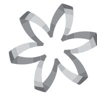
ATTENTION FOR STUDENTS NOT HAVING STUDY MATERIALS ON PAPER-17 OF AUGUST, 2019 EDITION ON CORPORATE FINANCIAL REPORTING OF FINAL COURSE (SYLLABUS-2016)

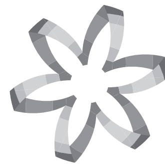
Date: 27.09.2019

The Directorate of Studies (D.O.S) has decided to upload this special Supplementary Issue considering those students who are not having the August, 2019 Edition of Paper – 17: Corporate Financial Reporting of Final Level.

Out of total 8 Study Notes of Paper 17, 6 Study Notes (1,2,3,4,5 & 6) have been changed considerably due to incorporation of Ind AS in a phased manner.

Students using Study Material of Paper 17 of an edition published earlier to August 2019 edition, may follow this Supplementary Issue instead of purchasing the August, 2019 Edition.



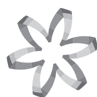


SUPPLEMENTARY

Paper-17

CORPORATE FINANCIAL REPORTING

(Syllabus - 2016)



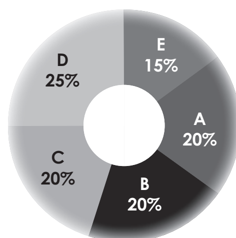
Syllabus- 2016

PAPER 17: CORPORATE FINANCIAL REPORTING (CFR)

Syllabus Structure

The syllabus comprises the following topics and study weightage:

A	GAAP and Accounting Standards	20%
B	Accounting of Business Combinations & Restructuring	20%
C	Consolidated Financial Statements	20%
D	Developments in Financial Reporting	25%
E	Government Accounting in India	15%



ASSESSMENT STRATEGY

There will be written examination paper of three hours.

OBJECTIVES

To understand the recognition, measurement, disclosure and analysis of information in an entity's financial statements to cater the needs of the stakeholders.

Learning Aims

The syllabus aims to test the student's ability to:

- Demonstrate the financial statements for understanding of stakeholders ;
- Analyze the impact of GAAP and its application for reporting and compliance ;
- Evaluate financial statements for strategic decision-making ;
- Interpret and apply the ongoing developments for financial reporting.

Skill set required

Level C: Requiring skill levels of knowledge, comprehension, application, analysis, synthesis and evaluation.

Section A : GAAP and Accounting Standards	**20%**
1. Accounting Standards	
Section B : Accounting of Business Combinations & Restructuring (Ind AS)	**20%**
2. Accounting of Business Combinations & Restructuring	
Section C : Consolidated Financial Statements (Ind AS)	**20%**
3. Group Financial Statements	
Section D : Developments in Financial Reporting and other item of Reporting	**25%**
4. Recent Trends in Financial Reporting	
5. Valuation, Accounting and Reporting of Financial Instruments and others (Ind AS)	
6. Share Based Payments (Ind AS)	
7. Reporting through XBRL (eXtensible Business Reporting Language)	
Section E : Government Accounting in India	**15%**
8. Government Accounting Procedure and Standards	

SECTION A: GAAP AND ACCOUNTING STANDARDS [20 MARKS]

1. Accounting Standards

(a) Generally Accepted Accounting Principles in India

(b) Overview of Accounting Standards (AS)

(c) International Financial Reporting Standards

(d) Over View of Ind AS

SECTION B: ACCOUNTING OF BUSINESS COMBINATIONS & RESTRUCTURING [20 MARKS]

2. Accounting of Business Combinations & Restructuring (as per Ind AS)

(a) Relevant Terms, Types of merger, methods of accounting, treatment of Goodwill arising on merger, Purchase consideration and settlement

(b) Accounting in books of vendor/ transferor and transferee

(c) Accounting for investment in subsidiary

(d) Accounting for Mergers / Acquisitions (including chain holdings, cross holdings, multiple holdings)

(e) Corporate Financial restructuring, Reconstruction Schemes, De-merger, Reverse merger

(f) Notes to Accounts & related disclosures under amalgamation

SECTION C: CONSOLIDATED FINANCIAL STATEMENTS [20 MARKS]

3. Group Financial Statements (as per Ind AS)

(a) Concept of a group, Purposes of consolidated financial statements, Consolidation procedures, Non-controlling interest, Goodwill, Treatment Pre-acquisition profit and Postacquisition profit and concept of Fair value at the time of acquisition.

(b) Consolidation with two or more subsidiaries, consolidation with foreign subsidiary.

(c) Consolidated Income Statement, balance Sheet and Cash Flow Statements for Group of companies.

(d) Impact on group financial statements at the point of acquisition

(e) Treatment of investment in associates in consolidated financial statements. Compare and contrast acquisition and equity methods of accounting

(f) Treatment of investment in joint ventures in consolidated financial statements

SECTION D: DEVELOPMENTS IN FINANCIAL REPORTING AND OTHER ITEM OF REPORTING [25 MARKS]

4. Recent Trends in Financial Reporting

(a) Sustainability Reporting

(b) Tripple Bottom Line Reporting

(c) Corporate Social Responsibility Reporting (CSR Reporting)

(d) Fair Value Measurement

(e) Integrated Reporting (IR)

(f) Business Responsibility Reporting

5. Valuation, Accounting and Reporting of Financial Instruments and others

(a) Recognition & Valuation Financial Instruments **(Ind AS)**

(b) GST Accounting

(c) NBFC – Provisioning Norms and Accounting

(d) Valuation of Shares

(e) Valuation of Goodwill

6. Share Based payments transactions (Ind AS)

7. Reporting Through XBRL (eXtensible Business Reporting Languate)

SECTION E: GOVERNMENT ACCOUNTING IN INDIA [15 MARKS]

8. Government Accounting

(a) General Principles and comparison with commercial accounting

(b) Role of Comptroller and Auditor General of India

(c) Role of Public Accounts Committee, Review of Accounts

(d) Government Accounting Standards issued by Government Accounting Standards Advisory Board (GASAB)

(e) Government Accounting and Reporting

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1.4 Applicability of Indian Accounting Standards
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There is no change in Study Note-7 & Study Note-8

Study Note - 1

ACCOUNTING STANDARDS

This Study Note includes

1.1 Generally Accepted Accounting Principles in India
1.2 Overview of Accounting Standards
1.3 International Financial Reporting Standards
1.4 Applicability of Indian Accounting Standards
1.5 Overview of Indian Accounting Standards (Ind AS)

1.1 GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN INDIA

MEANING OF GAAP

The various factors that have led to difference in accounting practices comprise widely of the culture, traditions, economic development, economic growth mode, inflation, legal system etc.

The diversity demands unification to the extent possible to develop Generally Accepted Accounting Practices (GAAP). GAAP are the common set of accounting principles, standards and procedures that are used by accountants to prepare the financial statements. They are derived from practice, and on being useful get accepted into the accounting system. These principles are developed by the professional accounting bodies of different countries of the world, with the aim of attaining uniformity in accounting practiced by the entities of the respective countries. As such different GAAP have developed in different countries of the world.

Indian GAAP comprises of a set of pronouncement issued by various regulatory authorities mostly in consultation with the ICAI. The Accounting Standards and the Indian Accounting Standards i.e. Indian GAAP is supplemented by Guidance notes, Interpretation, General Clarification and/or revision from time to time.

The Accounting Standards and the Indian Accounting Standards will apply to "General Purpose Financial statement" e.g. Balance Sheet, Statement of Profit & Loss, Schedules and Notes forming Integral part, issued for use by the Shareholders, Members, Creditors, Employees, and Public at large.

Generally Accepted Accounting Principles (GAAP) refers to accounting policies and procedures that are widely used in practice. It incorporates the body of principles that governs the accounting for financial transactions underlying the preparation of a set of financial statements.

GAAP includes principles on:

- **Recognition:** It deals with the items should be recognized in the financial statements (e.g. assets, liabilities, revenues, and expenses).
- **Measurement:** It determines the amounts should be reported for each of the elements included in financial statements.
- **Presentation:** It states regarding the line items, subtotals and totals should be displayed in the financial statements and how might items be aggregated within the financial statements.
- **Disclosure:** It states about the specific information that is most important to the users of the financial statements.

1.2 OVERVIEW OF ACCOUNTING STANDARDS (AS)

Accounting Standards

Accounting standards put together provides a framework of norms as to recognition, measurement and disclosure on the part of all enterprises that follow them to ensure comparability and depiction of true and fair view of the Financial Statements. High quality accounting standards are a prerequisite and important for a sound Capital Market System. The surge in the cross-border capital raising and Investment transactions demands formulation of high quality international accounting standard for financial reporting worldwide.

In this section we focus on AS based on Companies (Accounting Standards) Rules, 2006**.**

Companies (Accounting Standards) Rules, 2006.

As per Section 133 of Companies Act, 2013, the Central Government may prescribed the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under Section 3 of the Chartered Accountants Act, 1949, in notified the rules named "Companies (Accounting Standards) Rules, 2006.

Applicability of Accounting Standards:

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

For the purpose of applicability of Accounting Standards, enterprises are classified into three categories, viz., Level I, Level II and Level III. **Level II and Level III enterprises are considered as SMEs.**

Level I Enterprises:

- Enterprises whose equity or debt securities are listed whether in India or outside India.
- Enterprises which are in the process of listing their equity or debt securities as evidenced by the Board resolution in this regard.
- Banks including co-operative banks
- Financial institutions
- Enterprises carrying insurance business
- Enterprises whose turnover exceeds ` 50 crores
- Enterprises having borrowings in excess of ` 10 crores at any time during the accounting period.
- Holding companies and subsidiaries of enterprises falling under any one of the categories mentioned above.

Level II Enterprises:

- Enterprises whose turnover exceeds ` 40 lakhs but does not exceed ` 50 crores.
- Enterprises having borrowings in excess of ` 1 crore but not in excess of ` 10 crores at any time during the accounting period.
- Holding companies and subsidiaries of enterprise falling under any one of the categories mentioned above.

Level III Enterprises:

- Enterprises which are not covered under Level I and Level II.

Accounting standards and their applicability based on three tier classification

Accounting Standards	Applicability (Based on the three tier classification)
AS1,2,4-16,22,26,28,30,31,32	All Enterprises
AS 3,17,18,24,	Not applicable to Level II and Level III enterprises in their entirety.

AS 19,20,29	All enterprises but relaxation given to Level I and Level II enterprises for certain disclosure requirements.
AS 21,23,27	Not applicable to Level II and Level III enterprises
AS 25	Not mandatorily applicable to Level II and Level III enterprises

It is mandatory for on or after 1-4-2011 for all commercial, industrial and business entities except to a Small and Medium-sized Entity.

However, on and after 1-4-2016 the Companies (Indian Accounting Standards) Rules, 2015 made Ind AS applicable to the specified companies. ASs are no more applicable to those specified companies where Ind ASs are applicable.

In the following section brief introduction is given to the ASs.

1.4 APPLICABILITY INDIAN ACCOUNTING STANDARDS (Ind AS)

The Accounting Standard Board (ASB), a committee of the ICAI is responsible for the formulation of accounting standards in India. First, the ASB prepares a preliminary draft of the standard in the identified area. Then this preliminary draft is circulated to all concerned authorities, like the Department of Company Affairs (DCA), the SEBI, the CBDT, Standing Conference of Public Enterprises (SCPE), Comptroller and Auditor General of India etc. Then it is finalized as exposure draft and presented to the public for their review and comments. After due consideration of the comments, the final draft is prepared and brought under review of the Council of ICAI. Finally, the Central Government of India issues Indian Accounting Standards in consultation with the National Advisory Committee on Accounting Standards (NACAS). National Advisory Committee on Accounting Standards (NACAS) recommends the standards to the Ministry of Corporate Affairs. Ministry of Corporate Affairs (MCA) makes Ind AS applicable on the companies in India. In 2006, ICAI initiated the process of shifting towards the International Financial Reporting Standards (IFRS). Indian AS (Ind AS) are IFRS converged standards. They are named and numbered in the same way as their corresponding IFRS.

Ind AS has become applicable in following phases

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

A. On and with effect from1st April 2016 till 31st March 2017— Mandatory Basis

(a) Companies listed/ in the process of listing on Stock Exchanges in India or Outside India having net worth of more than INR 5 Billion

(b) Unlisted Companies having net worth of more than INR 5 Billion

(c) Parent, Subsidiary, Associate and Joint Venture of above

B. On and with effect from 1st April 2017— Mandatory Basis

(a) All companies which are listed/ or in the process of listing inside or outside India on Stock Exchanges not covered in Phase One (other than companies listed on SME Exchanges)

(b) Unlisted companies having net worth more than 2.5 Billion

(c) Parent, Subsidiary, Associate and Joint Venture of above

C. On and with effect from 1st April 2018 till 31st March 2019 — Mandatory Basis

(a) NBFCs having a net worth of ₹500 crore or more

(b) Holding, subsidiary, joint venture or associate companies of the above, other than those companies already covered under the corporate roadmap announced by MCA

D. On and with effect from1st April 2019 — Mandatory Basis

(a) NBFCs whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India

(b) NBFCs that are unlisted companies, having a net worth of ₹250 crore or more

(c) Holding, subsidiary, joint venture or associate companies of the above, other than those companies already covered under the corporate roadmap announced by MCA

E. On 1st April 2019 - Mandatory Basis — (as postponed by RBI)

(a) Scheduled commercial Banks , excluding RRBs

(b) India term-lending refinancing institution i.e. Exim bank, NABARD etc.

(c) Holding, subsidiary, joint venture or associate companies of scheduled commercial banks

F. On 1st April 2020 — Mandatory Basis — (as postponed by IRDA)

(a) Insurers/insurance companies

(b) Holding, subsidiary, joint venture or associate companies of the above, other than those companies already covered under the corporate roadmap announced by MCA

G. Further, once a company applies Ind AS voluntarily, it has to continue to apply Ind AS mandatorily.

1.6 RELATIVE VIEW OF AS vs IND AS vs IFRS

Has been fully deleted.

Study Note-2 & 3
(Completely Revised)
Old Study Note-2 & 3 has been deleted

Study Note - 2

ACCOUNTING OF BUSINESS COMBINATIONS & RESTRUCTURING

This Study Note includes

2.1 Introduction

2.2 Types of Merger

2.3 Concept of Business Combination

2.4 Ind AS: 103 Business Combination

2.5 Scheme of Reconstruction

2.6 Business Combination under Common Control

2.7 Demerger – Cocept

2.8 Reverse Acquisition

2.1 INTRODUCTION

In today's global business environment, companies – both new and existing, face immense competition for their survival. Moreover, the companies have to ensure a steady growth. The growth can be achieved by a company through the regular 'organic' process by increase in its scale of operations, by diversification and capturing higher market share. But many companies today adopt an indirect route that happens to be 'inorganic' in nature. One of the best ways for a company through grow via the indirect route is by merging with another company or acquiring other companies.

2.2 TYPES OF MERGER

Merger is a process in which either two or more companies unifies into another existing company or any one or more companies may form a new company to take over the business of two or more existing companies.

Mergers may be broadly classified as follows:

1. **Cogeneric Mergers**

   It happens within same industries and taking place at the same level of economic activity - exploration, production or manufacturing. It may be wholesale distribution or retail distribution to the ultimate consumer. The Cogeneric mergers are of two types:

   (a) Horizontal merger:

   - This class of merger is a merger between business competitors who are manufacturers or distributors of the same type of products or who render similar or same type of services for profit i.e. they are in the same stage of business cycle.
   - It involves joining together of two or more companies which are producing essentially the same products or rendering same or similar services or their products and services directly competing in the market with each other.
   - It is a combination of two or more firms in similar type of production/distribution line of business.

(b) Vertical merger:

- It occurs between firms which are complementary to each other, e.g. one of the companies is engaged in the manufacture of a particular product and the other is established and expert in the marketing of that product.
- In this merger the two companies merge and control the production and marketing of the product.

Types of vertical merger:

Vertical merger may take the form of forward or backward merger.

A vertical may result into a smooth and efficient flow of production and distribution of a particular product and reduction in handling and inventory costs. It may also pose a monopolistic trend in the industry.

Forward-looking merger: When a company combines with the customer, it is known as forward merger.

Backward merger: When a company combines with the supplier of material, it is called a backward merger.

2. Conglomerate merger:

This type of merger involves coming together of two or more companies engaged in the different industries and/or services. Their businesses or services are neither horizontally nor vertically related to each other. They lack any commonality either in their product, or in the rendering of any specific type of service to the society.

This is the type of merger of companies which are neither competitors, nor complementaries nor suppliers of a particular raw material nor consumers of a product or consumable. In this, the merging companies operate in unrelated markets no functional economic relationship.

The conglomerate merger may be of three types:

(a) Product extension merger

(b) Market extension merger

(c) Pure conglomerate merger

2.3 CONCEPT OF BUSINESS COMBINATION

Business Combination is a transaction or an event in which an acquirer obtains control of one or more businesses (e.g. acquisition of shares or net assets, legal mergers, reverse acquisitions).

A Business Combination can be structured in a number of ways for legal, taxation and other reasons, which include but are not limited to:

(a) one or more subsidiaries become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer; or

(b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;

(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests to a newly formed entity (sometimes referred to as a roll-up or put together transaction); or

(d) a group of former owners of one of the combining entities obtain control of the combined entity.

The accounting for all forms of business combinations are accounted for as per the provisions set out in Indian Accounting Standard (Ind AS) 103 and AS 14.

An entity shall determine whether a transaction or other event is a business combination by applying the definition in this Indian Accounting Standard, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition.

2.4 IND AS: 103 BUSINESS COMBINATION

1. A business combination is a transaction or other event in which an acquirer obtains **control** of one or more **businesses**.
2. Objective: The objective of this Indian Accounting Standard 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.
3. Accounting and reporting is made under Acquisition Method. [There is another method of accounting for business combination under Common Control where no change in control takes place for the transaction. We shall discuss it later.]

Under Acquisition Method 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;

- Based on Recognition principle:
    - must meet definition of assets or liabilities at acquisition date.
    - must be exchanged as part of acquisition.
    - recognise even those assets or liabilities which were not recognised by the acquiree.
- Based on Measurement principle:

    The acquirer shall measure the —
    - identifiable assets acquired and the liabilities assumed at their acquisition-date **fair values**.
    - Non-controlling interest at its **fair value** at the acquisition date or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

(b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase;

Acquirer shall recognise —

- Goodwill on the acquisition date as excess of (A) over (B) and
- Gain from bargain purchase as excess of (B) over (A) as stated below :

    (A) The aggregate of
    - Fair value of consideration transferred.
    - Recognised amount of any NCI in acquiree.
    - Fair value of any previously held equity interest in the acquiree (for a business combination achieved in stages).

    (B) Net of acquisition-date amounts of the identifiable assets acquired and liabilities assumed.

(c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

4. When Acquiree Company ceases to exist due to business combination the accounting will be reflected on the stand alone balance sheet of the acquirer company. But when Acquiree Company exists (i.e., Non-Controlling Interest exists) after business combination, accounting for business combination will reflect on consolidated balance sheet. In such cases reference to both Ind AS 103 and Ind AS 110 is made for consolidation.
5. For practice let us have some illustrations to see how the principles and requirements are applied.

Illustration 1.

A Ltd. acquires B Ltd. for ₹9,60,000. Fair Value (FV) of B's net assets at time of acquisition amounts ₹ 8,00,000.

Required:

1. **Calculate Goodwill.**
2. **Journal Entries in the books of A.**

Answer:

Purchase consideration ₹ 9,60,000

FV of Net Assets ₹ 8,00,000

Goodwill = Consideration – Net Assets = ₹ (9,60,000– 8,00,000) = ₹ 1,60,000

Journal entry

Particulars		Dr. (₹)	Cr. (₹)
Net assets A/c	Dr.	8,00,000	
Goodwill A/c	Dr.	1,60,000	
To, Consideration A/c			9,60,000

As B ceases to exist after business combination, in the books of B entries will be passed for closing all the accounts through Realisation A/C and Equity Shareholders A/C. See para 17.

Illustration 2.

On March 31, 201X, K Ltd. acquired L Ltd. K Ltd. issued 60,000 equity shares (₹10 par value) that were trading at ₹240 on March 31. The book value of L Ltd.'s net assets was ₹72,00,000 on March 31. The fair value of net assets was assessed at ₹1,35,00,000.

Show acquisition journal entry under Ind AS 103.

Answer:

Journal Entry

Particulars		Dr. (₹)	Cr. (₹)
Net assets A/c	Dr.	1,35,00,000	
Goodwill A/c	Dr.	9,00,000	
To, Consideration A/c			1,44,00,000
Consideration A/c	Dr.	1,44,00,000	
To, Equity Share Capital A/c			6,00,000
To, Securities Premium A/c			1,38,00,000

As L ceases to exist after business combination, in the books of L entries will be passed for closing all the accounts through Realisation A/C and Equity Shareholders A/C. See para 17.

Illustration 3.

A Ltd. acquires 80% of B Ltd. for ₹ 9,60,000 paid by equity at par. Fair Value (FV) of B's net assets at time of acquisition amounts ₹ 8,00,000.

Required:

1. **Calculate Non-Controlling-Interest (NCI) and Goodwill.**
2. **Journal Entries in the books of A.**

Answer:

Purchase consideration ₹ 9,60,000 ; FV of Net Assets ₹ 8,00,000

NCI = ₹ 8,00,000 × (20%) = ₹ 1,60,000 [at proportionate to fair value of net assets]

Goodwill = Consideration + NCI – Net Assets = ₹ (9,60,000 + 1,60,000 – 8,00,000) = 3,20,000

Journal Entry

Particulars		**Dr. (₹)**	**Cr. (₹)**
Net assets A/c	Dr.	8,00,000	
Goodwill A/c	Dr.	3,20,000	
To, Consideration A/c			9,60,000
To NCI A/c			1,60,000
Consideration A/c	Dr.	9,60,000	
To, Equity Share Capital A/c			9,60,000

In the books of B there is no entry.

As B exists after business combination, the above entries are passed in the consolidated accounts of A. A requires to pass entries in books for separate financial statements also, as stated below.

Particulars		**Dr. (₹)**	**Cr. (₹)**
Investment A/c	Dr.	9,60,000	
To, Equity Share Capital A/c			9,60,000

Illustration 4.

