SYLLABUS - 2016

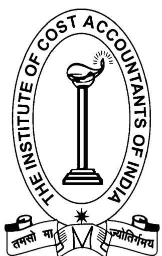
FINAL : PAPER - 17

CORPORATE FINANCIAL REPORTING

FINAL

STUDY NOTES

(Incorporating IND-AS)



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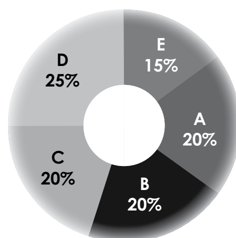
Syllabus- 2016

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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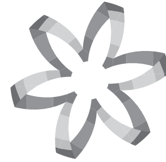
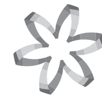
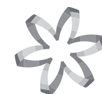




Section A
GAAP and Accounting Standards
(Syllabus - 2016)



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)

[Ind AS 40 (amended), Ind AS 17 has been replaced by Ind AS 116 and Ind AS 11 & 18 has been replaced by Ind AS 115]

INTRODUCTION

Accounting is the language of business. The primary function of the discipline of accounting is to provide financial information to the users of the financial statements. For this purpose, it is required to record the transactions entered into by a concern during an accounting period in different books of accounts. However, different organisations may practice it in different ways. Thus, to ensure uniformity among different entities and to ensure consistency over a period of time, a framework has been developed over the time period. This framework is referred to as 'Generally Accepted Accounting Principles' (GAAP).

Indian GAAP is nothing but a set of accounting standards that every company operating in India has to follow when reporting its financial results. Generally Acceptable Accounting Standards differ for each country as they incorporate policies and procedures that have to be followed for financial disclosures as per the standards set in each country.

Institute of Chartered Accountants of India (ICAI), Ministry of Corporate Affairs (MCA) are the bodies in India that have set the Accounting standards(Indian Accounting Standards) that need to be followed while financial reporting, So Indian Accounting Standards are termed as Indian GAAP.

MEANING OF ACCOUNTING

Accounting may be defined as the process of recording, classifying, summarising, analysing and interpreting financial transactions and communicating the results thereof to the users interested in such communication. In other words, accounting can be defined as an information system that provides information to users about the economic activities and condition of an entity for the purpose of decision-making.

From the above definition, the following attributes of accounting can be observed:

- **Identification** of monetary transactions and events.
- **Measurement** of the identified transactions and events.
- **Recording** of such transactions.
- **Classifying** and **summarising** of the recorded transactions.
- Obtaining the results of operations.
- **Analysing** and **interpreting** the results to help in decision-making.
- **Communicating** such information to the users (both, internal and external).

Primarily the focus of Accounting is limited upto to the preparation of financial statement, later on the communicating function was incorporated in the definition of accounting. It is a service activity to provide qualitative financial information and it is useful in making economic decision.

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.

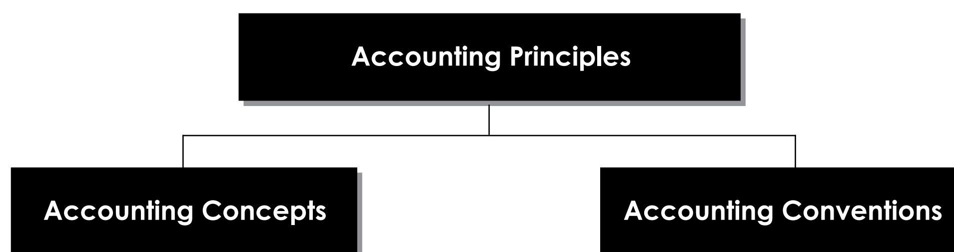
ACCOUNTING PRINCIPLES

Accounting Principle is the 'grammar' of accounting language. It refers to those **rules of action** which are universally adopted by the accountants for recording accounting transactions. They act as the guidelines for recording and reporting transactions. These have evolved out of assumptions made and conventions followed in accounting. These provide explanations to the current accounting practices.

Accounting Principles can be classified into two categories:

(a) Accounting Concepts; and

(b) Accounting Conventions.



ACCOUNTING CONCEPTS

Accounting Concepts refers to the **assumptions** on the basis of which the transactions are recorded in the books of accounts and financial statements are drafted. They are perceived, presumed and accepted in accounting to provide a unifying structure and internal logic to the accounting process. They are also referred to as **Accounting Postulates**. These are the necessary assumptions and ideas which are fundamental to accounting practice. These are the ideas which have been accepted universally.

E.g. Entity concept, Going concern concept, Money measurement concept etc.

ACCOUNTING CONVENTIONS

Accounting conventions are the **traditions or customs** that are observed by the accountants for preparation of financial statements. They have evolved out the different accounting practices followed by different entities over a period of time. They have been developed over a period of time by the accountants by usage and practice.

E.g. convention of conservatism, convention of consistency, convention of materiality etc.

It should be noted that the terms 'Concepts' and 'Conventions' are usually used interchangeably. However, the basic difference between them is that 'Concepts' are primarily concerned with maintenance of books of accounts, while 'Conventions' are applied for preparation of financial statements.

NEED FOR GAAP FOR FINANCIAL REPORTING

The accounting standards developed and established by the standard-setting bodies determine how those financial statements are prepared. The standards are known collectively as Generally Accepted Accounting Principles or GAAP.

GAAP is based on established concepts, objectives, standards and conventions that have evolved over time to guide how financial statements are prepared and presented. GAAP is set with the objective of providing information that is useful to investors, lenders, or others that provide or may potentially provide resources to a profit-seeking concern or not-for-profit organization. Investors, lenders, and other users of financial information rely on financial reporting based on GAAP to make decisions about how to allocate their capital and to help financial markets operate as efficiently as possible.

While establishing GAAP, the standard setting bodies are mainly concerned about the end users of financial statements. End users include people like investors, banks, lenders who use third party financial statements to evaluate business decisions. For instance, an investor will look at a company's financial statements in order to decide whether to invest. The standard setting bodies wants to make consistent standards that help end users understand and use the company's financial data. GAAP's primary intent is not to help businesses. It is intended to help the end users. All of the objectives that MCA and the prior accounting standard setting body(ICAI) wanted to accomplish can be simplified to one main objective: to make financial statements universally understandable and usable for all of their users.

REGULATORY BODIES IN INDIA

- **The Ministry of Corporate Affairs (MCA):** MCA is an Indian Govt. Ministry. The Ministry is primarily concerned with administration of the Companies Act 2013, the Companies Act 1956, the Limited Liability Partnership Act, 2008 & other allied Acts and rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. It is responsible mainly for regulation of Indian enterprises in Industrial and Services sector.

  Presently, they are entrusted with the development of India ASs. The Ind AS are named and numbered in the same way as the corresponding International Financial Reporting Standards (IFRS). National Advisory Committee on Accounting Standards (NACAS) recommend these standards to the Ministry of Corporate Affairs (MCA). MCA has to spell out the accounting standards applicable for companies in India. As on date MCA has notified 39 Ind AS. This shall be applied to the companies of financial year 2015-16 voluntarily and from 2016-17 on a mandatory basis.

- **The Institute of Chartered Accountants of India (ICAI):** ICAI is the national professional accounting body of India. It was enacted by the Parliament (acting as the provisional Parliament of India) to regulate the profession of Chartered Accountancy in India. It recommends the accounting standards to be followed by companies in India to The National Financial Reporting Authority (NFRA) and sets the accounting standards to be followed by other types of organisations. ICAI is solely responsible for setting the auditing and assurance

standards to be followed in the audit of financial statements in India. It also issues other technical standards like Standards on Internal Audit (SIA), Corporate Affairs Standards (CAS) etc. to be followed by practicing Chartered Accountants. It works closely with the Government of India, Reserve Bank of India and the Securities and Exchange Board of India in formulating and enforcing such standards.

- **SEBI:** Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the functions of securities market. SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions. It was left as a watch dog to observe the activities but was found ineffective in regulating and controlling them. As a result in May 1992, SEBI was granted legal status. SEBI is a body corporate having a separate legal existence and perpetual succession. The SEBI has been entrusted with both the regulatory and developmental functions. The SEBI plays a pivotal role in the capital market. They protect the investors so that there is a steady flow of savings into the Capital Market. They ensures the fair practices by the issuers of securities, namely, companies so that they can raise resources at least cost. They help in the promotion of efficient services by brokers, merchant bankers and other intermediaries so that they become competitive and professional. It has initiated the basis for control and regulation of the market, arranged for the licensing of merchant banks, mutual funds etc. and performed the advisory functions to the Govt. The legislation giving powers to SEBI in the form of the Securities & Exchange Board of India Act to protect the interests of investors in securities and to promote the development of and to regulate the securities market and for matters connected therewith or incidental thereto.

COMPONENTS OF FINANCIAL STATEMENTS [SCHEDULE III Division I and Division II]

Financial reporting is the language that communicates information about the financial condition and operational results of a company (public or private), not-for-profit organization, or state or local government. A financial statement (or financial report) is a formal record of the financial activities and position of an entity.

Relevant financial information is presented in a structured manner and in a form easy to understand. Specifically, financial reporting includes the following information:

1. **Balance Sheet:** It is also referred to as a statement of financial position, reports on a company's assets, liabilities, and owners' equity at a given point in time.
2. **Statement of Profit and Loss:** It is also known as a statement of comprehensive income, statement of revenue & expense, P&L or profit and loss report, reports on a company's income, expenses, and profits over a period of time. A profit and loss statement provides information on the operation of the enterprise. These include sales and the various expenses incurred during the stated period.
3. **Statement of Changes in Equity:** It is also known as equity statement or statement of retained earnings, reports on the changes in equity of the company during the stated period.
4. **Cash Flow Statement:** A cash flow statement reports on a company's cash flow activities, particularly its operating, investing and financing activities.
5. **Notes to accounts:** The notes are an integral part of these financial statements. It warns users that failure to read the notes (or footnotes) to the financial statements will result in an incomplete picture of the company's financial health. Notes provide supplemental information about the financial condition of a company without which the financial statements cannot be fully understood. There are three basic types of notes – (a) notes related to the descriptions of the accounting rules applied in the company's statements; (b) Notes related to additional detail about a line on the financial statements; and (c)Notes related to additional financial disclosures about items not listed on the statements themselves.

USER OF ACCOUNTING INFORMATION

Accounting Information refers to the information generated by the accounting system of an entity relating to a particular accounting period. They disclose the operating results, and financial position of the entity. It acts as a mirror of the financial performance of a concern.

The Framework discusses objective of financial statements, qualitative characteristics that determine the usefulness of information contained in the financial statements, definition, recognition and measurement of the elements from which financial statements are constructed and concepts of capital and capital maintenance.

Identification of user of financial statements and their information needs are just the oretical as general purpose financial statements cannot satisfy the specific information need of various user groups. The Frame-work has identified the following user groups and their information needs:

1. Users of Financial Statements and their Information Needs

1. Investors	Information need of the group primarily relates to decision making of buy, hold or sale of the entity's share. Also dividend paying ability of the entity is a matter of interest.
2. Employees	Need to know about the stability and continued profitability of the employer which would ensure payment of remuneration, employee opportunities and retirement benefits.
3. Lenders	Interested in debt servicing ability.
4. Suppliers and other trade creditors	Interested in information about the entity's ability in the short run to pay their dues. Of course, they are interested in long run viability of the entity, if it is the major customer.
5. Customers	Seek information about the continuation of the entity in particular if the entity is the major supplier.
6. Government and their agencies	They have manifold interests like taxation, contribution of the entity in the employment generation and economic activities of the nation and also the infrastructural facilities to be provided to serve the need of the entity commensurate with its contribution to the society.
7. Public	Mostly interested in employment generation and societal contribution.

QUALITATIVE CHARACTERISTICS OF FINANCIAL STATEMENTS AS PER IFRS CONCEPTUAL FRAMEWORK:

- **The fundamental qualitative characteristics are *relevance* and *faithful representation*.**
- **Relevance:** Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both. (**Predictive value** helps users in **predicting** or anticipating future outcomes. **Confirmatory value** enables users to check and confirm earlier predictions or evaluations)
- **Faithful representation:** It would be *complete, neutral* and *free from error*.
- **Enhancing Qualitative Characteristics:** *Comparability, verifiability, timeliness and understandability are qualitative* characteristics that enhance the usefulness of information that is relevant and faithfully represented.
- **Comparability:** Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date.
- **Verifiability**: Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.
- **Understandability**: Classifying, characterising and presenting information clearly and concisely makes it *understandable*.

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.

AS-1: DISCLOSURE OF ACCOUNTING POLICIES

This standard deals with disclosure of significant accounting policies followed in the preparation and presentation of the financial statements and is mandatory in nature.

The accounting policies refer to the specific accounting principles adopted by the enterprise.

Proper disclosure would ensure meaningful comparison both inter/intra enterprise and also enable the users to properly appreciate the financial statements.

Financial statements are intended to present a fair reflection of the financial position financial performance and cash flows of an enterprise.

Areas involving different accounting policies by different enterprises are

- Methods of depreciation, depletion and amortization
- Treatment of expenditure during construction
- Treatment of foreign currency conversion/translation, Valuation of inventories
- Treatment of intangible assets
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profit on long-term contracts Valuation of fixed assets
- Treatment of contingent liabilities

Factors governing the selection and application of accounting policies are:

- Prudence: Prudence means making of estimates, which is required under conditions of uncertainty. Profits are not anticipated till certain for realization, while provisions are made for all known liabilities ascertainable or based on estimates (e.g. warranty expenses).
- Substance over form: It means that transaction should be accounted for in accordance with actual happening and economic reality of the transactions, i.e. events governed by substance and not merely by the legal form
- Materiality :
  - (a) As to the disclosure of all material items, individually or in aggregate in the context of fair presentation of financial statements as a whole if its omission or misstatement could influence the economic or financial decision of the user relying upon the financial statements
  - (b) Depends on the size of the items or errors judged in the particular circumstances of its omissions or misstatements.
  - (c) Is a cutoff point rather than being a primary qualitative characteristic which information must have.
  - (d) This is a matter of judgment, varies from one entity to another and over one period to another.

AS-1 requires that all "significant" (i.e. only accounting policy that is useful for an understanding by the user of the financial statements) accounting policies adopted in the preparation and presentation of financial statements, should be disclosed by way of 'Note in one place as the note No I (this is the basis of the preparation of financial statements.)

Changes in Accounting Policies:

Any change in the accounting policies which has a material effect in the current period or which is reasonably expected to have a material effect in the later period should be disclosed.

In the case of a change in accounting policies, having material effect in the current period, the amount by which any item in the financial statements, is affected by such change should also be disclosed to the extent as ascertainable, otherwise the fact that the effect is not (wholly or partially) ascertainable, should be disclosed.

The following are not considered as changes in accounting policies:

(a) Accounting policies adopted for events or transactions that differ in substance at present (introducing Group Gratuity Scheme for employees in place of adhoc ex-gratia payment earlier followed.)

(b) Accounting policies pertains to events or transactions which did not occur previously or that were immaterial.

