Securities and Exchange Board of India (SEBI) is in the process of setting up a SEBI Unified Platform for Electronic Reporting and Dissemination (SUPER-D), which will be a XBRL technology based platform for reporting by listed companies, Mutual Funds and other SEBI registered intermediaries. The platform will also be used to disseminate requisite information relating to listed companies, mutual funds and other intermediaries, to the public. SEBI has started a XBRL Pilot Project for filing / reporting by Mutual Funds with SEBI. Under this XBRL MF Pilot Project, SEBI invited all the registered Mutual Fund/Assets Management Companies to participate on voluntary basis as filers for doing XBRL filings of the specified reports to SEBI. These XBRL filings have to be done in addition to the filings under the current system.

[D] Adoption of XBRL by Bombay Stock Exchange (BSE)

As a part of regulatory compliances, BSE collects data/disclosures in specified formats from its listed companies. With a view to making reporting more accurate and more efficient, BSE has moved towards the XBRL based reporting. BSE became the first stock exchange in India to introduce and implement XBRL based reporting in association with its partner in this endeavor, Microvista Technologies. With implementation of XBRL, BSE is in the club of international stock exchanges that have implemented XBRL based reporting.

Quarterly Earnings Call Management

7.11

Keeping in line with continuous improvement, BSE has now made it mandatory for filing of Corporate Governance report and Shareholding Pattern in XBRL mode. Moreover, the BSE is making its taxonomies available online to promote the development of software by the private sector.

Concept of Earnings Call

An earnings call (also known as Earnings Conference Call) is a conference call (typically held in the form of a teleconference or a webcast) during which the management of a company announces and discusses the financial results of a company for a given quarter or a year. The calls are usually preceded or accompanied by a press release containing a summary of the financial results. Typical participants are investors, equity analysts, and business journalists. Earnings calls of large companies are often heavily covered in business news. The recording of the call as well as a transcript of the same are normally hosted in the official website of the company.

- **Frequency and Timing of Earnings Call**

Earning calls are not legally mandated. So, a company may not actually have any earnings call. The culture is, however, more prevalent in western countries and slowly becoming popular in India as well. According to the National Investor Relations Institute, USA, 92% of companies represented by their members conduct earnings calls. In India also, most of the large publicly listed companies organise earnings conference call. There is no general requirement for how far in advance notice of a call must be given. However, to ensure a fruitful discussion and to reach the target audience as much as possible, the call is generally announced a few days or weeks in advance. The schedule of the call (along with the link of the meet) is generally posted by the company in the Investor Relations section of their website.

- **Structure of an Earnings Call**

Normally, an earnings call is found to have the following three parts.

a. Safe Harbour Statement

A typical earnings call starts with the safe harbour statement made by the company's management. The safe harbour statement generally warns the participants of the earnings presentation that the discussion of financial results may include forward-looking statements. Thus, the estimates of results based on the forward-looking statements may substantially differ from the actual results.

b. Presentation and Discussion of the Financial Results

After the safe harbour statement, the managers take over the call. In an earnings call, generally, a company is represented by C-level executives. Depending on a company and its corporate hierarchy,

the number of participating executives may vary. However, the two key executives that are always present in the earnings call are the chief executive officer (CEO) and chief financial officer (CFO). The executives present and discuss the financial results for the given reporting period (quarter or year). In addition, the managers provide an overview of the company's upcoming goals and milestones, as well as discuss how the plans will impact the future financial performance of the company.

c. Question and Answer Session

The final section of the earnings call is reserved for the Q&A session. During this session, investors, analysts, and other participants in the call have an opportunity to ask the management questions regarding the presented financial results. The representatives of the management answer the questions based on the data available with them. However, they may decline or defer their answers for certain questions.

- **Importance of Earnings Call**

Earnings calls are considered one of the key resources for investors and equity analysts. The information provided during earnings calls can be incorporated into the fundamental analysis of a company. In fundamental analysis, analysts can combine the information obtained during the event with the information presented in the management, discussion, and analysis (MD&A) section of the company's reports.

The importance of earnings calls is acknowledged by the fact that investors frequently plan their trades close to the date of an upcoming conference. Equity analysts use the information provided during such events to update their earnings estimates.

Due to this importance to the investors and analysts, now-a-days earnings calls are recognised as an important tool for corporate reporting.

[**Note:** Students may follow the attached link to access the Earnings Conference Call Recordings and Transcript of the Call of Bajaj Auto:

https://www.bajajauto.com/investors/financial-and-operational-performance]

Exercise

A. Theoritical Questions:

- **Multiple Choice Questions**

1. The three pillars of sustainability are often referred to as
   a. Planet – People – Profit
   b. People – Planet – Profit
   c. People – Profit – Planet
   d. People – Plant – Profit
2. External benefits of sustainability reporting can include
   a. Mitigating – or reversing – negative environmental, social and governance impacts
   b. Improving reputation and brand loyalty
   c. Enhanced perception on organisation's value
   d. All of the above
3. International Integrated Reporting Council (IIRC) launched IR as a global framework in ______________.
   a. November 2013
   b. December 2012
   c. November 2012
   d. December 2013
4. As per the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, the following classes of companies were required to file the Financial Statements in XBRL Form only from the year 2010-2011
   a. All companies listed in India and their subsidiaries
   b. All companies having a paid up capital of ₹ 5 crore (₹ 50 million) and above
   c. All companies having turnover of ₹ 100 crore (₹ 1 billion) or above, excluding power and banking companies, insurance companies, Non-Banking Financial Companies and overseas subsidiaries of these companies
   d. Any of the above
5. A company required to furnish cost audit report and other documents to the Central Government under Section 148(6) of the Companies Act, 2013 and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure-III to the said Rule for the financial years on or after April 1, 2014 in e-Form ______ specified under the Companies (Cost Records and Audit) Rules, 2014
   a. CRA-2
   b. CRA-3
   c. CRA-4
   d. CRA-1

Answer:

1.	2.	3.	4.	5.
b.	d.	d.	d.	c.

Fill in the Blanks

1. XBRL is managed by ___________________.
2. XML stands for _______________________.
3. XBRL stands for _______________________.
4. Economic Value Added (EVA) is a performance measure developed by _______________ to find the true economic profit generated by a company.
5. _______________ is the accounting surplus generated by the business and distributable not only to the owners or the shareholders but also to other stakeholders i.e., the lenders, the employees and the government.

Answer:

1.	XBRL International Inc.	**2.**	eXtensible Markup Language
3.	eXtensible Business Reporting Language	**4.**	Stern Stewart & Co.
5.	Value Added		

Short Essay Type Questions

1. State the benefits of Sustainability Reporting.
2. Define Human Resource Reporting.
3. List the types of HR reports.
4. Explain the concept of Economic Value Added and Market Value Added.
5. Describe Quarterly Earnings Call Management.
6. Define the three pillars of sustainability reporting and briefly state the role of GRI in this context.
7. Present an abridged format of sustainability reporting and the principles to be complied as per national voluntary guidelines.
8. How does Integrated reporting highlight value creation?
9. Describe the components of value added statement and discuss its significance.
10. Distinguish EVA from MVA and compute EVA and MVA with arbitrary figures.
11. What is XBRL? Enumerate the benefits of XBRL.
12. Write a note on Earnings Conference Call.

Essay Type Questions

1. Explain the concept of Quadruple Bottom Line Reporting as an extension of Triple Bottom Line Reporting.
2. Explain how through Sustainability Reporting an organisation identifies its impact on the economy, environment and the society and assesses its contribution for sustainable development.
3. Explain how Integrated Reporting provides a holistic report of value creation by considering human, social, manufactured, natural and intellectual capital as well as financial capital.
4. What a company is legally required to comply in regard CSR? What activities are accepted under CSR? What particulars are required to be reported under CSR Rules?
5. Discuss the ESG criteria of corporate reporting.
6. Briefly discuss different types of Human Resource Reporting.
7. Explain the significance of Value-Added Statement, EVA and MVA.
8. Explain how XBRL provides a digital reporting format that transmits not only "Content" but also "Context".
9. What service is rendered by "Earnings Conference Call"?
10. What is CSR? For which companies CSR is mandatory? What are the CSR provisions to be complied with and what are the CSR activities in India? How is CSR reporting made?
11. What criteria are tested in ESG?
12. Briefly discuss on different types of human resource reporting.

Section-F

Government Accounting In India

Government Accounting in India 8

This Module Includes

8.1 General Principles and Comparison with Commercial Accounting

8.2 Role of Comptroller and Auditor General of India

8.3 Role of Public Accounts Committee, Review of Accounts

8.4 Government Accounting Standards issued by Government Accounting Standards Advisory Board (GASAB)

8.5 Government Accounting and Reporting

Government Accounting in India

SLOB Mapped against the Module

To expose students to the financial reporting of NBFCs, to government accounting, and to XBRL.

Module Learning Objectives

- To introduce to the students the system of financial accounting in the government in contrast with commercial accounting
- To provide reasonable knowledge about the machinery of government audit
- To give exposure to the government accounting and reporting standards

General Principles and Comparison with Commercial Accounting

8.1

Accounting is the process of recording, classifying and summarizing the financial transactions and communicating the results of its operations and also the financial position to its stake-holders.

Government accounting refers to the system of financial accounting that is applicable to government, its departments, offices and institutions. The accounting system that is put to use in government offices or institutions for the purpose of recording and reporting the financial transactions is referred to as government accounting. It is also referred to as Public Finance Accounting.

According to **Oshisami and Dean,** "Governmental Accounting is the process of recording, analyzing, classifying, summarizing, communicating, and interpreting information about government in aggregate and in detail, reflecting all transactions involving the receipts, transfer, and disposition of government funds and property." -

By the given definition, it is clear that the government account is the systematic and scientific process of recording, presenting, analyzing, summarizing, classifying and communicating the financial transaction of the government offices. It is concerned with keeping a record of government revenue and their proper utilization in different development and administration work. It presents the receipt and payment position of the public fund. It reveals how public funds have been generated and utilized for the welfare of the general public.

It is the systematic process of collecting, recording, classifying, summarizing and interpreting the financial transactions relating to the revenues and expenditures of government institutions/ offices. Thus, simply stated, government accounting is concerned with systematic and scientific recording of government revenues and expenditures.

Therefore, government accounting may be defined as an accounting system used in government institution for the purpose of recording, classifying, summarizing and communicating the financial information regarding the collection and utilization of public funds and properties. It is concerned with keeping records of government revenues and their expenditure in different development and administrative works.

Features of Government Accounting

Government Accounting is a unique application area which has certain characteristics of its own. Some of the main features of Government Accounting are discussed as under:

1. **Specific system of accounting:** It is a specific accounting system which is followed by government in its departments, offices and institutions.
2. **Reporting of utilisation of public funds:** The government and its institutions are public institution whose main objective is to provide services to the society and also to maintain law and order in the country. So, the accounting system used by such institutions has to reveal how public funds and properties have been used for that purpose. It is to be noted that government accounting is not done for revealing any profit and loss.