Z Ltd. acquired a 60% interest in P Ltd. on January 1, 2017. Z Ltd. paid ₹720 Lakhs in cash for their interest in P Ltd. The fair value of P Ltd.'s assets is ₹1,800 Lakhs, and the fair value of its liabilities is ₹900 Lakhs. Provide the journal entry for the acquisition using Ind AS, assuming that P Ltd. does not wish to report the NCI at fair value.

Answer:

Journal Entry

Particulars		**Dr. (₹ in Lakhs)**	**Cr. (₹ in Lakhs)**
Acquired assets A/c	Dr.	1,800	
Goodwill A/c	Dr.	180[2]	
To, Consideration A/c			720
To Acquired liabilities			900
To Non-controlling interests (NCI)A/c			360[1]
Consideration A/c	Dr.	720	
To, Cash A/c			720

Workings:

(1) NCI = 40% × ₹(1,800 – 900) = ₹360 Lakhs

(2) Goodwill = ₹720 +360 – ₹(1,800 – 900) = ₹180 Lakhs

In the books of P there is no entry.

As P exists after business combination, the above entries are passed in the consolidated accounts of Z. Z requires to pass entries in books for separate financial statements also, as stated below.

Particulars		Dr. (₹ in Lakhs)	Cr. (₹ in Lakhs)
Investment A/c	Dr.	720	
To, Cash			720

Now we may consider a case of bargain purchase.

Illustration 5.

On 1 January 20X5 M Ltd. acquires 80 per cent of the equity interests of P Ltd in exchange of cash of ₹216. The identifiable assets acquired are measured at ₹350 and the liabilities assumed are measured at ₹50.

Answer:

Amount of the identifiable net assets acquired	(₹ 350 – ₹ 50)	₹ 300
Less: Consideration	₹ 216	
Less: Fair value of non-controlling interest (20/80) × 216*	₹ 59	₹ 275
Gain on bargain purchase of 80 per cent interest		₹ 25

* NCI is measured at fair value.

M would record its acquisition of P in its consolidated financial statements as follows:

Journal entry

Particulars		Dr. (₹)	Cr. (₹)
Identifiable Assets Acquired A/c	Dr.	350	
To, Cash A/c			216
To, Liabilities assumed			50
To, Gain on the bargain purchase*			25
To, Non-controlling Interest in P			59

* The gain on bargain purchase will be recognised in other comprehensive income and accumulated in equity as Capital Reserve.

6. In para 1 we defined business combination. We may elaborate the concept here.

   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). [1 if no NCI and 2 if NCI exists]

   (b) by acquisition of shares.[2] or

   (c) by other legal process.[2]

   [1] Recording be done for the (Individual) financial statements of the Acquirer.

   [2] Recording be done for the consolidated financial statements and separate financial statements of the Acquirer.

[It may be pointed out that AS-14 deals with accounting of (a)1 cases, Ind AS 103 takes up the cases (a)2, (b) and (c) also.]

7. An entity shall account for each business combination by applying the acquisition method, similar to 'Purchase method'. (It does not include 'business combination under common control', which is accounted under 'Pooling of Interest' method and discussed later.)

8. 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.

   In the first part we started with discussion and illustrations on clauses (c) and (d) of para 8 because they are closely related to accounting. In para 9 and 10 we shall discuss clauses (a) and (b) of para 8.

9. 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, i.e. the acquiree.

   [When it is not clear from Ind AS 110, the following factors should be considered under Ind AS 103:

   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.]

10. 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.

11. 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 recognize 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.

Illustration 6.

D has acquired 100% of the equity of F on March 31, 20X7. 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.

Answer:

	₹ lakhs
Immediate cash payment	10.00
Fair value of contingent consideration (1.21/1.1 +1.21/1.12)	2.10
Total purchase consideration	12.10

Illustration 7.

C Ltd acquires 60% share in D Ltd. for cash payment of ₹300,000. 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 acquiree approach

when on the acquisition date, the aggregate value of D's identifiable net assets is:

(a) ₹ **4,40,000;**

(b) ₹ **5,30,000.**

Answer:

	(ia) ₹	(ib) ₹	(iia) ₹	(iib) ₹
Consideration (1)	3,00,000	3,00,000	3,00,000	3,00,000
NCI (2) 300000*40/60 = 200000	2,00,000	2,00,000	176,000x	2,12,000y
Net assets (3)	4,40,000	5,30,000	4,40,000	5,30,000
Goodwill (1+2-3)	60,000		36,000	
Gain on Bargain Purchase (3-1-2)		30,000		18000

x 40% × 440000 = 176,000

y 40% × 530000 = 212,000

[Under Ind AS 103, Goodwill is not amortised but tested for annual impairment in accordance with Ind AS 36.]

12. Additional explanations and guidance for accounting of business combination by the acquirer under Acquisition method are provided in the following section.

13. 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)

Illustration 8.

Z Company acquired C Company on April 1, 201X. For a lawsuit contingency C has a present obligation as on April 1, 201X 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 Company under Ind AS for this contingent liability of C Company?

Answer:

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.

14. A business combination achieved in stages:

    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 B. 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 its 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 in 2015 for ₹35,000. In 2016, fair value of shares of entity B is ₹42,000, thus ₹7,000 reported under OCI

In 2016, A further acquired 40% stake in B. Consideration paid ₹60,000. Entity A identifies the net assets of B as ₹120,000, value 35% shares at ₹45,000. NCI is valued at proportionate net assets.

Show workings and Journal entries.

Answer:

A will make transfer to P&L:

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		₹10,000

A will measure goodwill as follows:

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
	₹1,35,000
Less : Fair value of net assets of acquiree	₹1,20,000
Goodwill	**₹15,000**

Particulars		Dr. (₹)	Cr. (₹)
Investment A/c	Dr.	3,000	
OCI A/c	Dr.	7,000	
To, P&L 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 we already have control of the acquiree (e.g. already own 70% of the equity and purchase the remaining 30%) then this is NOT a step acquisition.

15. **Disclosure (mentioned in clause c of para 3)**

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.

16. Difference between Ind AS 103 and AS 14.

Scope: Ind AS 103 has a wider scope than AS 14 [See para 6].

Method of accounting: Ind AS 103 prescribe only acquisition method for every business combination whereas AS 14 states two method 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 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 NCI, AS 14 do 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. AS14 do not prescribe any different accounting for such transactions.

Contingent Consideration: Ind AS 103 recognise contingent consideration, AS 14 do not.

Reverse acquisitions: Ind AS 103 deal with reverse acquisitions, AS 14 do not.

17. **Entries to close the books of Acquiree Company when it ceases to exist for business combination:**

1.	**For transfer of Assets:**		
	Realisation A/c…………………………..……..	Dr.	With the book value of assets
	To All Assets A/c		
2.	**For transfer of External liabilities:**		
	All External Liabilities A/c……………………..	Dr.	With book value of external liabilities
	To Realisation A/c		
3.	**For the due entry for consideration:**		
	Acquirer Company A/c …………	Dr.	With the aggregate amount of purchase consideration
	To Realisation A/c		
4.	**For transfer of internal liabilities:**		
	Equity Share Capital A/c ………………….....	Dr.	
	Other Equity A/c ...…………………………...	Dr.	
	To Equity Share Holder A/c		

5. For transfer of accumulated loss:

Equity Share Holder A/c……………………… Dr.
To Profit & Loss A/c

6. For receiving of purchase consideration:

Equity shares in transferee Company A/c……………… Dr.
Preference shares in transferee Company A/c………. Dr.
Debenture in transferee Company A/c…………………. Dr.
Cash or other Assets A/c…………………………………….. Dr.
To Acquirer Company A/c

7. For the amount payable to Preference share Holder:

Preference Share Capital A/c………………..…. Dr.
Realisation A/c……………………………….……. Dr. [Excess amount payable]
To Pref. Share Holder A/c
To Realisation A/c [Deficit amount]

8. For payment to pref. shareholders:

Pref. Share Holder A/c ………………….……... Dr.
To Bank A/c
To Shares in Acquirer Company A/c
To Debenture in Acquirer Company A/c

9. For realisation of assets not taken over:

Bank A/c ……………………………………….……….. Dr.
To Realisation A/c

10. For settlement of Liabilities not taken over

Realisation A/c……..……………………………….. Dr.
To Bank A/c

11. For transfer of realisation profit:

Realisation A/c .………………………………….. Dr.
To Equity Share Holder A/c

12. For settlement of account of share holders:

Equity share Holders A/c …………………….. Dr.
To Shares in Acquirer Company A/c
To Debenture in Acquirer Company A/c
To Cash A/c

Entries in the books of Acquirer Company for its individual financial statements (stand alone financial statements):

1. For acquisition of Assets and liabilities:

Debtors A/c………………………………………………… Dr.

Stock A/c………………………………………………..… Dr.

Bank A/c…………………………………………………... Dr.

Goodwill A/c (bal fig)..…………..………..…..……….… Dr.

To Gain on Bargain PurchaseA/c (bal. fig.)

To Creditors A/c

To Consideration A/c

2. For discharge of consideration:

Consideration A/C………………. Dr.

Discount on Issue of Securities A/C………………….. Dr

To Bank or other Asset A/C

To Equity Share Capital A/C

To Preference Share Capital A/C

To Debentures A/C

To Securities Premium A/C

Computation of Consideration

Consideration transferred should 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.

Illustration 10.

X Ltd. agreed to takeover Y Ltd. as on 1 October, 2018. No Balance Sheet of Y Ltd. was prepared on that date:

Summarised Balance Sheets of X Ltd. and Y Ltd. as at 31st March, 2018 were as follows:

Liabilities	X Ltd (₹)	Y Ltd (₹)	Assets	X Ltd (₹)	Y Ltd (₹)
Equity of ₹10 each fully paid	20,00,000	15,00,000	Fixed assets	15,50,000	12,60,000
Reserves and Surplus:			Current Assets:		
Reserve	3,90,000	3,40,000	Stock	5,35,500	3,81,500
Profit & Loss A/c	3,30,000	1,60,000	Debtors	3,49,500	2,31,000
Creditors	85,000	75,000	Bank	3,40,000	1,80,000
			Miscellaneous Expenditure:		
			Preliminary Expenses	30,000	22,500
Total	28,05,000	20,75,000	Total	28,05,000	20,75,000

Additional information available:

(i) For the six months period from 1st April 2018, X Ltd. and Y Ltd. made profits of ₹ 5,40,000 and ₹ 3,60,000 respectively, after writing off depreciation @ 10% per annum on their fixed assets.

(ii) Both the companies paid on 1 August 2018, equity dividends of 10%. Dividend tax at 15% was paid, by each of them on such payments.

(iii) Goodwill of Y Ltd. was valued at ₹1,68,900 on the date of takeover. Stock of Y Ltd., subject to an abnormal item of ₹8,500 to be fully written off, would be appreciated by 20% for purpose of takeover.

(iv) X Ltd. would issue to Y Ltd.'s shareholders fully paid equity shares of ₹10 each, on the basis of the comparative intrinsic values of the shares on the date of takeover.

You are required to:

(1) Calculate consideration to be transferred by X Ltd.

(2) Calculate Number of shares to be issued by X Ltd. to Y Ltd.

(3) Ascertain closing bank balance which will appear in the Balance Sheet of X Ltd. (After absorption of Y Ltd.).

Solution based on Ind AS 103:

The transaction is a business combination where the acquiree ceases to exist. We maintain the principles of measuring consideration transferred.

1. Computation of cash and bank balance of the Companies as on 1st October

Particulars	X Ltd. (₹)	Y Ltd.(₹)
Balance as on 1st April	3,40,000	1,80,000
Add: Net Profit during the 6 months	5,40,000	3,60,000
Add: Depreciation for 6 months (15,50,000 x 10% x 6/12) & (12,60,000 x 10% x6/12)	77,500	63,000
Total of above	9,57,500	6,03,000
Less: Dividend paid	2,00,000	1,50,000
Less: Dividend distribution Tax @15%	30,000	22,500
Balance as on 30th September	7,27,500	4,30,500

2. Computation of Net Assets of X Ltd and V Ltd. as on 1st October

Particulars	X Ltd. (₹)	Y Ltd. (₹)
Goodwill (at agreed value)	—	1,68,900
Fixed Assets (Book Value- Depreciation @10% for 6 months)	14,72,500	11,97,000
Debtors	3,49,500	2,31,000
Stock (including appreciation @ 20%)	5,35,500	4,47,600
Cash and Bank balances as computed above	7,27,500	4,30,500
Total Assets	30,85,000	24,75,000
Less: Creditors	85,000	75,000
Value of Net Assets on 1st October (considered as Fair Value)	30,00,000	24,00,000
No: of equity shares	2,00,000	1,50,000
Intrinsic value per share (considered as Fair Value)	₹15	₹16

So, consideration to be transferred by X Ltd. will be ₹24,00,000.

3. Calculation of Number of shares to be issued by X Ltd. to Y Ltd —

Number of shares to be issued by X Ltd. to Y Ltd. = ₹24,00,000/₹15 per shares = 1,60,000 shares.

Purchase Consideration & Drafting of Balance Sheet

Illustration 11.

The summarised Balance Sheets of A Ltd. and B Ltd. as on 31st March, 2017 are given below. B Ltd. was merged with A Ltd. with effect from 31st March, 2017.

Summarised Balance Sheets as on 31.03.2017

Liabilities	A Ltd. (₹)	B Ltd. (₹)	Assets	A Ltd. (₹)	B Ltd. (₹)
Share Capital:			Fixed assets	10,00,000	4,50,000
Equity Shares of ₹ 10 each	8,00,000	3,00,000	Investments (Non-trade)	1,50,000	50,000
General Reserve	3,00,000	2,00,000	Stock	1,60,000	50,000
Profit & Loss A/c	2,50,000	80,000	Debtors	80,000	90,000
12% Debentures	2,00,000	1,00,000	Advance Tax	60,000	30,000
Sundry Creditors	60,000	50,000	Cash and Bank Balance	2,30,000	1,10,000
Provision For Taxation	90,000	50,000	Preliminary Expenses	20,000	—
Total	17,00,000	7,80,000	Total	17,00,000	7,80,000

A Ltd. would issue 12% Debentures to discharge the claims of the debenture holders of B Ltd. at par. Non-trade investments of A Ltd. fetched @ 20% while those of B Ltd. fetched @ 12%. Profit (Pre-tax) by A Ltd. and B Ltd. during 2014-15, 2015-16 and 2016-17 were as follows:

Year	A Ltd. (₹)	B Ltd. (₹)
2014-15	6,00,000	2,00,000
2015-16	7,00,000	2,50,000
2016-17	5,00,000	1,50,000

Goodwill may be calculated on the basis of capitalisation method taking 20% as the pre-tax normal rate of return.

Purchase consideration is discharged by A Ltd. on the basis of intrinsic value per share.

Prepare Balance Sheet of A Ltd. after merger as per Schedule III Division II.

Solution:

1. Calculation of Closing Capital Employed

Particulars	A Ltd. (₹)	B Ltd. (₹)
Sundry Assets as per Balance Sheet	17,00,000	7,80,000
Less: Preliminary Exps.	20,000	---
Less: Non -Trade Investment	1,50,000	50,000
Less: Creditors	60,000	50,000
Less: 12% Debentures	2,00,000	1,00,000
Less: Provisions for Taxations	90,000	50,000
Net Capital Employed	11,80,000	5,30,000

2. Calculation of goodwill:

Particulars	A Ltd. (₹)	B Ltd. (₹)
Total of profits for the 3 years	18,00,000	6,00,000
Simple Average Profits	6,00,000	2,00,000
Less: Income from Non -Trade Investment	30,000	6,000

Average income from capital employed	5,70,000	1,94,000
Capitalized value of Average Profits = Average Income from capital	28,50,000	9,70,000
employed/20%		
Net Capital Employed (From Table 1)	11,80,000	5,30,000
Goodwill (considered as Fair Value)	16,70,000	4,40,000

3. Calculation of Intrinsic value

Particulars	**A Ltd. (₹)**	**B Ltd. (₹)**
Capital Employed	11,80,000	5,30,000
Add: Non Trade Investment	1,50,000	50,000
Add: Goodwill	16,70,000	4,40,000
Total	30,00,000	10,20,000
No. of shares	80,000	30,000
Intrinsic value Per Share (considered as fair value)	₹ 37.50	₹34

Assumed Net Assets (at Fair Value) = Capital Employed + Non-Trade Investment

4. **Calculation of Consideration**

Consideration = 30,000 shares at ₹ 34 per share = ₹10,20,000 Discharged By A Ltd.: By issue of its own 27,200 shares of 10 @ ₹ 37.50.

Note: As consideration is calculated based on value of goodwill, it is same as consideration — Net Assets.

Balance Sheet of A Ltd.

as at 1st April 2018

	Particulars	**Note No.**	**Amount (₹)**
I.	**Assets**		
	1. Non-Current Assets		
	PPE		14,50,000
	Goodwill		4,40,000
	Non-current investment		2,00,000
	2. Current Assets	3	8,10,000
	Total		29,00,000
II.	**Equity and Liabilities**		
	1. Equity		
	(a) Equity Share Capital	1	10,72,000
	(b) Other Equity	2	12,78,000
	2. Non-Current Liabilities : 12% Debentures		3,00,000
	3. Current Liabilities		
	(a) Creditors		1,10,000
	(b) Provision for Tax		1,40,000
	Total		29,00,000

[Relevant Notes]

1. Share Capital

Particulars	Amount (₹)
Authorized, issued, subscribed and paid up capital of 1,07,200 Equity Shares of ₹10 each (of the above 27,200 shares were issued to vendors for non cash consideration)	10,72,000
Total	**10,72,000**

2. Other Equity

Particulars	Amount (₹)
Securities Premium (@ ₹ 27.5 on 27,200 shares)	7,48,000
Profit & Loss A/c	3,00,000
General Reserve	2,50,000
Total	12,98,000
Less: Preliminary Expenses written off	(20,000)
Total	**10,78,000**

3. Other Current Assets (Acquiree's assets/liabilities considered at fair value)

Particulars	Amount (₹)
(a) Stock [1,60,000 + 50,000]	2,10,000
(b) Sundry Debtors [80,000 + 90,000]	1,70,000
(c) Advance Tax [60,000 + 30,000]	90,000
(d) Cash and Bank [2,30,000 +1,10,000]	3,40,000
Total	**8,10,000**

Illustration 12.

A Z Ltd. took over the business of X Ltd. and Y Ltd. The summarised Balance Sheets of Z Ltd., X Ltd. and Y Ltd. as on 31 March, 2017 are given below:

(₹in Lakhs)

Liabilities	Z Ltd. ₹	X Ltd. ₹	Y Ltd. ₹	Assets	Z Ltd. ₹	X Ltd. ₹	Y Ltd. ₹
Share Capital				Fixed Assets:			
Equity shares of ₹ 100 each		800	750	Land and Building	600	550	400
12% Preference shares of ₹ 100 each	1,000	300	200	Plant and Machinery	400	350	250
Reserves and Surplus:				Investments		150	50
Revaluation Reserve		200	150	Current Assets, Loans and Advances:			
General Reserve	600	170	150	Stock	500	350	250
Profit and Loss Account		50	30	Sundry Debtors	300	250	300
Secured Loans:				Bills Receivables		50	50
10% Debentures (₹100 each)		60	30	Cash and Bank	200	300	200
Current Liabilities and Provisions:							
Sundry Creditors	400	270	120				
Bills payables		150	70				
Total	2,000	2,000	1,500	Total	2,000	2,000	1,500

Additional Information:

(1) 10% Debenture holders of X Ltd., and Y Ltd., are discharged by Z Ltd., issuing such number of its 15% Debentures of ₹100 each, so as to maintain the same amount of interest.

(2) Preference shareholders of the two companies are issued equivalent number 15% preference shares of Z Ltd., at a price of ₹150 per share (face value of ₹100).

(3) Z Ltd. will issue 5 equity shares for each equity share of X Ltd. and 4 equity shares for each equity share of Y Ltd. The shares are to be issued ₹30 each, having a face value of ₹10 per share.

Prepare the Balance Sheet of Z Ltd. as on 1 April, 2018 in the Schedule III Division II format.

Solution:

1. Computation of Consideration (₹ in lakhs)

Particulars	**X Ltd. (₹)**	**Y Ltd. (₹)**
Preference Share Holders treated as Equity : 3,00,000 shares of ₹150 each	450	
: 2,00,000 shares of ₹ 150 each		300
Equity Share Holders : 5 x 8,00,000 shares of ₹ 30 each	1,200	
: 4 x 7,50,000 shares of ₹ 30 each		900
15% debentures for 10% old debentures	40	20
Total	1,690	1,220

2. Computation of Securities Premium

Particulars	**Equity Share Capital**	**Securities premium**	**Total**
Preference Share Capital = (3,00,000 + 2,00,000) = 5,00,000 shares	₹ 100 each = 500	At ₹ 50 each = 250	750
Equity Share Capital = (40,00,000 + 30,00,000) = 70,00,000 shares	₹ 100 each = 700	At ₹ 20 each = 1,400	2,100
Total	1,200	1,650	2,850

3. Computation of Goodwill / Gains on Bargain Purchase

Particulars	**X Ltd.**	**Y Ltd.**
Consideration	1,650	1,250
Less: Net assets taken over (considered at Fair Value)	1,540	1,290
Goodwill	110	
Gains on Bargain Purchase		90
Net Goodwill	(110-90)=20	

Balance Sheet of Z Ltd.
(As at 1st April 2018)

(₹ in lakhs)

	Particulars	Note No.	Amount
I.	**ASSETS**		
	(1) Non-current Assets		
	PPE	4	2,550
	Goodwill		20
	Non-current investment	5	200
	(2) Current Assets		2,750
	Other Current Assets	6	
	Total		**5,520**
II.	**EQUITY AND LIABILITIES**		
	(1) Equity		
	(a) Equity Share Capital	1	1,700
	(b) Instruments entirely Equity in nature		500
	(c) Other Equity (Securities Premium)		2,250
	(2) Non-current Liabilities: Long term Borrowings	2	60
	(3) Other Current Liabilities	3	1,010
	Total		**5,520**

[Relevant Notes]

1. Equity

Particulars	**Amount (₹ in Lakhs)**
Authorized, issued, subscribed and paid up capital:	
(a) Equity share capital: 1,70,00,000 equity shares of ₹10 each [100,00,000 + 70,00,000]	1,700
(b) Instruments entirely equity in nature: 5,00,000 preference shares of ₹100 each (treated as equity in nature)	500
(c) Other equity (600 + 1,650)	2,250
Total	4,450

2. Non Current Liabilities

Particulars	**Amount (₹ in Lakhs)**
15% Debentures of ₹100	60
Total	60

3. Other Current Liabilities

Particulars	**Amount (₹ in Lakhs)**
Sundry Creditors (270 + 120) + 400	790
Bills payable (150 + 70)	220
Total	1,010

4. PPE:

Particulars	Amount (₹ in Lakhs)
(a) Plant and Machinery [350 + 250] + 400	1,000
(b) Land and Building [550 + 4001] + 600	1,550
Total	2,550

5. Non Current Investments

Particulars	Amount (₹ in Lakhs)
Investment [150+50]	200
Total	200

6. Other Current Assets

Particulars	Amount (₹ in Lakhs)
(a) Stock [350 + 250] + 500	1,100
(b) Sundry Debtors [250 + 300] + 300	850
(c) Bills receivable [50 + 50]	100
(d) Cash and Bank [300 + 200] + 200	700
Total	2,750

Accounting in the event of Inter-Company Investment

Illustration 13.