Fundamental Accounting Assumptions

Certain basic assumptions, in the preparation of financial statements are accepted and their use are assumed, no separate disclosure is required except for noncompliance in respect of-

(a) Going Concern: continuing operation in the foreseeable future and no interim necessity of liquidation or winding' up or reducing scale of operation.

(b) Consistency: accounting policies are consistent from one period to another

(c) A*ccrual:*

(i) Revenues and costs are accrued i.e. they are earned or incurred (not actually received or paid) and recorded in the financial statements

(ii) Extends to matching revenue against relevant costs.

Examples:

1. The gross block of fixed assets are shown at the cost of acquisition, which includes tax, duties (net of MODVAT and set off availed) and other identified direct expenses. Interest on borrowing to finance the fixed assets is considered as revenue.

   — The policy appears to be correct.

2. Compensation payable to employees under voluntary retirement scheme has been deferred to be written off over a period of four years as against the past practice of charging out the same on payment/due basis.

   Comment.

   — The reason for change must be incorporated with notes to accounts.

3. Sales includes inter-departmental transfers, sales during trial run and are net of discounts. Comment.

   — The policy is not as per AS-9, Revenue Recognition.

An overview of Accounting Standards as per Companies (Accounting Standards) Rules, 2006:

AS-2: VALUATION OF INVENTORIES (Revised)

Objective:

The objective of this standard is to formulate the method of computation of cost of inventories/stock, to determine the value of closing stock/ inventory at which, the inventory is to be shown in balance sheet till its' sale and recognition as revenue.

Accounting Standard-2 is not applicable in following cases:

- Work-in-progress arising under construction contract including directly related to service contract (AS-7 • Construction contracts).
- Work-in-progress arising in ordinary course of business for service providers (Incomplete consultancy services, Incomplete merchant bank activities, Medical services in progress)
- Financial Instrument held as stock-in-trade (Shares, Debentures, Bonds etc.)
- Producer's inventories like livestock, agricultural and forest products, mineral oils, ores and gases. Such inventories are valued at net realisable value.

Inventories include:

- Held for sale in the ordinary course of business (finished goods)
- In the process of production of such sale (raw material and work-in-progress)
- In the form of materials or supplies to be consumed in production process or in the rendering of services (stores, spares, raw material, consumables).
- Inventories do not include machinery.

Spare parts and servicing equipments —

Inventories consists of—

- goods purchased and held for resale
- Inventories also consists finished goods produced, or work in progress being produced, by the enterprise and include materials, maintenance supplies, consumables and loose tools held for use in the production process.
- ***Inventories do not include spare parts, servicing equipment and standby equipment which meet the definition of property, plant and equipment as per AS-10, Property, Plant and Equipment (PPE).***
- Machinery spares, not specific to a particular item of fixed asset and which can be used generally for various items of fixed assets, should be treated as inventories for the purpose of AS-2. Such machinery spares should be charged to the statement of profit and loss as and when issued for consumption in the ordinary course of operations.

Inventories should be valued at lower of cost and net realisable value.

Steps for valuation of Inventories:

1. Determination of cost of inventories;
2. Determination of net realisable value;
3. Comparison between the cost and net realisable value. The comparison should be made item by item or by group of items.

Cost of inventory consists the following —

1. Cost of purchase
2. Cost of conversion
3. Other costs incurred in bringing the inventories to their present location and condition

1. Cost of purchase includes —

- Purchase price, Duties and Taxes, Freight inward, other expenditures directly attributable to the acquisition.

  Less:

- Duties and taxes recoverable by enterprises from taxing authorities**,** Trade discount**,** Rebate**,** Duty drawback**,** Other similar items.

2. Cost of conversion —

It consists of the cost directly related to the units + Systematic Allocation of fixed and variable production overheads that are incurred in converting material into finished goods.

Fixed Production overhead means Indirect cost of production that remains relatively constant regardless of volume of production. Allocation of fixed production overhead is done on normal capacity.

Variable Production overhead means indirect cost of production that varies directly or nearly directly with the volume of production. Allocation of variable production overhead is done on actual production.

In aces of Joint-products, when the cost of conversion of each product is not identifiable separately, total cost of conversion is allocated between the products on the rational and consistent basis.

If **by-products**, **scrap or waste materials** are not of material value, they are measured at net realisable value, then the net realisable value is deducted from cost of conversion. Net cost of conversion is distributed among the main products.

3. Other costs: Cost incurred in bringing the inventories to their present location and condition.

Items to be excluded from the cost of Inventories:

- Abnormal amounts of wasted materials, labour, other production costs;
- Storage cost;

- Administrative overhead;
- Selling and distribution cost;
- Interest and borrowing cost. However, if AS-16 allows such cost to be included it, can form part of the cost.

Cost formula

Specific identification method means directly linking the cost to the specific item of inventories.

If in any case, specific identification method is not applicable the cost of inventories is valued by the following methods:

♦ FIFO (First In First Out)

♦ Weighted Average cost.

When it is not practical to calculate the cost, the following methods may be followed to ascertain cost:

♦ Standard Cost

♦ Retail Method

Net Realisable Value —

Net realisable value means the estimated selling price in ordinary course of business, **less** estimated cost of completion and estimated cost necessary to make the sale. It is estimated on the basis of most reliable evidence at the time of valuation. The estimation of net realisable value also considers the purpose for which the inventory is held. The estimation is made as at each balance sheet date.

Estimation of net realisable value —

♦ If finished product in which raw material and supplies used is sold at cost or above cost, then the estimated realisable value of raw material and supplies is considered more than its cost. Therefore inventories of raw material will be valued at cost.

♦ If finished product in which raw material and supplies used is sold below cost. Then the estimated realisable value of raw material or supplies is equal to replacement price of raw material or supplies and this raw material will be valued at replacement price.

Disclosure in the financial statement

- Accounting policy adopted in measuring inventories.
- Cost formula used.
- ***Classifications of inventories are:***
  - (i) Raw materials and components
  - (ii) Work-in-progress
  - (iii) Finished goods
  - (iv) Stock-in-trade (in respect of goods acquired for trading)
  - (v) Stores and spares
  - (vi) Loose tools
  - (vii) Others (specify nature)

AS-3 (REVISED): CASH FLOW STATEMENT

Cash Flow Statement deals with the provision of information about the historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

- **Cash** comprises cash on hand and demand deposits with banks.
- **Cash equivalents** are 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.

- **Cash flows** are inflows and outflows of cash and cash equivalents.
- **Operating activities** are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.
- **Investing 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.

Methods of preparing Cash Flow Statement:

1. Direct Method: In this method major classes of gross cash receipts and gross cash payments are disclosed.
2. Indirect Method: Under this method, the following adjustment to reported net profit or loss to be made:
   - Effects of transactions of non-cash nature.
   - Deferrals in accruals of past or future operating receipt or payments.
   - Changes in current assets and liabilities
   - Income & expenses associated with investing and financing cash flows.

Example:

Consider a hypothetical example on the preparation of cash from operating activities under both direct and indirect method of preparing cash flow statement.

Direct Method Cash Flow Statement [Paragraph 18(a)]	(₹ '000)
Cash flows from operating activities	
Cash receipts from customers	33,150
Cash paid to suppliers and employees	(29,600)
Cash generated from operations	3,550
Income taxes paid	(1,860)
Cash flow before extraordinary item	1,690
Proceeds from earthquake disaster settlement	180
Net cash from operating activities	1,870

Indirect Method Cash Flow Statement [Paragraph 18(b)]	(₹ '000)
Cash flows from operating activities	
Net profit before taxation, and extraordinary item	3,350
Adjustments for:	
Depreciation	450
Foreign exchange loss	40
Interest income	(300)
Dividend income	(200)
Interest expense	400
Operating profit before working capital changes	3,740
Increase in sundry debtors	(500)
Decrease in inventories	1,050
Decrease in sundry creditors	(740)
Cash generated from operations	3,550

Income taxes paid	(1,860)
Cash flow before extraordinary item	1,690
Proceeds from earthquake disaster settlement	180
Net cash from operating activities	1,870

Illustration 1.

Oriental Bank of Commerce, received a gross ₹4,500 crores demand deposits from customers and customers withdrawn ₹4,000 crores of demand deposits during the financial year 2017-18. How would you classify such cash flows?

Soltuion:

It will be treated as an Operating activity, on net basis ₹500 crores, inflow.

AS-4 (REVISED): CONTINGENCIES AND EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

A **Contingencies and events occurring after the Balance Sheet date**

This Standard deals with the treatment in financial statements of (a) contingencies, and (b) events occurring after the balance sheet date.

The following subjects, which may result in contingencies, are excluded from the scope of this standard in view of special considerations applicable to them:

a. liabilities of life assurance and general insurance enterprises arising from policies issued;

b. obligations under retirement benefit plans; and

c. commitments arising from long-term lease contracts.

The following terms are used in this Standard:

Contingency is a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence, of one or more uncertain future events.

Contingencies are of two types:

- Contingencies relating to existing condition or situation at the balance sheet date, the expected outcomes are two:
  - ✓ Contingent loss, it may be —
    - Probable Loss
    - Reasonably possible
    - Remote
  - ✓ Contingent gain, it is covered by AS - 29
- No accounting treatment is required, neither by way of provision nor by giving accounting notes.

Note:

- Probable - future event or events are likely to occur.
- Reasonably possible - chance of the future event or events occurring is more than remote but less than likely.
- Remote - chance of the future event or events occurring is slight.

Estimates are required for determining the amounts to be stated in the financial statements for many on-going

and recurring activities of an enterprise. One must, however, distinguish between an event which is certain and one which is uncertain.

The estimates of the outcome and of the financial effect of contingencies are determined by the judgement of the management of the enterprise. This judgement is based on consideration of information available up to the date on which the financial statements are approved and will include a review of events occurring after the balance sheet date, supplemented by experience of similar transactions and, in some cases, reports from independent experts.

Provision for loss is estimated on the basis of information available up to the date of approval of accounts by competent authority. But the contingency must exist on the date of balance sheet. If contingency does not exist on balance sheet date no provision nor notes to accounts is required.

Accounting Treatment of Contingent Gains

Contingent gains are not recognised in financial statements since their recognition may result in the recognition of revenue which may never be realized. The contingent gains are not disclosed in the financial statements. If the realization of a gain is virtually certain, then such gain is not a contingency and accounting for the gain is appropriate.

Events occurring after the Balance Sheet date are as under:—

- Events, which occur between the balance sheet date and date on which financial statements are approved by competent authority.

For the purpose of accounting treatment the events are classified in two categories.

- The events related to circumstances existing on the date of Balance Sheet — the loss should be accounted in the accounts and assets & liabilities to be adjusted. (Known as adjusting events)
- The events not related to circumstances existing on the date of Balance Sheet — to be disclosed by way of notes to accounts only, no adjustment in accounts are required. (Known as non-adjusting events)

Insolvency of a customer is an Adjusting event as insolvency of a customer, occurs after the balance sheet date usually, provides additional information on the condition that existed at the balance sheet date. Therefore, the carrying amount receivables should be adjusted for the event.

It is assumed that —

- The condition of insolvency existed at the balance sheet date
- The entity could not collect the complete information about the collectability of the receivable
- it could not estimate the insolvency of the customer

However, insolvency due to a major casualty occurring after the balance sheet date is not an adjusting event.

Event occurring after approval of accounts

Event occurring after the balance sheet date and also after approval of accounts by board of directors of a company such event should be disclosed in the director's report if material.

Disclosure

- The disclosure requirements herein referred to apply only in respect of those contingencies or events which affect the financial position to a material extent.
- If a contingent loss is not provided for, its nature and an estimate of its financial effect are generally disclosed by way of note unless the possibility of a loss is remote. If a reliable estimate of the financial effect cannot be made, this fact is disclosed.

- When the events occurring after the balance sheet date are disclosed in the report of the approving authority, the information given comprises the nature of the events and an estimate of their financial effects or a statement that such an estimate cannot be made.

AS-5 (REVISED): NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGES IN ACCOUNTING POLICIES.

The statement requires the classification and disclosure of extraordinary and prior period items and the disclosure of certain items within the profit or loss from ordinary activities and also accounting treatment for changes in the accounting estimate, and disclosure regarding changes in Accounting Policies in the financial statement.

To ensure preparation of Profit or Loss statement on a uniform basis, in turn to enhance better comparability of the enterprise over time and with other enterprises.

All items of income and expense, which are recognized in a period, are normally included for the determination of the Net Profit/Loss for the period unless otherwise permitted (AS-22 exception for deferred tax in the income tax).

Each extraordinary items, both income and expense arises from events/transactions, which are clearly distinct from ordinary activities and not ex petted to recur frequently or regularly, should be disclosed as apart of net profit/loss for the period in a distinct manner to understand the impact on current profit/loss.

An event or transaction may be extraordinary for one enterprise but not for the other because of difference between their respective ordinary activities.

Only on rare occasion does an event/transaction give rise to extraordinary items.

Ordinary activities are those undertaken as part of business of ail enterprise and related activities for furtherance of, incidental to or arising from these activities. Frequency of occurrence is not the sole criteria to determine extraordinary or ordinary nature.

However, when items of income or expense within profit/loss from ordinary activities are of such a size, nature or incidence that their disclosure is relevant to explain the performance for the period the nature and amount of such items should be disclosed separately as exceptional items (distinct from extraordinary items) e.g.

(a) write off/ write back of inventories to Net Realizable Value, provision/write back of cost of restructuring

(b) disposal of fixed asset/long term investments

(c) effect of legislative changes with retrospective application

(d) settlement of litigation

(e) other reversal of provisions

Prior period items (income/expense) arise in the current period as a result of errors/ omissions in the preparation of the financial statements, in one or more prior period are generally infrequent in nature and distinct from changes in accounting estimates.

Prior period items are normally included in the determination of net profit/loss for the current period shown after determination of current period profit/loss. The objective is to indicate the "effect of such items in the profit/loss. The separate disclosure is intended to show the impact on the current profit/loss. Disclosure is made:

(a) by showing the prior period items distinctively under the relevant head of income/expenditure

(b) by putting under "Prior Period Adjustment A/c either in the main statement of P/L or in a schedule containing the respective details with the net figure in the P/L A/c of current period in compliance with schedule III part II requirement.

Notes to the Accounts should provide detail description with impact on the current period and tax implication arising thereof (e.g. stock valuation not correctly made in the previous period).

The use of reasonable estimate based on then available information circumstances are an essential part of the preparation of financial statement. There may arise a need to change the estimate on the basis of new information

more experience or subsequent development. The revision in estimate does not bring the adjustment within the definition of an extraordinary item or prior period item.

The effect of change in Accounting Estimate should be included in the determination of net profit/loss

(a) in the period of change (if restricted for the period only)

(b) in the period of change and future period (if the change affects both) (e.g. estimate of bad debt for (a) and change in estimated life of a depreciable asset in terms of depreciation.

Classification as to ordinary or extraordinary as previously followed should be maintained to disclose the effect of changes in accounting estimate for better comparability.

The nature and change in an accounting estimates having material effect in the current period or in subsequent period should be disclosed. If quantification is not predictable such fact should also be disclosed.