3. **Government Regulations:** Government accounting is maintained according to government rules and regulations. The financial policies, rules and regulations as determined from time to time provide the system of government accounting.
4. **Double Entry System:** Government accounting is based on the principles and assumptions of double entry system of book keeping system. Accordingly, every financial transactionentered into by a government/ government office/ institution are recorded showing their double effects. It implies that for each government financial transaction one aspect of the transaction is debited and the other aspect is credited.
5. **Budget Heads:** All the expenses of government offices are classified into different budget heads and expenditures are made only on approved budget heads.
6. **Budgetary Regulation:** Government expenditures are governed by budgetary regulations. In other words, no government office can make expenditure more than the amount allocated in the budget. Thus, in effect, government accounting gets regulated by the budget.
7. **Mode of Transaction:** All government transactions are supposed to be performed through banks.
8. **Fund-based Accounting:** Apeculiar characteristic of governmental accounting is the employment of separate funds. The government is engaged in an ever-growing number of operations and activities which are quite unrelated to each other. The particular sources of revenue or income often are dedicated to use for a particular phase of the government's operations. The accounts must segregate these specially dedicated resources and isolate them from all other transactions in a separate "fund."
9. **Auditing:** The audit the books of accounts maintained by government departments, offices or institutions are to be audited by a recognised department of the government so as to ensure proper governance and also to prevent misuse and misappropriation of public funds.

Objectives of Government Accounting

The objectives of government accounting are the financial administration of the activities of the government to promote maximisation of welfare in the form of various services. The specific objectives can be stated as under:

1. To record financial transactions of revenues and expenditure relating to the government organizations.
2. To provide reliable financial data and information about the operation of public fund.
3. To record the expenditures as per the appropriate Act, Rules, and legal provisions as set by the government.
4. To avoid the excess expenditures beyond the limit of the budget approved by the government.
5. To help in the preparation of various financial statements and reports.
6. To facilitate the auditing by the concerned government department.
7. To prevent misappropriation of government properties by maintaining the systematic records of cash and store items.
8. To facilitate for estimating the annual budget by providing historical financial data of government and expenditures.

The general principles of government accounting are highlighted hereunder:

1. **Classification of expenditures:** The Government Expenditures are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of account. The method of budgeting and accounting under the service heads is not designed to bring out the relation in which Government stands to its material assets in use, or its liabilities due to be discharged at more or less distant dates.

2. **Based on budget:** government accounting is based on the annual budget of the government. In its budget for a year, Government is interested to forecast with the greatest possible accuracy what is expected to be received or paid during the year, and whether the former together with the balance of the past year is sufficient to cover the later.

   Similarly, in the compiled accounts for that year, it is concerned to see to what extent the forecast has been justified by the facts, and whether it has a surplus or deficit balance as a result of the year's transactions. On the basis of the budget and the accounts, Government determines:

   (a) whether it will be justified in curtailing or expanding its activities; and

   (b) whether it can and should increase or decrease taxation accordingly.

3. **End products of government accounting:** In the field of Government accounting, the end products are the monthly accounts and the annual accounts. The monthly accounts serve the needs of the day-to-day administration, while the annual accounts present a fair and correct view of the financial stewardship of the Government during the year.
4. **Period of Accounts:** The annual accounts of the central, state and union territory government shall record transactions, which take place during financial year running from 1st April to 31st March.
5. **Cash basis of accounting:** With the exception of such book adjustments as may be authorized by these rules on the advice of the Comptroller and Auditor General of India (C&AG),the transactions in government accounts shall represents the actual cash receipt and disbursement during a financial year.
6. **Form of Accounts:** The accounts of Government are kept in three parts namely, Consolidated Fund, Contingency Fund and Public Account.

Comparison Between Government Accounting and Commercial Accounting

Although the basic principles of financial accounting that are applicable in regular commercial activities apply to the government accounts, there are certain features of governmental accounting which make it quite different from that of regular commercial accounting. The differences between commercial and government accounting have been presented hereunder:

1. **Meaning:** The accounting system applied in the government departments, offices and institutions is referred to as government accounting. While, the system of accounting applied by non-government organizations (whether profit-oriented or non-profit oriented) is known as commercial accounting.
2. **Objective:** Government accounting is maintained by the government offices for recording and reporting the utilisation and position of public funds. Commercial accounting is maintained by business organizations to know the profit or loss for an accounting period and disclose the financial position of the entity.
3. **Scope:** The government accounting happens to be more elaborate that that followed in commercial accounts.
4. **Budget:** Government accounting is directly influenced by the government budgeting system, while commercial accounting does not follow the government budgeting system.
5. **Basis:** Government accounting is prepared on cash basis. On the other hand, commercial accounting may be done on cash basis or accrual basis, or sometimes even on hybrid basis.
6. **Level of Accounting:** Government accounting has the system of central level and operating level accounting. Commercial accounting has no provision of central level and operating level accounting.

7. **Rules and Provisions:** Government accounting is strictly maintained by following the financial rules and provisions as set by the concerned government. Commercial accounting is maintained by following the applicable rules and the 'Generally Accepted Accounting Principles' (GAAP).

8. **Information:** Government accounting provides information to the government about the receipts, deposit, transfer and utilisation of public funds. Commercial accounting provides information to the various stake-holders about the operating result and financial position of the business.

9. **Auditing:** The audit the books of accounts maintained by government departments, offices or institutions are to be audited by a recognised department of the government(namely, the Auditor General Office); while the books of accounts maintained under commercial accounting is audited by any professional auditor.

Role of Comptroller and Auditor General of India

8.2

The Comptroller and Auditor General (C&AG) of India is an authority, established by the Constitution under Constitution of India/Part V Chapter V/Sub-part 7B/Article 148, who audits all receipts and expenditure of the Government of India and the state governments, including those of bodies and authorities substantially financed by the government. The CAG is also the external auditor of Government-owned corporations and conducts supplementary audit of government companies, i.e., any non-banking/ non-insurance company in which Union Government has an equity share of at least 51 per cent or subsidiary companies of existing government companies. Comptroller and Auditor General (C&AG) is the guardian or care-taker of the national purse. He is appointed by the President of India for a tenure of 6 years.

The constitution has instituted the British system of responsible government in India. The substance of responsibility is that the executive i.e. the Prime Minister and the Cabinet remains answerable for all their activities to the popularly elected chamber of the legislature. The responsibility becomes empty unless financial activities of the government are subject to parliamentary scrutiny. For this it is imperative that there should be an independent authority to examine and scrutinize the financial transactions of the government. Since he is the impartial head of the audit and accounts system of India, it is essential that he should be independent of executive control.

With this object in view, the Government of India Act of 1935, made the Auditor General of India irremovable except "in like manner and on like grounds as a judge of the Federal Court." The office of the Comptroller and Auditor General is an adaptation of the office of the Auditor General under the Act of 1935.Articles 148 to 151 of the Indian constitution create and regulate the office of Comptroller and Auditor General of India. The office of the Comptroller and Auditor General is considered as "pivotal" to the control of entire financial system of the country. Dr. B. R. Ambedkar felt that the Comptroller and Auditor General of India shall be the most important officer under the constitution of India.

Role, Function and Duties of the Comptroller and Auditor General (C&AG)

The role, function and duties of the Comptroller and Auditor General (CAG) are elaborated by the Comptroller and Auditor General's (Duties, Powers and Conditions of Service)Act, 1971 (56 of 1971).An amendment of this act in 1976 has relieved him from preparing the accounts of the government. As per Sec. 10 of the said Act, the role/ duties of the C&AG has been discussed as under:

1. **Comptroller and Auditor General to compile accounts of Union and States:** The role of the C&AG includes:
    - **Compilation of accounts:** Compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such accounts; and
    - **Keeping accounts:** Keeping such accounts in relation to any of the matters specified in the above clause as may be necessary.

However, the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for compiling:

(i) the said accounts of the Union (either at once or gradually by the issue of several orders); or

(ii) the accounts of any particular services or departments of the Union;

(iii) relieve him from the responsibility for keeping the accounts of any particular class or character.

Moreover, the Governor of a State with the previous approval of the President and after consultation with Comptroller and Auditor General, by order, relieve him from the responsibility for compiling:

(i) the said accounts of the State (either at once or gradually by the issue of several orders); or

(ii) the accounts of any particular services or departments of the State.

2. **Comptroller and Auditor General to prepare and submit accounts to the President Governors of States and Administrators of Union territories having Legislative Assemblies:** The Comptroller and Auditor-General shall from the accounts compiled by him or by the Government or any other person responsible in that behalf prepare in each year accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrator of the Union territory having a Legislative Assembly, as the case may be on or before such dates as he may, with the concurrence of the Government concerned, determine.

   However, the President may, after consultation with the Comptroller and Auditor-General, by order, relieve him from the responsibility for the preparation and submission of the accounts relating to annual receipts and disbursements for the purpose of the Union or of a Union territory having a Legislative Assembly. Further the Governor of a State may, with the previous approval of the President and after consultation with the Comptroller and Auditor-General, by order, relieve him from the responsibility for the preparation and submission of the accounts relating to annual receipts and disbursements for the purpose of the State.

3. **Comptroller and Auditor General to give information and render assistance to the Union and States:** The Comptroller and Auditor-General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union government, to the State Governments or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require, and render such assistance in the preparation of their annual financial statements as they may reasonably ask for.

4. **General provisions relating to audit:** It shall be the duty of the Comptroller and Auditor-General:

   - to audit all expenditure from the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
   - to audit all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
   - to audit all trading, manufacturing, profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State; and in each case to report on the expenditure, transactions or accounts so audited by him.

5. **Audit of receipts and expenditure of bodies or authorities substantially financed from Union or State Revenues:** Where anybody or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union territory having a Legislative Assembly, the Comptroller and

Auditor-General shall, subject to the provisions of any law for the time being in, force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

However, Comptroller and Auditor-General may with the previous approval of the President or the Governor of a State or the Administrator of a Union territory having a Legislative Assembly, as the case may be, audit all receipts and expenditure of anybody or authority where the grants or loans to such body or authority from the Consolidated Fund of India or of any State or of any Union territory having a Legislative Assembly, as the case may be in a financial year is not less than rupees one crore.

6. **Functions of Comptroller and Auditor General in the case of grants or loans given to other authorities or bodies:** Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor-General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given. For this purpose the C&AG shall have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

   However, the President, the Governor of a State or the Administrator of a Union territory having a Legislative Assembly, as the case may be, may, where he is of opinion that it is necessary so to do in the public interest, by order, relieve the Comptroller and Auditor-General, after consultation with him, from making any such scrutiny in respect of anybody or authority receiving such grant or loan.