The summarized Balance Sheet of A Ltd. and B Ltd. as at 31st March, 2017 were as under:

	A Ltd. (₹)	B Ltd. (₹)
Fully paid up equity shares of ₹ 10 each	20,00,000	12,00,000
Share Premium Account	4,00,000	—
General Reserve	5,20,000	5,00,000
Profit and Loss Account	3,60,000	3,20,000
10% Debentures	10,00,000	—
Secured Loan	6,00,000	6,00,000
Sundry Creditors	—	3,40,000
	48,80,000	29,60,000
Land and Buildings	18,00,000	9,00,000
Plant and Machinery	10,00,000	7,60,000
Investments (10,000 shares in B Ltd.)	1,60,000	—
Stock	10,40,000	7,00,000
Debtors	8,20,000	5,20,000
Bank	60,000	80,000
	48,80,000	29,60,000

Z Ltd., an existing company took over both A Ltd. and B Ltd.

(a) The shares of A and B are to be valued as under:

A Ltd. — ₹ 18 per share

B Ltd. — ₹ 20 per share

(b) A contingent liability of A Ltd. of ₹ 1,20,000 is to be treated as real liability.

(c) The shareholders of A Ltd. and B Ltd. are to be paid by issuing sufficient number of shares of Z Ltd. at par.

(d) The shares of Z Ltd. are issued at ₹10 each.

Required:

(i) Show the computation of the number of shares Z Ltd. will issue to the shareholders of A Ltd. and B Ltd.

(ii) Pass the journal entries in the books of Z Ltd.

Solution:

(i) Calculation of number of shares to be issued

	A Ltd. (₹)	B Ltd. (₹)
Existing Shares	2,00,000	1,20,000
Less: Held by A Ltd.	-	10.000
	2,00,000	1,10,000
Agreed Value per Share (Considered as Fair Value)	18	20
Total Fair Value of equity shares issued	36,00,000	22,00,000
No of shares to be issued of ₹10 each	3,60,000	2,20,000
Total no. of shares to be Issued of ₹10		**5,80,000**

(ii)

Books of Z Ltd.

Journal

	Dr. (₹ '000)	**Cr. (₹ '000)**
Land & Building A/c	2700	
Plant & Machinery A/c	1760	
Stock A/c	1740	
Debtors A/c	1340	
Bank A/c	140	
Goodwill	780	
To, Loan A/c		1200
To, Creditors A/c		340
To, Other Current Liability (Contingent Liability recognized as other current liability)		120
To, Consideration*		6800
(Assets and liabilities acquired and consideration payable all at fair value, balance accounted as Goodwill)		

* Consideration = (Equity) 5,800 + (Debenture) 1,000 = 6,800

Consideration A/c	6800	
To, 10% Debenture [of Z Ltd]		1000
To, Equity Share Capital A/c		5800
(Consideration transferred to the owners of the Acquiree company by issue of 10% Debentures and Equity shares of ₹ 10 at par)		

Note: Inter company investment is not acquired by the Acquirer.

Working Note:

Goodwill	As on 1st April 2018 (₹)
Assets agquired at Fair Value	76,80,000
Liabilities acquired at Fair Value	16,60,000
Net Assets acquired (i)	60,20,000
Consideration Transferred (ii)	68,00,000
Goodwill (ii – i)	7,80,000

Illustration 14:

The following are the Balance Sheets of Good Ltd. and Bad Ltd. as on 31.03.2018:

	Good Ltd. (₹in crores)		Bad Ltd. (₹ in crores)	
Equity and Liabilities:				
Equity Share Capital:				
Authorised		25		5
Issued and Subscribed Equity Shares of ₹ 10 each fully paid		12		5
Other Equity		88		10
Equity		100		15
Unsecured loan from Good Ltd.		---		10
		100		25
PPE at cost		80		40
Less: Depreciation		60		34
Written down value		20		6
Investments at Cost:				
30 lakhs equity shares of ₹10.each of Bad Ltd.		3		---
Long term loan to Bad Ltd.		10		
Current Asset:	200		134	---
(Less Current Liabilities)	(-)133	67	(-)115	19
		100		25

On that day Good Ltd. absorbed Bad Ltd. The Members of Bad Ltd. are to get one equity share of Good Ltd. issued at a premium of ₹ 2 per share for every five equity share held by them in Bad Ltd. The necessary approvals are obtained;

You are asked to pass Journal entries in the books of the two companies to give effect to the above.

Solution:

We need to assume that the swap ratio is based on Fair Value of shares. Again, it is assumed that Assets and liabilities acquired are all at Fair Value.

Books of Bad Ltd.

Journal

Particulars		Dr. (₹ in Crore)	Cr. (₹ in Crore)
Realization A/c	Dr.	174.00	
To PPE A/c			40.00
To Current Assets A/c			134.00
(Being the Assets taken over by Good Ltd. transferred to Realization A/c)			
Provision for Depreciations A/c	Dr.	34.00	
Current Liabilities A/c	Dr.	115.00	
Unsecured Loan from Good Ltd. A/c	Dr.	10.00	159.00
To Realization A/c			
(Being the transferred of liabilities and provision to Realization A/c)			
Good Ltd. A/c	Dr.	1.20	
To Realization A/c			1.20
(Being P.C Credited o Realization A/c)			
Equity Shareholders A/c	Dr.	13.80	
To Realization A/c			13.80
(Being loss on Realization transferred to Equity shareholders A/c)			
Equity Share Capital A/c	Dr.	5.00	
Other Equity A/c	Dr.	10.00	15.00
To Equity Shareholders A/c			
(Being the amount of share capital and reserve transferred to equity shareholders A/c)			
Equity Shareholders (Good Ltd.) A/c	Dr.	0.72	
To Good Ltd. A/c			0.72
(Being 3/5th of the considerations due from Good Ltd. adjusted against the amount due to Good Ltd.)			
Equity Shares of Good Ltd. A/c	Dr.	0.48	
To Good Ltd. A/c			0.48
(Being the receipts of 4 lacs Equity Shares of ₹10 each at ₹12 per Share for allotment of outside shareholders)			
Equity Shareholders A/c	Dr.	0.48	
To Equity Share of Good Ltd. A/c			0.48
(Being the distributions of equity shares received from Good Ltd. to Shareholders)			

Books of Good Ltd.

Journal

Particulars		**Dr. (₹ in Crore)**	**Cr. (₹ in Crore)**
Profit and Loss A/c	Dr.	2.28	
To Investment A/c (Bk Value - Fair Value = 3 - 0.72)			2.28
(Investment measured at Fair Value and difference with book value transferred to P & L)			
PPE A/c	Dr.	6.00	
Current Assets A/c	Dr.	134.00	
To Current Liabilities A/c			115.00
To Unsecured Loan (from Good Ltd.) A/c			10.00
To Consideration A/c [See Note]			0.48
To Investment in Bad Ltd. (at Fair Value)			0.72
To Gain on Bargain Purchase A/c			13.80
(Being. the assets and liabilities taken over and the difference transferred to Gain on Bargain Purchase)			
Consideration A/c	Dr.	0.48	
To Equity Share Capital A/c			0.40
To Security Premium A/c			0.08
(Being the allotment to outside Shareholders at a premium of ₹ 2 per Share)			
Unsecured Loan (From Good Ltd.) A/c	Dr.	10.00	
To Loan to Bad Ltd. A/c			10.00
(Being the cancellations of unsecured loan)			

Working Notes

(₹ in Crores)

Purchase Considerations	1.20
(50 lacs/5) x ₹12 = 1.20	
Equity Shares of ₹12 each belonging to Good Ltd. 3/5 x 1.20	0.72
Payable to other equity shareholders	0.48
Number of equity shares of ₹ 10 each to be issued 48 lacs /12	4 lacs

Inter company holding

Illustration 15.

Following are the extract Balance sheets of two companies, B Ltd. and D Ltd. as at March 31, 2018.

Liabilities	B Ltd. (₹)	D Ltd. (₹)	Assets	B Ltd. (₹)	D Ltd. (₹)
Equity Share Capital:			Sundry Assets	7,50,000	3,50,000
(Shares of ₹ 10 each)	5,00,000	3,00,000	10,000 Shares in		
Reserve	1,00,000	55,000	B Ltd.	—	1,00,000
Creditors	1,50,000	95,000			
Total	**7,50,000**	**4,50,000**	**Total**	**7,50,000**	**4,50,000**

B Ltd. was to absorb D Ltd. on the basis of intrinsic value of the shares, the purchase consideration was to be discharged in the form of fully paid shares. A sum of ₹ 20,000 is owed by B Ltd. to D Ltd. Also included in the stocks of B Ltd. ₹ 30,000 goods supplied by D Ltd. cost plus 20%. Give Journal entires in the books of both the Companies and prepared a Balance Sheet after absorption.

Solution:

It is business combination. It is assumed that intrinsic value of shares is same as the fair value. The book value of assets and liabilities of D Ltd. are same as their fair value.

Part I: In the Books of D Ltd.

	Particulars		*Debit* ₹	*Credit* ₹
1.	Realisation A/c	Dr.	3,50,000	
	To Sundry Assets A/c			3,50,000
	[Being the assets taken over by B Ltd. transferred to Realisation A/c]			
2.	Creditors A/c	Dr.	95,000	
	To Realisation A/c			95,000
	[Being Creditors taken over by B Ltd. transferred Realisation A/c]			
3.	B Ltd. A/c	Dr.	2,55,000	
	To Realisation A/c			2,55,000
	[Being purchase consideration (WN # 2) receivable]			
4.	Shares in B Ltd. A/c	Dr.	2,55,000	
	To B Ltd. A/c			2,55,000
	[Being discharge of purchase consideration]			
5.	Equity Share Capital A/c	Dr.	3,00,000	
	Reserves A/c	Dr.	55,000	
	To Shareholders A/c			3,55,000
	[Being Share capital and Reserves transferred to Shareholders A/c]			
6.	Shareholders A/c	Dr.	3,55,000	
	To Shares in B Ltd.			3,55,000
	[Being the settlement to shareholders for the amount due]			

WN # 1 : ***Fair value of share***

	Particulars	*B Ltd (₹)*	*D Ltd. (₹)*
(a)	Sundry Assets	7,50,000	3,50,000
(b)	Investments in B Ltd. 10,000 shares @ ₹ 12 each	—	1,20,000
(c)	Creditors	(1,50,000)	(95,000)
(d)	Net Assets	6,00,000	3,75,000
(e)	No. of shares outstanding	50,000	30,000
(f)	Intrinsic and Fair Value of shares [d ÷ e]	12	12.5

WN # 2: ***Consideration at fair value***

	Particulars	*Amount (₹)*
(a)	No. of shares of D Ltd.	30,000
(b)	Value of shares @ ₹ 12.50	₹ 3,75,000
(c)	No. of shares issuable based on intrinsic value of ₹ 12 (3,75,000 ÷ 12)	31,250
(d)	No. of shares held by D Ltd.	(10,000)
(e)	Net shares to be issued	21,250
(f)	Total consideration at par (21,250 x ₹ 12)	₹ 2,55,000

Part - II : ***In the books of B Ltd.***

Particulars		**Debit (₹)**	**Credit (₹)**
Assets A/c (3,50,000 less unrealised profit*)	Dr.	3,45,000	
Goodwill	Dr.	5000	
To Creditors A/c			95,000
To Consideration A/c			2,55,000
Discharge of consideration			
Consideration A/c	Dr.	2,55,000	
To Equity Share Capital A/c			2,12,500
To Securities Premium A/c			42,500
Others			
Cancellation of Inter company owings			
Creditors A/c	Dr.	20,000	
To Sundry Assets (acquired) A/c			20,000

* Unrealised profit = $30,000 \times \frac{20}{120} = 5,000$

Name of the Company: B Ltd.				
Balance Sheet as at 31.03.2018				
Ref No.		**Particulars**	**Note No.**	**₹**
	I.	**Sundry Assets**	4	10,75,000
		Goodwill	3	5,000
		Total		10,80,000
	II.	**Equity and Liabilities**		
	1	**Equity**		
		(a) Equity Share capital	1	7,12,500
		(b) Other Equity	2	1,42,500
	2	**Non-current liabilities**		Nil
	3	**Current Liabilities**		
		(a) Trade payables		2,25,000
		Total		10,80,000

Note: Relevant items of Assets/ Liabilities are reflected in Balance Sheet and Schedule III. Hence sub-item not having any value for the given illustration is not shown/ represented in Balance Sheet.

(₹)

Note 1. Equity Share Capital	**After**
A. Authorised Capital	
B. Issued,and paid up Capital Eqity Share Capital(Share of ₹10 each)[out of which 21,250 shares were issued for consideration other than cash)	7,12,500
Total	7,12,500

Note 2. Other Equity	**After**
Reserve	100,000
Securities Premium	42,500
Total	1,42,500

Note 3. Goodwill	**After**
Net Assets acquired at fair value (345000-95000)	2,50,000
Consideration Transferred	2,55,000
Goodwill	5,000

Note 4. Sundry Assets	**After**
Sundry Assets (7,50,000+3,50,000-20,000-5,000)	10,75,000
Total	10,75,000

Note:Sundry assets are reduced by Inter-company debt and by unrealized profit on Inter company stock: ₹ 5000 (30000/6)

Cross Holding of Shares

Illustration 16.

The following are the Balance Sheets of BEE Ltd. And DEE Ltd. as on 31.03.2018

	BEE Ltd. (₹)	DEE Ltd. (₹)
Equity and Liabilities:		
Equity		
Equity Share Capital:		
Equity shares of 100 each fully paid	90,00,000	30,00,000
Other Equity:		
General Reserve	8,00,000	6,00,000
Profit and Loss A/c	14,68,000	60,000
Non-Current Liabilities:		
14% Debentures	—	18,00,000
Current Liabilities:		
Trade payables	12,00,000	5,40,000
Total	1,24,68,000	60,00,000
Assets:		
Non-Current Assets:		
Tangible Assets	60,00,000	3,00,000
Non-Current Investments (at cost):		
6,000 shares in DEE Ltd.	9,00,000	—
18,000 shares in BEE Ltd.	—	30,00,000
Current Assets:		
Inventories	28,80,000	12,60,000
Trade Receivables	17,40,000	9,00,000
Cash and Cash equivalents	9,48,000	5,40,000
Total	1,24,68,000	60,00,000

Inventories of BEE Ltd. include goods worth ₹6,00,000 purchased from DEE Ltd. which made a profit of 20% on selling price. As on 31.03.2016, BEE Ltd. absorbs DEE Ltd. on the basis of the intrinsic value of the shares of both companies as on 31.03.2016. Before absorption, BEE Ltd. has declared a dividend of 12%. Dividend tax is 10%. The fair value per BEE Ltd. share is Rs. 120.

You are required to calculate:

(i) No. of shares to be issued to DEE Ltd.

(ii) Purchase consideration payable by BEE Ltd.

(iii) Gain on Bargain Purchase/Goodwill which will appear in the Balance Sheet of BEE Ltd.

Solution:

Computation of Net Assets excluding Inter-Company Investments

Particulars	**BEE Ltd. (₹)**	**DEE Ltd. (₹)**
Tangible Assets	1,15,68,000	30,00,000
Dividend Receivable [18,000 shares x 100 x 12%]	---	2,16,000
Total Assets [A]	**1,15,68,000**	**32,16,000**
Current Liabilities	12,00,000	5,40,000
Unpaid Dividend	10,80,000	---
Dividend Tax	1,08,000	---
14% Debentures	---	18,00,000
Total Liabilities [B]	**23,88,000**	**23,40,000**
Net Assets [A-B]	**91,80,000**	**8,76,000**

2. Intrinsic value of Equity Shares

Let 'a' as the intrinsic value (Net Assets including Inter Company Investments) of Equity Shares of BEE Ltd. and 'b' as the intrinsic value of Equity Shares of DEE Ltd.

a = 91,80,000 +1/5b….. (1) b = 8,76,000 + 1/5a….. (2) or, b = 8,76,000 + 1/5(91,80,000 + 1/5b)

or, b = ₹8,76,000 + 18,36,000 + b/25

or, b-(b/25) = 27,12,000

$\frac{24}{25}$ b = 27,12,000

or, b = 27,12,000 x 25/24 = ₹ 28,25,000

Putting the value of b in equation (1), we get, a = 91,80,000 + 1/5 x 28,25,000 = 97,45,000 Intrinsic value of shares of BEE Ltd. = 97,45,000/90,000 = ₹108.28

Intrinsic value of shares of DEE Ltd. = 28,25,000/30,000 = 94.167 approximately

3. Calculation of purchase consideration payable by BEE Ltd.

Value of Shares held by Outsiders in DEE Ltd.	= 24,000 x 94.167 = 22,60,000 (approx)
Shares to be issued by BEE Ltd. based on Intrinsic Value	= 22,60000 /108.28 = 20,872 Shares
Less: Shares held by DEE Ltd.	= 18,000 shares
Number of Shares to be issued	= 2,872 shares
Purchase consideration(2872 Shares x 120)	= 3,44,640

4. Calculation of Gain on Bargain Purchase / Goodwill

Particulars	₹
Assets taken over:	32,16,000
Less: Liabilities	23,40,000
Net Assets taken over (considered as Fair Value)	8,76,000
Less: Purchase Consideration	3,44,640
Gain on Bargain Purchase	5,31,360

2.5 SCHEME OF RECONSTRUCTION

Internal Reconstruction

The need for reconstruction arises when a company has accumulated losses or when a company finds itself over capitalized which means either that the value placed on assets is too much as compared to their earning capacity or that the profits as a whole are insufficient to pay a proper dividend. Apart from clarity, wide acceptance and justice, there construction scheme must take in to account the following:-

The fundamental basis of any proposals is the earning power of the company. Even the interest to debenture holders cannot be paid unless the company's activities are profitable. A very careful estimate should, therefore, be made of the profits expected by the company in the future. Unless the profits are sufficient to meet all the expenses including adequate depreciation, interest to debenture holders and other creditors, preference dividend, and a reasonable return to the equity shareholder, it would be useless to process with any reconstruction scheme because, otherwise, the need for reconstruction will soon arise again.

Assuming that adequate profits can be expected, the reconstruction scheme should not adversely affect the rights of preference shareholders (not to speak of creditors and debenture holders)unless it is absolutely necessary. Suppose, the profits are such that after paying dividends to preference shareholders little remains for equity shareholders: the preference shareholder may be persuaded to accept a sacrifice either by reduction of capital or by reduction in the rate of dividend or both because the alternative to such acceptance of sacrifice may be the liquidation of the company (in which case, due to forced sale, the asset may not realize much and the preference shareholder may not be able to get back what they have invested). If the company is in very bad position, even the debenture holders may be prevailed upon to accept a reduction of their claims. But, so far as is possible, contractual and legal rights and priorities should be maintained.

The equity share holder will naturally have to bear the brunt of the losses and sacrifice. This is not as bad as it sounds because (a) the equity shareholders realize from the very beginning that if losses occur they have to bear them before anybody else can be called upon to do so, and (b) they must have already known that the value of their holding is small due to absence of dividend. The market price of share is related to dividend and not to the face or nominal value of the share. It really does not matter, therefore, whether the nominal value of an equity share is ₹1 or ₹100 or ₹1,000 as long as it is not 0. (This does matter in case of preference share holders and debenture holders whose earnings depend on the nominal value). In fact, are construction scheme may be beneficial to the equity share holders by enabling the payment of a dividend on such shares. On this ground, it would be unjust to ask the preference shareholders to accept a sacrifice when the equity share holders improve their position.

There is, however, one important right which the equity shareholders enjoy. This is control over the affairs of the company. The equity share holders will not easily give up this rite, and hence there construction scheme should keep this in mind. The equity share holder may not agree to the conversion of preference share or debenture into equity share even if the holders of preference shares or debenture are willing to accept lower security for their holdings. The equity share holders may agree to this only if there is a threat of the company being wound up (in which case they will lose almost all). It should also be noted that without the consent of the parties their liability cannot be increased. For instances, fully paid shares cannot be converted into partly paid shares without the consent of the shareholders.

The requirements of the working capital must not be overlooked. Cash may require to pay certain dissenting creditor or even to pay arrears of preference dividend. Generally, therefore, a company under reconstruction will have to raise funds to enable it to pay off such dissenters and to carry on its work smoothly. Which of the various parties are willing to subscribe more shares will have to be seen. The equity shareholders will like to consolidate their position by buying more shares. Sometimes, outsiders are willing to subscribe to the shares but they will generally prefer to do so if they are given a controlling share.

Steps:

(1) First of all the total amounts to be written off should be as certained. This would mean totaling 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 share holders. (Equity share holders 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 share holders, 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.

Internal vs. External Reconstruction: Having decided who is to bear how much sacrifice of loss and having settled the broad details of the scheme, and important question remains to be decided. Will the reconstruction be internal or external? Internal reconstruction means that the scheme will be carried out by liquidating the existing company and incorporating immediately another company (with the name only slightly changed such as AB Ltd., to take over the business of the outgoing company. There are advantages in both, but generally internal reconstruction is preferred. The advantages in its favour are:-

(a) Creditors, specially bank over draft and debenture holders, may continue where as they may not if the company is formally liquidated which will involve payment of claims to out siders, If they do not continue, the company may suffer from want of financial assistance. This is, however, only academic since no reconstruction scheme, even internal, will be really formulated without the consent of the bank, debenture holders. etc.

(b) The company will be able to set off its past losses against future profits for income-tax purposes.