If it is difficult to distinguish between a change in Accounting Policy and change in Accounting Estimate the change is recognized as change in Accounting Estimate with appropriate disclosure.

Example of various disclosures under AS-5

1. change in depreciation method: change in accounting policy
2. useful life reduced but no change: change in accounting estimate in depreciation method
3. arithmetical error in depreciation computation: prior period item
4. due to oversight depreciation incorrectly computed: prior period item
5. fixed asset destroyed in earth quake: extraordinary item
6. major disposal of fixed items: ordinary activity (exceptional item)
7. maintenance provision no longer required since major part of the assets no longer exist: the write-back. if material should be disclosed as exceptional item and not as extraordinary' or prior period item.

Example:

Mr.Pradip an employee of CCL Ltd.went on leave with a pay for 9 months on 1.1.2017 upto 30.09.2017. His monthly pay was ₹25,000. While preparing the financial statement on 30.6.2015 for the year ended 31.03.17, the expense of salary of Mr. Pradip for 3 months (1.1.17 to 31.03.17) was not provided due to omission. When Mr.Pradip joined on 1.10.17, the whole salary for 9 months was duly paid to him.

In this case, three months salary of ₹75,000 is prior period expense and following entry should be passed:

Salary A/c	Dr. 1,50,000	
Prior period expense (Salary) A/c	Dr. 75,000	
To Bank A/c		2,25,000

If Mr. Pradip was terminated from service on 1.1.17 and was re-instated in service by the Court on 30.09.17 with full pay protection(i.e. total salary was rewarded to him). As the employee was re-instated in service as per the Court's Order as on 1.10.2017, the following entry should be made:

Salary A/c	Dr. 2,25,000	
To Bank A/c		2,25,000

In such a case, there shall arise no error or omission while preparing the financial statements for the earlier years.

DEPRECIATION ACCOUNTING [AS 6] shall stand withdrawn.

AS-7 (REVISED): ACCOUNTING FOR CONSTRUCTION CONTRACTS

The statement applies to accounting for construction contracts, in the financial statements of contractors,

A construction contract may be related to the construction of single asset or a number of assets closely, interrelated or interdependent in terms of the scope of the contract.

For the purpose of this statement construction contract covers:

(a) Contracts for rendering of services directly related to the construction of the asset e.g. service of project-managers, architects etc.

(b) Contracts for destruction/restoration of assets and restoration of environments following demolition.

(c) Consultancy contracts in project management, designing, computers where such contracts are related to the construction of the asset.

(d) Those long-term contracts not relating to construction of an asset.

A construction contract may be

(a) a fixed-price contract with/without escalation

(b) a cost-plus contract (provision for reimbursement of overhead on agreed basis in addition to fixed price/fees)

(c) a mix of both (a cost-plus contract with a minimum agreed price)

The statement usually apply to each contract separately, however, sometimes it is necessary to apply the statement to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance. When a contract covers —

(a) *Number of assets:* each asset treated as separate contract when the proposal, negotiation and cost/revenue can be identified distinctly.

(b) *Negotiated single package of interrelated identifiable with an overall profit margin performed concurrently or continuous sequence:* treated as a single contract whether a single customer or a group of customers.

(c) *Construction of an additional asset as the provision of the contract:* treated as separate contract if there is significant change in design, technology or transaction from original contract in terms of the scope and/or price.

Additional asset should be treated as a separate construction contract if there is significant change in design, technology or function from the assets covered in the original contract price.

Contract revenue comprises of

(a) revenue agreed in the contract

(b) variations in the scope of contract, adverse/favourable

(c) incentive payment (degree of certainty and reliability)

(d) penalties due to delay in execution

Contract costs comprise of

(a) directly related to specific contract

(b) attributable cost relating to contract activity in general and precisely allocable to the contract as reduced by incidental income not included in contract revenue (sale of surplus material, disposal of contract specific plants etc).

Contract cost and revenue are recognized for accounting only when the outcome of the construction contract

can be measured reliably with regard to the stage of completion of the contracts activity at its B/S date. All expected losses should recognized as an expense for the contract.

Under the percentage completion method, contract revenue is recognized in the P/L in the accounting period in which the work is performed and the related contract cost is shown as an expense. However, expected excess of total contract is recognized as an expense immediately. Revenue earlier recognized or becoming doubtful/ uncollectable should be treated as an expense.

A long-term contract is subject to fluctuation for various reasons in the original estimation thus likely to affect the determination of contract results. It is necessary that an annual review of the cost already incurred and future cost required to complete the project on schedule. While estimating the future cost care should be taken for foreign exchange rate fluctuation, labour problem, changes in material price etc.

Disclosure under AS -7 (on reporting date by an enterprise)

A) An enterprise should enclose

(a) The amount of contract revenue recognized as revenue in the period

(b) The methods used to determine the contract revenue recognized in the period

(c) Method used to determine the stage of completion of contract in progress

B) An enterprise should disclose the following for contracts in progress at the reporting date

1. The aggregate amount of costs incurred and recognized profit less recognized losses upto reporting date.
2. The amount of advance received and amount retained

C) An enterprise should present

(a) Gross amount due from customer is an asset

(b) Gross amount due to customer is a liability

(c) Contingencies as per AS-4 (warranty cost, penalties, guarantee issued by banks against counter indemnity of contractor)

Illustration 2.

A Company undertook to pay contract for a building for ₹ 40 lakhs. As on 31.3.2017, it incurred a cost of ₹ 6 lakhs and expects that there will be ₹ 36 lakhs more for completing the building. It has received ₹ 4 lakhs as progress payment. What is the degree of completion?

$$\text{Percentage of Completion} = \frac{\text{Cost to date}}{\text{Cumulative cost incurred + Estimated cost to complete}} \times 100$$

$$= \frac{6}{6+36} \times 100 = 14.28\%$$

AS-8 ACCOUNTING FOR RESEARCH & DEVELOPMENT

(STANDS WITHDRAWN ON INTRODUCTION OF AS-26 INTANGIBLE ASSETS)

AS-9 REVENUE RECOGNITION

The statement covers the recognition of revenue arising in the course of ordinary activities. of the enterprise *from*

(a) sale of goods

(b) rendering of service

(c) outsourcing of resources yielding interest, royalties and dividend Specific exclusion *from* the standard pertains

to:

(a) construction contracts

(b) lease/hire purchase agreement

(c) govt. grants/subsidies

(d) insurance contract of insurance companies

Essential criterion for recognition for revenue *from* ordinary activities as aforesaid is that the consideration is reasonably determinable even though the payments are made by installments. In the event of uncertainty, the recognition is postponed and considered as revenue of the period in which it is properly recognized.

The standard requires, in addition to the AS- I, that an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending resolution of significant uncertainties.

NOTE:

Revenue include the gross inflow of economic benefits only accrued to an enterprise on its own e.g. sales tax, service tax, VAT etc. do not accrue to the enterprise and thus not considered as revenue under IAS-18 and US GAAP. Practices vary in India and tend to show larger gross turnover for the enterprise (incidentally section 145A of the Income Tax Act '61 require purchase, inventory and turnover inclusive of Tax, duty and cess).

ICAI recommends disclosure in the manner :

Turnover (gross)	xxx
Less Excise duty	xxx
Net Turnover	xxx

Illustration 3.

AB Ltd. seeks your advise about the treatment of the following in the final statement of accounts for the year ended 31st March 2017:

"As a result of a recent announced price revision, granted by the Government of India with effect from 1st July, 2014, the company stands to receive ₹ 6 lakhs from its customers in respect of sales made in 2016-17"

Solution:

The company is preparing the financial statements for the year ended 31.3.17. Due to price revision granted by the Government of India, the company has to receive an additional sales revenue of ₹ 6 lakhs in respect of sales made during the year 2016-17.

As per AS-9, where uncertainty exists in collection of revenue, its recognition is postponed to the extent of uncertainty involved and it should be recognized as revenue only when it is reasonably certain about its collection.

In view of the above statement, if there is no uncertainty exists as to the collect ability of ₹ 6 lakhs, it should be recognized as revenue in the financial statements for the year ended 31.3.17.

Illustration 4.

Advise D Ltd.about the treatment of the following in the final statement of accounts for the year ended 31st March, 2017.

A claim lodged with the Railways in March, 2015 for loss of goods of ₹ 5 lakhs had been passed for payment in March, 2017 for ₹ 4 lakhs. No entry was passed in the books of the company, when the claim was lodged.

Solution:

The financial statements of the company are prepared for the year ended 31.3.17.

There was a loss of goods of ₹ 5 lakhs in 2014-15 and the claim was lodged in March 2015 with the Railway authorities. No entry was passed in the books of the company when the claim was lodged and the said treatment was correct in view of AS-9, which states that if uncertainty exists as to collectability, the revenue recognition should be postponed.

Since, the claim is passed for payment of ₹ 4 lakhs in March, 2017, it should be recognized as revenue in the financial statements prepared for the year ended 31.3.17.

As per AS-5 Revised, the claim amount received will not be treated as extraordinary item. AS-5 Revised further states that when items of income and expense within profit 0r loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately.

Illustration 5.

A private limited company manufacturing fancy terry towels had valued its closing stock of inventories of finished goods at the realisable value, inclusive of profit and the export cash incentives. Firm contracts had been received and goods were packed for export, but the ownership in these goods had not been transferred to the foreign buyer. Comment on the valuation of the stocks by the company.

Solution:

Accounting Standard 2 "Valuation of Inventories" states that inventories should be valued at lower of historical cost and net realisable value. AS 9 on "Revenue Recognition" states, "at certain stages in specific industries, such as when agricultural crops have been harvested or mineral ores have been extracted, performance may be substantially complete prior to the execution of the transaction generating revenue. In such cases, when sale is assured under forward contract or a government guarantee or when market exists and there is a negligible risk of failure to sell, the goods invoiced are often valued at Net-realisable value."

Terry Towels do not fall in the category of agricultural crops or mineral ores. Accordingly, taking into account the facts stated, the closing stock of finished goods (Fancy terry towel) should have been valued at lower of cost and net-realisable value and not at net realisable value. Further, export incentives are recorded only in the year the export sale takes place. Therefore, the policy adopted by the company for valuing its closing stock of inventories of finished goods is not correct.

PROPERTY, PLANT AND EQUIPMENT AS 10 (Revised)

Objective:

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

Scope / Applicability:

This Standard should be applied in accounting for property, plant and equipment except when another Accounting Standard requires or permits a different accounting treatment.

This Standard does not apply to:

(a) Biological assets related to agricultural activity other than bearer plants. This Standard applies to bearer plants but it does not apply to the produce on bearer plants; and

(b) Wasting assets including mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (a) and (b) above.

Other Accounting Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, AS 19, Leases, requires an enterprise to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards.

However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

Investment property, as defined in AS 13, Accounting for Investments, should be accounted for only in accordance with the cost model prescribed in this standard.

Important Terminology:

1. **Agricultural Activity** is the management by an enterprise of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.
2. **Agricultural Produce** is the harvested product of biological assets of the enterprise.
3. **Bearer plant** is a plant that:
    a) is used in the production or supply of agricultural produce;
    b) is expected to bear produce for more than a period of twelve months; and
    c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

    The following are not bearer plants:
    a) plants cultivated to be harvested as agricultural produce (for example, trees grown for use as lumber);
    b) plants cultivated to produce agricultural produce when there is more than a remote likelihood that the entity will also harvest and sell the plant as agricultural produce, other than as incidental scrap sales (for example, trees that are cultivated both for their fruit and their lumber); and
    c) annual crops (for example, maize and wheat).

    When bearer plants are no longer used to bear produce they might be cut down and sold as scrap, for example, for use as firewood. Such incidental scrap sales would not prevent the plant from satisfying the definition of a bearer plant.
4. **Biological Asset** is a living animal or plant.
5. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.
6. **Cost** is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other Accounting Standards.
7. **Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.
8. **Depreciation** is the systematic allocation of the depreciable amount of an asset over its useful life.
9. **Enterprise -specific value** is the present value of the cash flows an enterprise expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.
10. **Fair value** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
11. **Gross carrying amount** of an asset is its cost or other amount substituted for the cost in the books of account, without making any deduction for accumulated depreciation and accumulated impairment losses.
12. An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

13. **Property, plant and equipment** are tangible items that:
    a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
    b) are expected to be used during more than a period of twelve months.
14. **Recoverable amount** is the higher of an asset's net selling price and its value in use.
15. **The residual value** of an asset is the estimated amount that an enterprise would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.
16. **Useful life** is:
    a) the period over which an asset is expected to be available for use by an enterprise ; or
    b) the number of production or similar units expected to be obtained from the asset by an enterprise.

Recognition:

- The cost of an item of property, plant and equipment should be recognised as an asset if, and only if:
  (a) it is probable that future economic benefits associated with the item will flow to the enterprise; and
  (b) the cost of the item can be measured reliably.
- Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this Standard when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.
- This Standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to specific circumstances of an enterprise.
- An enterprise evaluates under this recognition principle all its costs on property, plant and equipment at the time they are incurred. These costs include costs incurred:
  (a) initially to acquire or construct an item of property, plant and equipment; and
  (b) subsequently to add to, replace part of, or service it.

Initial Costs:

The definition of 'property, plant and equipment' covers tangible items which are held for use or for administrative purposes. The term 'administrative purposes' has been used in wider sense to include all business purposes other than production or supply ofgoods or services or for rental for others. Thus, property, plant and equipment would include assets used for selling and distribution, finance and accounting, personnel and other functions of an enterprise. Items of property, plant and equipment may also be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an enterprise to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an enterprise to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the enterprise is unable to manufacture and sell chemicals. The resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with AS 28, Impairment of Assets.

Subsequent Costs:

- Under the recognition principle (as mentioned above), an enterprise does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-today servicing of the item. Rather, these costs are recognised in the statement of profit and loss as incurred. Costs of day-to-day servicing are

primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of such expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

- Parts of some items of property, plant and equipment may require replacement at regular intervals or it may require replacement several times. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement or to make a non-recurring replacement. Under the recognition principle (as discussed above), an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the 'derecognition provisions' of this Standard.
- A condition of continuing to operate an item of property, plant and equipment may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection is derecognised.
- The derecognition of the carrying amount occurs regardless of whether the cost of the previous part / inspection was identified in the transaction in which the item was acquired or constructed. If it is not practicable for an enterprise to determine the carrying amount of the replaced part/ inspection, it may use the cost of the replacement or the estimated cost of a future similar inspection as an indication of what the cost of the replaced part/ existing inspection component was when the item was acquired or constructed.

Measurement at Recognition:

An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost.

Elements of Cost:

The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non –refundable purchase taxes,, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as 'decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Measurement of Cost:

- The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with AS 16.
- One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset(s) received nor the asset(s) given up is reliably measurable.

The acquired item(s) is/are measured in this manner even if an enterprise cannot immediately derecognise the asset given up. If the acquired item(s) is/are not measured at fair value, its/their cost is measured at the carrying amount of the asset(s) given up.