   Except where he is authorised so to do by the President, the Governor of a State or the Administrator of Union territory having a Legislative Assembly, as the case may be, the Comptroller and Auditor-General shall not have, while exercising the powers conferred on him by sub-section (1), right of access to the books and accounts of any corporation to which any such grant or loan as is referred to in subsection (1) is given if the law by or under which such corporation has been established provides for the audit of the accounts of such corporation by an agency other than the Comptroller and Auditor-General:

   Moreover, such authorisation shall be made except after consultation with the Comptroller and Auditor-General and except after giving the concerned corporation a reasonable opportunity of making representations with regard to the proposal to give to the Comptroller and Auditor-General right of access to its books and accounts.

7. **Audit of receipts of Union or of States:** It shall be the duty of the Comptroller and Auditor-General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

8. **Audit of accounts of stores and stock:** The Comptroller and Auditor-General shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union or of a State.

9. **Powers of Comptroller and Auditor General in connection with audit ofaccounts:** The Comptroller and Auditor General shall in connection with the performance of his duties under this Act, have authority:

   - place as he may appoint for his inspection;
   - to put such questions or make such observations as he may consider necessary, to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which it is his duty to prepare.

   The person in charge of any office or department, the accounts of which have to be inspected and audited by

the Comptroller and Auditor-General, shall afford all facilities for such inspection and comply with requests for information in as complete a form as possible and with all reasonable expedition.\

10. **Audit of Government companies and corporations:** The duties and powers of the Comptroller and Auditor- General in relation to the audit of the accounts of Government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 1956 (1 of 1956).

The duties and powers of the Comptroller and Auditor-General in relation to the audit of the accounts of corporations (not being companies) established by or under law made by Parliament shall be performed and exercised by him in accordance with the provisions of the respective legislations.

The Governor of a State or the Administrator of a Union territory having a Legislative Assembly may, where he is of opinion that it is necessary in the public interest so to do, request the Comptroller and Auditor-General to audit the accounts of a corporation established by law made by the Legislature of the State or of the Union territory, as the case may be, and where such request has been made, the Comptroller and Auditor- General shall audit the accounts of such corporation and shall have, for the purposes of such audit, right of access to the books and accounts of such corporation. However, no such request shall be made except after consultation with the Comptroller, and Auditor-General and except after giving reasonable opportunity to the corporation to make representations with regard to the proposal for such audit.

1. **Laying of reports in relation to accounts of Government companies and corporations:** The reports of the Comptroller and Auditor-General, in relation to audit of accounts of a Government company or a corporation referred to in section 19, shall be submitted to the Government or Governments concerned. The Central Government shall cause every report received by it under sub-section (1) to be laid, as soon as may be after it is received, before each House of Parliament. The State Government shall cause every report received by it under sub-section (1) to be laid, as soon as may be after it is received, before the Legislature of the State.

2. **Audit of accounts of certain authorities or bodies:** Where the audit of the accounts of anybody or authority has not been entrusted to the Comptroller and Auditor-General by or under any law made by Parliament, he shall, if requested so to do by the President, or the Governor of a State or the Administrator of a Union territory having a Legislative Assembly, as the case may be, undertake the audit of the accounts of such body or authority on such terms and conditions as may be agreed upon between him and the concerned Government and shall have, for the purposes of such audit, right of access to the books and accounts of that body or authority. However, no such request shall be made except after consultation with the Comptroller and Auditor-General.

Role of Public Accounts Committee, Review of Accounts

8.3

The Public Accounts Committee (P.A.C.) is a committee of selected members of Parliament, constituted by the Parliament of India.

In the Indian parliamentary form of governance, the legislature has the power to ensure "that the appropriated money is spent economically, judiciously and for the purpose for which it was sanctioned". Even though the Comptroller and Auditor General of India (C&AG) is to audit the accounts of the government and to ensure the propriety of the money spent, yet its report is further examined by the special committee of the parliament, is known as Public Account Committee.

The Committee entrusted with the responsibility of examining the accounts of the Government. The Government expenditures are thoroughly examined and ensured that the Parliamentary limits are not breached. It examines the report of Accounts of the union government submitted by the Comptroller and Auditor General of India (C&AG), to the President for the purpose of auditing of the revenue and the expenditure of the Government of India. The Public Accounts Committee in India thus ensures Parliamentary control over government expenditure.

The Public Accounts Committee was first set up in India in 1921 under the Montague Chelmsford Reforms. The basic function of the committee had been to ensure that the expenditure had been incurred for the intended purposes as authorised by the authority concerned. Presently, it is formed every year with a strength of not more than 22 members, out of which 15 members are from Lok Sabha (the lower house of the Parliament), and 7 members are from Rajya Sabha (the upper house of the Parliament). The term of office of the members is one year.

Constitution of Public Accounts Committee (P.A.C)

The Committee consists of not more than 22 members comprising15 members elected by Lok Sabha every year from amongst its members according to the principle of proportional representation by means of single transferable vote, and not more than 7 members of Raj ya Sabha elected by that House in like manner are associated with the Committee. Thus, the present P.A.C is a joint committee of the two Houses.

The Chairman is appointed by the Speaker of Lok Sabha from amongst its members of Lok Sabha. Since 1967, the chairman of the committee is selected from the opposition. Earlier, it was headed by a member of the ruling party.

However, it is to be noted that, a Minister is not eligible to be elected as a member of the Committee. If a member after his election to the Committee is appointed a Minister, he ceases to be a member of the Committee from the date of such appointment.

Role of Public Accounts Committee (P.A.C)

1. **Role regarding examination of the C&AG report:** The chief function of P.A.C. is to examine the audit report of Comptroller and Auditor General (C&AG) after it is laid in the Parliament. C&AG assists the Committee during the course of investigation.

2. **Role regarding unauthorized expenditures or excess expenditures:** In examining the report of the Comptroller and Auditor General of India (C&AG), the committee has to satisfy itself that:

   - the expenditures made by the government, were authorized by the Parliament; and
   - the expenditures under any head has not crossed the limits of parliamentary authorization.

   It is to be noted that, every expenditure made by the government must be sanctioned by the Parliament. Thus, it is the role of the committee to bring to the notice of the Parliament instances of unauthorized expenditures or expenditures beyond sanctioned limits.

3. **Role regarding spending of money by ministries:** The committee not only ensures that ministries spend money in accordance with parliamentary grants, it also brings to the notice of the Parliament instances of extravagance, loss, in fructuous expenditure and lack of financial integrity in public services. However, the committee cannot question the polices of the government. It only concerns itself with the execution of policy on its financial aspects.

4. **Scrutinizing the audit reports of public corporations:** A new dimension has been added to the function of the P.A.C. by entrusting it with the responsibility of scrutinizing the audit report of public corporations.

5. **Scrutinising the working process of ministries and public corporations:** In examining the accounts and audits of the ministries and public corporations, the Committee gets the opportunity to scrutinize the process of their working. It points out the weakness and shortcomings of the administration of ministries and public corporations Criticisms of the P.A.C. draw national attention. This keeps the ministries and public corporations sensitive to the criticisms of the P.A.C. Thus, it is wrong to suppose that the P.A.C. is only an instrument of financial control, it is as well an instrument of administrative control.

Review of Accounts

The accounts of Government Companies set up under the provisions of the Companies Act (including Government Insurance Companies and deemed Government Companies) are audited by the Comptroller and Auditor General of India (C&AG) under the provisions of Section 143 of the Companies Act, 2013. Under these provisions, the C&AG:

(i) shall appoint statutory auditor of a Government company,

(ii) may conduct supplementary or test audit of accounts of a Government Company, and

(iii) may comment upon the report of the statutory auditor. In addition he issues directions to the statutory auditors regarding the manner in which the accounts of a Government Company are to be audited.

The accounts certified by the Statutory Auditors (Chartered Accountants) appointed by the Central Government on the advice of the CAG under the Companies Act, 2013 are subjected to supplementary or test audit by officers of the CAG and CAG gives his comments or supplements the report of the Statutory Auditors. The Companies Act, 2013 empowers the CAG to issue directions to the Statutory Auditors on the manner in which the Company's accounts shall be audited.

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Government Accounting Standards issued by Government Accounting Standards Advisory Board (GASAB)

8.4

Government Accounting Standard Advisory Board (GASAB)

The accounting systems, the world over, are being revisited with an emphasis on transition from rule to principle based standards and migration from cash to accrual based system of accounting. The GASAB, as a nodal advisory body in India, is taking similar action to formulate and improve standards of government accounting and financial reporting and enhance accountability mechanisms.

The Government Accounting Standards Advisory Board (GASAB) was constituted by the Comptroller and Auditor General of India (C&AG) with the support of Government of India through a notification dated August 12, 2002. This Board was constituted to establish and improve the standards of governmental accounting and financial reporting, and enhance the accountability mechanisms. The decision to set-up GASAB was taken in the backdrop of the new priorities emerging in the Public Finance Management and to keep pace with International trends. The new priorities focus on good governance, fiscal prudence, efficiency & transparency in public spending.

Structure of GASAB

The Board has high level representation from the important accounting heads in Government, Ministry of Finance, Department of Post, Finance Secretaries of states, RBI and heads of premier accounting & research organizations. The board consists of the following members:

1. Deputy Comptroller and Auditor General (Government Accounts) as Chairperson
2. Financial Commissioner, Railways
3. Member (Finance) Telecom Commission, Department of Telecom
4. Secretary, Department of Post
5. Controller General of Defence Accounts
6. Controller General of Accounts
7. Additional / Joint Secretary (Budget), Ministry of Finance, Government of India
8. Deputy Governor, Reserve Bank of India, or his nominee 9-12. Principal Secretary (Finance) of four States, by rotation
13. Director General, National Council of Applied Economic Research(NCAER), New Delhi
14. President, Institute of Chartered Accountants of India (ICAI), or his nominee
15. President, Institute of Cost and Works Accountants of India, or his nominee
16. Principal Director in GASAB, as Member secretary.

Responsibilities of GASAB

GASAB, inter alia, has the following responsibilities:

1. To formulate and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms.
2. To formulate and propose standards that improve the usefulness of financial reports based on the needs of the users.
3. To keep the standards current and reflect change in the Governmental environment.
4. To provide guidance on implementation of standards.
5. To consider significant areas of accounting and financial reporting that can be improved through the standard setting process.
6. To improve the common understanding of the nature and purpose of information contained in the financial reports.

Government Accounting Standards issued by Government Accounting Standards Advisory Board (GASAB)

The mission of the Government Accounting Standards Advisory Board (GASAB) is to formulate and recommend Indian Government Accounting Standards (IGASs) for cash system of accounting and Indian Government Financial Reporting Standards (IGFRS) for accrual system of accounting, with a view to improving standards of Governmental accounting and financial reporting which will enhance the quality of decision-making and public accountability.

GASAB has been developing two types of Accounting Standards, namely Indian Government Accounting Standards (IGAS) and Indian Government Financial Reporting Standards (IGFRS)for the Government. These standards have been developed to address the issues related with the existing cash system of accounting and its migration to the accrual system of accounting in future.