This will materially reduce the income-tax liability depending on the losses suffered during the preceding eight years. Losses can be carried forward for eight years provided the business is carried on. The business will technically end when the company is liquidated. Hence, in case of external reconstruction, losses cannot be carried forward for income tax purposes.

The arguments in favour of external reconstruction are as under:-

(a) External reconstruction may be the only way to bring about speedy reconstruction because sometimes a few people hold up the scheme by delaying tactics by means of legal objections.

(b) It may help in raising more finance by issuing to the existing shareholders partly paid shares in the new company. It should be remembered that in internal reconstruction fully paid up shares unless every share holder gives his assent in writing. This may prove cumbersome. However, if share holders are willing to accept partly paid shares in the new company, there is not much reason why they should refuse to buy new shares under a scheme of internal reconstruction.

External Reconstruction

- Reconstruction means reorganization of a company's financial structure. In reconstruction of a company, usually the assets and liabilities of the company are revalued, the losses suffered by the company are written

off by a deduction of the paid-up value of shares and /or varying of the rights attached to different classes of shares and compounding with the creditors. It may be done without liquidating the company and forming a new company in which case the process is called internal reconstruction. However, there may be external reconstruction in which case the undertaking being carried on by the company is transferred to a newly started company consisting substantially of the same shareholders with a view to the business of the transferor company being continued by the transferee company. An attempt is made that the newly started company has a sound financial structure and a good set off assets and liabilities recorded in the books of the transferee company at their fair values.

- From the point of view of an accountant, external reconstruction is similar to business combination under common control; the books of the transferee company are closed and in the books of the transferee company, the purchase of the business is recorded.
- But otherwise external reconstruction and amalgamation differs as follows:
  - (i) In external reconstruction, only one company is involved where as in amalgamation, there are at least two existing companies which amalgamate.
  - (ii) In external reconstruction, a new company is certainly formed where as in amalgamation a new company may be formed or in the alternative one of the existing companies may take over the other amalgamating company or companies and no new company may be formed.
  - (iii) The objective of the external reconstruction is to reorganize the financial structure of the company, on the other hand, the objective of the amalgamation is to cut competition and reap the economies of larger scale.

Illustration 17.

The following is the Balance Sheet as at 31st March, 2017 of Hospital 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
4,000 Cumulative		Stock in Trade	2,75,000
Preference Shares of ₹ 100 each fully paid up	4,00,000	Trade Debtors	1,50,000
Securities Premium	20,000	Bank Balances	65,000
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 total 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 entree for giving effect to the above arrangement and also draw the Balance Sheet of the company as at 30th September, 2017.

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			1,38,000
(Being the issue of 12% Unsecured Debentures and 2,760 Equity Shares of ₹ each issued as ₹ 50 paid up)	100		
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		20,000	
Capital Reduction A/c (Balancing figure)		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			7,500
(Being the change in value of assets)			
Capital Reduction A/c		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 30.09.17

		Particulars	Note No.	₹ (in Lakh)
I.		**Assets**		
	1.	**Non Current Assets**		
		PPE	3	7,87,500
		Other Non Current Assets		60,000
	2.	**Current Assets**	4	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 2017
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 2017
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 2017
PPE	9,00,000	
Less: Depreciation	1,12,500	7,87,500

Note - 4 Current Assets		As on 30th September 2017
Stock in trade	(2,75,000-75,000 + 70,000)	2,70,000
Trade Receivables	2,30,000	
Less: Provision for doubtful debt	7,500	2,22,500
Cash and Bank Balance		1,15,000
Total		**6,07,500**

Working Notes :-

1.	No. of equity shares issued to cumulative preferences	2,760
	Shareholders	
	No. of shares held by Equity Shareholders	8,500
		11,260
2.	Calculation of Cash Balance:	
	Opening cash balance as on 31.03.2017	65,000
	Add: Changes in cash balance (as given in question)	50,000
		1,15,000
3.	Calculation of Creditors:	
	Profit and Loss upto 30.09.2017	1,00,000
	Add: Depreciation (Non - cash item) average	1,12,500
	Cash from operations (A)	**2,12,500**
	Change in Current Assets	
	Debtors	+80,000
	Stock	+70,000
	Cash	+50,000
	Cash out flow (B)	**2,00,000**
	Decrease in Creditors:	
	Excess of (A) over (B)	-12500
	Add: Opening balance of Creditor	3,80,000
	Closing creditor (30.09.17)	**3,67,500**

Illustration 18:

The following are the Balance Sheet of Rito Ltd. and Arima Ltd. as on March 31, 2017.

(Amounts in ₹ lakh)

Liabilities	RITO LTD.	ARIMA LTD.	Liabilities	RITO LTD.	ARIMA LTD.
Share Capital:			Fixed Assets-net of deprecation	810	255
Equity Shares of ₹ 100 each fully paid up	600	300	Investments (including investment in Arima Ltd.)	210	-
			Debtors	120	45
Reserves & Surplus	240	-	Cash at Bank	75	-
10% Debentures	150	-	Accumulated loss	-	240
Loans from Banks	75	135	Profit & Loss A/c		
Bank Overdrafts	-	15			
Sundry Creditors	90	90			
Unpaid Dividends	60	-			
	1,215	**540**		**1,215**	**540**

It was decided that Arima Ltd. will acquire the business of Rito Ltd. for enjoying the benefits of carry forward of business loss. The following scheme has been approved for the merger:

(i) Arima Ltd. will reduce its shares to ₹10 per share and then consolidate ₹ 10 such shares into one share of ₹100 each (New Shares).

(ii) Banks agreed to waive the loan of ₹18 lakh of Arima Ltd.

(iii) Shareholders of Rito Ltd. will be given one (new) shares of Arima Ltd. in exchange of every share held in Rito Ltd.

(iv) Sundry Creditors of Arima Ltd. includes ₹ 30 lakh payable to Rito Ltd.

(v) After merger the proposed dividend of Rito Ltd. will be paid to Shareholders of Rito Ltd.

(vi) Rito Ltd. will cancel 20% holding of Arima Ltd. investment which was held at a cost of ₹75 lakh.

(vii) Authorised Capital of Arima Ltd. will be raised accordingly to carry out the scheme.

Required:

Pass necessary entries in the books of Arima Ltd. and prepare Balance Sheet (after merger) as on March 31, 2017.

Solution:

Arima Ltd.

Calculation Purchase Consideration

Particulars		₹
No. of Equity Shares of Rito Ltd:		6,00,000
One Share (new) of Arima for every one share of Rito		6,00,000
Less: Already held by Rito Ltd.		
20% of 3,00,000 = 60,000		
Shares converted into New Shares = 1/10 × 60000		6,000
Number of Shares to be issued by Arima Ltd. to Rito Ltd.		5,94,000
Total purchase Consideration (considered as fair value = ₹100 per share) = ₹ 594000 × 100	₹ 594 Lakh	

Books of Arima Ltd.

Journal

(₹ in Lakhs)

Particulars		**Dr. Amount**	**Cr. Amount**
Equity Share Capital A/c (₹ 100)	Dr.	300	
To Equity Share Capital A/c (₹ 10)			30
To Reconstruction A/c			270
(Being reduction in share capital)			
Equity Share Capital A/c (₹10 each)	Dr.	30	
To Equity Share Capital A/c (₹ 100)			30
(Being consolidation of share)			

Particulars		Dr.	Cr.
Loan from Banks	Dr.	18	
To Reconstruction A/c			18
(Being waiver of loan by Bank)			
Reconstruction A/c. (₹ 100)	Dr.	288	
To Profit and Loss A/c			240
To Capital Reserve A/c			48
(Being adjustment for accumulated loan)			
PPE A/c	Dr.	810	
Other Investments A/c	Dr.	135	
Trade Receivables A/c	Dr.	120	
Cash at Bank A/c	Dr.	75	
To Trade Payables A/c			90
To 10% Debentures A/c			150
To Loan from Banks A/c			75
To Unpaid Dividend A/c			60
To Consideration A/c			594
To Gain on Bargain PurchaseA/c			171
(Being entry on acquiring of Assets / Liabilities of Rito Ltd.)			
Unpaid Dividend A/c		60	
To Bank A/c			60
(Being payment of unpaid dividend to shareholders of Rito Ltd.)			
Consideration A/c		594	
To Equity Share Capital A/c (of Arima Ltd.)			594
(Discharge of purchase Consideration in the Form of equity Shares of Arima Ltd.)			
Sundry Creditors A/c.		30	
To Sundry Debtors A/c			30
(Cancellation of Inter Company ownings.)			

	Particulars	Note No.	As on 31st March 2017
I.	**Assets**		
	1. Non-Current Assets		
	Fixed Assets		1,065
	Non-current Investment [210-75]		135
	2. Current Assets		
	Sundry Debtors		135
	Cash at Bank [75-60]		15
	Total		**1,350**

II.		Equity and Liabilities		
	1.	Equity		
		(a) Equity Share Capital	1	624
		(b) Other Equity	2	219
	2.	Non Current Liabilities		
		10% Debenture		150
		Loan from banks [75+135-18]		192
	3.	Current Liabilities		
		Bank overdraft		15
		Sundry creditors		150
		Total		**1,350**

Note - 1 Equity Share Capital	**As on 31st March 2017**
Authorized, issued subscribed and paid up capital 6,24,000 equity shares of ₹100 each (594+30)	624

Note - 2 Other Equity	**As on 31st March 2017**
Capital Reserve	48
Gain on Bargain Purchase	171
Total	219

2.6 BUSINESS COMBINATION UNDER COMMON CONTROL

Business combination under common control (mentioned in para 3)

Appendix C deals with accounting for combination of entities or businesses under common control. Common control business combination means a business combination involving entities or businesses in which 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.

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 interests 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 recognise any new assets or liabilities.

(iii) The financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the earliest period presented in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

The consideration for the business combination may consist of securities, cash or other assets. Securities shall be recorded at nominal value. In determining the value of the consideration, assets other than cash shall be considered at their fair values.

The balance of the retained earnings appearing in the financial statements of the transferor is aggregated with the corresponding balance appearing in the financial statements of the transferee. Alternatively, it is transferred to General Reserve, if any.

The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor. Thus, for example, the General Reserve of the transferor entity becomes the General Reserve of the transferee, the Capital Reserve of the transferor becomes the Capital Reserve of the transferee and the Revaluation Reserve of the transferor becomes the Revaluation Reserve of the transferee. As a result of preserving the identity, reserves which are available for distribution as dividend before the business combination would also be available for distribution as dividend after the business combination. The excess, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor is recognised as goodwill in the financial statements of the transferee entity; in case of any deficiency, the same shall be treated as Capital Reserve.

Illustration 19: (Amalgamation)

DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31-03-X7 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-X7: ₹ Lakhs

	DA	TA
PPE	7500	8000
Financial Assets	800	500
Current Assets	4700	6500
Equity Share Capital	6000	8000
Other Equity	3000	3000
Borrowings	2000	3000
Current Liabilities	2000	1000

Pass journal entries in the books of DA, TA and DATA Ltd.

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 followed.

Journal in the books of DA Ltd.

Particulars		Dr.	Cr.
Current Liabilities	Dr.	2,000	
Borrowings	Dr.	2,000	
Realisation A/C	Dr.	9,000	
To PPE			7,500
To Current Assets			4,700
To Financial Assets			800
(Transferred to Realisation A/c)			
Shares in DATA Ltd #	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	Dr.	3,000	
To Equity Shareholders A/c			9,000
Equity Shareholders A/c	Dr.	6,300	
Shares in DATA Ltd.			6,300

#

	DA	TA
Net Assets	9,000	11,000
Proportion	9/20	11/20
Consideration = Equity share Capital of A & B = 14,000		
Payable to Transferee	$14,000 \times \frac{9}{20}$ = 6,300	$14,000 \times \frac{11}{20}$ = 7,700

Journal in the books of TA Ltd.

Particulars		Amount	Amount
Current Liabilities	Dr.	1,000	
Borrowings	Dr.	3,000	
Realisation A/c	Dr.	11,000	
To PPE			8,000
To Current Assets			6,500
To Financial Assets			500
(transferred to Realisation a/c)			
Shares in DATA Ltd #	Dr.	7,700	
To Realisation A/c			7,700
(Consideration)			
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	Dr.	3,000	
To Equity Shareholders A/c			11,000
Equity Shareholders A/c	Dr.	7,700	
Shares in DATA Ltd.			7,700

Journal in the books of Transferee company DATA Ltd.

Particulars		Amount	Amount
PPE	Dr.	15,500	
Current Assets A/c	Dr.	11,200	
Financial Assets A/c	Dr.	1,300	
To Consideration			14,000
To Borrowings			5,000
To Current Liabilities			3,000
To Other Equity*			6,000
Consideration A/c	Dr.	14,000	
To Equity Share Capital			14,000

*Carried in the same a/c name of the transferor companies. The identity of the reserves shall be preserved and shall appear in the financial statements of the transferee in the same form in which they appeared in the financial statements of the transferor.

2.7 DEMERGER – CONCEPT

The term "demerger" has been defined in the Income-tax Act, 1961. The definition of the term under the IT Act refers back to the provisions of sections 230 to 232 of the Companies Act, 2013, though an exception has been made in case of foreign companies. We know by now that the said sections 230 to 232 deal with a scheme of compromise or/and arrangement duly approved by the company or companies in question and further approved by the Tribunal. The IT Act has made provisions removing certain tax disabilities, often referred to in appropriately in our view, as tax incentives for demerger, to the companies' involved in a demerger and to their shareholders. To avoid some of the disabilities under the Income-tax Act, it is essential that a demerger squarely falls within the definition of the term "demerger" under section 2(19AA) of the IT Act. Section 2(19AA) reads as follows:

"Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more under takings to any resulting company in such a manner that—

(i) All the property of the under taking, being transferred by the demerged company, immediately before the demerger becomes the property of the resulting company by virtue of the demerger;

(ii) All the liabilities relatable to the under taking, being transferred by the demerged company, immediately before the demerger becomes the liabilities of the resulting company by –virtue of the demerger;

(iii) The property and the liabilities of the under taking or under takings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

(iv) The resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis;

(v) The share holders holding not less than three – fourths in value of the shares in the demerged company (other than shares already held there in immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;

(vi) The transfer of the under taking is on a going concern basis;

(vii) The demerger is in accordance with the conditions, if any, notified under sub –section (5) of section 72 A by the Central Government in this behalf.

Explanation 1. For the purposes of this clause "undertaking" shall include any part of an under taking or a unit or division of an under taking or a business activity taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2. For the purposes of this clause the liabilities referred to in sub-clause (ii) shall include —

(a) the liabilities which arise out of the activities or operations of the undertaking;

(b) the specific loans or borrowings (including debentures) raised, incurred and utilized solely for the activities or operations of the undertaking; and

(c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3. For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4. For the purposes of this clause, the splitting up or there construction of any authority or a body constituted or established under a Central, State – or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette by the Central Government.

Other related definitions:

Definition of 'demerged company'

Section 2 (19AAA)" demerged company " means the company whose under taking is transferred, pursuant to a demerger, to a resulting company;

Definition of 'resulting company'

Section 2(41A) "resulting company" means one or more companies (including a wholly owned subsidiary there of] to which the under taking of the demerged company is transferred in a demergerand, the resulting company in consideration of such transfer of undertaking, issues shares to the share holders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

Illustration 20.

AB Ltd. has 2 divisions-A and B. Division A has been making constant profit, while Division B has been suffering losses. The Division wise Balance Sheet as on 31 March, 2017 are as follows:

₹ in Lakhs

	Division A	**Division B**	**Total**
Fixed assets: cost (Tangible)	500	1,000	1,500
Less: Depreciation	450	800	1,250
Written Down Value (i)	50	200	250
Current Assets:	400	1,000	1,400
Less : Current Liabilities	50	800	850
Net Current Assets (ii)	350	200	550
Total (i) + (ii)	400	400	800

Financed by:			
Loan	---	600	600
Capital: Equity Shares of 10 each	50	---	50
Other Equity	350	(200)	150
Total	400	400	800

Division B along with its assets and liabilities was sold for 50 lakhs to X Ltd., a new company which issued 2 lakhs equity shares of ₹10 each at a premium of ₹15 per share to the members of B Division in full settlement of the consideration in proportion to their shareholding in the company. Assuming that there are no other transactions, You are required to:

(i) Show journal entries in the books of AB Ltd.

(ii) Prepare the Balance Sheet of AB Ltd. after the entries made in (i) above.

(iii) Show journal entries in the books of X Ltd. (iv) Prepare the Balance Sheet of X Ltd.

In both the cases, Balance Sheets to be prepared Under the Scheduled III Division II format.

Solution:

It is business combination under common control since businesses are ultimately controlled by the same party or parties both before and after the demerger. Accounting is made as per Appendix C of Ind AS 103 by applying pooling of interest method.

(i) Books of AB Ltd.

Journal

Date	Particulars		₹	₹
31.03.2017				
	Current Liability A/c	Dr.	800	
	Accumulated Depreciation A/c	Dr.	800	
	Loan A/c	Dr.	600	
	To PPE A/c			1,000
	To Current Assets A/c			1,000
	To Capital Reserve A/c			200
	(Being net assets transferred under scheme of demerger)			

Note: Division B was sold to X Ltd. The consideration received for transfer was equity shares of X Ltd. of 10 each fully paid, issued at a premium of ₹15.

The value of consideration = 2,00,000 shares x (10 + 15) = ₹ 50,00,000 (ii) Balance Sheet of AB Ltd. as on 31st March, 2017.

Ref. No.	Particulars	Note No.	Amount (₹ in Lakhs)
II.	**ASSETS**		
	(1) Non-current Assets		
	(a) PPE (500 - Dep. 450)		50
	(2) Current Assets	4	400
	Total		**450**
I.	**EQUITY AND LIABILITIES**		
	(1) Equity		
	(a) Equity Share capital	1	50
	(b) Other Equity	2	350
	(2) Current Liabilities	3	50
	Total		**450**

[Relevant Notes]

1. E. Share Capital

Particulars	Amount (₹ in Lakhs)
Authorized, issued, subscribed and paid up capital:	
5,00,000 equity shares of ₹10 each fully paid	50
Total	50

2. Other Equity

Particulars	Amount (₹ in Lakhs)
Other Equity (150 + capital reserve 200)	350
Total	350

3. Other Current Liabilities

Particulars	Amount (₹ in Lakhs)
Current Liabilities	50
Total	50

4. Other Current Assets

Particulars	Amount (₹ in Lakhs)
Current Assets	400
Total	400

(iii) Books of X Ltd.

Journal

Date	Particulars		Amount (₹)	Amount (₹)
31.03.2017	PPE A/c (1,000 – 800)	Dr.	200	
	Current Assets A/c	Dr.	1,000	
	Goodwill A/c (Bal. Fig. or the difference between equity and consideration)#	Dr.	220	
	To Current Liability A/c			800
	To Loan A/c			600
	To Consideration*			20
	(Being sundry assets and liabilities recognized at book value along with goodwill.)			
31.03.2017	Consideration A/c	Dr.	20	
	To Equity Share Capital A/c			20
	(Being consideration settled by issue of equity shares at ₹15 premium but recorded at nominal value* only.)			

The excess, if any, between the amount recorded as share capital issued plus any additional consideration in the form of cash or other assets and the amount of share capital of the transferor is recognised as goodwill in the financial statements of the transferee entity.

Consideration = 20

Equity of Divn B = (200)

Goodwill = Consideration – Equity

= 20 – (200) = 20 + 200

= 220

* The consideration for the business combination may consist of securities, cash or other assets. **Securities shall be recorded at nominal value**.

(iv) Balance Sheet of X Ltd. as on 31st March, 2017

(₹ in Lakhs)

Ref. No.	Particulars	Note No.	As at 31st March, 2017
I.	**ASSETS**		
	Non-current Assets		
	(a) PPE (1,000 - Dep. 800)		200
	(b) Goodwill		220
	Current Assets		1,000
	Total		**1,420**

II.	EQUITY AND LIABILITIES		
	1. Equity		
	Equity Share Capital (1)		20
	Other Equity		
	2. Non-current Liabilities		
	(a) Loan		600
	(b) Current Liabilities		800
	Total		**1,420**

(1) 20000 equity shares of ₹ 10 = 20 (₹ Lakhs)

Illustration 21.

XY Ltd. has two divisions: X and Y. The draft information of X and Y was: Rs. Lakhs

	X	Y	Total
PPE			
Cost	800	400	
Depreciation	(600)	(100)	
WDV	**200**	**300**	
Current Assets	500	400	
Current Liabilities	(200)	(300)	
	300	**100**	
Total	**500**	**400**	
Equity Share Cpital	100		100
Other Equity	?	?	600
Borrowing		200	200
Total	**500**	**400**	

Y Division is sold to a new company Z Ltd. and consideration of ₹ 250 lakhs was settled by issue of equity shares of Z Ltd of ₹ 10. Pass journal entries in the books of XY Ltd. and Z Ltd.

Solution:

It is demerger for which control over business did not change. The shareholders of XY Ltd. continue to hold the control. Thus it is a business combination under common control, and pooling of interest method of accounting is be followed.

Journal in the books of demerged company XY Ltd.

Current Liabilities	Dr.	300	
Prov. For Depreciation	Dr.	100	
Borrowings	Dr.	200	
Loss on Reconstruction	Dr.	200	
To PPE			400
To Current Assets			400

Journal in the books of Transferee company Z Ltd.

PPE 400-100	Dr.	300	
Current Assets	Dr.	400	
Goodwill #	Dr.	50	
To Consideration			250
To Borrowings			200
To Current Liabilities			300

Other Equity of Y = 200 (b.f) ; Goodwill = Consideration – Equity (of Y) = 250 – 200 = 50

2.8 REVERSE ACQUISITION

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.

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.

Illustration 22.

Reverse Acquisition takes place as H Ltd. acquires 100% equity shares of S Ltd on 31-03-2018. From the following data pass journal entries and prepare balance sheet in the books of Accounting Acquirer.

[Amount in ₹]

	H	S
Non Current Assets	2000	3000
Current Assets	1000	1000
Total	3000	4000
Equity Share Capital H: 100 shares; S: 80 shares	1000	800[s]
Other Equity	500	1600[s]
Non Current Liabilities	700	1200
Current Liabilities	800	400

H Ltd. and S Ltd. shares are quoted at ₹ 20 and ₹ 50 respectively on 31-03-2018. H Ltd. issues shares in exchange ratio based on quoted price.