- An enterprise determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:

  (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

  (b) the enterprise-specific value of the portion of the operations of the enterprise affected by the transaction changes as a result of the exchange;

  (c) and the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

- For the purpose of determining whether an exchange transaction has commercial substance, the enterprise -specific value of the portion of operations of the enterprise affected by the transaction should reflect post-tax cash flows. In certain cases, the result of these analyses may be clear without an enterprise having to perform detailed calculations.

- The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an enterprise is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

- Where several items of property, plant and equipment are purchased for a consolidated price, the consideration is apportioned to the various items on the basis of their respective fair values at the date of acquisition. In case the fair values of the items acquired cannot be measured reliably, these values are estimated on a fair basis as determined by competent valuers.

Measurement after Recognition:

An enterprise should choose either the cost model or the revaluation model as its accounting policy and should apply that policy to an entire class of property, plant and equipment. It is discussed hereunder:

(a) **Cost Model:**

After recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

(b) **Revaluation Model:**

- After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations should be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

- The fair value of items of property, plant and equipment is usually determined from market-based evidence by appraisal that is normally undertaken by professionally qualified valuers.

- If there is no market-based evidence of fair value because of the specialised nature of the item of property, plant and equipment and the item is rarely sold, except as part of a continuing business, an enterprise may need to estimate fair value using an income approach (for example, based on discounted cash flow projections) or a depreciated replacement cost approach which aims at making a realistic estimate of the current cost of acquiring or constructing an item that has the same service potential as the existing item.

- The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.
- When an item of property, plant and equipment is revalued, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:
  a. the gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset; or
  b. the accumulated depreciation is eliminated against the gross carrying amount of the asset.
- If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued.
- The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.
- An increase in the carrying amount of an asset arising on revaluation should be credited directly to owners' interests under the heading of revaluation surplus. However, the increase should be recognised in the statement of profit and loss to the extent that it reverses a revaluation decrease of the same asset previously recognized in the statement of profit and loss.
- A decrease in the carrying amount of an asset arising on revaluation should be charged to the statement of profit and loss. However, the decrease should be debited directly to owners' interests under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
- The revaluation surplus included in owners' interests in respect of an item of property, plant and equipment may be transferred to the revenue reserves when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset issued by an enterprise. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on its original cost. Transfers from revaluation surplus to the revenue reserves are not made through the statement of profit and loss.

Depreciation:

- Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately.
- An enterprise allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates each such part separately. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
- A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.
- To the extent that an enterprise depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an enterprise has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

- An enterprise may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
- The depreciation charge for each period should be recognised in the statement of profit and loss unless it is included in the carrying amount of another asset.
- The depreciation charge for a period is usually recognised in the statement of profit and loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see AS 2). Similarly, the depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with AS 26, Intangible Assets.

Depreciable Amount and Depreciation Period:

- The depreciable amount of an asset should be allocated on a systematic basis over its useful life.
- The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) should be accounted for as a change in an accounting estimate in accordance with AS 5, Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.
- Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.
- The depreciable amount of an asset is determined after deducting its residual value.
- The residual value of an asset may increase to an amount equal to or greater than its carrying amount. If it does, depreciation charge of the asset is zero unless and until its residual value subsequently decreases to an amount below its carrying amount.
- Depreciation of an asset begins when it is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is retired from active use and is held for disposal and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use (but not held for disposal) unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production.
- The future economic benefits embodied in an asset are consumed by an enterprise principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
  a. expected usage of the asset. Usage is assessed by reference to the expected capacity or physical output of the asset.
  b. expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
  c. technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.
  d. legal or similar limits on the use of the asset, such as the expiry dates of related leases.
- The useful life of an asset is defined in terms of its expected utility to the enterprise. The asset management policy of the enterprise may involve the disposal of assets after as pecified time or after consumption of a

specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the enterprise with similar assets.

- Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.
- If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation Method:

- The depreciation method used should reflect the pattern in which the future economic benefits of the asset are expected to be consumed by the enterprise.
- The depreciation method applied to an asset should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method should be changed to reflect the changed pattern. Such a change should be accounted for as a change in an accounting estimate in accordance with AS 5.
- A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the residual value of the asset does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The enterprise selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or that the method is changed in accordance with the statute to best reflect the way the asset is consumed.
- A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

Changes in Existing Decommissioning, Restoration and Other Liabilities:

- The cost of property, plant and equipment may undergo changes subsequent to its acquisition or construction on account of changes in liabilities, price adjustments, changes in duties, changes in initial estimates of amounts provided for dismantling, removing, restoration and similar factors and included in the cost of the asset. Such changes in cost should be accounted for as under:

  If the related asset is measured using the cost model:

  ✓ Changes in the liability should be added to, or deducted from, the cost of the related asset in the current period.

  ✓ The amount deducted from the cost of the asset should not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess should be recognised immediately in the statement of profit and loss.

- ✓ If the adjustment results in an addition to the cost of an asset, the enterprise should consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the enterprise should test the asset for impairment by estimating its recoverable amount, and should account for any impairment loss, in accordance with AS 28.

If the related asset is measured using the revaluation model:

- ✓ Changes in the liability alter the revaluation surplus or deficit previously recognised on that asset, so that:
  - a decrease in the liability should be credited directly to revaluation surplus in the owners' interest, except that it should be recognised in the statement of profit and loss to the extent that it reverses a revaluation deficit on the asset that was previously recognised in the statement of profit and loss;

    An increase in the liability should be recognised in the statement of profit and loss, except that it should be debited directly to revaluation surplus in the owners' interest to the extent of any credit balance existing in the revaluation surplus in respect of that asset.
- ✓ In the event that a decrease in the liability exceeds the carrying amount that would have been recognised had the asset been carried under the cost model, the excess should be recognised immediately in the statement of profit and loss.
- ✓ A change in the liability is an indication that the asset may have to be revalued in order to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date. Any such revaluation should be taken into account in determining the amounts to be taken to the statement of profit and loss and the owners' interest. If are valuation is necessary, all assets of that class should be revalued.

The adjusted depreciable amount of the asset is depreciated over its useful life. Therefore, once the related asset has reached the end of its useful life, all subsequent changes in the liability should be recognised in the statement of profit and loss as they occur. This applies under both the cost model and the revaluation model.

Impairment:

To determine whether an item of property, plant and equipment is impaired, an enterprise applies AS 28, Impairment of Assets. AS 28 explains how an enterprise reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

Compensation for Impairment:

- Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up should be included in the statement of profit and loss when the compensation becomes receivable.
- Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
  - ✓ Impairments of items of property, plant and equipment are recognized in accordance with AS 28;
  - ✓ Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
  - ✓ Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and
  - ✓ The cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Retirements:

Items of property, plant and equipment retired from active use and held for disposal should be stated at the lower of their carrying amount and net realizable value. Any write-down in this regard should be recognised immediately in the statement of profit and loss.

Derecognition:

- The carrying amount of an item of property, plant and equipment should be derecognised
  - ✓ on disposal; or
  - ✓ when no future economic benefits are expected from its use or disposal.
- The gain or loss arising from the derecognition of an item of property, plant and equipment should be included in the statement of profit and loss when the item is derecognised (unless AS 19, Leases, requires otherwise on a sale and leaseback).Gains should not be classified as revenue, as defined in AS 9, Revenue Recognition.
- However, an enterprise that in the course of its ordinary activities, routinely sells items of property, plant and equipment that it had held for rental to others should transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets should be recognised in revenue in accordance with AS 9, Revenue Recognition.
- The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g. by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an enterprise applies the criteria in AS 19 for recognizing revenue from the sale of goods. AS 19, Leases, applies to disposal by a sale and lease back.
- If, under the recognition principle, an enterprise recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an enterprise to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
- The gain or loss arising from the derecognition of an item of property, plant and equipment should be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.
- The consideration receivable on disposal of an item of property, plant and equipment is recognised in accordance with the principles enunciated in AS 9.

Disclosure:

- The financial statements should disclose, for each class of property, plant and equipment:
  - (a) the measurement bases (i.e., cost model or revaluation model) used for determining the gross carrying amount;
  - (b) the depreciation methods used;
  - (c) the useful lives or the depreciation rates used. In case the useful lives or the depreciation rates used are different from those specified in the statute governing the enterprise, it should make a specific mention of that fact;
  - (d) the gross carrying amount and the accumulated depreciation(aggregated with accumulated impairment losses) at the beginning and end of the period; and
  - (e) a reconciliation of the carrying amount at the beginning and end of the period showing: additions; assets retired from active use and held for disposal; acquisitions through business combinations; increases or decreases resulting from revaluations and from impairment losses; recognised or reversed directly in revaluation surplus in accordance with AS 28;impairment losses recognised in the statement of profit and loss in accordance with AS 28;impairment losses reversed in the statement of profit and loss in accordance with AS 28;depreciation;the net exchange differences arising on the translation of the financial statements of a non-integral foreign operation in accordance with AS 11, The Effects of Changes in Foreign Exchange Rates; and other changes.
- The financial statements should also disclose: the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; the amount of expenditure recognised in the carrying amount of an item of property, plant and equipment in the course of its construction; the amount of contractual commitments for the acquisition of property, plant and equipment; if it is not disclosed separately on the face of the statement of profit and loss, the amount of compensation from third parties for items of property, plant

and equipment that were impaired, lost or given up that is included in the statement of profit and loss; and the amount of assets retired from active use and held for disposal.

- Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other enterprises. For similar reasons, it is necessary to disclose: depreciation, whether recognised in the statement of profit and loss or as a part of the cost of other assets, during a period; and accumulated depreciation at the end of the period.
- In accordance with AS 5, an enterprise discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to: residual values; the estimated costs of dismantling, removing or restoring items of property, plant and equipment; useful lives; and depreciation methods.
- If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed: the effective date of the revaluation; whether an independent valuer was involved; the methods and significant assumptions applied in estimating fair values of the items; the extent to which fair values of the items were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms or were estimated using other valuation techniques; and the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.
- An enterprise is encouraged to disclose the following: the carrying amount of temporarily idle property, plant and equipment; the gross carrying amount of any fully depreciated property, plant and equipment that is still in use; for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; the carrying amount of property, plant and equipment retired from active use and not held for disposal.

Translation Provisions:

- Where an entity has in past recognized an expenditure in the statement of profit and loss which is eligible to be included as a part of the cost of a project for construction of property, plant and equipment in accordance with the requirements, it may do so retrospectively for such a project. The effect of such retrospective application of this requirement, should be recognised net-of-tax in revenue reserves.
- The requirements regarding the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction should be applied prospectively only to transactions entered into after this Standard becomes mandatory.
- On the date of this Standard becoming mandatory, the spare parts, which hitherto were being treated as inventory under AS 2, Valuation of Inventories, and are now required to be capitalised in accordance with the requirements of this Standard, should be capitalised at their respective carrying amounts. The spare parts so capitalised should be depreciated over their remaining useful lives prospectively as per the requirements of this Standard.
- The requirements regarding the revaluation model should be applied prospectively. In case, on the date of this Standard becoming mandatory, an enterprise does not adopt the revaluation model as its accounting policy but the carrying amount of item(s) of property, plant and equipment reflects any previous revaluation it should adjust the amount outstanding in the revaluation reserve against the carrying amount of that item. However, the carrying amount of that item should never be less than residual value. Any excess of the amount outstanding as revaluation reserve over the carrying amount of that item should be adjusted in revenue reserves.

AS-11: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

The statement applies mandatorily in respect of:

(a) Accounting for transaction in foreign currencies

(b) Translating the financial statements of foreign branches for inclusion in the financial statements of the reporting enterprise.

A transaction in a foreign currency is recorded in the financial records of an enterprise normally at the rate

(a) On the date of transaction i.e. spot rate,

(b) Approximate actual rate i.e. averaging the rates during the week/month in which transactions occur if there is no significant fluctuations.

(c) Weighted average in the above line.

However, for interrelated transaction (by virtue of being set off against receivables and payables) it is translated with reference to the net amount on the date of transaction.

After initial recognition, the exchange difference on the reporting date of financial statement should be treated as under:

(a) Monetary items like foreign currency balance, receivables, payables, loans at closing rate (in case of restriction or remittance other than temporary or when the closing rate is unrealistic, it is reported at the rate likely to be realized).

(b) Non-monetary items like fixed assets, which are recorded at historical cost, should be made at the rate on the date of transaction.

(c) Non-monetary items other than fixed assets are carried at fair value or net realizable value on the date which they are determined i.e. B/S date (inventories, investments in equity-shares).

Exchange difference on repayment of liabilities incurred for acquiring fixed assets should be adjusted in the carrying amount of fixed assets on reporting date. The same concept applies to revaluation as well but in case such adjustment on revaluation should result into showing the actual book value of the fixed assets/or class of, exceeding the recoverable amount, the remaining amount of the increase in liability should be debited to Revaluation Reserve or P/L Statement in case of inadequacy/ absence of Revaluation Reserve.

Except as stated above (fixed assets) other exchange difference should be recognized as income or expense in the period in which they arise or spread over to pertaining accounting period.

Depreciation as per AS-6 should be provided on the unamortised carrying amount of depreciable assets (after taking into account the effect of exchange difference).

Disclosure under AS -11: An enterprise should disclose:

(a) The amount of exchange difference included in the net profit or loss for the period.

(b) The amount of exchange difference adjusted in the carrying amount of fixed assets during the accounting period.

(c) The amount of exchange difference in respect of forward contracts to be recognized in the profit/loss for one or more subsequent accounting period.

(d) Foreign currency risk management policy.

Illustration 6.

	Exchange Rate
Goods purchased on 24.3.16 of US $1,00,000	₹ 64.60

Exchange rate on 31.3.2016 ₹ 65.00

Date of actual payment 5.6.2017 ₹ 65.50

Calculate the loss/gain for the financial years 2015-16 and 2016-17.

Solution:

As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods purchased on 24.03.2016 and cores sponding creditor would be recorded at ₹ 64.60

= 1,00,000 x 64.60 = ₹ 64,60,000

As per AS-11, at the balance sheet date all monetary items should be reported using the closing rate. Therefore, the creditors of US $1,00,000 outstanding on 31.3.2016 will be reported as:

1,00,000 x 65.00 = ₹ 65,00,000.

Exchange loss ₹ 40,000 (= 65,00,000 – 64,60,000) should be debited in Profit and Loss Account for 2016-17.

As per AS-11, exchange difference on settlement on monetary items should be transferred to Profit and Loss Account as gain or loss thereof:

1,00,000 x 65.50 = ₹ 65,50,000 – 65,00,000 = ₹50,000 should be debited to profit or loss for the year 2016-17.

Illustration 7.

Z Ltd. acquired a machine on 1.4.2016 costing US $ 1,00,000. The suppliers agreed to the following terms of payment:

1.4.2016	:	down payment 50%
1.4.2017	:	25%
1.4.2018	:	25%

The company depreciates machinery @ 10% on the Straight Line Method. The rate of exchange is steady at US $ 1= ₹60 upto 30.9.2017. On 1.10.2017, due to an official revaluation of rates, the exchange rate is adjusted to US $ 1= ₹68.

Show the extracts of the relevant entries in the Profit and Loss Account for the year ending 31st March, 2016 and the Balance Sheet as on that date, showing such workings as necessary.