The standards being developed to make existing cash system of accounting more transparent are called Indian Government Accounting Standards (IGAS) The Indian Government Accounting Standards (IGAS), formulated by the Government Accounting Standards Advisory Board (GASAB) and notified by the Ministry of Finance, Government of India are:

- Guarantees given by Governments: Disclosure Requirements (IGAS 1);
- Accounting and Classification of Grants-in-aid (IGAS 2)
- Loans and Advances made by Governments (IGAS 3)

The Indian Government Accounting Standards (IGAS), approved by the Government Accounting Standards Advisory Board (GASAB) and under consideration of Government of India, are:

- Foreign Currency Transactions and Loss/Gain by Exchange Rate Variations (IGAS 7);
- Government Investments in Equity (IGAS 9);
- Public Debt and Other Liabilities of Governments: Disclosure Requirement (IGAS 10).

IGAS – 1 Gurantees Given by Governments: Disclosure Requirements

Introduction: The Union Government and the State Governments give Guarantees for repayment of borrowings within such limits, if any, as may be fixed upon the security of the Consolidated Fund of India or of the State, as the case may be, in terms of articles 292 and 293 of the Constitution.

Guarantees are also given by the Union Government

- for payment of interest on borrowings, repayment of share capital;
- payment of minimum annual dividend; and
- payment against agreements for supplies of materials and equipments on credit basis on behalf of the State Governments, Union territories, local bodies, railways, Government companies or corporations, joint stock companies, financial institutions, port trusts, electricity boards and co-operative institutions.

Guarantees are also given by the Union Government to the Reserve Bank of India, other banks and financial institutions:

- for repayment of principal and payment of interest;
- cash credit facility;
- financing seasonal agricultural operations; and
- for providing working capital in respect of companies, corporations, co-operative societies and co-operative banks.

Further, guarantees are also given in pursuance of agreements entered into by the Union Government with international financial institutions, foreign lending agencies, foreign Governments, contractors and consultants towards repayment of principal, payment of interest and payment of commitment charges on loans.

The Union Government also gives performance guarantees for fulfillment of contracts or projects awarded to Indian companies in foreign countries as well as foreign companies in foreign countries besides counter-guarantees to banks in consideration of the banks having issued letters of credit to foreign suppliers for supplies or services rendered by them on credit basis in favour of companies or corporations.

Furthermore, guarantees are given by the Union Government to railways, and electricity boards for due and punctual payment of dues and freight charges by the companies and corporations.

Similarly, guarantees are also given by the State Governments and Union Territory Governments (with legislature).

As the statutory corporations, Government companies, co-operative institutions, financial institutions, autonomous bodies and authorities are distinct legal entities, they are responsible for their debts. Their financial obligations may be guaranteed by a Government and thus the Government has a commitment to see that these are fulfilled.

When these entities borrow directly from the market, it reduces a Government's budgetary support to them and the magnitude of a Government's borrowings. However, it adds to the level of Guarantees given by the Governments. In consideration of the Guarantees given by the Governments, the beneficiary entities are required to pay guarantee commission or fee to the Governments. The Guarantees have an important economic influence and result in transactions or other economic flows when the relevant event or conditions actually occur. Thus, Guarantees normally constitute contingent liability of the Governments.

Objective: The objective of this Standard is to set out disclosure norms in respect of Guarantees given by the Union, the State Governments and Union Territory Governments (with legislature) in their respective Financial Statements to ensure uniform and complete disclosure of such Guarantees.

Scope: The scope of this standard is stated as under:

- This Standard applies to preparation of the Statement of Guarantees for inclusion and presentation in the Financial Statements of the Governments. Financial Statements should not be described as complying with this Standard unless these comply with all its requirements.

- The Authority in the Government which prepares the Statement of Guarantees for inclusion and presentation in the Financial Statements shall apply this Standard. The Accounting Authority is responsible for inclusion and presentation of the Statement of Guarantees in the Financial Statements as provided by the Authority in the Government.

Important Definitions:

- **Accounting Authority :** It means the Authority which prepares the Financial Statements of the Government
- **Authority in the Government :** It means the tracking (monitoring) unit or Authority for Guarantees and in its absence, the Ministry or the Department of Finance, as the case may be.
- **Automatic Debit Mechanism :** It means the arrangement whereby the Government's cash balance is affected on a specified date or on the occurrence of specified events to meet certain obligations arising out of Guarantees given by it.
- **Financial Statements :** It means the Annual Finance Accounts of the Governments.
- **Guarantee :** It means an accessory contract, by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person, whose
- **Structured Payment Arrangement :** It means the arrangement whereby the Government agrees to transfer funds to the designated account in case the beneficiary entity fails to ensure availability of adequate funds for servicing the debts, as per stipulations.

Disclosure:

The Financial Statements of the Union Government, the State Governments and the Union Territory Governments (with legislature) shall disclose the following:

- maximum amount for which Guarantees have been given during the year, additions and deletions (other than invoked during the year) as well as Guarantees outstanding at the beginning and end of the year;
- amount of Guarantees invoked and discharged or not discharged during the year:
- details of Guarantee commission or fee and its realisation; and
- other material details.

The Financial Statements of the Union Government, the State Governments and the Governments of Union Territories (with legislature) shall disclose in the notes the following details concerning class or sector of Guarantees:

- limit, if any, fixed within which the Government may give Guarantee;
- whether Guarantee Redemption or Reserve Fund exists and its details including disclosure of balance available in the Fund at the beginning of the year, any payments made and balance at the end of the year;
- details of subsisting external foreign currency guarantees in terms of Indian rupees on the date of Financial Statements;
- details concerning Automatic Debit Mechanism and Structured Payment Arrangement, if any;
- whether the budget documents of the Government contain details of Guarantees:
- details of the tracking unit or designated authority for Guarantees in the Government; and
- other material details.

Effective date:

This Indian Government Accounting Standard becomes effective for Financial Statements covering periods

beginning on or after 1.4.2010 for class-wise disclosures in the Financial Statements of the Union Government and sector-wise disclosures in the Financial Statements of the State Governments and Union Territory Governments (with legislature).

IGAS — 2 Accounting and Classification of Grants-In-Aid

Introduction: Grants-in-aid are payments in the nature of assistance, donations or contributions made by one government to another government, body, institution or individual. Grants-in-aid are given for specified purpose of supporting an institution including construction of assets.

The general principle of grants-in-aid is that it can be given to a person or a public body or an institution having a legal status of its own. Such grants-in-aid could be given in cash or in kind used by the recipient agencies towards meeting their operating as well as capital expenditure requirement.

Grants-in-aid are given by the Union Government to State Governments and by the State Governments to the Local Bodies discharging functions of local government under the Constitution. This is based on the system of governance in India, which follows three-tier pattern:

- with the Union Government at the apex,
- the States in the middle, and
- the Local Bodies (LBs) consisting of the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) at the grass root level.

Accounts of these three levels of Government are separate and consequently the assets and liabilities of each level of government are recorded separately. Grants-in-aid released by the Union Government to the State Governments are paid out of the Consolidated Fund of India as per Articles 275 and 282 of the Constitution. The Union Government releases grants-in-aid to the State/ Union Territory Government under Central Plan Schemes and Centrally Sponsored Schemes. Sometimes, the Union Government disburses funds to the State Governments in the nature of Pass-through Grants that are to be passed on to the Local Bodies. Funds are also released directly by the Union Government to District Rural Development Agencies (DRDAs) and other specialized agencies including Special Purpose Vehicles (SPVs) for carrying out rural development, rural employment, rural housing, other welfare schemes and other capital works schemes like construction of roads, etc.

The 73rd and 74th Constitutional Amendment Acts envisage a key role for the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) in respect of various functions such as education, health, rural housing, drinking water, etc.

The State Governments are required to devolve funds, functions and functionaries upon them for discharging these functions. The extent of devolution of financial resources to these bodies is to be determined by the State Finance Commissions. Such funds received by the Local Bodies from the State Governments as grants-in-aid are used for meeting their operating as well as capital expenditure requirements. The ownership of capital assets created by Local Bodies out of grants-in-aid received from the States Government lies with the Local Bodies themselves.

Apart from Grants-in-aid given to the State Governments, the Union Government gives substantial funds as Grants- in-aid to other agencies, bodies and institutions. Similarly, the State Governments also disburse Grants-in-aid to agencies, bodies and institutions such as universities, hospitals, cooperative institutions and others. The grants so released are utilized by these agencies, bodies and institutions for creation of capital assets as well as for meeting day-to-day operating expenses.

Objective:

The objectives of this Standard are:

- to prescribe the principles for accounting and classification of Grants-in-aid in the Financial Statements of Government both as a grantor as well as a grantee.
- to prescribe practical solutions to remove any difficulties experienced in adherence to the appropriate principles of accounting and classification of Grants-in-aid by way of appropriate disclosures in the Financial Statements of Government.

Scope:

This Standard applies to the Union Government and the State Governments in accounting and classification of Grants-in-aid received or given by them. The Financial Statements should not be described as complying with this Standard unless they comply with all the requirements contained therein. This Standard encompasses cases of Pass-Through Grants such as Grants-in-aid given by the Union Government to State Governments and by the State Governments to the Local Bodies discharging functions of local government under the Constitution.

Important Definitions:

- **Accounting Authority:** It is the authority which prepares the Financial Statements of the Government
- **Financial statements:** It means the Annual Finance Accounts of the Governments.
- **Grants-in-aid:** The Grants-in-aid are payments, transfers of funds, in cash or in kind, in the nature of donations or contributions by one government (grantor) to another government, body, institution or individual (grantee).
- **Government:** Itmeans all departments and ministries of a Government taken together, whether of the Union Government or State Government or Union Territory Government with Legislature.
- **Local Bodies:** It includes Panchayati Raj Institutions and Urban Local Bodies under the provisions of Article 243 and Schedule 12 of the Constitution.
- **Pass-Throuah Grants:** It means grants-in-aid given by the Union Government to the State Governments for transfer to an ultimate grantee

Recognition:

- Grants-in-aid in cash shall be recognised in the books of the grantor at the time cash disbursements take place. Grants-in-aid in cash shall be recognised in the books of the grantee at the time cash receipts take place.
- Grants-in-aid in kind shall be recognized in the books of the grantor at the time of their receipt by the grantee. Moreover, it shall be recognized in the books of the grantee at the time of their receipt by the grantee.

Disclosure:

- In order to ascertain the extent of Grants-in-aid disbursed by the grantor to the grantee for the purpose of creation of capital assets, the Financial Statements of the grantor shall disclose the details of total funds released as Grants-in-aid and funds allocated for creation of capital assets by the grantee during the financial year, in the form of an Appendix to the Financial.
- This will enhance transparency and lead to improved disclosure of information in the Financial Statements of the grantor. Such disclosures shall also enable the users of Financial Statements to assess the quantum of future capital formation activity to be undertaken by different grantees supported by funds from the Government.

Effective Date: This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning from 1.4.2011.