Solution:

I. It is a business combination. H issues 2.5 shares for every one share of S (50/20). Thus 200 shares (80×2.5) of H are issued to owners of S, who become 2/3 rd owner of the group interest (200 out of total 300 shares, 100 shares belonging to the owners of H). For accounting purpose the subsidiary company S Ltd., (holding 2/3rd of the group interest) the legal acquiree is considered as the acquirer company. It is a reverse acquisition. The carrying amounts of assets and liabilities are considered to be their fair value. 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 and 200 shares are held by owners of S. Effective consideration from the view point of accounting acquirer S is the fair value of 100 shares held by H = 20 × 100 = 2000.

III. Goodwill:

	[Amount in ₹]
Net Assets of H identified	1500
Consideration transferred	2000
Goodwill (2000 – 1500)	500

IV. Journal in the books of S (Accounting purpose acquirer)

		Dr.	Cr.
Non current assets	Dr.	2000	
Current assets	Dr.	1000	
Goodwill	Dr.	500	
To Non current Liabilities			700
To Current Liabilities			800
To Consideration			2000
Consideration	Dr.	2000	
To Equity Share Capital			1000c
To Securities Premium			1000p

V. Consolidated Balance Sheet on 31-03-2018 in books of S Ltd.

Particulars	Amount (₹)
Non Current Assets	5000
Goodwill	500
Current Assets	2000
Total	7500
Equity Share Capital (300 shares of H*) 800^{s}+1000^{c}	1800
Other Equity 1600^{s}+1000^{p}	2600
Non Current Liabilities	1900
Current Liabilities	1200
Total	**7500**

* Equity structure reflects the legal parent H.

Illustration 23.

DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31-03-X7 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-X7: ₹ Lakhs

	DA	TA
PPE	7500	8000
Financial Assets	800	500
Current Assets	4700	6500
Equity Share Capital	6000	10000
Other Equity	3000	1000
Borrowings	2000	3000
Current Liabilities	2000	1000

Fair value of the following items is given:

	DA	TA
PPE	8000	6000
Current Assets	5000	7000
Fair Value of Business	7500	15000

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.

₹ Lakhs

	DA	TA
Fair Value of Business	7500	15000
Share of each company in the merged company	1/3	2/3

Fair value per share of TA = 15000/1000 = ₹15

Consideration payable by TA to DA is : 7500 in 7500/15 = 500 lakh shares

Or, No. of shares held by TA for 2/3 share in DATA = 1000; 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 = 7500.

(Abstract) Consolidated Balance Sheet **₹ Lakhs**

Assets		Amount
Non Current Assets		
PPE (8000+8000) [FV of DA + Carrying asset of TA]		16000
Financial Assets		1300
Current Assets (5000 + 6500)		11500
Total		28800
Equity and Liabilities		
Equity		
Equity Share Capital		17500
Other Equity	Note 1	3300
Borrowings		5000
Current Liabilities		3000
Total		**28800**

Note 1:

PPE	8000
Financial Assets	800
Current Assets	5000
	13800
Borrowings	2000
Current Liabilities	2000
	4000
Net Assets (13,800 – 4,000)	9800
Consideration	7500
Gain on Bargain Purchase (9,800 – 7,500)	2300

Other Equity = Other Equity of TA + Gain on Bargain Purchase = 1000+2300 = 3300

Study Note - 3

CONSOLIDATED FINANCIAL STATEMENTS

This Study Note includes

3.1 Holding Company
3.2 Transactions and accounting
3.3 Ind AS 110: Consolidated Financial Statements – Summarised
3.4 Accounting Requirements
3.5 Equity Method
3.6 Preparation of Group Cash Flow Statement
3.7 Ind AS 27: Separate Financial Statements
3.8 Ind AS 28: Investments in Associates and Joint Ventures
3.9 Ind AS 105: Non-current Asset held for sale and Discountinued Operations
3.10 Ind AS 111: Joint Arrangements
3.11 Ind AS 112: Disclosure of Intersts in Other Entities

3.1 HOLDING COMPANY

1. Concept of group:

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.

2. Financial Statements:

There are three types of **financial statements: (a)** An Individual financial statements, (b) Consolidated financial statements and (c) Separate financial statements.

Ind AS 110 requires that a **parent** company in a group of companies shall prepare **consolidated financial statements** and further it shall prepare **separate financial statements** as per Ind AS 27.

A company having investments in associates or joint ventures prepares **consolidated 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.

We may also note that the companies Act, 2013 in Section 129 sub section 2 and 3 state:

(2) At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting **financial statements** for the financial year.

(3) Where a company has one or more subsidiaries or associate companies, it shall, in addition to financial statements provided under sub-section (2), prepare a **consolidated financial statement** of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

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.

A company that does not have a subsidiary, associate or investment in joint venture shall prepare Individual financial statements.

3.2 TRANSACTIONS AND ACCOUNTING

3. Purchasing of shares of another company is an important transaction for which different situations may arise and different accounting methods are applied based on the requirement of the Ind ASs.

Different situations: By purchase of shares

(i) entailing voting power of 20% or more, the investor company may have significant influence over the investee company (called Associate).

(ii) the investor company may have joint control in the investee company (called Joint Venture).

(iii) the investor company may acquire control in the investee company (called subsidiary).

(iv) entailing voting power of less than 20%, the investor company may have none of the above.

Different accounting methods:

a. Accounting for consolidated financial statements (Ind AS 110) is made for transactions falling under 3(iii).

b. Again consolidated financial statements are prepared for investments in associates and joint ventures (Ind AS 28) falling under 3(i) and 3(ii). However, the accounting in these cases is based on **equity method**.

c. For 3(i), (ii) and (iii) in addition to consolidated financial statements, separate financial statements shall also be prepared (Ind AS 27) by the investor company and investments are valued **at cost or as per Ind AS 109.**

d. Individual financial statements are prepared in case of transactions falling under 3(iv) and Ind AS 109 is applicable for such investment.

Thus we see that there are two types of consolidation: (1) Consolidation using Equity Method by application of Ind AS 28; and (2) Consolidation by combining the Accounts of parent and subsidiary by application of Ind AS 110. In both the cases Ind AS 27 is attracted for preparation of Separate Financial Statements in addition to CFS.

When there is no consolidation of any type accounts are made for preparation of Individual Financial Statements.

The Stand Alone Financial Statements are representing both Separate Financial Statements and Individual Financial Statements.

In this section we shall first show the Consolidation under Ind AS 110 and then the Equity method of accounting (Ind AS 28).

4. Consolidation of parent with subsidiary (as stated in 3a) is done by combining assets and liabilities of parent and subsidiaries, measuring non-controlling interest [Ind AS 110] and recognizing goodwill [Ind AS 103].

5. Ind AS 103 states that the acquirer obtaining control over acquiree, recognises and measures in its financial statements (in consolidated financial statements when acquiree continues to exist) (i) the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree and (ii) the goodwill acquired in the business combination or a gain from a bargain purchase.

6. Ind AS 110 states that consolidated financial statements shall be produced by the parent company by measurement of non-controlling interest on the reporting date, by measuring goodwill/bargain purchase on the acquisition date and by combining of accounts (also offsetting and eliminating) of parent and subsidiary.

7. At the time of acquisition identified assets and liabilities are recorded in the books of parent (acquirer) at fair value. Subsequently the non current items 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 is reverted through post acquisition retained earnings**, and thus the book values of parent and subsidiaries are combined for consolidation.

8. In subsequent CBS (Consolidated Balance Sheet) Goodwill is recorded at acquisition date Goodwill value measured as per Ind AS 103. However the NCI changes from the value on acquisition date for post acquisition profit or loss.

9. Thus the share of parent in pre-acquisition profit of subsidiary is considered for measurement of goodwill. Share of NCI in pre-acquisition profit of subsidiary may be considered for measurement of NCI on the date of acquisition (Equity share capital plus Share of NCI in Pre-acquisition profit = Net Assets identified at fair value). Alternatively, for measurement of NCI at fair value, share of NCI in pre-acquisition profit of subsidiary is not required. But for consolidation on subsequent date the share of NCI in post acquisition profit or loss of the subsidiary must be added to NCI acquisition date value.

Illustration 1.

Company P Ltd. (a listed company) acquires 60% shares in company Q Ltd. on 1-4-17 at a cost of (₹ Lakhs) 1,38,000, paid by issue of shares of ₹ 10 at par, when fair value of identifiable net assets of Q was (₹ Lakhs) 2,20,000. 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:

	Q (₹ Lakhs)			P (₹ Lakhs)	
	1-4-17 book value	1-4-17 Fair Value	31-3-18 book value	1-4-17	31-3-18
PPE	184000	200000	196000	276000	300000
Investment in Q					138000
Inventories	45000	50000	58000	68000	80000
Financial Assets	78000	60000	88000	100000	120000
Total assets	**307000**		**342000**	**444000**	**638000**
Equity Share Capital	130000		130000	200000	338000
Other Equity	87000		117000	120000	150000
Borrowings	60000	60000	64000	80000	100000
Trade Paybles	30000	30000	31000	44000	50000
Total of Equity and Liabilities	**307000**		**342000**	**444000**	**638000**

(a) Pass journal entries in consolidated accounts of P and show consolidated balance sheet of P on 1-4-17 based on Ind AS 103 and Ind AS 110.

(b) Prepare consolidated balance sheet and separate balance sheet of P on 31-3-18 based on Ind AS 110.

Solution:

(a) Assets, liabilities and NCI are recognized at Fair value. (₹ Lakhs)

		Dr.	Cr.
PPE in Q	Dr.	2,00,000	
Inventories in Q	Dr.	50,000	
Financial assets in Q	Dr.	60,000	
Goodwill (balancing Figure#)	Dr.	10,000	
To Equity share capital			1,38,000
To NCI @			92,000
To Borrowings in Q			60,000
To Trade Payables in Q			30,000

[**Notes:** @ NCI recognized at Fair Value: 40%* 1,38,000/60% = 92,000;

Goowill = Consideration + NCI – Fair Value of Identifiable Net Assets = 1,38,000 + 92,000 – 2,20,000 = 10,000.

Alternative solution: @NCI can be measured at proportionate share of identifiable net assets = 40% * 2,20,000 = 88,000.]

Balance sheet abstracts of Q and P based on Ind AS 103, Ind AS 110 and Ind AS 27 as at 01-04-2017

(₹ Lakhs)

	Q (Fair Value)	P		
		Before acquisition	After acquisition	
			Consolidated	Separate
PPE	2,00,000	2,76,000	4,76,000	2,76,000
Goodwill			10,000	
Investment in Q				13,80,00
Inventories	50,000	68,000	1,18,000	68,000
Financial Assets	60,000	1,00,000	1,60,000	1,00,000
Total assets		**4,44,000**	**7,64,000**	**5,82,000**
Equity Share Capital		2,00,000	3,38,000	3,38,000
NCI			92,000	
Other Equity		1,20,000	1,20,000	1,20,000
Borrowings	60,000	80,000	1,40,000	80,000
Trade Paybles	30,000	44,000	74,000	44,000
Total of Equity and Liabilities		**4,44,000**	**7,64,000**	**5,82,000**

(b) Working Notes: Balance sheet data of Q (₹ Lakhs)

	1	2	3	4	5	6
	1-4-17	1-4-17 Fair Value	Change on acquisition	Reversal of change in Current items to Retained Earnings [see para 7]	Change in Bk Value carried to subsequent B/S	Adj. B/S on 31-3-18 (1+3+4+5) or (2+4+5)
PPE	184000	200000	+16000	-	12000	212000[x]
Inventories	45000	50000	+5000	-5000	13000	58000[Y]
Financial Assets	78000	60000	-18000		10000	70000[Z]

Abstract of Separate and Consolidated balance sheet of P as at 31-3-18 (Rs.Lakhs)

	P (Separate balance sheet)	Balance sheet of Q (adjusted value)	Consolidated balance sheet
PPE	300000	212000[X]	512000
Goodwill			10000[#]
Investment in Q	138000		
Financial Assets	120000	70000[Z]	190000
Inventories	80000	58000[Y]	138000
Total assets	**638000**	**365000**	**850000**
Equity Share Capital	338000	130000	338000
Other Equity	150000	140000	165000$
NCI			102000&

Borrowings	100000	64000	164000
Trade Paybles	50000	31000	81000
Total of Equity and Liabilities	**638000**	**365000**	**850000**

Goodwill is recognised in (a) above.

& NCI at the time of acquisition = 92000

Post acquisition total comprehensive income of Q = 117000 – 87000 - 5000 = 25000;

Share of NCI = 40% * 25000 = 10000;

Total NCI at the year end = 92000+10000 = 102000.

$Other Equity of P at the end of the year = 150000;

Share of post acquisition Total comprehensive income of Q = 60%*25000 = 15000;

Other equity consolidated = 150000 + 15000 = 165000.

Illustration 2.

Company P Ltd. acquires 60% shares of company S Ltd. on 1/4/17 by issue of equity shares at fair value of 360, paid up value 100. The book values and fair values of the assets and liabilities of the companies at the date of acquisition and at the end of the year are stated below. The total comprehensive income of P and S in the year ending 31-03-2018 amounted to 60 and 70 respectively. (₹ Lakhs)

	On 1-4-17			On 31-3-18	
	P	S	FV of S	P	S
PPE	680	440	700	720	500
Investment in S				360	
CA	420	360	300	500	400
Equity	500	300		920	370
Noncurrent Liability	300	300	300	340	320
Current Liability	300	200	200	320	210

Pass entries for business combination under acquisition method and prepare CBS on 1-4-17 and on 31-3-18.

Solution:

PPE	Dr.	700	
CA	Dr.	300	
Goodwill (bf)	Dr.	100#	
To Non Current Liability			300
To Current Liability			200
To Purchase Consideration			360
To NCI [= 40% / 60% * 360] (at F.V.)			240
Purchase Consideration	Dr.	360	
To Equity Share Capital			100
To Security Premium			260

Goodwill = Consideration + NCI – Net Assets

= 360 + 240 – (700 + 300 – 300 – 200)

= 100

Consolidated Balance Sheet of P on 1-4-17 (Abstract) **(₹ Lakhs)**

		Consolidated
PPE Goodwill Investment in S CA	680+700 420+300	1380 100# 720
Total Assets		2200
Equity NCI Noncurrent Liability Current Liability	500+360 300+300 300+200	860 240 600 500
Total of Equity and Liability		2200

Consolidated Balance Sheet of P on 31-3-18 **(Abstract)** **(₹ Lakhs)**

	BV	Adj (FV – BV)	Consolidated
PPE	720+500	+260	1480
Goodwill			100
CA	500+400		900
Total Assets			**2480**
Equity	920+0.6*(70+60$)		998
NCI	240 + 0.4*(70+60$)		292
Noncurrent Liability	340+320		660
Current Liability	320+210		530
Total of Equity and Liability			**2480**

$60 revaluation loss on current item reverted. [See para 7]

Illustration 3.

The following are the extract Balance Sheet of H & S Company as on 31-03-2016

(in ₹)

Liabilities	H	S	Assets	H	S
Share Capital @ ₹ 10 each	20,000	10,000	Fixed Assets (Tangible)	30,000	15,000
General Reserve	10,000	5,000	Current Assets	35,000	25,000
P/L A/c (1.4.15)	5,000	4,000	Shares in S Ltd. (8000)	10,000	
12% Debenture	20,000	10,000			
S. creditors	10,000	5,000			
Profit for the year	10,000	6,000			
	75,000	40,000		75,000	40,000

H Limited acquired shares in S Limited on 01-10-2015. S limited has a balance of ₹ 4,000 in General Reserve on 01-04-2015. On the account fire goods costing ₹ 2,000 of S Limited were destroyed in June, 2015. The loss has been charged to the Profit and Loss Account for the year.

Required to prepare a consolidated Balance Sheet.

Solution:

Working Notes:

1. Date of Acquisition: 01.10.2015
2. Holding Company Share: 800/1000 *100 = 80%
3. Non-Controlling Interest (NCI): 200/1000*10 =20%
4. Analysis of profit (of S)

Particulars	Pre-acquisition Profit	Post-Acquisition Profit
General Reserve of 01.04.15	4000.00	-
Profit & Loss of 01.04.15	4000.00	-
Profit for the year [9,000] #	4500.00	4500.00
	12500.00	4500.00
Less: Loss on fire in June	−2000.00	-
Other Equity at acquisition	10500.00	4500.00
Holding Company's share (80%)		3600.00*
NCI share (20%)		900.00$

#		
#	Profit for the year	6,000
	Adj for loss on fire	2,000
	Transfer to Reserve	1,000
		9,000

5. fair value of net assets identified

Equity Share Capital of S	10,000
Other Equity at acquisition	10,500
Total Equity representing fair value of net assets =	20,500

6. **Gain on Bargain Purchase**

Net asset identified		20,500
Less: NCI at acquisition [20% × 20,500]	4,100 *	
Less: Consideration for acquiring control	10,000	14,100
Gain on Bargain Purchase		**6,400**

7. NCI at reporting date = NCI at acquisition + NCI share in Post-acquisition profit
   = 4,100 (*) + 900 ($)
   = 5,000

Name of the Company: H Ltd.

Consolidated Balance Sheet as at 31st March, 2016

Ref No.	Particulars	Note No.	As at 31st March, 2016 (₹)
	ASSETS		
1	**Non-current assets**		
	(a) PPE	4	45,000.00
2	**Current assets**		
	(a) Other current assets	5	60,000.00
	TOTAL (4+5)		105,000.00
A	**EQUITY AND LIABILITIES**		
1	**Equity**		
	(a) Equity Share capital		20,000.00
	(b) Other Equity	1	35,000.00
	(c) NCI		5,000.00
4	**Non-current liabilities**		
	(a) Long-term borrowings (10% debentures)	2	30,000.00
5	**Current liabilities**		
	(a) Trade payables	3	15,000.00
B	**TOTAL (1+2+3)**		105,000.00

Note: Relevant items of Assets/ Liabilities are reflected in Balance Sheet as per Div II of Schedule III. Hence sub-item not having any value for the given illustration is not shown/ represented in Balance Sheet.

Note 1. Other Equity			**Note 2. Long Term Borrowings**	
	Current Year	**Previous Year**		**Current Year**
General Reserve	10,000.00	-	12% Debenture	
P/L A/c	-	-	H	20,000.00
H	15,000.00	-	S	10,000.00
S	3,600.00*	-		30,000.00
Gain on Bargain Purchase	6,400.00	-		
	35,000.00	-		

Note 3. Trade Payable			**Note 4. Tangible Assets**	
	Current Year	**Previous Year**		**Current Year**
H	10,000.00	-	H	30,000.00
S	5,000.00	-	S	15,000.00
	15,000.00	-		45,000.00

Note 5. Other Current Assets	
	Current Year
H	35,000.00
S	25,000.00
	60,000.00

3.3 IND AS 110: CONSOLIDATED FINANCIAL STATEMENTS – SUMMARISED

10. Summary of Ind AS 110

Objective:

The objective of this Indian Accounting Standard (Ind AS110) is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. For this purpose this Ind AS: (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 controls 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.

Scope:

An entity that is a parent shall present consolidated financial statements, with certain exceptions as specified in the standard.

Principle of Control:

An investor shall determine whether it is a parent by assessing whether it controls the investee. 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 shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed in paragraph 7 (see paragraphs B80–B85).

Two or more investors collectively control an investee when they must act together to direct the relevant activities. In such cases, because no investor can direct the activities without the co-operation of the others, no investor individually controls the investee. Each investor would account for its interest in the investee in accordance with the relevant Ind ASs, such as Ind AS 111, *Joint Arrangements*, Ind AS 28, *Investments in Associates and Joint Ventures,* or Ind AS 109, *Financial Instruments.*

Power:

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee's returns.

Power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements.

An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

An investor can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has *significant influence*. However, an investor that holds only protective rights does not have power over an investee (see paragraphs B26–B28), and consequently does not control the investee.

Returns:

An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Although only one investor can control an investee, more than one party can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

Link between power and returns:

An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

Thus, an investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent in accordance with paragraphs B58–B72 does not control an investee when it exercises decision-making rights delegated to it.

Illustration 4.

An investor acquires 48 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. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Illustration 5.

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. 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.

Illustration 6.

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. 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.

Illustration 7.

Investor A holds 70 per cent of the voting rights of an investee. Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of investor A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the relevant activities of the investee.

In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive.

Illustration 8.

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60 per cent of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares.

Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Illustration 9.

The only assets of an investee are receivables. When the purpose and design of the investee are considered, it is determined that the only relevant activity is managing the receivables upon default. The party that has the ability to manage the defaulting receivables has power over the investee, irrespective of whether any of the borrowers have defaulted.

3.4 ACCOUNTING REQUIREMENTS

11. Accounting Requirements:

(A) 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.

(B) A parent shall present non-controlling interests in the consolidated balance sheet within equity, separately from the equity of the owners of the parent. Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

(C) Consolidation procedures:

- (I) Consolidated financial statements:
  - (a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
  - (b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Note that Ind AS 103 explains how to account for any related goodwill).
  - (c) eliminate in full intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intra-group transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in

full). Intra-group losses may indicate an impairment that requires recognition in the consolidated financial statements. Ind AS12, *Income Taxes,* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

12. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies.

Illustration 10.

A Ltd. uses WDV method of depreciation. It acquires 80% shares of B Ltd. which follows SLM of depreciation. How will the PPE both the companies be depreciated for CFS of A Ltd?

Depreciation method is not a policy but estimate (Ref. Ind AS 16 and Ind AS 8). Uniformity of accounting policies as per Ind AS 110 is not violated for using different methods of depreciation. A Ltd. can depreciate its PPE under WDV method and B Ltd's PPE under SLM in the CFS.

13. An entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the consolidated statement of profit and loss after the acquisition date is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.
14. When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of profit or loss and changes in equity allocated to the parent and noncontrolling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph B90 applies.
15. In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent and noncontrolling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns.
16. Ind AS 109 does not apply to interests in subsidiaries that are consolidated. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in a subsidiary, the instruments are not subject to the requirements of Ind AS 109. In all other cases, instruments containing potential voting rights in a subsidiary are accounted for in accordance with Ind AS 109.
17. The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall have the same reporting date. When the end of the reporting period of the parent is different from that of a subsidiary, the subsidiary prepares, for consolidation purposes, additional financial information as of the same date as the financial statements of the parent to enable the parent to consolidate the financial information of the subsidiary, unless it is impracticable to do so.
18. If it is impracticable to do so, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months, and the length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.
19. An entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

Illustration 11.