Working Notes:

2016-17:

1. Original Cost of the machine = $1,00,000 x ₹60 = ₹60,00,000
2. Depreciation (SLM) @ 10% = ₹6,00,000

2017-18:

1. Original Cost of the machine upto 30.9.2017 = ₹60,00,000

2. Revised cost of the machine as on 1.10.2017

Due to official revaluation of exchange rates, the US $ 1 = ₹68. There is a foreign exchange loss of ₹ 8 for each dollar liability. The total loss on foreign currency fluctuation was $25,000 x ₹8 = ₹2,00,000. This has to be added to the original cost of the machine. Therefore, revised cost of the machine as on 1.10.2017 is ₹62,00,000 (i.e. ₹60,00,000 + ₹2,00,000)

The revised cost of the machine as on 1.10.2017 :		₹
Original Cost on 1.4.2016		60,00,000
Less: Depreciation:		
01.4.2016 to 31.3.2017	6,00,000	
01.4.2017 to 30.9.2017	3,00,000	9,00,000
		51,00,000
Add: Loss on foreign exchange fluctuation as on 1.10.2017		2,00,000
		53,00,000

Depreciation:		
1.4.2017 to 30.9.2017	(60,00,000 x 10/100 x 6/12)	3,00,000
1.10.2017 to 31.3.2018	$\left(\frac{53,00,000 \times 6}{8.5 \times 12}\right)$	3,11,765
Total Depreciation for the year 2017-18		6,11,765

Note: As per AS-6 Revised, 'Depreciation Accounting', in case of change in historical cost due to foreign exchange fluctuation, depreciation on the revised unamortized depreciable amount should be provided prospectively over the residual life of the asset. In this case, the residual life is 8.5 years.

Profit and Loss Account (extract)
for the year ended 31st March, 2018

Particulars	₹	Particulars	₹
To Depreciation on Machinery	6,11,765		

Balance Sheet (extract) as at 31st March, 2018

Liabilities	₹	***Assets***		₹
Current Liabilities	12,00,000	Fixed Assets		
Creditors for Supply of Machinery		Machinery (at cost)	60,00,000	
		Add: Adj.for foreign		
		Exchange fluctuation	2,00,000	
			62,00,000	
		Less: Accumulated		
		Depreciation	6,11,765	
				55,88,235

AS -12: ACCOUNTING FOR GOVERNMENT GRANTS

Government refers to Union/State, Govt. Agencies and similar bodies - Local, National or International.

Grants also include subsidies, cash incentive, and duty drawback either in cash or kind/benefits to an enterprise on recognition of compliance in the past or future compliance with condition attached to it.

The accounting for the grant should be appropriate to reveal the extent of benefit accrued to the enterprise during the reporting period.

For the purpose of the statement, following are not dealt with.

(a) Effects of changing prices or in supplementary information

(b) Government assistance other than grants.

(c) Ownership participation by government.

In order to recognize the income there should be conclusive evidence that conditions attached to the grant have been or will be fulfilled to account for such earned benefits estimated on a prudent basis, even though the actual amount may be finally settled/received after the accounting period. Mere receipt would not suffice for income recognition.

AS-4 (contingencies etc) and AS-5 (Prior period etc) would be applicable as the case may be.

The accounting for Govt. grants should be based on the nature of the relevant grant:

(a) In the nature of promoter's contribution as shareholder's fund (capital approach)

(b) Otherwise as Income Approach to match with related cost recognizing AS-1 accrual concept disclosure.

Government grants in the form of non-monetary assets e.g. land or other resources is accounted for at the acquisition cost or recorded at nominal value if it is given free of cost.

Grants received specifically for fixed asset is disclosed in the financial statement either

(a) by way of deduction from the gross block of the asset concerned, thus grant is recognized in P/L Account through reduced depreciation (in case of funding of specific asset Cost entirely, the asset should be stated at a nominal value in B/S); or

(b) the grant treated as deferred revenue income and charged off on a systematic and rational basis over the useful life of the asset, until appropriated disclosed as "Deferred Govt. grant under Reserve and Surplus in the B/S (grants relating to depreciable assets should be credited to Capital Reserve and suitably credited to P/L Account to offset the cost charged to income).

Disclosure under AS-12

(a) the accounting policy, method of presentation in the financial statements.

(b) the nature and extent of Govt. grants recognized in the financial statements, including grants of non-monetary assets given at a concessional rate or free of cost.

Illustration 8.

Z Ltd. has set up its business in designated backward area which entitles it to receive as per a public scheme announced by the Government of India, a subsidy of 25% of the cost of investment. Having fulfilled the conditions laid down under the scheme, the company on its investment of ₹100 lakhs in capital assets during its accounting year ending on 31st March, 2017, received a subsidy of ₹25 lakhs in January, 2017 from the Government of India. The Accountant of the company would like to record the receipt as an item of revenue and to reduce the losses on the Profit and Loss Account for the year ended 31st March, 2017. Is his action justified?

Solution:

As per AS-12, the Government grants related to depreciable fixed assets to be treated as deferred income which should be recognized in the Profit and Loss Account on a systematic and rational basis over the useful life of the asset. Such grants should be allocated to income over the periods and in proportions in which depreciation on those assets is charged.

The company has received ₹25 lakhs subsidy for investment in capital assets which are depreciable in nature. In view of the provisions under AS-12, the subsidy amount ₹25 lakhs received should not be credited to the Profit and Loss Account for the year ended 31st March, 2017. the subsidy should be recognized and credited to the Profit and Loss Account in the proportion of depreciation charge over the life of the subsidized assets.

Illustration 9.

Hero Ltd. belongs to the engineering industry. The Chief Accountant has prepared the draft accounts, taking note of the mandatory accounting standards.

"The company purchased on 1.4.2017 a special purpose machinery for ₹50 lakhs. It received a Central Government grant for 20% of the price. The machine has an effective life of 5 years". Discuss how to treat the Government Grant in Accounts.

Solution:

AS-12 prescribes two methods in accounting treatment of Government grants for specific fixed assets.

Method I: Government grants related to depreciable fixed assets to be treated as deferred income which is to be recognized in the Profit and Loss Account in proportion in which depreciation on those assets is charged over the useful life of the asset. Method II. The deferred income pending its apportionment to Profit and Loss Account to be disclosed in the balance sheet separately with a suitable description,e.g. Deferred Government Grants, to be shown after "Reserves & Surplus" but before " Secured Loans".

AS-13: ACCOUNTING FOR INVESTMENTS (Revised)

Investment is the assets held for earning income by way of dividend, interest and rentals, for capital appreciation or for other benefits to the investing enterprise. Assets held as stock-in-trade are not 'investments'.

1. This Standard deals with accounting for investments in the financial statements of enterprises and related disclosure requirements.
2. This Standard does not deal with:
   (a) the bases for recognition of interest, dividends and rentals earned on investments which are covered by Accounting Standard 9 on Revenue Recognition;
   (b) operating or finance leases;
   (c) investments of retirement benefit plans and life insurance enterprises; and
   (d) mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions.

The following terms are used in this Standard with the meanings assigned:

Current investment is an investment that is by its nature readily realisable and is intended to be held for not more than one year from the date on which such investment is made.

Long term investment is an investment other than a current investment.

Investment property is an investment in land or buildings that are not intended to be occupied substantially for use by, or in the operations of, the investing enterprise. For example, if a company purchases land or building not for its business use but for earning the rent by letting the land or building, the land or building is not fixed asset but it is an investment or even if building is not let out but held with the intention to earn capital appreciation, then it is an investment.

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction. Under appropriate circumstances, market value or net realisable value provides an evidence of fair value.

Market value is the amount obtainable from the sale of an investment in an open market, net of expenses necessarily to be incurred on or before disposal.

Classification of investment

Investment is classified as long-term investment and current investment as defined above.

Cost of Investment

- The cost of an investment includes acquisition charges such as brokerage, fees and duties.
- If an investment is acquired, or partly acquired, by the issue of shares or other securities, the acquisition cost is the fair value of the securities issued. The fair value may not necessarily be equal to the nominal or par value of the securities issued.
- If an investment is acquired in exchange, or part exchange, for another asset, the acquisition cost of the investment is determined by reference to the fair value of the asset given up. It may be appropriate to consider the fair value of the investment acquired if it is more clearly evident.
- When interest has accrued in pre-acquisition period and was included in cost of investment at the time of acquisition, then subsequent receipt of such pre-acquisition interest is deducted from the cost of investment.
- Dividend - When dividend is declared from pre-acquisition profits, and later on received by the purchaser of investment, then such amount of dividend is deducted from the cost of investment.
- When right shares offered are subscribed for, the cost of the right shares is added to the carrying amount of the original holding. If rights are not subscribed for but are sold in the market, the sale proceeds are taken to the profit and loss statement. However, where the investments are acquired on cum-right basis and the market value of investments immediately after their becoming ex-right is lower than the cost for which they were acquired, it may be appropriate to apply the sale proceeds of rights to reduce the carrying amount of such investments to the market value.

Carrying amount of investment —

Current investment

Carrying amount of each current investment is the lower of cost and realisable value.

Any reduction in realisable value is debited to profit and loss account and if realisable value of investment is increased subsequently, the increase in value of current investment to the level of the cost is credited to profit and loss account.

Long-term investment

- It is usually carried / valued at cost.
- If there is a decline in value of investment and, if such decline is not temporary, then carrying amount of investment is reduced by the amount of such decline. The resultant reduction in carrying amount is charged to the profit and loss account. This reduction amount is reversed when there is a rise in the value of investment but such rise in value should not be temporary.
- Indicators of the value of an investment:
  (a) its market value,
  (b) the investee's assets and results,
  (c) the expected cash flows from the investment,
  (d) the type and extent of the investor's stake in the investee,
  (e) restrictions on distribution by the investee or on disposal by the investor.

Investment Property

An investment property is accounted for in accordance with cost model as prescribed in Accounting Standard (AS) 10, Property, Plant and Equipment. The cost of any shares in a co-operative society or a company, the holding of which is directly related to the right to hold the investment property, is added to the carrying amount of the investment property.

Disposal of Investment

- When an investment is disposed of, the difference between the carrying amount and net sale proceeds (gross sale less expenses) is recognized in the profit and loss account.

- When only a part of total investment is disposed of, the carrying amount of that part of investment is determined on the basis of the average carrying amount of the total investment.

Reclassification of Investments

- Where long-term investments are reclassified as current investments, transfers are made at the lower of cost and carrying amount at the date of transfer.
- Where investments are reclassified from current to long-term, transfers are made at the lower of cost and fair value at the date of transfer.

Disclosures:

- the accounting policies for the determination of carrying amount of investments.
- the amounts included in profit and loss statement for:
  (i) interest, dividends (showing separately dividends from subsidiary companies), and rentals on investments showing separately such income from long term and current investments. Gross income should be stated, the amount of income tax deducted at source being included under Advance Taxes Paid;
  (ii) profits and losses on disposal of current investments and changes in carrying amount of such investments;
  (iii) profits and losses on disposal of long-term investments and changes in the carrying amount of such investments;
- significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal;
- the aggregate amount of quoted and unquoted investments, giving the aggregate market value of quoted investments;
- other disclosures as specifically required by the relevant statute governing the enterprise.

AS -14: ACCOUNTING FOR AMALGAMATIONS (Revised)

This standard deals with accounting for amalgamations and the treatment of any resultant goodwill or reserves. This standard is directed principally to companies although some of its requirements also apply to financial statements of other enterprises.

This standard does not deal with cases of acquisitions which arise when there is a purchase by one company (referred to as the acquiring company) of the whole or part of the shares, or the whole or part of the assets, of another company (referred to as the acquired company) in consideration for payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other. The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Purchase consideration

As the Transferee Company is purchasing the business of Transferor Company, the transferee company pays purchase consideration to the transferor company. Which means total of the shares and other securities issued and payment made in form of cash or other assets given by the transferee company to shareholders of the transferor company.

Types of amalgamation

There are two types of amalgamation:

- Amalgamation in the nature of merger;
- Amalgamation in the nature of purchase.

Conditions to be satisfied for **Amalgamation in the nature of merger**:

- Business of the transferor company is intended to be carried on by the transferee company.
- All assets and liabilities of Transferor Company are taken over by the transferee company.

- The shareholders holding at least 90% or more of the equity shares of the transferor company become the equity shareholder of the transferee company, shares already held by the transferee company and its subsidiaries are not counted for the purpose of 90% or more limit.
- Consideration for the amalgamation is paid in equity shares by the transferee company to the equity shareholder of the transferor company and fractional shares can be paid in cash.
- No adjustment is made in the book values of the assets and liabilities of the transferor company by way of revaluation or otherwise, except the adjustments to ensure uniformity of accounting policies.

Amalgamation in the nature of purchase:

If any of the conditions regarding amalgamation in the nature of merger is not satisfied.

Methods of Accounting

- in case of merger - pooling interest method
- in case of purchase - purchase method

AS-14 does not mention, how accounting is to be made in Transferor Company's books in that case accounting as per common practice has to be done , irrespective of the type of amalgamation.

Pooling interest method —

- After amalgamation in preparation of the financial statement of the transferee company, line by line addition of assets and liabilities of should be made except for share capital.
- The difference between purchase consideration paid and the amount of share capital (equity + preference capital) of the transferor company should be adjusted with reserves.
- If purchase consideration is more than the share capital of the transferor company, then amount shall be debited to reserves, if reverse is the case, the difference is credited to reserves.

Purchase Method —

- If any of the conditions of merger is not satisfied, then the amalgamation shall be classified as purchase, therefore the purchase method of accounting shall be followed.
- In the books of transferee company assets and liabilities shall be recorded at the value at which these assets and liabilities are taken over by the transferee; assets do not include fictitious assets and liabilities do not include inside/internal liabilities.
- If purchase consideration exceeds the net assets taken over (Net Assets = Assets at their agreed value less liabilities at agreed value), the difference is debited to Goodwill account. If purchase consideration is less, the difference is credited to capital reserve.

Treatment of Statutory Reserves

Statutory Reserves are those reserves, which are created as per the particular statute/law, under that law, the reserve is created and this law puts some restriction on utilisation and maintenance of reserves for a particular period.

- Separate accounting adjustment/entry is not required for statutory reserves in the case of merger, in case of amalgamation by way of purchase, the reserves being internal liabilities, are not recorded in the books of transferee.
- To comply with the requirements of particular statute, the statutory reserves created in the books of transferor company is to be maintained for some more years in the transferee company books. In that case transferee company shall record the statutory reserves in its books by debiting to amalgamation adjustment reserve and crediting statutory reserve. When the maintenance of statutory reserves is no longer required, the entry passed should be reversed.

- ***Amalgamation adjustment reserve shall be presented in balance sheet as a separate line item as there is not any sub-heading like 'miscellaneous expenditure' in Schedule III of The Companies Act, 2013.***

Goodwill arising on Amalgamation — Treatment

It is considered appropriate to amortize goodwill over a period not exceeding five years unless a somewhat longer period can be justified. The requirement of AS-26 intangible asset regarding amortization shall not apply to such goodwill.