IGAS — 3 Loans and Advances Made by Government

Introduction: The Government of India has been empowered under proviso (2) of Article 293 of the Constitution of India to make loans to the States, subject to such conditions as may be laid down by or under any law made by Parliament, any sums required for the purpose of making such loans being chargeable to the Consolidated Fund of India.

The Union Government has been providing financial assistance to the State Governments, a substantial portion of which is in the form of loans. These loans are advanced to the States both in the form of plan and non-plan assistance intended for both developmental and non-developmental purposes. Loans are also provided by the Union Government to Foreign Governments, Government companies and Corporations, Non-Government institutions and Local bodies. The Union Government also disburses recoverable advances to Government servants.

The State Governments disburse loans to Government Companies, Corporations, Local Bodies, Autonomous Bodies, Cooperative Institutions, Statutory Corporations, quasi-public bodies and other non-Government/private institutions. The State Governments also disburse recoverable advances to Government servants.

Objective: The objectives of the Standard are:

- to lay down the norms for Recognition, Measurement, Valuation and Reporting in respect of Loans and Advances made by the Union and the State Governments in their respective Financial Statements to ensure complete, accurate, realistic and uniform accounting practices, and
- to ensure adequate disclosure on Loans and Advances made by the Governments consistent with best international practices.

Scope: This Standard applies to Loans and Advances given by the Government for incorporation and presentation in the Financial Statements of the Government. Financial Statements shall not be described as complying with this Standard unless they comply with all the requirements contained therein. This standard shall apply only to government accounts being maintained on a cash basis.

Important Definitions:

- **Accounting Authority:** It is the authority which prepares the Financial Statements of the Governments.
- **Accounting Period:** It means the period covered by the Financial Statements.
- **Advances:** These are loans made to Government servants.
- **Carrying amount:** It means the net amount which the debtor owes the creditor at any point of time and it reflects the historical cost of the loan and subsequent cash flows resulting in either decrease due to repayments or write-offs or increase due to additional disbursements.
- **Cash Basis of Accounting:** It means the accounting transactions of an entity represent the actual cash receipts and disbursements during a financial year as distinguished from the amount due to or by the entity during the same period
- **Charged and Voted Loans and Advances:** All loans to State Governments and a part of the same to Union Territory Governments made by the Union Government are 'charged' loans whereas all other loans and advances are 'voted' loans and advances.
- **Consolidated Fund of India :** It is the fund referred to in clause (1) article 266 of the Constitution of India.
- **Financial Statements :** It means the Annual Finance Accounts of the respective Governments.

- **Government :** It means the Union Government or any State Government or Government of any Union territory with Legislature.
- **Historical Cost :** It is the original book value of loans and advances.
- **Loanee Entity :** It is an entity in whose favor a loan or an advance is sanctioned by the Government.
- **Loanee Group :** It consists of a group of loanee entities of similar nature and characteristics.
- **Loans :** These are the assistance by the Governments by providing money, goods or services directly or indirectly to the beneficiary entities which entails a contractual right to receive back equivalent moneys along with interest thereon, if any, as per terms and conditions of the loan agreements.
- **Major Heads of Account :** It represents the functions of Government as per the 'List of Major and Minor Heads of Account of Union and States.
- **Minor Heads of Account :** It represents various programmes or schemes undertaken by departments of Government to achieve the objectives of the function represented by the major head as per the 'List of Major and Minor Heads of Account of Union and States.
- **Sub-Major Heads of Account :** It represents the sub-functions of Government. It is under the Major Heads and as per the 'List of Major and Minor Heads of Account of Union and States.
- **Plan Loans :** These are the loans sanctioned by the Government for plan purposes;
- **Sector :** It consists of a grouping of specific functions or services as per the 'List of Major and Minor Heads of Account of Union and States.
- **Write-off :** These are when a competent authority remits or writes off any loan owing to its irrecoverability or otherwise, whereby irrecoverable portion of loan is transferred from the debt head of account to an expenditure head as loss to the Government.

Recognition:

- A loan shall be recognized by the disbursing entity as an asset from the date the money is actually disbursed and not from the date of sanction and if a loan is disbursed in installments then each installment shall be treated as a separate loan for the purpose of repayment of principal and payment of interest, except where the competent authority specifically allows consolidation of the installments into a single loan at the end of the concerned financial year.
- The loans converted into equity shall be treated as conversion and shall lead to a reduction in the outstanding loan amount
- The debt assumption due to invocation of guarantees shall be treated as disbursement of loan, unless otherwise so specified.

Measurement and Valuation:

- Historical Cost measurement shall be the basis for accounting and reporting on loans and advances made by Governments.
- As of the last date of accounting period of Financial Statements, the carrying amount of loans shall undergo revision an account of additional disbursement and repayments or write-offs during the accounting period.

Disclosure:

- The Financial Statements of the Union and State Governments shall disclose the Carrying Amount of loans and advances at the beginning and end of the accounting period showing additional disbursements and repayments or write-offs.

- An additional column in the relevant Financial Statements shall also reflect the amount of interest in arrears and this amount shall not be added to the closing balance of the loan which shall be in nature of an additional disclosure.
- The Financial Statements of the Union Government shall disclose the following details under 'Loans and Advances made by the Union Government' in the Annual Finance Accounts of the Union Government:
  - the summary of Loans and Advances showing Loanee group-wise details;
  - the summary of Loans and Advances showing Sector-wise details;
  - The summary of repayments in arrears from Governments and other loanee entities.
- The Financial Statements of the Union Government shall disclose the following details under 'Detailed Statement of Loans and Advances made by the Union Government in the Annual Finance Accounts of the Union Government -
  - the detailed statement of Loans and Advances showing the Major Head;
  - the detailed Statement of repayments in arrears from State or Union territory Governments;
  - the detailed Statement of repayments in arrears from other Loanee entities.
- The Financial Statements of the Union Government shall disclose the following details under 'Additional Disclosures' in the Annual Finance Accounts of the Union Government:
- The fresh Loans and Advances made during the year.
- the Financial Statements of the State Governments shall disclose the following details under 'Statement of Loans and Advances made by the State Governments' in the Annual Finance Accounts of the State Government
  - the summary of Loans and Advances showing Loanee group-wise details;
  - the summary of Loans and Advances showing Sector-wise details;
  - the summary of repayments in arrears from Loanee entities.
- The Financial Statements of the State Governments shall disclose the following details under 'Detailed Statement of Loans and Advances made by the State Government in the Annual Finance Accounts of the State Government:
  - the detailed statement of Loans and Advances showing the Major Head and Minor Head-wise details;
  - the detailed Statement of repayments in arrears from Loanee entities.
- The Financial Statements of the State Governments shall disclose the details relating to fresh Loans and Advances made during the year under 'Additional Disclosures' in the Annual Finance Accounts of the State Government.

Effective Date: This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning from 1.4.2011.

IGAS — 7 Foreign Currency Transactions and Loans or Gain by Exchange Rate Variation

Introduction: Government Accounting Rules, 1990 require that the accounts of the Government shall be maintained in Indian currency i.e., Indian rupees. Indian rupee is the reporting currency for the financial statements of the Government.

All transactions of the Union and State Governments taking place in other countries are passed periodically by the Indian Embassies/ Missions to India and brought to account finally in the Indian books after they have been converted into rupees.

All transactions taking place with foreign Governments or foreign entities or international agencies in foreign currency are also to be recorded in the reporting currency applying exchange rate on the date of transaction.

The missions and embassies of India abroad incur expenditure on their operations including the pay and other entitlements of the officials employed there. They also make payments on behalf of other Ministries and Departments relating to defense, commerce, education as well as public sector undertakings and State Governments. These involve foreign currency transactions and loss or gain due to difference between exchange rate applicable and exchange rate internally adopted by Government like official rate of exchange or salary rate of exchange. Government may use various rates of exchange internally determined for foreign currency transactions that might give rise to loss or gain for accounting purpose.

Under Article 292 of the Constitution of India, the executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by the Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed. The Union Government may have bilateral and multi-lateral transactions involving foreign currency. This may involve borrowing or lending involving repayment of principal and payment of interest denominated in foreign currency and loss or gain by exchange rate variation.

In case of foreign currency loans to various projects, particularly by the World Bank, there are different procedures for disbursement. These are (i) Reimbursement through Special Account, (ii) Reimbursement outside Special Account, and (iii) Direct payment/ Commitment procedure. The Direct payment/ Commitment procedure involves direct payment of foreign currency to contractor/ supplier/ consultants from the loan/ credit funds the World Bank, as opted by the project implementing agency. The rupee equivalent of the foreign currency paid directly from the loan/credit is recoverable from the project implementing agency. However, under externally aided projects the Union Government releases ‘additional central assistance towards disbursements under this procedure. But the rupee amount of the foreign currency paid directly from the loan/credit is recoverable from the project implementing agency.

Government may float or may enter into agreement with designated bank(s), for example, the State Bank of India to float schemes involving foreign currency denominated bonds/ deposits, such as ‘The NRI Bonds’, ‘India Millennium Deposits’ and ‘Resurgent India Bonds’ for subscription by the Non-Resident Indians, Overseas Corporate Bodies or Banksacting in fiduciary capacity on their behalf. The proceeds may not flow into the Consolidated Fund and are either kept in the Public Account as in the case of the NRI Bonds or acquired by the Reserve Bank of India. Rupees securities issued to the international financial institutions such as the Asian Development Bank, International Bank of Reconstruction and Development (World Bank), International Development Association, International Fund for Agricultural Development, African Development Bank are accounted for under ‘internal debt’ of the Central Government that may require repayment on encashment of rupee securities in convertible currencies giving rise to exchange difference.

Foreign currency transactions for acquisition of Special Drawing Rights (SDRs) at the IMF are accounted for under Special Deposit and Accounts-SDR at the IMF-Exchange Rate.

Objective: The objective of this standard is to provide accounting and disclosure requirements of foreign currency transactions and financial effects of exchange rate variations in terms of loss or gain in the financial statements. It also deals with the requirements of disclosure of foreign currency external debts and the rate applied for disclosure. The principal issues in accounting and reporting for foreign currency transactions are to decide which exchange rate to apply and how to recognise in the financial statements the financial effects of exchange rate variations in terms of loss or gain.

Scope: The Accounting Authority which prepares and presents the financial statements of the Government under the cash basis of accounting, as defined in the Government Accounting Rule 21 of GAR 1990 and Government Financial Rule 68 of GFR 2005 should apply this Standard:

(a) in accounting and disclosure for transactions in foreign currencies;

(b) in accounting and disclosure for financial effects of exchange variations in terms of loss or gainby exchange rate variation, and

(c) in disclosure of foreign currency external debts and the rate(s) applied for disclosure.

Financial statements should not be described as complying with this Standard unless they comply with all its requirements.

This Standard shall apply to foreign currency transactions of the Union Government as well as that of the State Governments.

This Standard deals with presentation of expenditure and revenue in terms of loss or gain by exchange rate variations arising from foreign currency transactions. It also deals with disclosure of foreign currency external debt.