X Ltd. acquires 80% of equity of Y Ltd. on 31-03-20x3 at cost of (₹ Lakhs) 100, when the Equity Share Capital and Other Equity of Y Ltd. were 40 and 80 respectively. For the years ending on 31-03-20x4 and 31-03-20x5, Y Ltd accounted Total Comprehensive income of (15) and 25. Find NCI (Proportionate Net Asset Method), 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.

Solution: (₹ Lakhs)

At the end of the years	31-03-20x3	31-03-20x4	31-03-20x5
TCI		(15)	25
Other Equity of Y Ltd.	80	65@	90@
Net Asset = Share Capital + Other Equity	120	105	130
Consideration	100		
NCI = Net Asset*20%	24	21	26
Goodwill = Consideration + NCI – Net Assets (at acquisition)	4	4	4
X Ltd's share in post-acquisition profits = 80%* TCI	-	(12)	15

@ Other Equity of Y Ltd. = Closing balance of the last year + TCI for the current year

If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Note: Thus, measurement for Goodwill/ Bargain Purchase is done as per Ind AS 103 at the time of acquirement of control. However, the measurement of Non-Controlling Interest is done on the date of consolidation.

20. The Subsidiary company may declare dividend on its equity shares and the following are the possibilities with respect to it.

a. Intention to propose dividend: In such a case since the proposal has not been approved in the meeting the intention may be ignored and no adjustment is required (in terms of calculation) with respect to this dividend intention.

b. Proposed dividend: It is possible that dividend has been proposed in a meeting on the closing date of the financial year but no notification of this fact has been made in the books of the Holding company. In such a case, the amount of dividend declared may be added to the profits of the Subsidiary company (assuming this has been deducted) and then the analysis of profits is performed in the usual manner. No adjustment is needed in the books of the Holding company.

c. Dividends Payable: In some cases, the dividends that have been declared by the Subsidiary firm may have been adjusted for in both the books i.e. the Subsidiary and Holding company. In this case adjustment is made in the books of the Subsidiary company. In the books of the Holding company the dividend that are receivable fro the Subsidiary company will be credited to Profit and Loss Account of the Holding company (in terms of income receivable on investments).It is possible that these dividends have been paid by the subsidiary firm out of Capital profit, revenue profit, combination of both profit. No adjustment is required for consolidated balance sheet.

(i) If dividend of subsidiary company have been declared totally out of capital profit, then it is incorrect that this capital income should stand credited to the revenue P/L Account of the holding company. Therefore in separate financial statement Investment account is adjusted as below. However in consolidated financial statements net assets at acquisition includes pre-acquisition dividends and

goodwill needs no further adjustment for such dividend receivable.

P/L Account (H Ltd.) Dr.

To Investment Account

With the amount of dividend receivable from the Subsidiary firm

(ii) If the dividend of the subsidiary firm have been declared out of Revenue profit then that should be credited to the P/L A/c. of the Holding Company and of they are already included therein as per our presumption, no adjustment is required.

(iii) The dividend receivable by Holding Company may be partly out of capital profit or out of revenue profit of Subsidiary company. The portion paid out of capital profit will be adjusted in Investment account in separate financial statement. However in consolidated financial statements net assets at acquisition includes pre-acquisition dividends and goodwill needs no further adjustment for such dividend receivable. With respect to the NCI irrespective of the dividend declared by the Subsidiary company being payable out of capital profit or revenue profit will be shown as separate liability in consolidated balance sheet.

d. Dividend paid: The Subsidiary company may have declared a dividend in the course of the financial year and this fact has been adjusted for in both the books and in fact the cash liability has already been met by subsidiary firm for the purpose of dividend payment. This implies there is no liability outstanding with respect to payment of dividends therefore no adjustment on account dividends has to be made to minority interest. With respect to Holding company has stated in point (iii) the dividend must have been credited to P/L Account out of capital profit, revenue profit are a combination from the subsidiary company's books. The portion out of capital profit stated earlier will be transferred from the P/L Account of the Holding company to the Investment account in separate financial statement.

21. **Preliminary Expenses:**

If the Holding company has preliminary expenses they continue as such. If subsidiary company has preliminary expenses it is not recognized as identified assets.

22. **Provision for Taxation:**

Taxes are payable to outside agencies and provision for taxation with respect to holding and subsidiary company will be shown as such in the consolidated Balance Sheet.

23. **Bonus Shares:**

The Subsidiary company may issue Bonus shares either at the time of acquisition of shares by the holding company or after the acquisition of shares by the Holding company. For issuing bonus shares, in the consolidated statement of change in equity there will be a transfer from Other Equity to Equity share capital, total equity remaining unchanged. There will be no other accounting in Separate or consolidated financial statements.

Illustration 12.

Z Ltd. purchased 80% shares in C Ltd. on 1-10-20x1 at 240000. C Ltd. at 31-03-20x1 had Issued Share Capital 200000 and Other Equity 60000. For year ending on 31-03-20x2 C Ltd. made profits 30000 and declared dividend 40000.

Other information:

A. NCI measured at fair value. or

B. NCI measured at proportionate net assets. Or

C. On the date of acquisition fair value of identified net assets measured at 250000 and NCI measured (I) at fair value; (II) at proportionate net assets value.

For each of A, B and C:

(a) (i) Find NCI on date of acquisition and on 31-03-20x2. (ii) Find Goodwill and (iii) pass journal entry (in consolidated accounts).

(b) Pass journal entries for Separate financial statements.

(c) Show relevant parts in Consolidated Balance sheet and Separate Balance Sheet

Solution:

A: NCI measured at fair value

(a): In consolidated accounts

	NCI		**Goodwill**
	on acquisition date	**On 31-03-20x2**	
(i) NCI= 20/80*240000(consideration for 80%)	60,000		
NCI = 60000+ 20%*15000 (post-acquisition profits) – 8000 (dividend share)		55,000	
a. Consideration = 240000			
b. NCI at acquisition= 60000			
c. Net Assets represented by Equity on acquisition = 260000+50%*30000 = 275000			
(ii) Goodwill = a+b-c =			25000

(iii)

Net Assets	Dr.	2,75,000	
Goodwill	Dr.	25,000	
To NCI			60,000
To Consideration			2,40,000

(b) In separate financial statements for acquiring control:

Investment	Dr.	2,40,000	
To Equity/Assets			2,40,000
On declaration of dividends by C:			
Dividend Receivable	Dr.	32,000	
To Profit and Loss			32,000
Profit and Loss	Dr.	32000	
To Investment			32000

(c) Balance Sheet of Z Ltd. (includes)

	Separate		Consolidated	
	01-10-20x1	31-03-20x2	01-10-20x1	31-03-20x2
Goodwill			20,000	20,000
NCI			60,000	55,000
Dividend Payable to NCI				8,000

Other Equity (share of post acquisition profits in C) 30000*50%*80%				12,000
Investment	2,40,000	2,08,000		
Dividend Receivable		32,000		

Solution:

B. NCI measured at proportionate net assets

(a) In consolidated accounts

	NCI		Goodwill
	on acquisition date	On 31-03-20x2	
(i) NCI= 20%*275000 (see 'c' below)	55,000		
NCI = 55000+ 20%*15000 (post-acquisition profits) – 8000 (dividend share)		50,000	
a. Consideration = 240000			
b. NCI at acquisition = 55000			
c. Net Assets represented by Equity on acquisition = 260000+50%*30000 = 275000			
(ii) Goodwill = a+b-c =			20,000

(iii)

Net Assets	Dr.	2,75,000	
Goodwill	Dr.	20,000	
To NCI			55,000
To Consideration			2,40,000

(b) In separate financial statements for acquiring control:

Investment	Dr.	2,40,000	
To Equity/Assets			2,40,000
On declaration of dividends by C:			
Dividend Receivable	Dr.	32,000	
To Profit and Loss			32,000
Profit and Loss	Dr.	32,000	
To Investment			32,000

(c) Balance Sheet of Z Ltd.

	Separate		Consolidated	
	01-10-20x1	31-03-20x2	01-10-20x1	31-03-20x2
Goodwill			20,000	20,000
NCI			55,000	50,000
Dividend Payable to NCI				8,000
Other Equity (share of post acquisition profits in C) 30000*50%*80%				12,000
Investment	2,40,000	2,08,000		
Dividend Receivable		32,000		

Solution:

C. On the date of acquisition fair value of identified net assets measured at 250000 and NCI measured (I) at fair value

(a) In consolidated accounts

	NCI		Goodwill
	on acquisition date	On 31-03-20x2	
(i) NCI= 20%*240000	60,000		
NCI = 60000+ 20%*15000 (post-acquisition profits) – 8000 (dividend share)		55,000	
a. Consideration = 2,40,000			
b. NCI at acquisition = 60,000			
c. Net Assets = 2,50,000			
(ii) Goodwill = a+b-c =			50,000

(iii)

Net Assets	Dr.	2,50,000	
Goodwill	Dr.	50,000	
To NCI			60,000
To Consideration			2,40,000

(b) In separate financial statements for acquiring control:

Investment	Dr.	2,40,000	
To Equity/Assets			2,40,000
On declaration of dividends by C:			
Dividend Receivable	Dr.	32,000	
To Profit and Loss			32,000
Profit and Loss	Dr.	32,000	
To Investment			32,000

(c) Balance Sheet of Z Ltd.

	Separate		Consolidated	
	01-10-20x1	31-03-20x2	01-10-20x1	31-03-20x2
Goodwill			50,000	50,000
NCI			60,000	55,000
Dividend Payable to NCI				8,000
Other Equity (share of post acquisition profits in C) 30000*50%*80%				12,000
Investment	2,40,000	2,08,000		
Dividend Receivable		32,000		

C. On the date of acquisition fair value of identified net assets measured at 250000 and NCI measured (II) at proportionate net assets value.

(a): In consolidated accounts

	NCI		Goodwill
	on acquisition date	On 31-03-20x2	
(i) NCI = 20%*250000 (see 'c' below)	50,000		
NCI = 50000+ 20%*15000 (post-acquisition profits) – 8000 (dividend share)		45,000	
a. Consideration = 240000			
b. NCI at acquisition = 50000			
c. Net Assets = 250000			
(ii) Goodwill = a+b-c =			40,000

(iii)

Net Assets	Dr.	2,50,000	
Goodwill	Dr.	40,000	
To NCI			50,000
To Consideration			2,40,000

(b) In separate financial statements for acquiring control:

Investment	Dr.	2,40,000	
To Equity/Assets			2,40,000

On declaration of dividends by C:

Dividend Receivable	Dr.	32,000	
To Profit and Loss			32,000
Profit and Loss	Dr.	32,000	
To Investment			32,000

(c) Balance Sheet of Z Ltd.

	Separate		Consolidated	
	01-10-2011	31-03-2012	01-10-2011	31-03-2012
Goodwill			40000	40000
NCI			50000	45000
Dividend Payable to NCI				8000
Other Equity (share of post acquisition profits in C) 30000*50%*80%				12000
Investment	240000	208000		
Dividend Receivable		32000		

Illustration 13. with inter-company dividend

P acquires 60% shares in Q on 1- 10 - 2017. Q makes profits 10000 in the year 2017-18 and declared dividend 6000. NCI is valued at 12000 at acquisition. (₹ lakhs)

Balance Sheet as at 31-03-2018 (₹ Lakhs)

	P	Q
PPE	50000	30000
Investment in shares of Q	21000	
Current Assets	20000	14000
	91000	44000
Equity Shares	60000	25000
Other Equity	16000	4000
Current Liabilities		
Trade Payables	15000	9000
Dividend Payable		6000
	91000	44000

Show consolidated and Separate Balance sheet in books of P.

Solution:

Working Notes:

1. Goodwill = B+C - A = 12000+21000 – 30000 = 3000

   Where:

   A. Net Assets identified on acquisition in the mid of the year, represented by Value of Equity of Q = 25000+ Pre acquisition profits (50% of yearly profit) = 25000+5000 = 30000. [Other Equity on 1-4-17 was NIL for Q]

   B. NCI = 12000 (at acquisition)

   C. Consideration = Investment in shares of Q = 21000.

2. NCI at the reporting date = NCI at acquisition + Share of NCI in post acquisition profits of Q – Dividend payable to NCI = 12000+40%*5000 (50% of yearly profit) - 40%*6000 (dividend payable to be shown separately) = 12000+2000 -2400 = 11600.

3. Consolidated Other Equity = P's Other Equity + Share from Post acquisition profits of Q=16000+ 60%*5000 =19000

4. Other Equity of Q at 1-4-17 = NIL

Clg other Equity	4,000
Div. Payable	6,000
	10,000
Less: Profit	10,000
Balance at 1-4-17	NIL

Balance Sheet (Abstract) as at 31-03-2012

(₹ Lakhs)

	In P's Book	
	Separate	Consolidated
Goodwill (1)		3000
PPE	50000	80000
Investment in shares of Q (21000 – 1800 Pre-acquisition Dividend)	19200	
Current Assets (20000+1800 Div Receivable)	21800	34000#
	91000	117000
Equity Shares	60000	60000
Other Equity (3)	16000	19000
NCI (2)		11600
Current Liabilities		
Trade Payables	15000	24000
Dividend Payable (to NCI)		2400
	91000	117000

(20000+14000 = 34000); In Consolidated balance sheet Inter-company dividend is set off and does not appear.

24. Change in NCI

When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent (in other Equity).

Illustration 14.

On 1-4-x6 BM Ltd. acquired 80% share of CM Ltd. at 1000000, when the fair value of its net assets was 1000000. During 1-4-x6 to 31-3-x7 CM Ltd made TCI 120000. On that date BM sold 20% holding to outsiders at 280000. Pass journal entries for sale of partial holding retaining control.

Workings:

Net Assets on 31-3-x7 = 1000000 + 120000 (TCI) = 1120000

Carrying amount of 20% holding sold ie. NCI recognised= 20% ×1120000 = 224000

Sale price = 280000

Gain credited to Other Equity = 280000 – 224000 = 56000

Journal:

Bank	Dr.	2,80,000	
To NCI			2,24,000
To Other Equity			56,000

Illustration 15.

DQ Ltd acquired 60% shares of RK Ltd. on 1-4-17. Fair value of net assets at the time of acquisition was 300000. In 17-18 RK made a profit of 60000. Individual and consolidated balance sheets as at 31-3-18:

	DQ	RK	Consolidated
Goodwill			50000
PPE	500000	280000	780000
Investment in RK	230000		
Current Assets	200000	180000	380000
	930000	460000	1210000
Equity Share Capital	400000	200000	400000
Other Equity	410000	160000	446000
NCI			144000
Current Liabilities	120000	100000	220000
	930000	460000	1210000

On 1-4-18 DQ acquired further 10% shares of RK. at 46000. NCI is measured at proportionate carrying amount. Pass journal entry for change in holding and prepare Separate and Consolidated balance sheet as at 01-04-2018.

NCI (144000 × 10%/40%)	Dr.	36,000	
Other Equity (Loss on acquisition)	Dr.	10,000	
To Bank			46,000

Separate and Consolidated Balance sheet

	Separate	Workings	Consolidated
Goodwill			50000
PPE	500000	500000+280000	780000
Investment in RS	276000		
Current Assets	154000	200000-46000+180000	334000
	930000		1164000
Equity Share Capital	400000		400000
Other Equity	410000	446000-10000	436000
NCI		144000-36000	108000
Current Liabilities	120000	120000+100000	220000
	930000	460000	1164000

Chain Holding

Illustration 16: Prepare Consolidated Balance Sheet (CBS) of a group of P Ltd., Q Ltd. and R Ltd. for which the abstracts of Balance sheets on 31-03-20x6 are given below. (Rs. In lakhs)

	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			
E. Share Cap (₹ 10)	600	500	300
Other Equity	460	160	120
Current Liabilities			
Trade Payables	500	300	200
Bills Payables	100	90	70
Total	**1660**	**1050**	**690**

Control was acquired on 30-09-20x5. On 01-04-20x5 the balances:

	Q	R
Other Equity	100	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:

(₹ In lakhs)

Consolidated Balance sheet of the group as at 31-03-20x6

Assets	Workings	Amount
Non-Current:		
PPE	400+500+320	1220
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		**2546**
Equity and Liabilities		
Equity Share Cap		600
Other Equity	Note 1	516
NCI of Q	Note 2	66
NCI of R	Note 2	174
Current Liabilities		
Trade Payables	500+300+200	1000
Bills Payables	100+90+70-30-40	190
Total Equity and Liabilities		**2546**

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. Analysis of Other Equity

Analysis of Other Equity			P	Q	R
Other Equity at the yearend			460	160	120
Other Equity at the beginning				100	50
TCI (Profits) during the year		(a)		60	70
Pre-acquisition upto 30-09-20x5	(50%)	(b)		30	35
Post-acquisition Profits	c = (a – b)			30	35
Share from Q = 80%*30	(80% of c)		24		
Share from R= 60%*35	(60% of c)		21		
			505		
Less Unrealised Profits in inter-company Inventory = 16*1/4			4		
Consolidated Other Equity			501		

III. Net Assets on acquisition

Net Assets on acquisition	Q	R
Share Cap	500	300
Other Equity on 01-04-20x5	100	50
Add Profits (b)	30	35
Net Assets	630	385

IV. NCI on 30-09-20x5

NCI on 30-09-20x5 = Consideration X (NCI share/Parent Share)	Q	R
NCI Q = 480*20%/80%	120	
NCI R = 300*40%/75%		160

Note 1: Goodwill/ Bargain Purchase

		Q	R	consolidated
Net Assets	a	630	385	
Consideration	b	480	240$	
NCI on acquisition at fair value	c	120	160	
Gains on bargain Purchase	a-(b+c)	30		
Goodwill	b+c-a		15	
Net amount to Other Equity				15

$ 80% × 300 = 240 is the consideration for Goodwill calculation and 20% × 300 = 60 is the NCI share in Investment adjusted against NCI.

Note 2: NCI on 31-03-20x6

		Q	R
NCI on acquisition		120	160
Post acquisition profit= Q: 30*20%; R: 35*40%	(Share in c)	6	14
Less: NCI share in investment in R = 20%*300	($)	60	
NCI on Reporting date		66	174

25. Loss of control:

A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

(a) They are entered into at the same time or in contemplation of each other.

(b) They form a single transaction designed to achieve an overall commercial effect.

(c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.

(d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

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

26. Investment Entity:

(I) 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.

(II) 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.

However, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities it shall consolidate that subsidiary in accordance with paragraphs of this Ind AS and apply the requirements of Ind AS 103 to the acquisition of any such subsidiary.

(III) A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

3.5 EQUITY METHOD

27. Equity Method:

(a) 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.

(b) 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.

(c) 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, and Ind AS 27.

Illustration 17.

Company P Ltd. (a listed company) acquires 20% shares in company Q Ltd. on 1-4-17 at a cost of Rs. 46000, paid by cash. During the financial year 17-18, Q made profits of Rs. 20000 and other comprehensive income of Rs. 10000.

I. Investment entails 20% 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 statements 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 20% voting power through holding of 20% shares in Q. 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 for cases I, II and III for Consolidated and separate financial statements:

Investment	Dr.	46,000	
To Cash			46,000

Journal Entry for cases IV and V: As per Ind AS 109 for Individual financial statements.

At initial measurement:

Investment	Dr.	46,000	
To Cash			46,000

(c) 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.

At the yearend in consolidated accounts of P Ltd., adjustments are made to the Investment and income accounts as per equity method:

Investment	Dr.	6,000	
To Profit and Loss			4,000
To Other Comprehensive Income			2,000

Working Note: Change in investee's net assets = 20000+10000 = 30000; share of P = 20% of 30000 = 6000.

Investor's Profit or loss includes 20% of 20000 = 4000 and other comprehensive income includes 20% of 10000 = 2000.

(ii) At the yearend for the separate financial statements of P, Investment is valued at cost at Rs. 46000 or at a value as per Ind AS 109,(ie., at fair value through OCI).

(iii) For cases IV and V: As per Ind AS 109, (ie., at fair value through OCI) in Individual financial statements.

3.6 PREPARATION OF GROUP CASH FLOW STATEMENT

The actual cash paid for the subsidiary is shown under the heading 'Acquisitions and Disposals'. It is possible that the purchase consideration will include other forms of payments such as the issue of shares or loan stock and there is no cash flow effect in these cases.

In exchange for the purchase consideration, the group acquires the individual net assets of the subsidiary and goodwill is recognized on acquisition.

The net assets in the closing consolidated Balance Sheet will include those of the newly acquired subsidiary. The preparation of the group cash flow statement must recognize that the movement from opening to closing positions is increased in party by the net assets of the new subsidiary and the amounts relating to that subsidiary are therefore excluded from the cash flow statement.

For example, additions to fixed assets are represented by purchases during the year plus fixed assets of the acquired subsidiary. This is broken down as follows:

Opening + cash purchases + fixed assets of – disposals- depreciation=closing

NBV for additions acquired subsidiary NBV

Only cash purchase for additions are included in the cash flow statement under 'inventive activities'.

Statement of Cash Flows

"The information provided in a statement of cash flows, if used with related disclosures and information in the other financial statements, should help investors, creditors, and others to (a) assess the enterprise's ability to generate positive future net cash flows; (b) assess the enterprise's ability to meet its obligations, its ability to pay dividends, and its needs for external financing; (c) assess the reasons for differences between net income and associated cash receipts and payments; and (d) assess the effects on an enterprise's financial position of both its cash and non-cash investing and financing transactions during the period." - SFAS 95 Statement of Cash Flows, Financial Accounting Standards Board, US.

LEARNING OBJECTIVES

After learning this Chapter, you will be able to understand that—

- When a company earns profit that may not be available in cash. Cash profit and accounting profit are different.
- What is the meaning of 'cash and cash equivalent'?

- How to classify cash flow from operational activities, financing activities and investment activities?
- How to reconcile cash balance of a company?

Importance of Cash flows

Cash flows are crucial to business decisions. Cash is invested in the business and the rationality of such investment is evaluated taking into account the future cash flows it is expected to generate. Economic value of an asset is derived on the basis of its ability to generate future cash flows. Economic value of an asset is given by the present value of future cash flows expected to be derived from the asset.