Disclosure

In first financial statement of transferee company the following disclosures are made for all amalgamation:

- Names and general nature of business of amalgamating companies;
- Effective date of amalgamation;
- Method of accounting applied;
- Particulars of scheme sanctioned under a law.

Amalgamation accounted under pooling interest method—

- description and number of shares issued,
- difference between consideration and net assets acquired and treatment thereof

Amalgamation accounted under purchase method—

- Consideration for the amalgamation.
- Difference between consideration and net assets acquired and treatment thereof. including period of amortization of goodwill.

Note: Amalgamation as per this Accounting Standard means an amalgamation pursuant to the provisions of the Companies Act, 2013 or any other law/statute which is applicable to companies, it also includes 'merger'.

Illustration 10.

X Ltd. having a share capital of ₹ 20 lakhs and Y Ltd.having a share capital of ₹30 lakhs. Z Ltd. was formed to take over the business of X Ltd and Y Ltd. at a purchase consideration of ₹ 25 lakhs and ₹ 28 lakhs, payable in shares of Z Ltd. The assets and liabilities were taken at their carrying amounts. Compute the Goodwill or Capital Reserve.

Solution:

Since the purchase consideration is payable in shares of the transferee company and all the assets and liabilities are taken over at their carrying amounts, the amalgamation is in the nature of merger, i.e. pooling of interests method.

For X Ltd. Purchase consideration = ₹ 25 lakhs

Less: Share capital of X Ltd = ₹ 20 lakhs

Excess of purchase consideration = ₹5 lakhs. This shall have to be adjusted against the Reserves of Z Ltd.

For Y Ltd. Purchase Consideration = ₹28 lakhs

Less: Share Capital of Y Ltd = ₹30 lakhs

since purchase consideration is less than share capital of the transferor company, ₹2 lakhs shall be treated as Capital Reserve.

Note: In case of amalgamation in the nature of purchase, goodwill shall have to be shown in the Balance Sheet of the Transferee company. Such goodwill shall have to be written off over a maximum period of 5 years.

Illustration 11.

Net Assets of the Transferor Campany : ₹ 20 lakhs. If Purchase Consideration is (i) ₹ 18 lakhs (ii) ₹23 lakhs & amalgamation is in the nature of purchase. Compute the Goodwill or Capital Reserve.

Solution:

(i) Net Assets ₹20 lakhs > Purchase Consideration ₹18 lakhs. So, ₹2 lakhs will be treated as Capital Reserve.

(ii) Net Assets ₹20 lakhs < Purchase Consideration ₹23 lakhs. So, ₹3 lakhs will be treated as Goodwill.

AS-15: EMPLOYEE BENEFITS

The statement applies to benefit usually comprising of Provident Fund, Superannuation/Pension Fund, Gratuity, Leave encashment or retirement, Post retirement health and welfare schemes and other benefits provided by an employer to employees either in pursuance of legal requirement or otherwise, but does not extend to employers' obligation which cannot be reasonably estimated (e.g. ex-gratia ad-hoc on retirement).

There may be obligation on the part of the employer either against defined contribution plan or defined benefit schemes as elaborated below:

(a) Defined Contribution Plans (DCP):

1) Retirement benefit is determined by contribution at agreed/specified rate to the Fund together with earnings thereof.

2) Contribution (e.g. PF) whether paid or payable for the reporting period is charged to P/L statement

3) Excess if any is treated as prepayment

(b) Defined Benefit Plans (DBP):

1) Amount paid is usually determined with reference to employee's earnings and/or years of service (if the basis of contribution are determined, it will be treated as defined contribution scheme)

2) However, if the employer's responsibility is subject to specified benefits or a specified level of benefits, it is defined benefit scheme.

3) The extent of employer's obligation is largely uncertain and subject to estimation of future condition and events beyond control.

Accounting treatment for Gratuity benefit and other defined benefit schemes depends on the arrangement made by the employer:

(a) No separate fund i.e. out of nonspecific own fund:

1) Provision for accruing liability in the P/L Account for the accounting period is made.

2) The provision is based on an actuarial method or some other rational method (assumption that all employers are eligible at the end of the accounting period)

(b) *Own separate/specific fund established through Trust:*

The amount required to be contributed on actuarial basis is certified by the Actuary, and the actual contribution plus and shortfall to meet the actuarial amount is charged to P/L Account for the accounting period, any excess payment treated as prepayment.

(c) *Fund established through Insurer:* in the same manner as in (b) above

Actual valuation may be carried out annually (cost can be easily determined for the purpose of contribution as a charge to P/L) or periodically (say, once in 3 years) where Actuary's certificate specifies contribution on annual basis during inter-valuation period.

Leave encashment is an accrued estimated liability based on employers' past experience as to such benefit actually availed off and probability of encashment in future and therefore should relate to the period in which relevant service is rendered in compliance with section 128 - accrual basis and AS-15.

Disclosure under AS-15:

(a) In view of the varying practices, adequate disclosure of method of accounting for an understanding of the significance of such costs to an employer.

(b) Disclosure separately made for statutory compliance or otherwise the retirement benefit costs are treated as an element of employee remuneration without specific disclosure.

(c) Financial statements should disclose whether actuarial valuation is made at the end of the accounting period or earlier (in which case the date of actuarial valuation and the method used for accrual period if not based on actuary report).

Treatment of Voluntary Retirement scheme payments:

1) Termination benefits to be paid irrespective of the voluntary retirement scheme i.e. balance in P.F, leave encashment; gratuity etc.

2) Termination benefits which are payable on account of VRS i.e. monetary payment on the basis of years of completed service or for the balance period of service whichever is less and notice pay.

Expert Advisory Committee (EAC) opines in favour of treating the costs (except gratuity which should have been provided for in the respective accounting period) as deferred revenue expenditure since it is construed upon as saving in subsequent periods, on some rational basis over a period, preferably over 3 - 5 year. However, the terminal benefit is, to the extent these are not deferred should be treated as expense in the P/L Account with disclosure.

Illustration 12.

ZERO Bank has followed the policies for retirement benefits as under:

(a) contribution to pension fund is made based on actuarial valuation at the year end. In respect of employees who have opted for pension scheme.

(b) Contribution to the gratuity fund is made based on actuarial valuation at the year end.

(c) Leave encashment is accounted for on "PAY-AS-YOU-GO" method.

Comment whether the policy is in accordance with AS-15.

Solution:

(a) As the contribution to Pension Fund is made on actuarial basis every year, there fore the policy is as per AS-15, which is based on actuarial basis of a counting.

(b) As the contribution is being made on annual basis to gratuity fund on actuarial basis, the policy is in accordance with AS-15.

(c) As regard leave encashment, which is accounted for on PAY-AS-YOU-GO basis, it is not in accordance with AS-15. It should be accounted for on accrual basis.

Illustration 13.

In the context of relevant Accounting Standards, give your comment on the following matter for the financial year ending 31st March, 2017:

"Increase in pension liability on account of wage revision in 2016-17 is being provided for in 5 instalments commencing from that year. The remaining liability of ₹300 lakhs as redetermined in actuarial valuation will be provided for in the next 2 years"

Solution:

As per AS-15, the costs arising from an alteration in the retirement benefits to employees should be treated as follows:

(i) The cost may relate to the current year of service or to the past years of service.

(ii) In case of costs relating to the current year, the same may be charged to Profit and Loss Account

(iii) Where the cost relates to the past years of service these should be charged to Profit and Loss Account as 'prior period' items in accordance with AS-5.

(iv) Where retirement benefit scheme is amended in a manner which results in additional benefits being provided to retired employees, the cost of the additional benefits should be taken as " Prior Period and Extraordinary Items" as per AS-5.

In view of the above, the method adopted for accounting the increase in pension liability is not in consonance to the provisions mentioned in AS-15.

AS-16: BORROWING COST

Borrowing costs are interests and other costs incurred by an enterprise in connection with the borrowing of funds.

A qualifying asset is an asset that necessarily takes substantial period of time to get ready for its intended use of sale.

Examples of qualifying assets:

- Any tangible fixed assets, which are in construction process or acquired tangible fixed assets, which are not ready for use or resale. Such as plants and machinery.
- Any intangible assets, which are in development phase or acquired but not ready for use or resale, such as patent.
- Investment property.
- Inventories that require a substantial period(i.e. generally more than one accounting period) to bring them to a saleable condition.

The Statement is applied in accounting for borrowing costs which include:

1. Interest and commitment charges on bank borrowing and other short term borrowings
2. Amortization of discounts/premium relating to borrowings
3. Amortization of ancillary cost incurred in connection with arrangement of borrowings
4. Finance charges for assets acquired under finance lease or other similar arrangement
5. Exchange difference in foreign currency borrowing to the extent it relates to interest element

Borrowing cost incurred on assets, which takes substantial period, is treated as cost of that asset in respect of (1) above.

As per the Guidance Note on Audit of Miscellaneous Expenditure issued by ICAI, deferment for amortization cost upto the time the asset is put to use, in respect of (2) and (3), should be capitalized (see below for AS-16 provision).

Finance charges as in (4) can be capitalized upto the time the asset is put to use (AS-19 deals with elaborate provision)

Conditions for capitalization of borrowing costs:

- Directly attributable costs for acquisition, construction or production of qualifying asset, are eligible for capitalization.
- Qualifying assets will render future economic benefit to the enterprise and the cost can be measured reliably.

Amount of borrowing costs eligible for capitalization (specific borrowing):

- Amount of borrowing eligible for capitalization = Actual borrowing cost incurred during the period less income generated on the temporary investment of amount borrowed.

All other borrowing costs are charged to P/L Account:

AS-16 establishes a key test for capitalization which states that "borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those costs that would have been avoided if the expenditure on the qualifying asset had not been made".

Accounting treatment of borrowing cost as per AS-16:

(a) Borrowing costs should either be capitalized or charged to P/L Account depending on the situation but deferment is not permitted.

(b) Borrowing costs are capitalized as part of cost of qualifying asset when it is probable that they will result in future economic benefits and cost can be measured reliably - other borrowing costs are charged to P/L Account in the accounting period in which they are incurred.

(c) Capitalization, on one hand reflects closely the total investment in the asset and on the other hand to charge the cost to future period against accrual of revenue.

(d) Notional interest cost are not allowed to be capitalized.

(e) A qualifying asset is an asset that necessarily takes a substantial period of time (usually a period of 12 months unless otherwise justified on the basis of facts and circumstances) to get ready for its intended use or sale.

(f) Capitalization should be suspended during extended period in which active development is interrupted.

(g) Capitalization should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

(h) Capitalization also ceases 'when part is completed, which is capable of being used independent of the whole.

Disclosure under AS- 16

(a) Accounting Policy adopted

(b) Amount of borrowing cost capitalized during the accounting period

Illustration 14.

A company capitalizes interest cost of holding investments and adds to cost of investment every year, thereby understating interest cost in profit and loss account. Whether it leads to unusual accounting?

Solution:

The Accounting Standard Board (ASB) has opined that investments other than investment properties are not qualifying assets as per AS-16, Borrowing Costs. Therefore, interest cost of holding such investments cannot be capitalized. Further, even interest in respect of investment properties can only be capitalized if such properties meet the definition of qualifying assets, namely, that it necessarily takes a substantial period of time to get ready for its intended use or sale, even where the investment properties meet the definition of "qualifying asset", for the capitalization of borrowing costs the other requirements of the standard such as that borrowing costs should be directly attributable to the acquisition or construction of the investment property and suspension of capitalization as per paragraphs 17 and 18 of AS-16 have to be complied with.

Illustration 15.

X Ltd. has obtained an institutional loan of ₹ 800 lakhs for modernization and renovation of its machinery. Machinery acquired under the modernization scheme and installation completed on 31.3.17 amounts to ₹ 600 lakhs. ₹ 80 lakhs has been advanced to suppliers for additional assets and balance loan of ₹120 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to ₹80 lakhs during 2016-17.

You are required to state how the interest on the institutional loan is to be accounted in the year 2016-17.

Solution:

The total interest of ₹80 lakhs is related to two periods. Upto the date of installation of the machinery, amount disbursed is ₹680 lakhs ₹ (600 + 80). Interest on such amounting to ₹68 lakhs should be capitalized and the balance of the interest ₹12 lakhs ₹ (i.e. 80-68) should be treated as an expense.

Illustration 16.

Happy Ltd.has taken a loan of US $10 lakhs on 1st April, 2016, for a specific project at an interest rate of 10% p.a., payable annually. On 1st April, 2016, the exchange rate between the currencies was ₹65 per US $. The exchange rate, as at 31st March, 2017, is ₹ 68 per US $. The corresponding amount could have been borrowed by Happy Ltd. in local currency at an interest rate of 15% p.a. as on 1st April, 2016. Show the treatment of borrowing costs as per AS-16.

Solution:

The following computation would be made to determine the amount of borrowing costs for the purposes of paragraph 4(e) of AS-16.

(a) Interest for the period = US $10,00,000 x 10% x ₹68 per US $ = ₹ 68,00,000

(b) Increase in the liability towards the principal amount = US $ 10,00,000 x (68 - 65)= ₹30,00,000.

(c) Interest that would have resulted if the loan was taken in Indian currency = US $ 10,00,000 x 65 x 15% = ₹97,50,000

(d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹97,50,000 – ₹ 68,00,000 = ₹ 29,50,000

Therefore, out of ₹30,00,000 increase in the liability towards principal amount, only ₹ 29,50,000 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹97,50,000 being the aggregate of interest of ₹68,00,000 on foreign currency borrowings (as per Para 4(a) of AS-16) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹29,50,000. Thus, ₹97,50,000 would be considered as the borrowing cost to be accounted for as per AS-16 and the remaining ₹ 50,000 would be considered as the exchange difference to be accounted for as per AS-11 "The Effects of Changes in Foreign Exchange Rates".

Illustration 17.

On 30.4.2017 MNC Ltd.obtained a loan from the bank for ₹ 5 crores to be utilized as under:

(i)	Construction of a factory shed	₹2 crores.
(ii)	Purchase of Machinery	₹ 1.5 crores.
(iii)	Working Capital	₹ 1 crore.
(iv)	Advance for Purchase of truck	₹ 50 lakhs.

In March 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ended 31.3.17 was ₹90 lakhs. Show the treatment of interest as per AS-16.

Solution:

As per AS-16, borrowing cost(interest) should be capitalized if borrowing cost is directly attributable to the acquisition, construction or production of qualifying asset. ₹5 crores borrowed from Bank was utilized for four different purposes, only construction of factory shed is a qualifying asset as per AS-16, while the other three payments are not for the qualifying asset. Therefore, borrowing cost attributable to the construction of a factory shed should only be capitalized which will be equal to ₹ 90 lakhs x 2/5 = ₹36 lakhs.

The balance of ₹ 54 lakhs (₹90 lakhs – ₹36 lakhs) should be treated as an expense and debited to Profit and Loss Account.