This Standard does not deal with disclosure requirements of external guarantees. The requirements of disclosure of details of subsisting external guarantees in terms of Indian rupees on the date of financial statements have been dealt with in IGAS1 “Guarantees given by Governments: Disclosure Requirements’.

The Reserve Bank of India is the custodian of foreign currency and foreign exchange reserves and this Standard does not deal with foreign currency reserves.

Important Decision :

- **Accounting Authority :** It is the authority which prepares the financial statements of the Government.
- **Capital Account :** It means a division of Government accounts wherein receipts and expenditure of capital nature are accounted for.
- **Closing Rate :** It is the exchange rate on the last working day of the period for which the financial statement is prepared.
- **Consolidated Fund of India or Consolidated Fund of State :** It means the Consolidated Fund referred to in Article 266 (I) of the Constitution of India.
- **Cross Currency Swap Agreement :** Itis a financial agreement between two parties to exchange a stream of principal and interest payments in one currency for a stream of principal and interest payments in another currency.
- **Direct Payment Procedure :** It involves direct payment of foreign currency to contractor / supplier / consultants, from the loan / credit funds of the World Bank, as opted by the project implementing agency.
- **Exchange Rate :** It is the ratio for exchange of two currencies.
- **Exchange Rate Variation :** It means change in the ratio for exchange of two currencies;
- **Exchange Difference :** It is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.
- **External Guarantee :** It means a guarantee against liability denominated in foreign currency.
- **Financial Statements :** It means the Annual Finance Accounts of the Governments.
- **Foreign Currency :** It means a currency other than the reporting currency of the Government.

- **Forward Rate :** It means the specified exchange rate for exchange specified by the terms of agreement for exchange of two currencies at a specified future date.
- **Government :** It means the Central (Union) Government or a State Government, or a Union Territory Government;
- **Government Accounts :** It mean the form and divisions of accounts and accounting records in which all transactions ofGovernment are accounted for.
- **Guarantee :** It is an accessory contract, by which the promisor undertakes to be answerable to the promisee for the debenture default or miscarriage of another person, whose primary liability to the promisee must exist or be contemplated.
- **Indian Currency :** It means currency which is expressed or drawn in Indian rupees.
- **Official Rate of Exchange :** It means official accounting rateof exchange between Indian rupees and foreign currencies determined and issued by the Ministry of External Affairs, Government ofIndia periodically.
- **Public Account:** It means the Public Account of India referred to in Article 266(2) of the Constitution of India;
- **Public Sector Undertaking:** It means government companies incorporated under the Companies Act, 1956 and Statutory Corporations set up under the specific Acts of Parliament and State Legislatures, as the context may imply.
- **Reporting Currency:** It means Indian Rupees.
- **Revenue Account:** It means a division of Government accounts wherein receipts and expenditure of revenue nature are accounted for.
- **Salary Rate of Exchange:** It means the rate of exchange between the reporting currency and foreign currency fixed by Ministry of External Affairs, Government of India for disbursement of salary of the officials posted at Mission abroad.
- Special Drawing Right means the international reserve asset created by the International Monetary Fund

Foreign Currency Transactions : A Foreign currency transaction of Government is a transaction which is denominated in or requires settlement in a foreign currency. This may include:

- transactions arising due to operations of the missions and embassies abroad and receipts and payments made by them including those on behalf of other Ministries and Departments relating to defence, commerce, education as well as public sector undertakings and State Governments;
- bilateral and multi-lateral foreign currency transactions involving borrowing or lending including debt servicing;
- purchasing/ selling goods or services where purchase/ sale price is denominated in foreign currency;
    - transactions arising from the schemes involving foreign currency such as ‘The NRI Bonds’, the flow of which goes to Government account;
- transactions for acquisition of Special Drawing Rights at the International Monetary Fund and quota contributions to IMF and the transactions under Financial Transaction Plan;
- rupees securities issued to the international financial institutions which are accounted for under the head internal debt of the Central Government but requiring repayment on encashment of rupee securities in convertible currencies.

A foreign currency transaction of Government shall be reported in the reporting currency by applying to the foreign currency amount, exchange rate between the reporting currency and the foreign currency at the date of receipts and payments.

The exchange rate at the date of receipts and payments is the rate as determined by the Government of India for the purpose viz., salary rate, official rate, etc. or else the rate as indicated by the Reserve Bank of India in its buying and selling rate as may be appropriate, issued every day.

Treatment of Loss or Gain by Exchange Rate Variation : This standard set out the following accounting treatment required by this Standard with respect to loss or gain by exchange rate variations and exchange difference on different types of foreign currency transactions.

- All losses or gains by exchange rate variation in respect of Government transactions in foreign currencies shall be recognised as revenue loss or gain.
- Government may have losses or gains by exchange rate variations on its operating activities like operation of its missions abroad as mentioned in paragraph 2 above or due to contractual commitments to bear the financial effect of exchange rate variations as part of its fiscal and economic policy.
- Loss or gain arising out of transactions for acquisition of Special Drawing Rights at the International Monetary Fund shall be reported in the financial statements.
- Exchange difference may arise out of Government's financing activities like borrowing of loans denominated inforeign currencies and issuing of rupees securities. External borrowings of the Government are recorded at the historical rate of exchange i.e., rate of exchange prevailing at the date of transaction. As most of the loans have long repayment period(s), their repayment extends over several years. Meanwhile, exchange rate(s) may undergo significant changes. If the exchange rate is higher at the time of repayment, repayment of loans in Indian rupees exceed the rupee amount of loan drawn.

In case repayment of loans, at the end of loan period the balance, if any, remaining in external debt head may be cleared adjusting the same under appropriate revenue or expense head for exchange rate fluctuations or to miscellaneous Government Account head.

Disclosure:

The financial statements shall disclose rates of exchange adopted internally by the Government for different types of foreign currency transactions including forward contract rate, if any, along with their basis as part of Statement of Accounting Policies.

The financial statements shall disclose the following details of foreign loans in the format given in paragraph 30:

(a) loans outstanding on historical cost basis at the beginning and end of the year;

(b) loans outstanding on closing rate basis at the beginning and end of the year;

(c) loans outstanding in foreign currency units at the beginning and end of the year;

(d) additions during the year in foreign currency terms and in Indian Rupee along with the rate of exchange adopted;

(e) discharge during the year showing separately the amounts in foreign currency units, on historical basis and

(f) current rate of exchange basis;

(g) loss or gain on repayment of loans due to variation of exchange rate;

(h) amount outstanding at the end of the year in foreign currency units, on historical basis and on closing rate basis;

(i) interest paid on external debt; and

(j) closing rate of exchange applied.

Financial statements shall disclose in the notes the following:

(a) category-wise gross figure of loss and gain by exchange rate variation for the financial year;

(b) loss and gain by exchange rate variation separately for Capital Head transactions and Revenue Head transactions;

(c) amount of loan and exchange difference in respect of fully repaid loans; and

(d) amount of loss or gain, if any, on cross-currency swap agreements.

Effective Date: This Indian Government Accounting Standard shall be effective for financial statements for the periods commencing from the 1st April subsequent to the date of notification of the standard by Government.

IGAS — 9 Government Investments in Equity

Introduction:

The Union Government, State Governments, and Governments of Union Territories with Legislatures (hereinafter called Government), make investments in entities like Government companies, Statutory Corporations, other Joint Stock Companies and Cooperative Banks/ Societies etc. In addition, the Union Government also invests in international bodies and authorities like the International Monetary Fund, Asian Development Fund, and International Finance Corporation.

Government's investments in equity include direct investment in share capital, conversion of outstanding loans (principal and interest) against the entity into equity, and conversion of dividends declared by the entity, but not received, into equity. This standard covers all such investment in equity, and does not cover investment in the loan capital of the entity.

Objective:

The objective of the Standard is to lay down the norms for recognition, measurement,and reporting of investments of the Government in the Financial Statements so that the financial statements provide a true and fair view of investments of the Government, consistent with best international practices.

Scope:

This Standard applies to investments made in different investee entities by the Government for incorporation, and presentation in the Financial Statements. This standard will apply only to Government accounts being maintained on cash basis.

It applies to investment in equity of the investee entities and not in debt, like debentures, bonds, and such other instruments which are normally accounted for by the investee entities as long term and short term debt. The Financial Statements shall not be considered as giving a true arid fair view of investments unless they comply with this Standard.

Important Definitions:

- **Accounting Authority :** It is the authority that prepares the financial statements of the Government.
- **Accounting Period :** It means the financial year covered by the financial statements, which is normally from 01 April to 31 March.
- **Bonus Shares :** These are the shares issued free of cost to the shareholders by an investee entity by capitalising its reserves and / or the security premiums as per the requirement of the relevant law.

- **Cash Basis of Accounting :** It is one wherein the accounting transactions of the Government represent the actual cash receipts and disbursements during a financial year as distinguished from the amount due to or from the investee entity during the same period.
- **Disinvestment/ divestment / retirement of-Government Equity :** It means the sale or transfer of equity shares by the Government.
- **Equity Share :** It is a share, which is not a preference share.
- **Financial Statements :** It means the Annual Finance Account of the respective Government.
- **Government:** It means the Union Government or any State Government or Government of any Union Territory with Legislature.
- **Government Investment in Equity :** It includes investment in equity shares obtained by the Government on payment of cash or in exchange of any other asset; exercise of a right granted by the investee; issuance of bonus shares by the investee entity; reinvestment of dividends; or conversion of loans into equity.
- **Historical Cost :** It is the cost of acquisition of equity shares.
- **Investee Entity :** It is an entity in which an investment is made by the Government.
- **Investee Group :** It consists of a group of investee entities of similar nature and characteristics that can be collectively and distinctively addressed such as Statutory Corporations, Joint Stock Companies, International Bodies, State Cooperative Banks/other banks, Cooperative Societies, Employees Consumer Cooperative Societies, etc.
- **Preference Shares :** It mean those shares which have the following two characteristics:

  (a) that with respect to dividends, carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate;

  (b) that with respect to capital, they carry, over the equity share hotter, on winding up or repayments of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up.
- **Right Shares :** These are the allotment of shares on the issue of fresh capital by an investee entity to which a shareholder, by virtue of his holding, is entitled to, certain shares on payment in the investee enterprise in proportion to the number of shares already held by him.

Recognition :

An investment in equity shall be recognised by the Government as an asset from the date on which the investment details are entered in the books of the entity.

Loans converted into equity and dividends declared but not distributed by the investee entity, converted into equity shall be treated as equity investments from the date on which such conversion takes plate, i.e. from the date on which details of conversion are entered in the books of the investee entity.