Profit is an accounting concept. Profit is derived on accrual assumption. Profit and cash flows from operational activities are not the same. Dividend decision is taken on the basis of profit, although it is to be paid in cash. Similarly, debt servicing capacity of a company is determined on the basis of cash flows from operations before interest. Ploughing back of profit is a much talked about source of financing modernisation, expansion and diversification. Unless retained profit is supported by cash, ploughing back is not possible. Thus cash flows analysis is an important basis for making several management decisions.

Meaning of Cash and Cash Equivalent

A cash flow statement explains the reasons for change in the cash and cash equivalent between two financial statement dates. Before we introduce the technique of cash flow analysis, let us learn the meaning of the term 'cash and cash equivalent'.

Cash means cash in hand and balance of foreign currency. Cash equivalent implies bank balance and other risk-free short term investments, and advances which are readily encashable. Cash equivalent means short term highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. An investment of short maturity, say three months or less from the date of acquisition is generally considered as cash equivalent. Equity investments are not considered as cash equivalent because of high market risk. Investments in call money market, money market mutual funds, repo transactions, badla transactions, etc., are usually classified as cash equivalents.

Types of Cash flow

Cash Flow Statement explains cash movements under three different heads, namely

- Cash flow from operating activities;
- Cash flow from investing activities;
- Cash flow from financing activities.

Sum of these three types of cash flow reflects net increase or decrease of cash and cash equivalents.

Operating activities are the principal revenue - producing activities of the enterprise and other activities that are not investing and financing. Operating activities include all transactions that are not defined as investing or financing. Operating activities generally involve producing and delivering goods and providing services.

Investment activities are the acquisition and disposal of long term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Elements of operating cash flow

Given below are elements of operating cash flow:

Description of elements of operating cash flow

- Cash receipts from sale of goods and rendering services.
- Cash receipts from royalty, fees, commissions and other revenue.
- Cash payments to suppliers for goods and services.
- Cash payments to and on behalf of employees.
- Cash receipts and cash payments by an insurance enterprise for premiums and claims, annuities and other policy benefits.

- Cash payments and refunds of income taxes unless these are specifically identified as cash flow from financing or investment.
- Cash receipts and payments relating to contracts held for dealing or trading purposes.
- Cash flow arising from dealing in securities when an enterprise holds securities for such purpose.
- Cash advances and loans made by financial institutions including all contracts held for trading purposes which may range from sale licence, export-import quota, any other operating contract. This may not necessarily be a contract relating to derivative instruments.

Elements of cash flow from investment activities

Given below are eight elements of investment cash flow:

Elements of cash flow from investment activities:

1. Cash payments for acquisition of fixed assets including intangibles.
2. Cash receipts from disposal of fixed assets.
3. Cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint venture.

   This does not include an item covered in cash equivalents and items held for dealing or trading purposes.
4. Cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint venture.

   This does not include an item covered in cash equivalents and items held for dealing or trading purposes.
5. Cash advances and loans made to third parties.

   This does not include loans and advances made by financial institutions as these fall under operating cash flow.
6. Cash receipts from repayments of advances and loans made to third parties. This does not include loans and advances made by financial institutions as these fall under operating cash flow.
7. Cash payments for future, forward, option and swap contracts.

   This does not include contracts held for dealing or trading purposes or contracts which are classified as financing activities.
8. Cash receipts from future, forward, option and swap contracts.

This does not include contracts held for dealing or trading purposes or contracts which are classified as financing activities.

Classification of derivative transactions –

Derivative Transactions which are for Heading	Speculative contracts
• Of Operating transactions like oil future, currency forward relating to sale or purchase of goods or services, commodity futures or options that relates to raw materials and finished goods: Should be classified as operating cash flow.	• Of dealers - Operating activities.
• Of investment transactions like stock index futures to protect value investment in shares, T- bill futures or options to protect value of in vestment debt instruments Should be classified as investment cash flow.	• Of others - Investment activities.
• Of financing activities like swaps against foreign currency loans and floating rate interest: Should be classified as financing cash flow.	

Elements of cash flow from financing activities

Given below are five elements illustrated cash flow from financing activities:

Elements of cash flow from financing activities

1. Cash proceeds from issuing shares or other equity instruments.
2. Cash payments to owners to acquire or redeem the enterprise's shares.
3. Cash proceeds from issuing debentures, loans, notes, bonds, mortgages, and other short term and long term borrowings.
4. Cash repayments of amounts borrowed.
5. Cash payments by a lease for the reduction of the outstanding liability relating to a finance lease.

Cash Flow from Operating Activities

Operating cash flows can be derived either in pursuance of a direct method or indirect method. Under direct approach major classes of cash receipts and payments are disclosed. Whereas under indirect approach net profit or loss adjusted to derive operating cash flow. Although direct method is not appropriate, the SEBI requires computation of cash flow from operating activities using indirect method.

Direct Method

Cash flow from operating activities is computed taking into account the following items:

Cash Receipts	Cash Payments
• Cash sales and cash collection = Sales + Opening Balance of Receivables — Closing Balance of Receivables.	• Cash purchase of raw materials and spares for manufacturing activities = [Raw material consumed + Closing stock - Opening Stock] + [Opening creditors - Closing creditors]
	• Cash purchase of finished goods for trading [Goods sold + Closing stock - Opening Stock] + [Opening creditors - Closing creditors].
	• Payment to and on behalf of employees Wages & Salaries + Closing outstanding balance -Opening outstanding balance.
	• Payment of expenses = Expenses incurred + Opening balance of outstanding - Closing balance of outstanding.

Notes:

(1) Figures of cash sales may be directly available from cash book. Then Cash collection can be derived taking Credit sales + Opening balance of debtors - closing balance of debtors.

(2) Similarly figures of cash purchases can also be obtained from cash books.

(3) Interest and dividend are investment cash inflow and, therefore, to be excluded.

(4) Interest expense is financing cash outflow.

(5) Tax provision is not cash expense, advance tax paid should be treated as tax cash outflow.

Indirect Method

Under this method operating cash flow is derived indirectly by making adjustments for non-cash items, cash flow of different types included in the profit and working capital adjustments. Starting from profit before tax adjustments can be made to arrive at operating cash flow.

Profit Before Tax Add: Depreciation and Amortisation being non-cash item Interest - being financing cash outflow Lease rental of finance lease - being financing cash outflow
Less : Interest and dividend received - being investment cash inflow Lease rental received of finance lease - being investment cash inflow Advance tax paid to the extent relates to operating cash flow (Tax paid for financing cash flow and investment cash flow should be separated)
Add/Less : Working Capital Adjustments Increase in current assets like receivables, inventories (-) Decrease in current assets like receivables, inventories (+) Increase in current liabilities (+) Decrease in current liabilities (-)

Illustrations on Cash Flow Statement

Given below is Profit and Loss Account of ABC Ltd. and relevant Balance Sheet information :

Illustration: 18.

Profit and Loss Account of ABC Ltd. for the year ended 31-03-2017

(₹ in Lakhs)

Revenue	
Sales	4150
Interest and dividend	100
Stock adjustment	20
Total	**4270**
Expenditure	
Purchases	2400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total	**3560**
Profit before tax	710
Tax Provision	200
Profit after tax	**510**
Balance of Profit & Loss Account	50
Profit available for distribution	560

Appropriation	
Transfer to General Reserve	200
Proposed dividend	300
Distribution tax	30
Total	**530**
Balance	30

Relevant Balance Sheet information	**31-03-2017** (₹ in Lakhs)	**31-03-2016** (₹ in Lakhs)
Debtors	400	250
Inventories	200	180
Creditors	250	230
Outstanding wages	50	40
Outstanding expenses	20	10
Advance tax	195	180
Tax provision	200	180
Assessed tax liability		180

Let us now study the technique of direct method of calculating operating cash flow:

Computation of cash flow from Operating		
Activities		
Direct Method		
Cash Receipts		
Cash sales & Collection from debtors		
Sales+Opening Debtors - Closing Debtors	(4150+250-400)	4000
Cash Payments		
Cash purchases & Payment to creditors		
Purchases+ Opening Creditors - Closing creditors	(2400+230-250)	2380
Wages & salaries paid	(800+40-50)	790
Cash Expenses	(200+10-20)	190
Taxes paid - Advance tax		195
		3555
Cash Flow from Operating Activities		**445**
Indirect Method		
Profit before tax		710
Add : Non-cash items : Depreciation		100
Add : Interest : Financing cash outflow		60
Less : Interest and Dividend : Investment		
Cash inflow		-100
Less : Tax paid		-195

Working Capital Adjustments		
Debtors	(250-400)	-150
Inventories	(180-200)	-20
Creditors	(250-230)	20
Outstanding wages	(50-40)	10
Outstanding expenses	(20-10)	10
Cash Flow from Operating Activities		**445**

Illustration 19.

Deepak Chemicals presents the following Balance Sheets as at 31-03-17 and 31-03-16. You are required to prepare cash flow statement.

(₹ in thousand)

Balance Sheet		**31-03-17**		**31-03-16**
Equity share capital	8,500		7,000	
General Reserve	3,800		4,000	
Profit & Loss Account	0		250	
Share Premium Account	1,500		750	
Shareholders' Funds		13,800		12,000
Secured Loans	4,800		5,000	
Unsecured Loans	5,350		4,000	
Loan Funds		10,150		9,000
Sources		23,950		21,000
Fixed Assets				
Gross Block	22,400		21,000	
Accumulated Depreciation	3,450		3,200	
Net Block		18,950		17,800
Capital Work-in-progress		1,860		0
Investments		1,650		2,320
Current Assets, Loans & Advances				
Inventories	2,150		2,240	
Debtors	1,090		1,200	
Cash & Bank Balances	120		280	
Loans	1,700		200	
Advance Tax	0			
Creditors	1,050		1,200	
Outstanding expenses	30		0	
Tax Provision	0		500	
Proposed Dividend	3,400		2,800	
	4,480		4,500	
Net Current Assets		940		280
Miscellaneous Expenditure		550		600
Applications		23,950		21,000

Other Information:

(1) Fixed assets costing ₹ 4,00,000, accumulated depreciation ₹ 3,00,000 were sold for ₹ 1,50,000.

(2) Actual tax liability for 2015-16 was ₹ 5,00,000.

(3) Loans represent long term loans given to group companies.

(4) Interest on loan funds for 2015-16 was ₹ 14,21,000 and interest and dividend income were ₹ 4,02,000.

(5) Investments costing ₹ 20,00,000 were sold for ₹ 25,00,000.

Solution:

(₹ in thousand)

Cash flow from operating activities		
Change in general reserve	-200	
Change in profit and loss account	-250	
Proposed dividend	3400	
Provision for tax	0	
Profit Before tax		2950
Add : Depreciation	550	
Add : Misc.Expn.	50	
Add/(Less) Loss (profit) on sale of fixed assets	-50	
Add/(Less) Loss (profit) on sale of Investments	-500	50
Funds flow from operations		3000
Add: Interest paid		1421
Less Interest and Dividend Received		-402
Add/Less Working Capital Adjustment		
Inventories	90	
Debtors	110	
Creditors	-150	
Outstanding expenses	30	80
Cash Flow from Operating Activities (Before tax)		4099
Less Advance tax for 2016-17		0
Cash flow from Operating Activities (After Tax)		4099

Cash flow Financing Activities		
Issue of shares		
Face value	1500	
Premium	750	2250
Repayment of Secured Loans	-200	
Raising of Unsecured Loans	1350	
Net loan		1150
Interest payment		-1421
Dividend payment for 2015-16		-2800
		-821

Cash flow from Investment Activities		
Purchase of Fixed Assets	-1800	
Sale of Fixed Assets	150	
Capital WIP	-1860	
Fixed Assets (Net)		-3510
Purchase of Investments	-1330	
Sale Proceeds of Investments	2500	
Investments (Net)		1170
Loans		-1500
Interest & Dividend Income		402
		-3438

Cash Flow Statement		
Cash flow from Operating Activities (After Tax)		4099
Cash flow from Financing Activities		-821
Cash flow from Investment Activities		-3438
Increase/decrease in Cash & Bank Balance		-160

Illustration 20.

Given below are summarised Balance Sheets of Harsh Chemicals Ltd. as at 31-03-16 and 31-03-17. The company issued one bonus share for every 4 shares held. The company also acquired machinery amounting to ₹ 30,00,000 from Levenz of France on deferred credit basis. You are required to prepare the cash flow statement.

(₹ in thousand)

Balance Sheet		31-03-17		31-03-16
Equity share capital	8,500		4,000	
General Reserve	7,000		7,600	
Profit & Loss Account	1,200		1,000	
Share Premium Account	1,500		750	
Shareholders' Funds		18,200		13,350
Secured Loans	4,800		5,400	
Unsecured Loans	5,350		4,000	
Deferred Credit	3,000		0	
Loan Funds		13,150		9,400
Sources		31,350		22,750
Fixed Assets				
Gross Block	22,400		17,000	
Accumulated Depreciation	3,450		3,200	
Net Block		18,950		13,800
Capital Work-in-progress		8,200		3,000
Investments		1,650		2,320
Current Assets, Loans & Advances				
Inventories	4,000		3,200	

Debtors	1,090		2,200	
Cash & Bank Balances	540		750	
Loans	1,700		200	
Advance Tax	1,600		1,400	
	8,930		7,750	
Creditors	1,050		1,600	
Outstanding expenses	880		120	
Tax Provision	1,600		1,400	
Proposed Dividend	3,400		1,600	
	6,930		4,720	
Net Current Assets		2,000		3,030
Miscellaneous Expenditure		550		600
Applications		31350		22750

Other Information:

(1) Fixed assets costing ₹ 4,00,000, accumulated depreciation ₹ 3,00,000 were sold for ₹ 1,50,000.

(2) Actual tax liability for 2015-16 was ₹ 14,00,000.

(3) Loans represent long term loans given to group companies.

(4) Interest on loan funds for 2016-17 was ₹18,41,000 and interest and dividend income were ₹ 4,02,000.

(5) Investments costing ₹ 20,00,000 were sold for ₹ 25,00,000.

Solution:

(₹ in thousand)

Cash flow from operating activities		
Change in general reserve	400	
Change in profit and loss account	200	
Proposed dividend	3,400	
Provision for tax	1,600	
Profit before tax		5,600
Add : Depreciation	550	
Add : Misc. Expenses	50	
Add/(Less) Loss (profit) on sale of fixed assets	(50)	
Add/(Less) Loss (profit) on sale of Investments	(500)	
Funds flow from operations		5,650
Add : Interest paid		1,841
Less : Interest and Dividend Received		-402
Add/Less Working Capital Adjustment		
Inventories	(800)	
Debtors	1,110	
Creditors	(550)	
Outstanding expenses	760	520

Cash Flow from Operating Activities (Before tax)		7,609
Less : Advance tax for 2014-17		1,600
Cash flow from Operating Activities (After Tax)		6,009

Cash flow Financing Activities		
Issue of shares		
Face value	3,500	
Premium	750	4,250
Repayment of Secured Loans	(600)	
Raising of Unsecured Loans	1350	
Net loan		750
Interest payment		-1,841
Dividend payment for 2015-16		-1,600
		1,559

Cash flow from Investment Activities		
Purchase of Fixed Assets	(5,800)	
Sale of Fixed Assets	150	
Capital WIP	(2,200)	
Fixed Assets (Net)		(7,850)
Purchase of Investments	(1,330)	
Sale Proceeds of Investments	2,500	
Investments (Net)		1,170
Loans		(1,500)
Interest & Dividend Income		402
		(7,778)

Cash Flow Statement		
Cash flow from Operating Activities (After Tax)		6,009
Cash flow from Financing Activities		1,559
Cash flow from Investment Activities		(7,778)
Increase/decrease in Cash & Bank Balance		(210)

Illustration 21.

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2017 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.03.2017

Particulars	₹ '000	Particulars	₹ '000
Balance on 1.4.2016	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from Customers	2,800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.3.2017	150
	3,250		3,250

Solution:

X Ltd.
Cash Flow Statement for the year ended 31st March, 2017
(Using the direct method)

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	2,800	
Cash payment to suppliers	(2,000)	
Cash paid to employees	(100)	
Cash payments for overheads	(200)	
Cash generated from operations	500	
Income tax paid	(250)	
Net cash from operating activities		250
Cash flows from investing activities		
Payment for purchase of fixed assets	(200)	
Proceeds from sale of fixed assets	100	
Net cash used in investing activities		(100)
Cash flows from financing activities		
Proceeds from issuance of equity shares	300	
Bank loan repaid	(300)	
Dividend paid	(50)	
Net cash used in financing activities		(50)
Net increase in cash		100
Cash at beginning of the period		50
Cash at end of the period		150

Illustration 22.

(a) Arrange and redraft the following Cash Flow Statement in proper order keeping in mind the requirements of AS 3:

		₹ in Lakhs	₹ in Lakhs
Net Profit			60,000
Add:	Sale of Investments		70,000
	Depreciation on Assets		11,000
	Issue of Preference Shares		9,000
	Loan raised		4,500
	Decrease in Stock		12,000
			1,66,500
Less:	Purchase of Fixed Assets	65,000	
	Decrease in Creditors	6,000	
	Increase in Debtors	8,000	
	Exchange gain	8,000	
	Profit on sale of investments	12,000	
	Redemption of Debenture	5,700	
	Dividend paid	1,400	
	Interest paid	945	1,07,045
			59,455
Add:	Opening cash and cash equivalent		12,341
	Closing cash and cash equivalent		71,796

Solution:

(a) **Cash Flow Statement**

		(₹ in Lakhs)
Cash flows from operating activities		
Net profit		60,000
Less: Exchange gain		(8,000)
Less: Profit on sale of investments		(12,000)
		40,000
Add: Depreciation on assets		11,000
Change in current assets and current liabilities		51,000
(-) Increase in debtors	(8,000)	
(+) Decrease in stock	12,000	
(-) Decrease in creditors	(6,000)	(2,000)
Net cash from operating activities	49,000	
Cash flows from investing activities		

Sale of investments	70,000	
Purchase of fixed assets	(65,000)	
Net cash from Investing activities	5,000	
Cash flows from financing activities		
Issue of preference shares	9,000	
Loan raised	4,500	
Redemption of Debentures	(5,700)	
Interest paid	(945)	
Dividend paid	(1,400)	
Net cash from financing activities		5,455
Net increase in cash & cash equivalents	59,455	
Add: Opening cash and cash equivalents		12,341
Closing cash and cash equivalents		71,796

3.7 IND AS 27: SEPARATE FINANCIAL STATEMENTS

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.

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.

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.

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 in accordance with Ind AS 109, Financial Instruments.

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.

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.

An entity shall apply all applicable Ind ASs when providing disclosures in its separate financial statements. 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.

3.8 IND AS 28: INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Objective:

The objective of this Standard is to prescribe the accounting and to use the equity method in accounting for investments in associates and joint ventures.

Scope:

This Standard shall be applied by all entities having investments in associates and joint ventures.

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.

If an entity holds, directly or indirectly (e.g. 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.

(iii) 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.

(iv) A joint arrangement is an arrangement of which two or more parties have joint control.

(v) 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.

(vi) 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.

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.

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.

An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with paragraph 10 of Ind AS 27.

3.9 IND AS 105: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Objectives:

(a) **To measure:** assets that meet the criteria to be classified as **held for sale** (or held for distribution to owners) to be measured **at the lower of carrying amount and fair value less costs to sell** (less cost to distribute), and depreciation on such assets to cease; and

(b) **To present:** assets that meet the criteria to be classified as held for sale to be presented separately in the balance sheet and the results of discontinued operations to be presented separately in the statement of profit and loss.

Scope:

The classification and presentation and measurement requirements of this Standard apply to all recognised **non-current assets** and to all **disposal groups** of an entity (with exception to measurement requirements for assets covered under listed Ind ASs).

Meaning of the terms:

(a) **Non-current assets:** Non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period.

(b) **Disposal groups:** Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. Such a **disposal group** may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit. The measurement requirements of this Ind AS apply to this disposal group as a whole, so that the group is measured at the lower of its carrying amount and fair value less costs to sell.

(c) An entity shall classify a non-current asset (or disposal group) **as held for sale** if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

Note 1:

To qualify for classification as held for sale, a non-current asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups). A non-current asset (or disposal group) is available for immediate sale if an entity currently has the intention and ability to transfer the asset (or disposal group) to a buyer in its present condition.

(d) A non-current asset (or disposal group) is classified **as held for distribution to owners** when the entity is committed to distribute the asset (or disposal group) to the owners.

Changes to a plan of sale: The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:

(a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale, and

(b) its recoverable amount at the date of the subsequent decision not to sell.

(A) Presentation and disclosure: An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

An entity shall disclose:

(a) a single amount in the statement of profit and loss comprising the total of:

  (i) the post-tax profit or loss of discontinued operations and

  (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation.

(b) an analysis of the single amount into before tax profit/loss/gains and related income tax expenses.

(B) An entity shall present non-current assets/assets of a disposal group classified as held for sale separately from other assets in the balance sheet. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the balance sheet. Those assets and liabilities shall not be offset and presented as a single amount. An entity shall present separately any cumulative income or expense recognised in other comprehensive income relating to a non-current asset (or disposal group) classified as held for sale.

Abandoned Assets: This standard prohibits assets that will be abandoned from being classified as held for sale. However, if the assets to be abandoned are a major line of business or geographical area of operations, they are reported in discontinued operations at the date at which they are abandoned.

Illustration 23.

(a) X Company commits a plan on 1st July, 2018 to sell its head office building to a buyer after it vacates the building. For vacating ordinarily one month time is required. Should the building be classified as asset held for sale on 1st July or one month later?

(b) X Company commits a plan on 1st July, 2018 to sell its head office building to a buyer after it constructs a new building. Should the building be classified as asset held for sale on 1st July?

Answer:

(a) It should be classified as held for sale on 1st July as it is available for immediate sale in its present condition since the time necessary to vacate the building is usual and customary for sales of such assets.

(b) No. It is not classified as held for sale on July 1st as it is not available for sale immediately on 1st July and it remains not available for sale until the new construction is completed.

Illustration 24.

A company is committed to a plan to sell a factory to a buyer on 30th September with back log of uncompleted customer order with a condition that (a) the factory will be transferred immediately along with the back log orders to the buyer. (b) the factory will be transferred after finishing the back log orders. Should the factory be classified as available for sale on 30th in case of (a) and (b)?

Answer:

In case of (a) it is available for immediate sale at its present condition on 30th and hence on that date it should be classified as available for sale. In case of (b) it is not available for immediate sale on 30th rather it is not available for sale until the back log customer orders are completed.