AS 17: SEGMENT REPORTING

In view of the complexities of types of businesses, the aggregated financial information is not adequate to evaluate a company's and management's operating and financial strategies with regard to specific or distinct line of activities i.e. segment. As an enterprise deals in multi-product/ multiple services and operates in different geographical areas, the degree of risk and return also varies considerably.

Segment information will enable the users to understand better and also to assess the underlying risks and returns of an enterprise.

Initially the segment needs to be broadly classified into either 'Business Segments' or 'Geographical Segments' before being slotted as 'Primary' or 'Secondary' for reporting in the financial statements as per AS- 7.

A 'Business Segment' is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of products or services, and that is subject to risk and return as distinctly different from those of other business segments. For grouping related products or services, following factors are considered:

(a) The nature of product/service;

(b) The nature of production processes (e.g. labour or capital intensive);

(c) The type or Class of customer (e.g. gender, income).

(d) The method used to describe the products or provide services (e.g. wholesaler, franchisee, dealer) similarity of economic and political condition relationship between operations in different geographical areas proximity of operation special risks associated with operation in a particular area exchange control regulation underlying currency risk (geographical location means the location of production or service facilities and other assets of an enterprise and the location of markets and customers).

(e) Nature of regulatory environment e.g. insurance, banking, public utilities etc the majority of the factors will be considered to form a single segment even though, there may be dissimilarities and a single business segment does not include products and services with significant differing risks and returns (risk in investment and potential earnings as reward).

A 'Geographical segment' is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risk and returns that are different from those of components operating in other economic environments. Factors for identification of geographical segments are:

(a) Significant difference in risk and rewards;

(b) Internal MIS and organization structure;

(c) Essential factors that defines a business segment.

Segment accounting policies: AS-17 does not require that the enterprise apply accounting policies to reportable segments on stand-alone reporting entities, hence, additional segment information may be disclosed provided that:

(i) Information is reported internally to the Board or CEO for the purpose of making decisions about allocating resources to the segment and assessing its performance.

(ii) The basis of measurement for additional information is closely described.

Segment Revenue is the aggregate of the portion of enterprise's total revenue that is attributable to a segment on a reasonable basis as distinct from other segments including inter-segment transfer with the exception of

(a) extra ordinary item as AS-5

(b) income by way of interest/dividend etc unless the operation of the segments are primarily of a financial nature

(c) gains or sale of investment or on extinguishments of debts unless the operation of the segment, are primarily of a financial nature

Inter-segment transfer should be made on the basis that is actually used to price those transfers i.e. at cost, below cost or market price and the same should be disclosed and followed consistently.

Segment result is segment revenue less segment expense

Segment Assets comprise of directly attributable or reasonably allocable operating asset to the segment as reduced by related allowances or provisions pertaining to those assets including allocable common assets, however exclude:

(a) income tax asset

(b) general enterprise asset/H.O asset

Segment liabilities are worked out or above basis but excluding:

(a) income tax liabilities

(b) general enterprise liabilities/H.O lease liabilities.

For primary segment disclosure required for:

(a) segment revenue with a break-up of sales to external customers and inter segment result deduction made to arrive at segment result in respect of total amount of non cash expenses (provisions, unrealized foreign exchange gain/loss as included in segment expenses);

(b) total amount of depreciation and amortization in respect of segment assets (not required if cash flow of the enterprise reports operating, investing and financing activities;

(c) total carrying amount of segment assets;

(d) total amount of segment liabilities;

(e) total cost incurred during the period to acquire segment assets that are expected to be used for more than one period (both fixed assets and intangible assets).

For secondary segment, disclosure required for:

(a) If primary format for reporting segment is business segment, it should also report;

    1. segment revenue from external customers by geographical location of customers for each geographical segment consisting 10 percent or more of enterprise revenue.

    2. total carrying amount of segment assets, by geographical location of assets for each of such geographical segment accounting for 10 percent or more of the total assets of all geographical segments.

    3. total cost incurred during the accounting period to acquire segment assets, which are expected to be used for more than one accounting period with 10 percent more criteria as in the aforesaid line.

(b) where primary format is geographical, disclosure also required for each business segment accounting for 10 percent or more of revenue from sales to external customers of enterprises' total revenue or whose segment assets are 10 percent or more of the total assets of all business segments:

    1. segment revenue from external customers

    2. total carrying amount of segment assets

    3. total cost incurred during the accounting period to acquire segment assets with expected use extending beyond one accounting period (both tangible and intangible) of all geographical location where geographical segment used for primary format is based on a location, of assets which is different from location of customers.

Additional disclosure required for

1) revenue from sales to external customers for each customer based geographical segment whose revenue from sales to external customers constitutes 10 percent or more of enterprise's revenue.

2) in a reverse situation, disclosure for

   (i) total carrying amount of segment assets by geographical location of assets

   (ii) total cost incurred during the accounting period to acquire segment assets expected to be used for more than one accounting period both tangible and intangible by location of assets.

Illustration 18.

M/S ABC Ltd. Has three segments namely A, B, C. The total assets of the company are ₹ 10.00 crs. Segment A has ₹ 2.00 crs. Segment B has ₹ 3.00 crs and Segment C has ₹ 5.00 crs. Deferred tax assets included in the assets of each segments are A – ₹ 0.50 crs. B- ₹ 0.40 crs. C- ₹ 0.30 crs. The accountant contends that al the three segments are reportable segments. Comment.

Solution:

According to AS-17 "Segment Reporting, segment assets do not include income tax assets. So, assets of

Segment A = 2.00 – 0.50 =	₹ 1.50 crs.
Segment B = 3.00 – 0.40 =	₹ 2.60 crs.
Segment C = 5.00 – 0.30 =	₹ 4.70 crs.
Total Segment Assets	₹ 8.80 crs.

Since each segment's assets is more than 10% of total segment assets (i.e. ₹ 0.88 crs.) all segments are reportable segments.

Illustration 19.

M Ltd. Group has three divisions A, B and C. Details of their turnover, results and net assets are given below:

	₹ ('000)
Division A	
Sales to B	9,150
Other Sales (Home)	180
Export Sales	12,270
	21,600
Division B	
Sales to C	90
Exports Sales to Europe	600
	690
Division C	
Export Sales to America	540

	Head Office ₹ ('000)	A ₹ ('000)	B ₹ ('000)	C ₹ ('000)
Operating Profit or Loss before tax		480	60	(24)
Re-allocated cost from Head Office		144	72	72
Interest cost		12	15	3
Fixed assets	150	600	120	360
Net current assets	144	360	120	270
Long-term liabilities	114	60	30	360

Prepare a Segmental Report for publication in M Ltd. Group.

Solution:

M Ltd.

Segmental Report

(₹ in '000)

	Division				
Segment Revenue	A	B	C	Inter segment Eliminations	Consolidated Total
Sales:					
Domestic	180				180
Export	12,270	600	540		13,410
External Sales	12,450	600	540		13,590
Inter-segment Sales	9,150	90		9,240	
Total Revenue	21,600	690	540	9,240	13,590
Segment result (given)	480	60	(24)		516
Head office expenses					(288)
Operating profit					228
Interest expenses					(30)
Profit before tax					198
Other information:					
Fixed assets	600	120	360		1,080
Net current assets	360	120	270		750
Segment assets	960	240	630		1,830
Unallocated corporate assets					294
Segment liabilities	60	30	360		450
Unallocated corporate liabilities					114

Sales Revenue by Geographical Market

(₹ in '000)

	Home Sales	Export Sales (by division A)	Export to Europe	Export to America	Consolidated Total
External Sales	180	12,270	600	540	13,590

Illustration 20.

Identify the reportable segment by profitability test is demonstrated as follows for XYZ Ltd.

Segment	Prof it (Loss)
A	450
B	50
C	(350)
D	(40)
E	(210)

Solution :

First, the operating segments are grouped accordi ng to whether they incurred a profit or loss, as follows :

Segments Incurring Profits		Segments Incurring Losses	
Segment	Profit (₹)	Segment	Loss (₹)
A	450	C	(350)
B	50	D	(40)
	-	E	(210)
	500		600

From this point on the profitability test, only absolute amounts are used. The combined total of those segments incurring a loss is larger than the combined total of those segments incu rring a profit. Therefore, any segment for which the absolute amount of its operating profit or loss equals or exceeds ₹ 60 (i.e., 10% of ₹ 600) meets the profitability test and is therefore a reportable segment. Segments A, C and E meet the profitability test, summarized as follows :

Operating Segment	Absolute amount of Profit or loss	₹ 60	
A	450	Yes	(reportable segment)
B	50	No	
c	350	Yes	(reportable segment)
D	40	No	
E	210	Yes	(reportable segment)

If the total external reven ue *(i.e.,* sales to unaffiliated customers) of the reportable segments is less than 75% of total consolidated revenue, additional operating segments must be identified as reportable segments (even if they do not otherwise qualify as a reportable segment) until at least 75% of total consolidated revenue is included in reportable segments.

Information about all operating segments that did not qualify as reportable segments must be combined and disclosed in an "all other" category.

If an operating segment was identified in the immediately preceding prior period as a reportable segment and management deems that segment to be of continuing significance, information about that segment should continue to be reported separately in the current period even if that segment does not otherwise qualify as a reportable segment in the current period.

If an operating segment qualifies in the current period as a reportable segment but did not qualify as a reportable segment in the prior period(s), prior-period segment data presented for comparative purposes should be restated as if the segment qualified as a reportable segment in the prior period(s).

Illustration 21.

The Chief Accountant of Sports Ltd. gives the following data regarding its six segments:

Particulars	**M**	**N**	**0**	**p**	**Q**	**R**	**Total**
Segment Assets	40	80	30	20	20	10	200
Segment Result	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1200

The Chief Accountant is of the opinion that segments "M" and "N" alone should be reported. Is he justified in his view? Discuss.

Solution:

No, he is not justified in his view, because as per Para 27 of AS-17 "Segment Reporting", Business Segment or geographical segment which has been identified as reportable segment shall be further divided to include sub-segments based on the following conditions:

+ Segment revenue from sales to external customers and internal transfer is

10% or more than total external and internal revenue of all segments.

Or

+ 10% or more of segment result

+ (Segment result means: if some segments are in loss then total loss of all loss making segments or if some segments are profit, total profit of all profit making segments. Whichever is higher *i.e.*, total profit or total loss figure in absolute term.)

Or

+ Segment asset is 10% or more than total assets of all segments.

+ Ensure whether at least 75% of total external revenue should be in the reportable segments.

In the question, the segments "M" and "N" are reportable segments on the basis of 10% of more segment revenue other two criteria should also be applied to make reportable segment as per AS-17. I0% of segment result which is 20 or more (loss) (190+10) × 10%. By these criteria "R" is also reportable segment. As per the 1096 or more asset criteria "0", "P" and "Q" also becomes the reportable segments; therefore all the 6 segments should be reportable segments.

AS -18: RELATED PARTY DISCLOSURE

The scope and objective of the standard is to establish requirements for disclosure of (a) related party relationship (b) transaction between a reporting enterprise and its related parties.

This disclosure would make the financial statements of the reporting enterprise more transparent and allow the users to compare both intra-enterprise with corresponding earlier accounting period and inter-enterprise as well.

However disclosure is not required

(i) if there is statutory bar on the reporting enterprise on confidentiality (banks) in respect of constituents

(ii) in case of consolidated financial statements in respect members of the group (holding & subsidiary) with exception for transaction with Associated Enterprise accounted for under equity method

(iii) in the financial statement of State (Central or State) controlled enterprises with other state controlled enterprise even related party relationship exists. When parties are considered related?

If at any time during the reporting period one party has the ability

(a) to control the other party

(b) to exercise significant influence over the other party in making financial and/or operating decisions, then by virtue of AS -18 both parties would be considered as related.

Definition

(a) Control:

  (i) ownership directly or indirectly, of more than 50 percent of the voting power of an enterprise

  (ii) the composition of the board of directors (company) or the Governing Body (other enterprise)

  (iii) a substantial interest in voting power and the power to direct by Statute or by agreement, the financial/ operating policies of the enterprise (20 percent or more interest in voting power)

(b) Significant Influence:

   (i) refers to participation in the financial and/or operating policy decisions of an enterprise but not control of those policies.

   (ii) may be gained by ownership in share (including investment through intermediaries restricted to mean subsidiaries as defined in AS-21 Consolidated Financial Statement)

Related party disclosures are applicable only to the following related party relationships:

1. enterprises that directly or indirectly through one or more intermediaries control or are controlled by or under common control with the reporting enterprise
2. associates and joint venturers of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or joint venturer,.
3. individuals owning directly or indirectly an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise and relatives of any such individual.
4. key management personnel and relatives of such individuals.
5. enterprise over which any person in (3) and (4) is able to exercise significant influence (including enterprise owned by directors or major shareholders of the reporting enterprise and enterprise that have a member of key management in common with the reporting enterprise).

Related party transactions involve transfer of resources or obligations between related parties, regardless of whether or not .a price is charged, e.g. use of logo/brand name provision of management services, providing financial guarantee use of common infrastructure etc.

Type of disclosure under AS-18

(a) in case of related party relationship by virtue of significant influence (not control) e.g. those of associates, key management personnel, relatives, there is no need. to disclose the related party relationship unless there have been actual transaction during the reporting period with such related parties.

(b) in the event of transaction between related parties during the existence of a related party relationship (control or significant influence) the reporting enterprise should disclose:

   (i) the name of transacting related party

   (ii) description of the relationship between parties

   (iii) description of nature of transaction

   (iv) volume of transaction, either in amount or approximate proportions

   (v) any other element of the related party transactions necessary for understanding of financial statements (e.g. transfer of major asset taken at price different from normal commercial terms i.e. not at fair value)

   (vi) either in amount or proportion of outstanding items and provisions for doubtful debts pertaining to related parties on B/S date.

   (vii) amounts written off/back in the accounting period in respect of debts due from or to related parties.

AS -19: LEASES

Lease is an arrangement by which the “Lessor” gives the right to use an asset for given period of time to the “Lessee” on rent.

It involves two parties, a Lessor and a Lessee and an asset which is to be leased. The Lessor, who owns the asset, agrees to allow to the Lessee to use it for a specified period of time in return for periodic rent payments.

Types of lease

(a) ***Finance Lease*** – It is a lease, which transfers substantially all the risks and rewards incidental to ownership of an asset to the Lessee by the Lessor but not the legal ownership. In following situations, the lease transactions are called Finance Lease.

- The lessee will get the ownership of leased asset at the end of the lease term.
- The lessee has an option to buy the leased asset at the end of term at price, which is lower than its expected fair value at the date on which option will be exercised.
- The lease term covers the major part of the life of asset.
- At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
- The asset given on lease to lessee is of specialized nature and can only be used by the lessee without major modification.

(b) ***Operating Lease*** – It is a lease which does not transfer substantially all the risk and reward incidental to ownership.

Classification of lease is made at the inception of the lease; if at any time the Lessee and Lessor agree to change the provision of lease and it results in different category of lease, it will be treated as separate agreement.

Applicability

The Accounting Standard is not applicable to following types of lease:

- Lease agreement to explore natural resources such as oil, gas, timber, metal and other mineral rights.
- Licensing agreements for motion picture film, video recording, plays, manuscripts, patents and other rights.
- Lease agreement to use land.