Measurement :

- The method of initial measurement of investments in the financial statements of the Government is the historical cost of the investment. Where investment in equity is acquired on payment of cash including on exercise of rights granted by the investee, the historical cost is the amount of cash disbursed. Historical cost of Bonus shares is nil as there is no payment of cash. In case the Government acquires equity shares in consideration of any other asset, e.g., land, the historical cost of such investment shall be the face value of the equity shares. Where the equity shares are acquired on reinvestment of dividends, the historical cost of

such shares is the amount of dividends against which the shares are allotted. Historical cost of equity shares acquired on conversion of loans is the amount of the loan outstanding (principal and interest) against which such shares are allotted.

- Total market value of the investments will be calculated on the basis of the price quoted on the last day of the financial year in the primary market of trading of that particular stock or in case the quoted price is not available on that date, the price on the date at which it was last quoted before the closing of the financial year. This will be applicable to the listed companies whose shares are regularly traded on a recognised stock exchange during the year.
- Investments subsequent to initial measurement shall also be reflected in the financial statements at historical cost.
- The total amount of investments on the last date of an accounting period shall be the investments at the beginning of the period with additions and disinvestment / sale of investments during the period.

Disclosure :

The Financial Statements of the Government shall disclose the amount of investments at the beginning and at the end of the accounting period showing additional investments, disinvestments / divestments or retirement /write town of capital / transfer of share, if any.

They will reflect the additions made during the year by way of investments to the opening balance and disinvestments/ divestments there from, for arriving at the closing balance.

Types of investments are specifically mentioned and acquisitions of investments in terms of exchange of goods/ other assets are also recorded.

The amount of dividend received shall be reflected as revenue of the period.

The Financial Statements of the Government shall disclose the following details under the statement of 'Investments made by the Government':

(i) Detailed Statement of Investments made investee Entity wise.

(ii) Detailed Statement of Disinvestments / divestments / retirement of capital / transfer of shares made Investee Entity wise.

(iii) Summary of Investments: Investee group-wise (such as Statutory Corporations, Joint Stock Companies, Cooperative Banks, etc.

(iv) Additional disclosures of investee entities which have not submitted accounts and / or have suffered a loss during the preceding three consecutive years.

The detailed statement of investments, Investee entity wise in the Financial Statementswhich the entity belongs, the Ministry or Department under which the investee is functioning, whether the enterprise is in operation or not etc. Details of disinvestment / divestments / retirement of capital / transfer of share during the year are reported in the Statement of disinvestment / retirement of capital, investee entity wise. While indicating the type and number of units, the units acquired, and those allotted as bonus shares, shall be depicted separately along with year of allotment. The statements shall also disclose the total paid up capital of the entity. This would help indicate the extent of government control and whether the investment has increased or decreased.

Moreover, where the units of investments are traded in the market, the amount of investment in terms of market value may also be disclosed. The price quoted on the last day of the financial year in the primary market of trading of that particular stock orin case the quoted price is not available on that date, the price on the date at which it was last quoted before the closing of the financial year may be taken into account.

The amount of dividend received and credited to Government revenue shall also be reported entity wise. In case the dividend received pertains to previous accounting periods, the year to which the amounts actually pertain are disclosed by way of a foot note.

Additional disclosures shall include the investments and disinvestments / divestments / retirement of capital / transfer of shares made during the reporting period. In addition, disclosures shall be made by way of a note to accounts in respect of investments in entities which have made a net loss i.e., loss after interest and taxes in the previous accounting period along with remarks where further investments have been made during the reporting period. Where the accounts of the investee entities are in arrears for more than three consecutive years, the fact should be disclosed, along with remarks in cases where the G6vernment has invested in the entity during the reporting period.

Effective date :

This Indian Government Accounting Standard becomes effective for the financial statements covering periods beginning from the 01 April of the year following the notification of the Standard by the Government.

IGAS — 10 Public Debt and Other Liabilities of Governments: Disclosure Requirements

Introduction:

In terms of Article 292 of the Constitution, the executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by Law. Article 293(1) of the Constitution provides a similar provision in respect of State Governments. Section 48A(1) of the Government of Union Territory Act 1963 and Section 47A(1) of Government of NCT of Delhi Act 1991, also provides for borrowing upon the security of the Consolidated Fund of the Union Territory concerned or Consolidated Fund of the Capital within such limits, if any, as may be fixed by Parliament by law and the stipulations indicated therein.

Objective:

The objective of the IGAS isto lay down the principles for identification, measurement and disclosure of public debt and other obligation of Union and the State Governments including Union Territories with legislatures in their respective financial statements.

It ensures consistency with international practices for accounting of public debt in order to ensure transparency and disclosure in the financial statements of Government for the benefit of various stake holders.

Scope:

- The proposed IGAS shall apply to the financial statements prepared by the Union and State Governments and Union Territories with legislature.
- The IGAS shall also cover “other obligations” as defined in paragraph 4 of this standard relating to definitions. The IGAS shall not include in its ambit, guarantees and other contingent liabilities and non-binding assurances.

Important Definitions:

- **Accounting Authority:** It means the authority who prepares the Financial Statements of the Governments.
- **Accounting Period:** It means the period covered by the Financial Statements.
- **Cash Basis of Accounting:** It is that wherein accounting transactions of the Union Government, State Government and Government of Union Territory with legislature represent the actual cash receipts and

disbursement during a financial year as distinguished from the amounts due to or by the relevant Government, subject to the exceptions as may be authorized under the Government Accounting Rules 1990 or by any general or special orders issued by the Central Government on the advice of the Comptroller & Auditor General of India.

- **Consolidated Fund of India :** It is the fund referred to in Article 266(1) of the Constitution of India.
- **Consolidated Fund of a State :** It is the fund referred to in Article 266(1) of the Constitution of India.
- **Consolidated Fund of Union Territories with Legislature :** It is the fund referred to in Section 47(1) of the Union Territories Act, 1963 and Section 46(1) of the Government of National Capital Territory of Delhi Act, 1991.
- **Public Account of India :** It is the fund referred to in Article 266(2) of the Constitution of India.
- **Public Account of a State :** It is the fund referred to in Article 266(2) of the Constitution of India.
- **Public Account of Union Territory :** It is the Public Account referred to in Section 47A (1) and Section 46A (1) of the Government of Union Territories Act, 1963 and the Government of National Capital Territory of Delhi Act, 1991 respectively.
- **Financial Statements :** It means the Annual Finance Accounts of the Union Government, State Governments and Union Territories with legislature. It would also include appropriate statements, schedules and notes to the above statements.
- **Government :** It means the Union Government or any State Government or Government of any Union Territory with Legislature.
- **Face Value:** It is the contract value of the Public Debt or other obligations.
- **Public Debt:** It includes internal and external debts of the Central Government, State Governments and Government of the Union Territory with legislature, as applicable.
- **Other Obligations:** It refers to the net outcome of the receipt and payment transactions arising in the public account. It does not include transactions categorized as Remittances, Suspense and Miscellaneous and Cash Balance.

Measurement & Valuation:

The Public Debt and Other Obligations incurred by Governments shall be accounted and reported on the basis of Face Value. For the purpose of reporting external debt, changes in the Balance at the end of the Accounting Period arising from variations in the rate of exchange shall also be reported.

Disclosure:

The financial statements of the Union Government, State Governments and the Union Territories with legislature shall disclose the following details concerning Public Debt and other obligations:

(a) the opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to internal debt;

(b) the opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to external debt, wherever applicable;

(c) the opening balance, receipts and disbursements during the year, closing balance and net change in rupee terms with respect of other obligations.

The Financial Statements of the Union Government and the State governments shall disclose the following

details regarding servicing of debt and related parameters for the current year, preceding year and net change in rupee terms with respect to:

(a) Interest paid by the governments on public debt, small saving, provident funds, and reserve funds and on other obligations.

(b) Interest received on loans to State and Union Territory Governments, departmental Commercial Undertakings, PSUs and other Undertaking including Railways, Post & Telegraph.

(c) Interest received on other Loans, from investments of cash balances and other items.

External debt of the Central Government shall be classified according to source indicating the currency of transaction. Measurement of face value shall be in respect of both the currency of agreement and Indian rupees. It should also disclose the outstanding in terms of exchange rate prevailing at the end of the accounting period.

Effective date:

This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning on 1st April of the year after the notification of the Standard by the Government.

Government Accounting and Reporting

8.5

Controller General of Accounts (CGA) is the apex accounting body in the Government of India. It is the principal Accounts Adviser to the Government of India and is responsible for establishing and maintaining a technically sound management accounting system. The accounts of the Civil Ministries are compiled and maintained by the Pay and Accounts Offices, the basic accounting units.

The Pay and Accounts Offices maintain line item wise accounts of all the transactions involving Consolidated Fund of India, Contingency Fund of India and Public Account of India. Various subsidiary accounts such as Loan accounts, Fund accounts etc. are also maintained by these units.

The accounts compiled by the Pay and Accounts Offices are consolidated on a monthly basis in the Principal Accounts Offices at the Ministry's headquarters. The consolidated accounts of the Ministry are rendered to the Controller General of Accounts. The accounts received from various Ministries are consolidated in the office of the Controller General of Accounts to generate the accounts of the Government of India as a whole.

These monthly accounts are reviewed and a critical analysis of expenditure, revenue collection, borrowings and deficit is prepared for Finance Minister.

Role of CGA: Consolidating monthly accounts of the Government of India and reporting on the fiscal deficit is the primary responsibility of the CGA. The monthly accounts are compiled in the CGA office and a monthly review indicating flow of expenditure, revenue collection, internal and external borrowing and fiscal deficit is prepared for Minister of Finance. A summary of the monthly accounts is also placed on the web. He prepares a critical analysis of expenditures, revenues, borrowings and the deficit for the Finance Minister every month. He also prepares annual Appropriation Accounts and Union Finance Accounts for presentation to the parliament.

Ministries, Departments approach the Controller General of Accounts for advice on accounting procedures for new schemes, programmes or activities undertaken by them. The advice rendered by the CGA generally covers aspects related to maintenance of accounts, collection of receipts and it's crediting into Government account, release of payment and it's accounting, creation and operation of funds within Government accounts, banking arrangements for making payments and collecting receipts etc. The advice of the Controller General of Accounts is binding on the Ministries/Departments.

Government Accounting & Information Technology: In a continuous effort towards improving the efficiency and the quality of the services rendered by the Department, Information Technology has been introduced at almost all levels of operations.

At the three levels, namely the Controller General of Accounts, Principal Accounts Offices and the field Pay and Accounts Offices software packages, namely GAINS (Government Accounting Information System), CONTACT (Controller's Accounts) and IMPROVE (Integrated Multimodule Processor for Voucher Entries), are being used to consolidate Government of India Accounts.

The monthly accounts are now published on the Web on the last day of the month following the month of account

(i.e. the accounts for Oct 2017 will be available on the last day of November 2017). Efforts are continuing to automate a number of other processes at various levels.

The Systems Group, in the office of the Controller General of Accounts, assists the Controller General of Accounts in the policy formulation and use of Information technology in the accounting offices of the Government. The software support to the organisation is provided by the National Informatics Centre under the Ministry of Planning.