3.10 IND AS 111: JOINT ARRANGEMENTS

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.]

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]*

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 (i.e. *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.

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.

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*.]

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 25.

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.

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 in accordance with paragraph 6 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation.

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.

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.

3.11 IND AS 112: DISCLOSURE OF INTERESTS IN OTHER ENTITIES

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.

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 (i.e. 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 arrangement unless that interest results in significant influence over the arrangement or is an interest 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.

Disclosure :

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, i.e. 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.

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.

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.

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).

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:

(a) the name of the subsidiary.

(b) the principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary.

(c) the proportion of ownership interests held by non-controlling interests.

(d) the proportion of voting rights held by non-controlling interests, if different from the proportion of ownership interests held.

(e) the profit or loss allocated to non-controlling interests of the subsidiary during the reporting period.

(f) accumulated non-controlling interests of the subsidiary at the end of the reporting period.

(g) summarised financial information about the subsidiary.

D. About nature and extent of significant restrictions:

An entity shall disclose:

(a) significant restrictions (e.g. 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.

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.

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.

Study Note - 4

RECENT TRENDS IN FINANCIAL REPORTING

This Study Note includes

4.1 Sustainability Reporting
4.2 Concept of Triple Bottom Line (TBL)
4.3 Concept of Triple Bottom Line Reporting
4.4 Benefits of Triple Bottom Line Reporting
4.5 Implementation of Triple Bottom Line Reporting
4.6 Forms of TBL Reporting
4.7 Users of TBL Reporting
4.8 Financial Reporting vis- à-vis Triple Bottom Line Reporting
4.9 Challenges of Triple Bottom Line Reporting Framework
4.10 Corporate Social Responsibility Reporting (CSR Reporting)
4.11 Ind AS 113: Fair Value Measurement
4.12 Integrated Reporting (IR)
4.13 Business Responsibility Reporting

4.1 SUSTAINABILITY REPORTING

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: economic factors and social factors. Together these three pillars of sustainability are often referred to as '***People – Planet – Profit***'. In this scenario, the three 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.

With the shift in societal focus toward environmental longevity, businesses are encouraged to look at the big picture and see their impact on the world around them. Sustainable development was identified by the Brundtland Commission of the United Nations in 1987. The need was felt by the various entities to incorporate the concept of sustainability, in their financial reporting framework.

In 1981, Freer Spreckley first articulated this theme in a publication called 'Social Audit - A Management Tool for Co-operative Working' in which, he stated that enterprises should measure and report on social, environmental and financial performance.

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 recognise 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.

4.11 IND AS 113: FAIR VALUE MEASUREMENT

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.

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.

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.

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 fulfill a liability is not relevant when measuring fair value.

Measurement :

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 —

- the condition and location of the asset; and
- 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 (e.g. 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 (e.g. a cash-generating unit or a business).

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.

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

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.*

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.

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.

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.

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.

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.

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)*.

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.

4.12 INTEGRATED REPORTING (IR)

Concept:

Integrated reporting (IR) is the latest development in a long line of proposed reporting innovations that have sought to improve the usefulness of corporate reporting. International Integrated Reporting Council (IIRC) launched IR as a global framework in December 2013.

Integrated reporting refers to 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.

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. The primary objective of integrated reporting is to help stakeholders analyze and assess the company's ability to create and sustain value in the medium and long term.

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.

Value Creation and Six Capitals

For value creation companies should expand their reporting beyond the stewardship of financial capital, to include all the resources they use as inputs to their business activities. The IIRC uses the term "capitals" to denote these various resources, with six capitals identified: financial; manufactured; intellectual; human; social and relationship; and natural.

- Financial capital: Financial capital 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.
- Manufactured capital 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.
- Intellectual capital is a key element in an organization's future earning potential.It includes investment in R&D, innovation, human resources and external relationships.
- Human Capital • It is "generally understood to consist of the individual's capabilities, and the knowledge, skills and experience of the company's employees and managers, as they are relevant to the task at hand, as well as the capacity to add to this reservoir of knowledge, skills, and experience through individual learning". (Dess & Picken, 2000: 8)
- The OECD defines social capital as "networks together with shared norms, values and understandings that facilitate co-operation within or among groups".
- "Natural capital includes the land, water, atmosphere, and the many natural resources they contain, including ecological systems with living (biotic) and non-living (abiotic) components".

Benefits of IR

IR is beneficial as it contributes to:

- incorporate sustainability into its core business
- communicate the impact of a company's operations on environment and community
- identify ESG related risks and opportunities

- provide a competitive edge over its peers in the long term
- informed decisions and improved overall performance
- identify cost savings by analyzing financial and non-financial metrics together
- increase internal collaboration
- increase engagement with internal and external stakeholders through consistent and balanced reporting
- address reputational risk.
- increase brand value and customer loyalty

Challenges to IR:

Who will provide assurance to Integrated Reports?

There is no internationally acceptable standard or framework for IR.

Measuring and quantifying non-financial metrics and then integrating them with financial performance are complex tasks.

4.13 BUSINESS RESPONSIBILITY REPORTING

Introduction

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: 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.

Study Note - 5

VALUATION, ACCOUNTING AND REPORTING OF FINANCIAL INSTRUMENTS AND OTHERS

This Study Note includes

5.1 Recognition & Valuation of Financial Instruments (Ind AS-32, Ind AS-107 & Ind AS-109)

5.2 Goods and Services Tax (GST) Accounting

5.3 NBFC - Provisioning Norms and Accounting

5.4 Valuation of Shares

5.5 Valuation of Goodwill

5.2 GOODS AND SERVICES TAX (GST) ACCOUNTING

GST is a destination based tax and levied at a single point at the time of consumption of goods or services by the ultimate consumer. GST is based on the principle of value added tax. GST law emphasizes on voluntary compliance and on accounts based reporting and monitoring system. It is a comprehensive levy and envisages tax collection on both goods and services at the same rate.

The term GST is [defined in Article 366 (12A)] *"any tax on supply of goods or services or both except taxes on supply of the alcoholic liquor for human consumption"*.

It is one tax in dual system. It is dual system as both Centre and states have their revenue.

GST amalgamated a large number of Central and State taxes into a single tax. Allowing set-off of prior-stage taxes; it would mitigate the ill effects of cascading and pave the way for a common national market.

The GST replaced the following taxes levied and collected by the Centre:

a. Central Excise duty

b. Duties of Excise (Medicinal and Toilet Preparations)

c. Additional Duties of Excise (Goods of Special Importance)

d. Additional Duties of Excise (Textiles and Textile Products)

e. Additional Duties of Customs (commonly known as CVD)

f. Special Additional Duty of Customs (SAD)

g. Service Tax

h. Central Surcharges and Cesses so far as they relate to supply of goods and services

State taxes that are subsumed under the GST are:

a. State VAT

b. Central Sales Tax

c. Luxury Tax

d. Entry Tax (all forms)

e. Entertainment and Amusement Tax (except when levied by the local bodies)

f. Taxes on advertisements

g. Purchase Tax

h. Taxes on lotteries, betting and gambling

i. State Surcharges and Cesses so far as they relate to supply of goods and services

Salient Features of GST:

The GST is applicable on the supply of goods or services. It is a destination based consumption tax.

It would be a dual GST with the Centre and States simultaneously levying it on a common tax base. The GST to be levied by the Centre on intra-State supply of goods and / or services would be called the Central GST (CGST) and that to be levied by the States would be called the State GST (SGST). In case of inter- state transfer or import Integrated GST (IGST) is levied.

Scope:

The GST would apply to all goods other than alcoholic liquor for human consumption and five petroleum products, viz. petroleum crude, motor spirit (petrol), high speed diesel, natural gas and aviation turbine fuel. It would apply to all services barring a few to be specified.

Tobacco and tobacco products would be subject to GST. In addition, the Centre would have the power to levy Central Excise duty on these products.

GST is a tax on value addition basis on the transaction value of outward supply of goods and/or services of a month computed at notified rate [1%,5%, 12%, 18%, 28%] and paid through Electronic Cash Ledger after availing Input Tax Credit on or before 20th of next month along with monthly return.

Taxability:

Tax payers with an aggregate turnover in a financial year up to [₹20 lakhs/ 10 lakhs for NE states and Sikkim] would be exempt from tax.

Small taxpayers with an aggregate turnover in a financial year up to ₹ 1.50 crores shall be eligible for composition levy. Under the scheme, a taxpayer shall pay tax as a percentage of his turnover during the year without the benefit of (ITC) Input Tax Credit .

The GST to be levied by the Centre on intra-State supply of goods and/or services is Central GST (CGST) and that by the States is State GST (SGST).

On inter-state supply of goods and services, Integrated GST (IGST) will be collected by Centre. IGST will also apply on imports.

GST is a consumption based tax i.e. the tax should be received by the state in which the goods or services are consumed and not by the state in which such goods are manufactured. IGST is designed to ensure seamless flow of input tax credit from one state to another. One state has to deal only with the Central government to settle the tax amounts and not with every other state, thus making the process easier.

Time of Supply identifies the point of time when liability for GST arises.

Place of Supply indicates the state that will enjoy the tax so generated.

It is worth noting that Beneficiary of the tax generated is the state in which the place of supply is located (i.e., where the final consumption has taken place)

Benefits of GST:

Overall Reduction in Prices

Reduction in Cascading of Taxes

Common National Market

Benefits to Small Taxpayers

Self-Regulating Tax System

Non-Intrusive Electronic Tax System

Decrease in Inflation

Ease of Doing Business

Simplified Tax Regime

Reduction in Multiplicity of Taxes

Consumption Based Tax

GST Rates:

Threshold limit for exemption to be ₹ 20 lac (₹ 10 lac for special category States except J&K)

Four tax rates namely 5%, 12%, 18% and 28%

Some goods and services would be exempt

Separate tax rate (3% or 0.5%) for precious metals

Cess over the peak rate of 28% on specified luxury and sin goods

GST Accounting:

A supplier has to then maintain the following a/cs (apart from accounts like purchase, sales, stock) –

- Input CGST a/c
- Output CGST a/c
- Input SGST a/c
- Output SGST a/c
- Input IGST a/c
- Output IGST a/c
- Electronic Cash Ledger (to be maintained on Government GST portal to pay GST)

Illustration 1.

B of Orissa purchases goods at cost of ₹100000 from A of Orissa and sells goods to C of Orissa at a profit of ₹ 20000, who sells the goods at a profit of ₹ 15000 to D of West Bengal. D sold ₹ 1,50,000 in West Bengal and ₹1,00,000 in Bihar. GST rate applicable is 18%.

The transactions with Input and Output GST are shown below.

B in Orissa	₹	C in Orissa	₹	D in West Bengal	₹
Input CGST-9%	9,000				
Input SGST-9%	9,000			Input IGST	24,300
Purchase	1,00,000			Purchase	1,35,000
profit	20,000			Profit	1,15,000
Sale	1,20,000				
Output CGST	10,800	Input CGST	10,800	Sale Intra state	1,50,000
Output SGST	10,800	Input SGST	10,800	Sale Inter state	1,00,000
		Purchase	1,20,000	Output IGST	18,000
		profit	15,000	Output CGST	13,500
		Sale	1,35,000	Output SGST	13,500
		Output IGST	24,300		
CGST Liability	1,800			IGST Liability	0
SGST Liability	1,800	IGST Liability	2,700	CGST Liability	7,200
				SGST Liability	13,500

Accounting in books of suppliers:

In Books of B

Particulars		Dr. (₹)	Cr. (₹)
Purchase A/c	Dr.	1,00,000	
Input CGST A/c	Dr.	9,000	
Input SGST A/c	Dr.	9,000	
To Creditors A/c			1,18,000
Debtors A/c	Dr.	1,41,600	
To Sales A/c			1,20,000
To Output CGST A/c			10,800
To Output SGST A/c			10,800
Output CGST A/c	Dr.	10,800	
Output SGST A/c	Dr.	10,800	
To Input CGST A/c			9000
To Input SGST A/c			9000
To Electronic Cash Ledger A/c			3600

In Books of C

Particulars		Dr. (₹)	Cr. (₹)
Purchase A/c	Dr.	1,20,000	
Input CGST A/c	Dr.	10,800	
Input SGST A/c	Dr.	10,800	
To Creditors A/c			1,41,600
Debtors A/c	Dr.	1,59,300	
To Sales A/c			1,35,000
To Output IGST A/c			24,300
Output IGST A/c	Dr.	24,300	
To Input CGST A/c			10800
To Input SGST A/c			10800
To Electronic Cash Ledger A/c			2700

In the books of D in West Bengal

Particulars		Dr. (₹)	Cr. (₹)
Purchase A/c	Dr.	1,35,000	
Input IGST A/c	Dr.	24,300	
To Creditors A/c			1,59,300
Debtors A/c	Dr.	1,65,000	
To Sales A/c			1,50,000
To Output CGST A/c			13,500
To Output SGST A/c			13,500
Debtors A/c	Dr.	1,18,000	
To Sales A/c			1,00,000
To Output IGST A/c			18,000

Input Tax Credit set off against Output Tax Liability

	Total	CGST	SGST	IGST
Output Tax liability	45000	13,500	13,500	18,000
Less: Input tax credit	24300			

CGST [1.CGST, 2.IGST]				
SGST [1.SGST, 2.IGST]				
IGST [1.IGST, 2.CGST, 3.SGST]		6,300		18,000
Amount payable	20700	7,200	13,500	NIL

IGST input tax credit set off and net payment entries

Setoff against output IGST			
Output IGST	Dr.	18,000	
To Input IGST A/c			18,000
Setoff against output CGST			
Output CGST	Dr.	6300	
To Input IGST A/c			6300
Final payment			
Output CGST A/c	Dr.	7200	
Output SGST A/c	Dr.	13500	
To Electronic Cash Ledger A/c			20700

Illustration 2.

M of Mumbai purchased goods from C of Chennai costing ₹ 70000. M also purchased goods from B of Mumbai costing ₹ 120000. He paid telephone bill ₹ 6,000. He purchased an air cooler for his office for ₹ 12,000 from a supplier in Pune. He paid wages ₹ 26000 and sold goods at ₹ 40000 to T of Thane and at ₹ 240000 to Q of Bangalore. Assume GST rate 12% in all cases.

Purchase A/c	Dr.	70,000	
Input IGST A/c	Dr.	8400	
To Creditors A/c (Chennai)			78400
Purchase A/c	Dr.	1,20,000	
Input CGST A/c	Dr.	7200	
Input SGST A/c	Dr.	7200	
To Creditors A/c (Mumbai)			1,34,400
Debtors A/c	Dr.	44,800	
To Sales A/c (Thane)			40000
To Output CGST A/c			2400
To Output SGST A/c			2400
Debtors A/c	Dr.	268,800	
To Sales A/c (Bangalore)			240000
To Output IGST A/c			28800
Telephone Expenses A/c	Dr.	5,000	
Input CGST A/c	Dr.	300	
Input SGST A/c	Dr.	300	
To Bank A/c			5,600
Office Equipment A/c	Dr.	12,000	
Input CGST A/c	Dr.	720	
Input SGST A/c	Dr.	720	
To Bank A/c			13,440

Particulars		Dr. (₹)	Cr. (₹)
Setoff against CGST output tax liability Output CGST To Input CGST A/c	 Dr. 	 2400 	 2400
Setoff against SGST output Output SGST To Input SGST A/c	 Dr. 	 2400 	 2400
Setoff against IGST output Output IGST To Input IGST A/c To Input CGST To Input SGST	 Dr. 	 20040 	 8040 5820 5820
Final payment Output IGST A/c To Electronic Cash Ledger A/c	 Dr. 	 8760 	 8760

Workings:

	Total	CGST	SGST	IGST
Output Tax liability	33600	2400	2400	28800
Input tax credit: Purchase Chennai Purchase Mumbai Telephone Cooler		 7200 300 720	 7200 300 720	 8400
Total ITC	24840	8220	8220	8400
Set off Input tax credit				
CGST [1.CGST, 2.IGST]	8220	2400		5820
SGST [1.SGST, 2.IGST]	8220		2400	5820
IGST [1.IGST, 2.CGST, 3.SGST]	8400			8400
Total ITC set off	24840	2400	2400	20040
Amount payable = Output tax liability – ITC set off	8760	NIL	NIL	8760

Reverse Charge:

For inward supplies i.e. purchases which are made from unregistered tax payers in GST, Reverse Charge is applicable to such transactions. There is no Input Tax Credit for Reverse Charge paid, it is expensed as incurred.

Accounting:

Reverse Charge (CGST/SGST/IGST) Dr.
To Electronic Cash Ledger

For Composition Levy (no Input Tax Credit, no inter-state supply, no tax invoice,no collection from customer)

Composition Levy (CGST/SGST) Dr.
To Electronic Cash Ledger

So far we considered only CGST, SGST and IGST. There is UTGST in place of SGST for supplies in Union Territories. There is also GST Cess payable in certain cases.

Study Note - 6

SHARE BASED PAYMENTS

This Study Note includes

6.1 Introduction
6.2 Share Based Payment
6.3 Employee Share Based Payment Plans
6.4 Share Based Payment Transaction
6.5 Recognition of Share Based Payment in Financial Statement
6.6 Measurement of Share Based Payment
6.7 Disclosure
6.8 Accounting

Additional discussion on vesting condition in share based payment transactions with employees:

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.

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?

<table>
<tr><td rowspan="3">YES
It is service condition (A)</td><td colspan="2">NO
It is performance condition (B)</td></tr>
<tr><td colspan="2">Is the performance is related to market price of equity instruments?</td></tr>
<tr><td>YES
Market condition (C)</td><td>NO
(D)</td></tr>
</table>

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

B: It will be either C or D

C: Vesting period cannot be revised

D: Vesting period can be revised

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

Table 2.

<table>
<tr><td></td><td colspan="3">Problems on</td></tr>
<tr><td>Revision of</td><td>Vesting Period (T)</td><td colspan="2">Other than vesting period</td></tr>
<tr><td rowspan="2">For category of vesting condition</td><td rowspan="2">Only D</td><td>No. of employees (N)</td><td>Performance (P)</td></tr>
<tr><td>A, C, D</td><td>A, C, D</td></tr>
<tr><td>Complex problem types</td><td>DT</td><td>AN, CN, DN</td><td>AP, CP, DP</td></tr>
</table>

In all the cases the fair value is estimated on the grant date. However the Expense and Equity (for equity settled)/ Liability (for cash settled) will be recognized in each financial report of the entity during the relevant period based on the estimated fulfillment of the conditions, revision of estimates and actual fulfillment. Additional illustrations on vesting condition are given below.

Illustration 6.

D Ltd. offers the employees shares at a discount in recognition of their past services. In total 60000 shares of ₹ 10 each were accepted (and paid) by the employees at weighted average price of ₹ 40 when weighted average market price of the shares on the purchase date was ₹ 60. Pass journal entries.

Answer:

As for past services employee expense will be fully recognized immediately.

Market value of shares = 60000 X ₹ 60 = ₹ 3600000. Concession in share price is same as share option = Rs. 20 (i.e., 60 – 40). Hence service received is measured at ₹ 20* 60000 = ₹ 1200000; Amount paid per share = ₹ 40; for 60000 shares total bank received by the company = ₹ 2400000; Premium per share = market price – paid up value = 60 – 10 = 50; Security premium total credited and to be shown under Other Equity = ₹ 50* 60000 = 3000000.

Journal :

Bank	Dr.	24,00,000	
Employee expense	Dr.	1200,000	
To Equity Share Capital			6,00,000
To Other Equity (Security Premium)			30,00,000

(Employee expense recognized for share based payment by issue of equity at concession)		

Illustration 7.

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. 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.

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 ₹ 80. The fair value of the option at the grant date is taken at ₹ 30 only.

Pass journal entries with working notes.

Answer:

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 #)	336000	336000[1]
2	400*100*30*87%*2/3 (Note #)	696000	360000[2]
3	348*100*30*3/3 (Note #)	1044000[4]	348000[3]
	Total		1044000[4]

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.

Journal entries (without narration) in the books of Z Ltd.:

During the vesting period:

Year 1: Employee Expenses	Dr.	3,36,000	
To, Share based payment reserve (Other Equity)			336000[1]
Year 2: Employee Expenses	Dr.	3,60,000	
To, Share based payment reserve (Other Equity)			3,60,000[2]
Year 3: Employee Expenses	Dr.	3,48,000	
To, Share based payment reserve (Other Equity)			3,48,000[3]

At the time option is exercised:

Bank [348*100*50]	Dr.	17,40,000	
Share based payment reserve (Other Equity)	Dr.	10,44,000[4]	

To Equity Share Capital [348*100*10]		3,48,000
To Other Equity (Security Premium) [348*100*70]		2436000

Illustration 8.

MLL 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, 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 entity estimates the fair value of the SARs at the end of each year in which a liability exists as shown below. At the end of year 3, all SARs held by the remaining employees vest. 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 also 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 working notes.

Answer:

a: Basis of Calculation

At the end of Year	[Actual]+Estimated reduction in no. of employees	Expense and liability recognized for	SAR exercised by	Remaining Employees
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		Expense	Liability
1	(400 – 80)*80*15*1/3		128000	128000L1
2	(400 – 100)*80*16*2/3 – L1		128000	256000L2
3	(400 -110 -100)*80*18 – L2	17600		273600L3
	100*80*15	120000	137600	
4	(190 – 120)*80*18 – L3	-156000		117600L4
	120*80*20	192000	36000	
5	0 – L4	-117600		0

	70*80*24	134400	16800	
			446400	

c: **Journal:**

Year 1:	Employee Expense	Dr.	1,28,000	
	To Share based Payment Liability			1,28,000
	(Fair value of SAR recognized)			
Year 2:	Employee Expense	Dr.	1,28,000	
	To Share based Payment Liability			1,28,000
	(Fair Value of SAR recognized and remeasured)			
Year 3:	Employee Expense	Dr.	1,37,600	
	To Share based Payment Liability			1,37,600
	(Fair Value of SAR recognized and remeasured)			
	Share based payment Liability	Dr.	1,20,000	
	To Cash			1,20,000
	(SAR settled for 100 employees)			
Year 4:	Share based payment Liability	Dr.	1,56,000	
	Employee Expense	Dr.	36,000	
	To Cash			1,92,000
	(SAR settled for 120 employees)			
Year 5:	Share based payment Liability	Dr.	1,17,600	
	Employee Expense	Dr.	16,800	
	To Cash			1,34,400
	(SAR settled for 70 employees)			