Features of Government Accounting in India

One of the most distinctive features of the Government accounts in India is the minute detail with which the financial transactions are recorded in the account books. All transactions are classified on a six tier functional classification with Major Heads representing a broad function of the Government at the top and an object head representing the activity at the bottom. The intermediate levels represent sub-functions, programmes, schemes and sub-schemes. The functional classification is applicable to receipts as well as payments.

Since the Country follows a Plan based model of economy, the expenditure of Government is divided into Plan and Non-Plan. As the name suggests, the Plan expenditure is directly related to expenditure on schemes and programmes envisages in the plans. The Non-Plan expenditure is the expenditure incurred on establishment and maintenance activities.

Further distinction is made between the expenditure, which under the provisions of the Constitution, is subject to the vote of the legislature and the rest which is charged upon the Consolidated Fund of India.

Since the budget is on an annual basis, the accounts have to conform to it. The accounts are maintained on cash basis. Only the actual receipts realised and the payments made during the year are recorded.

Article of the Constitution provides for creation of a Consolidated Fund of India, Contingency Fund and Public Account.

Accounts of the Government

The Constitution of India provides for the manner in which the accounts of the Government have to be kept. The accounts of Government are kept in three parts namely, Consolidated Fund, Contingency Fund and Public Account. They are discussed as under:

1. **Consolidated Funds of India**

   The Consolidated Funds is constituted under Article 266 (1) of the Constitution of India. All revenues received by the Government by way of taxes like Income Tax, Central Excise, Customs and other receipts flowing to the Government in connection with the conduct of Government business i.e. Non-Tax Revenues are credited into the Consolidated Fund. Similarly, all loans raised by the Government by issue of Public notifications, treasury bills (internal debt) and loans obtained from foreign governments and international institutions (external debt) are credited into this fund. All expenditure of the government is incurred from this fund and no amount can be withdrawn from the Fund without authorization from the Parliament. This is the largest of all the three funds.

2. **Public Accounts of India**

   The Public Accounts of India is constituted under Article 266 (2) of the Constitution. The transactions to be recorded in it relate to debt other than those included in the Consolidated Fund of India. The transactions under Debt, Deposits and Advances in this part are those in respect of which Government incurs a liability to repay the money received or has a claim to recover the amounts paid. The transactions relating to 'Remittance' and 'Suspense' shall embrace all adjusting heads. The initial debits or credits to these heads will be cleared eventually by corresponding receipts or payments. The receipts under Public Account do

not constitute normal receipts of Government. Parliamentary authorization for payments from the Public Account is therefore not required.

3. **Contingency Funds of India**

The Contingency Fund of India Fund set by the Government of India under Article 267 of the Constitution of India. It records the transactions connected with Contingency.It is held on behalf of President by the Secretary to the Government of India, Ministry of Finance, Department of Economic Affairs. The corpus of this fund is ₹ 500 crores. Advances from the fund are made for the purposes of meeting unforeseen expenditure which are resumed to the Fund to the full extent as soon as Parliament authorizes additional expenditure. Thus, this fund acts more or less like an imprest account of Government of India.

Indian Government Financial Reporting Standards (IGFRS).

The standards being developed for accrual system of accounting in the Government are called the Indian Government Financial Reporting Standards (IGFRS).

Accrual based Accounting Standards, i.e., Indian Government Financial Reporting Standards (IGFRS), approved by the Government Accounting Standards Advisory Board (GASAB) under consideration of Government of India:

- **IGFRS 1:** Presentation of Financial Statements
- **IGFRS 2:** Property, Plant & Equipment
- **IGFRS 3:** Revenue from Government Exchange Transactions
- **IGFRS 4:** Inventories
- **IGFRS 5:** Contingent Liabilities (other than guarantees) and Contingent Assets: Disclosure Requirements.1 Formulation of some other IGFRSs/IGASs is under progress

IGFRS 1: Presentation of Financial Statements

IGFRS 1 has prescribed the manner of presentation of financial statements by Government entities that follow accrual basis of accounting. It sets out over all requirement for the presentation of financial statements, guidance for their structure and minimum requirements for the content of financial statements presented under the accrual basis of accounting.

IGFRS 2: Property, Plant and Equipment

This standard has prescribed the accounting treatment for property, plant and equipment (PPE) so that users of financial statements can obtain information regarding an entity's investment in its property, plant and equipment and any changes in such investment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them. In addition, this standard aims at categorising assets according to their nature and also aims to provide for depreciation of assets, taking into account their usage over the life of the assets. The Accounting Standard is essentially an adaptation to Indian requirements of International Public Sector

Accounting Standard (EPSAS 17) issued by IFAC on Property, Plant and Equipment. It also envisaged to provide guidance to pilot studies and the eventual development of a common reporting framework under accrual basis for the Union and the States. The IGFRS are subject to revision by GASAB based on experiences with pilot studies.

IGFRS 3: Revenue from Government Exchange Transaction

This Standard lays down the principles to be followed for recognition and measurement of revenue from exchange

transactions by government entities under accrual basis of accounting, wherein transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). It is envisaged to provide guidance to the pilot studies and eventual development of a common reporting framework under accrual basis for Union and the States. The IGFRS could be revised by GASAB based on pilot studies.

IGFRS 4: Inventories

This standard has prescribed the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. This Standard aims at using accrual principles of accounting for inventories – both at the stage of charging as expense and depicting the closing stock in the financial statements at the end of the reporting period.

The Accounting Standard has derived inputs from Indian Accounting Standards (Ind AS 2), IPSAS 12 and IAS 2 (International Accounting Standards). The Standard is envisaged to provide guidance to the pilot studies and eventual development of a common reporting framework under accrual basis for the Union and the States. The IGFRS 4 could be revised by GASAB based on pilot studies.

IGFRS 5: Contingent Liabilities (other than guarantees) and Contingent Assets: Disclosure Requirements

This standard has laid down the principles for disclosure requirements of Contingent Liabilities (other than guarantees) and Continent Assets for both the Union and the State Governments including Union Territories with Legislatures, in their respective Financial Statements in order to ensure uniform and appropriate disclosure of such liabilities and assets. It also ensures consistency with international best practices leading to transparency and improved quality of disclosure in the financial reports of Governments for the benefit of various stakeholders. An important objective of the IGFRS is to ensure that Governments portray the risks associated with contingent liabilities and contingent assets in a transparent manner. The purpose of this standard is to provide for disclosure requirements of contingent liabilities (other than guarantees) and contingent assets of Governments in the financial

Statements. Disclosure of contingent liability is relevant from the point of view of knowing what risk of future liability the government carries. Disclosure of contingent assets is relevant in knowing what possible assets may accrue to government.

Exercise

A. Theoritical Questions:

Multiple Choice Questions

1. The Financial Statements of the Union Government shall disclose the following details under 'Loans and Advances made by the Union Government' in the Annual Finance Accounts of the Union Government

   a. the summary of Loans and Advances showing loanee group-wise details

   b. the summary of Loans and Advances showing Sector-wise details

   c. the summary of repayments in arrears from Governments and other loanee entities

   d. All of the above

2. Consolidated Fund of India is the fund referred to in _______ of the Constitution of India

   a. Article 266(1)

   b. Article 266(2)

   c. Article 266(3)

   d. Article 266(4)

3. The financial statements of the Union Government, State Governments and the Union Territories with legislature shall disclose the following details concerning Public Debt and other obligations

   a. the opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to internal debt

   b. the opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to external debt, wherever applicable

   c. the opening balance, receipts and disbursements during the year, closing balance and net change in rupee terms with respect of other obligations

   d. All of the above

4. As per The Constitution of India, the Accounts of the Government are kept in

   a. Consolidated Funds of India

b. Public Accounts of India

c. Contingency Funds of India

d. All of the above

5. The standards being developed for accrual system of accounting in the Government are called the ________________________

a. Indian Government Accounting Standards

b. Indian Government Reporting Standards

c. Indian Government Financial Reporting Standards

d. Indian Government Accounting and Reporting Standards

6. Which of the following is not a general principal of Government Accounting?

a. Reporting of Utilisation of Public Funds

b. Expenditures are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of Accounts

c. Budget Based

d. Single Entry System

7. IGAS 2 is related to ______________________.

a. Accounting and Classification of Grants-in-aid

b. Guarantees given by Governments: Disclosure Requirements

c. Government Investments in Equity

d. None of the above

8. Which of the following is/ are responsibility/responsibilities of GASAB?

a. Formulating and proposing standards that improve the usefulness of financial reports

b. Keeping the standards up to date and reflect change in the Governmental environment.

c. Improving standard of Government accounting and financial reporting

d. All of the above

9. GASAB stands for ______________.

a. Government Accounting Standards Advisory Board

b. Government Accounting Standards Applicability Board

c. Government Auditing Standards Advisory Board

d. Government Accounting for States Advisory Board

10. Which of the following is not a feature of Government Accounting?

a. Non-fund based Accounting

b. Double Entry System

c. Adherence to Government Regulations

d. Transacting through Banks

Answer:

1.	2.	3.	4.	5.	6.	7.	8.	9.	10.
d.	a.	d.	d.	c.	d.	a.	d.	a.	a.

Fill in the Blanks

1. Government Accounting Standards is issued by ______________________.

2. __________________ means the arrangement whereby the Government agrees to transfer funds to the designated account in case the beneficiary entity fails to ensure availability of adequate funds for servicing the debts, as per stipulations.

3. ___________________ means the arrangement whereby the Government's cash balance is affected on a specified date or on the occurrence of specified events to meet certain obligations arising out of Guarantees given by it.

4. ____________ are payments, transfers of funds, in cash or in kind, in the nature of donations or contributions by one government (grantor) to another government, body, institution or individual (grantee).

5. _____________________ is a financial agreement between two parties to exchange a stream of principal and interest payments in one currency for a stream of principal and interest payments in another currency.

Answer:

1.	Government Accounting Standards Advisory Board (GASAB)	2.	Structured Payment Arrangement
3.	Automatic Debit Mechanism	4.	Grants-in-aid
5.	Cross Currency Swap Agreement		

Short Essay Type Questions

1. State the differences between commercial accounting and government accounting.
2. Enumerate the roles of Public Accounts Committee (P.A.C).
3. What is the structure of GASAB?
4. Write a short note on:
   a. Consolidated Funds of India
   b. Public Accounts of India
   c. Contingency Funds of India
5. State and explain in brief, the accrual based Accounting Standards, i.e., Indian Government Financial Reporting Standards (IGFRS), approved by the Government Accounting Standards Advisory Board (GASAB) under consideration of Government of India.

Essay Type Questions

1. List the features of Government Accounting.
2. Enumerate the objectives of Government Accounting.
3. Highlight the general principals of Government Accounting.
4. Discuss the Role of Comptroller and Auditor General of India.
5. ‘Comptroller and Auditor General to prepare and submit accounts to the President, Governors of States and Administrators of Union Territories having Legislative Assemblies’ - discuss.