Definitions

1. Guaranteed Residual value – (G.R.V.)

   - **In respect of Lessee:** Such part of the residual value (R.V.), which is guarantee by or on behalf of the lessee.
   - **In respect of Lessor:** Such part of the residual value, which is guaranteed by or on behalf of the lessee or by an independent third party.

   For the Lessor the residual value guaranteed by the third party can arise when the asset is leased to the third party after the first lease has expired and therefore it can be called the residual value guaranteed by the third party to the Lessor.

2. ***Unguaranteed Residual Value (U.R.V)*** – The difference between residual value of asset and its guaranteed residual value is unguaranteed residual value. [R.V- G.R.V.]

3. ***Gross Investment (MLP+URV)*** – Gross investment in lease is the sum of the following:
   - Minimum lease payment (from the standpoint of Lessor) and
   - Any unguaranteed residual value accruing to the Lessor.

4. ***Interest rate implicit in the lease*** – When the Lessor gives an asset on lease (particularly on finance lease), the total amount, which he receives over lease period by giving the asset on lease, includes the element of interest plus payment of principal amount of asset. The rate at which the interest amount is calculated can be simply called implicit rate of interest. It can be expressed as under:-

It is the discount rate at which

Fair Value of leased Asset = Present value of [Minimum lease payment (in respect of Lessor)]

(At the inception of lease) + Any unguaranteed residual value accruing to the Lessor.

5. ***Contingent Rent*** – Lease Rent fixed on the basis of percentage of sales, amount of usage, price indices, market rate of interest is called contingent rent. In other words, lease rent is not fixed, but it is based on a factor other than time.

6. ***Minimum lease payments [MLP]***

    - For Lessor = Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (by or on behalf of lessee) – contingent Rent – cost for service and tax to be paid by the reimbursed to Lessor + residual value guaranteed by third party.
    - For Lessee = Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (for lessee) – contingent rent – cost for service and tax to be paid by and reimbursed to Lessor.

7. ***Lease includes Hire Purchase*** – The definition of a 'lease' includes agreements for the hire of an asset, which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements.

Accounting for Finance Lease – In the books of Lessee

- Leased asset as well as liability for lease should be recognized at the lower of –
  - ✓ Fair value of the leased asset at he inception of lease or
  - ✓ Present value of minimum lease payment from the lessee point of view.
- Apportionment of lease payment-Each lease payment is apportioned between finance charge and principal amount.
- The lessee in its books should charge depreciation on finance lease asset as per AS-6(in this case, straight line method will be followed)
- Initial direct cost for financial lease is included is asset under lease.

Accounting for Finance Lease – In the books of Lessor

- The Lessor should recognize asset given under finance lease as receivable at an amount equal to net investment in the lease and corresponding credit to sale of asset.

  Net Investment = Gross Investment – Unearned Finance Income.

  Gross Investment = Minimum lease payment from Lessor point of view + Unguaranteed residual value.

  Unearned Finance Income=Gross Investment – Present Value of Gross Investment.
- Recognition of Finance Income

  The Lessor should recognize the finance income based on a pattern reflecting, constant periodic return on the net investment outstanding in respect of the finance lease. In simple words interest / finance income will be recognized in proportion to outstanding balance receivable from lease over lease period.

Accounting for Operating Lease- In the books of Lessor:

- Record leased out asset as the fixed asset in the balance sheet.
- Charge depreciation as per AS-6
- Recognize lease income in profit & loss account using straight line method. If any other method reflects more systematic allocation of earning derived from the diminishing value of leased out asset, that approach can be adopted.

- Other costs of operating lease should be recognized as expenses in the year in which they are incurred.
- Initial direct cost of the lease may be expensed immediately or deferred.

Accounting for operating lease – In the Books of Lessee

Lease payments should be recognized as an expense in the profit and loss account on a straight line basis over the lease term. If any other method is more representative of the time pattern of the user's benefit, such method can be used.

"Sale and Lease back"

A sale and lease back transaction involves the sale of an asset by vendor and leasing of the same asset back to the vendor.

Accounting treatment of Sale and Lease back

1. ***If lease back is Finance Lease***

   - Any profit or loss of sale proceeds over the carrying amount should **not** be immediately recognized as profit or loss in the financial statements of a seller-lessee.
   - It should be deferred and amortized over lease term in proportion to the depreciation of leased asset.

Example 1 – H Ltd. Sells machinery, WDV of which was ₹ 400 lakhs for ₹ 500 lakhs to B Ltd. The same machinery was leased back to H Ltd. by BLtd. for 10 years resulting in finance lease. What should be the treatment of profit in the books of seller lessee (H Ltd.)?

The profit of ₹100 lakhs on sale of machinery by H Ltd. (seller lessee) should not be immediately recognized in books rather it should be deferred and amortized over 10 years in proportion of the depreciation amount to be charged by the H Ltd. on the machinery.

2. ***If lease back is Operating Lease***

   Any profit or loss arising out of sale transaction is recognized immediately when sale price is equal to fair value.

   (A) ***If Sale price" below" fair value***

   - Profit – i.e. carrying amount (=book value or value as per balance sheet) is **less** than the sale value, recognize profit immediately.
   - Loss – i.e. carrying amount is **more** than the sale value, recognize loss immediately, provided loss is **not** compensated by future lease payment.
   - Loss – i.e. carrying amount is **more** than sale price defer and amortize loss if loss is compensated by future lease payment.

   (B) If Sale price "above" fair value

   - If carrying amount is **equal** to fair value which will result in profit, amortize the profit over lease period.
   - Carrying amount **less** than fair value will result in profit – amortize and defer the profit equal to "sale price less fair value" and recognize balance profit immediately.
   - Carrying amount is **more** than the fair value – which will result in loss equal to – (carrying amount less than fair value), should be recognized immediately. Profit equal to – selling price less fair value – should be amortized.

Example: H Ltd. sold machinery having WDV of ₹ 400 Lakhs to B Ltd. for ₹ 500 Lakhs and the same machinery was leased back by B Ltd. to H Ltd. The Lease back is operating lease.

Comment if –

(a) Sale price of ₹ 500 lakhs is equal to fair value

(b) Fair value is ₹ 600 lakhs

(c) Fair value is ₹ 450 lakhs and sale price is ₹ 380 lakhs

(d) Fair value is ₹ 400 lakhs and sale price is ₹ 500 lakhs

(e) Fair value is ₹ 460 lakhs and sale price is ₹ 500 lakhs

(f) Fair value is ₹ 350 lakhs and sale price is ₹ 390 lakhs

Answer:

(a) H ltd. should immediately recognize the profit of ₹ 100 lakhs in its books.

(b) Profit ₹ 100 lakhs should be immediately recognized by H Ltd.

(c) Loss of ₹ 20 lakhs to be immediately recognized by H Ltd. in its books provided loss is not compensated by future lease payment.

(d) Profit of ₹ 100 lakhs is to be amortized over the lease period.

(e) Profit of ₹ 60 lakhs (460-400) to be immediately recognized in its books and balance profit of ₹ 40 lakhs (500-460) is to be amortized / deferred over lease period.

(f) Loss of ₹ 50 lakhs (400-350) to be immediately recognized by H Ltd. in its books and profit of ₹ 40 lakhs (390-350) should be amortized / deferred over lease period.

Illustration 22.

Viraj Limited wishes to obtain a machine costing ₹45 lakhs by way of lease. The effective life of the machine is 14 years, but the company requires it only for the first 5 years. It enters into an agreement with Jhalak Ltd., for a lease rental for ₹4.5 lakhs p.a. payable in arrears and the implicit rate of interest is 15%. The chief accountant of Viraj Limited is not sure about the treatment of these lease rentals and seeks your advise.

Solution:

As per AS 19 'Leases', a lease will be classified as finance lease if at the inception of the lease, the present value of minimum lease payment amounts to at least substantially all of the fair value of leased asset. In the given case, the implicit rate of interest is given at 15%. The present value of minimum lease payments at 15% using PV- Annuity Factor can be computed as follows:

Annuity Factor (Year 1 to Year 5) 3.36 (approx.)

Present value of minimum lease payments (for ₹4.5 lakhs each year) ₹15.12lakhs (approx.)

Thus, present value of minimum lease payments is ₹15.12 lakhs and the fair value of the machine is ₹45 lakhs. In a finance lease, lease term should be for the major part of the economic life of the asset even if title is not transferred. However, in the given case, the effective useful life of the machine is 14 years while the lease is only for five years. Therefore, lease agreement is an operating lease. Lease payments under an operating lease should be recognized as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Illustration 23.

Milind Softex Ltd. has taken the assets on lease from ABC Impex Ltd. The following information is given below:

Lease Term = 4 years

Fair value at inception of lease = ₹ 16,00,000

Lease Rent = ₹ 5,00,000 p.a. at the end of year

Guaranteed Residual Value = ₹ 1,00,000

Expected Residual Value = ₹ 2,00,000

Implicit Interest Rate = 14.97%

Do the accounting in the book of lease?

Solution :

Present value of minimum lease payment

Year	MLP ₹	Discount rate 14.97%	PV ₹
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	6,00,000 (including 1,00,000)	0.5724	3,43,440
	21,00,000		14,85,590

Present value of minimum lease payment (₹ 14,85,590) is less than Fair value at the inception of lease (₹ 16,00,000) so the leased asset and liability should be recognized at ₹ 14,85,590.

Apportionment of finance lease : Rate of Interest 14.97%

Year	Liability ₹	MLP ₹	Finance Charge ₹	Principal Amount of reduction ₹
0	14,85,590	-	-	-
1	12,07,983	5,00,000	2,22,393	2,77,607
2	8,88,818	5,00,000	1,80,835	3,19,165
3	5,21,874	5,00,000	1,33,056	3,66,944
4	-	6,00,000	78,1245	5,21,875

Books of Milind Softex

Lease Rent Account

Year	Particulars	Amount ₹	Particulars	Amount ₹
1st year	To, Bank A/c	5,00,000	By, Finance Charges A/c	2,22,393
			By, Lease liability A/c	2,77,607
		5,00,000		5,00,000
2nd year	To, Bank A/c	5,00,000	By, Finance Charges A/c	1,80,835
			By, Lease liability A/c	3,19,165
		5,00,000		5,00,000

3rd year	To, Bank A/c	5,00,000	By, Finance Charges A/c By, Lease liability A/c	1,33,056 3,66,944
		5,00,000		5,00,000
4th year	To, Bank A/c	5,00,000	By, Finance Charges A/c By, Lease liability A/c	78,126 5,21,874
		5,00,000		5,00,000

Lease Liability Account (Lessor)

Year	Particulars	Amount ₹	Particulars	Amount ₹
1st year	To, Lease Rent A/c To, Balance c/d	2,77,607 12,07,983	By, Balance b/d	14,85,590
		14,85,590		14,85,590
2nd year	To, Lease Rent A/c To, Balance c/d	3,19,165 8,88,818	By, Balance b/d	12,07,903
		12,07,903		12,07,903
3rd year	To, Lease Rent A/c To, Balance c/d	3,66,944 5,21,874	By, Balance b/d	8,88,818
		8,88,818		8,88,818
4th year	To, Lease Rent A/c	5,21,874	By, Balance b/d	5,21,874
		5,21,874		5,21,874

Extract of Profit and Loss Account

Year	Particulars	Amount ₹
1st year	To, Finance Charge To Depreciation on leased Asset under SLM	2,22,393 3,71,397
2nd year	To, Finance Charge To Depreciation on leased Asset under SLM	1,80,835 3,71,397
3rd year	To, Finance Charge To Depreciation on leased Asset under SLM	1,33,056 3,71,397
4th year	To, Finance Charge To Depreciation on leased Asset under SLM	78,125 3,71,397

Extract balance Sheet

Year	Liability	Amount ₹	Asset	Amount ₹
1st year	Lease Liability A/c	12,07,983	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	3,71,397
				11,41,193
2nd year	Lease Liability A/c	8,88,818	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	7,42,794
				7,42,796
3rd year	Lease Liability A/c	5,21,874	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	11,14,191
				3,71,399
4th year	Lease Liability A/c	NIL	Fixed Asset under Finance Lease	14,85,590
			Less: Depreciation	14,85,590
				NIL

Illustration 24.

Milind Softex Ltd. has taken the assets on lease from ABC Impex Ltd. The following information is given below:

Lease Term	=	4 years
Fair value at inception of lease	=	₹ 16,00,000
Lease Rent	=	₹ 5,00,000 p.a. at the end of year
Guaranteed Residual Value	=	₹ 1,00,000
Expected Residual Value	=	₹ 2,00,000
Implicit Interest Rate	=	14.97%

How the accounting is done in the book of lessor ?

Solution :

Lessor should recognize asset given under lease at net investment in lease.

Net investment in lease = Gross investment – unearned finance income

Gross Investment = MLP + Guarenteed residual value + Unguaranteed residual value

= ₹20,00,000 + ₹1,00,000 + ₹1,00,000

= ₹22,00,000

Unearned Finance Income = Gross Investment – present value of gross investment

Year	Value of MLP ₹	Gross investment discount factor	Present Value ₹
1	5,00,000	0.8698	4,34,900
2	5,00,000	0.7565	3,78,250
3	5,00,000	0.6580	3,29,000
4	7,00,000	0.5724	4,00,680
	22,00,000		15,42,830

Unearned Finance Income = ₹22,00,000 - ₹15,42,830 = ₹6,57,170

Apportionment of MLP into Capital recovery & Finance income

Year	Balance of lease receivable	Cash receipts	Finance	Capital recovery reduced from receivable
0	15,42,830	-	-	-
1	12,73,792	5,00,000	2,30,962	2,69,038
2	9,64,479	5,00,000	1,90,687	3,09,313
3	6,08,862	5,00,000	1,44,383	3,55,617
4		7,00,000	91,147	6,08,853
			6,57,179	15,42,821

The lease receivable account shown in the books of lessor will not tally with the lease liability account as shown by the leasee in his book. Difference will remain because of guaranteed residual value from the third party or/ and unguaranteed residual value from the leasee point of view.

Illustration 25.

Amit purchased a computer for ₹44,000 and leased out it to Sumit for four years on leases basis, after the lease period, value of the computer was estimated to be ₹3,000; whichhe realized after selling it in the second hand market. Lease amount payable at the beginning of each year is ₹22,000; ₹13,640; ₹6,820 & ₹3,410. Depreciation was charged @ 40% p.a. You are required to pass the necessary journal entries in the books of both Amit and Sumit.

Solution:

Journals

In the books of Amit

	Particulars		Dr. ₹	Cr. ₹
1st	**Purchase of Computers:** Computer A/c To, Bank A/c	 Dr.	 44,000	 44,000
	Payment of first Year's Lease: Bank A/c To, Lease Rent A/c	 Dr.	 22,000	 22,000

	Depreciation for First Year: Depreciation A/c Dr. To, Computer A/c	17,600	 17,600
	Transfer to Profit & Loss Account: Profit & Loss A/c Dr. To, Depreciation A/c Lease Rent A/c Dr. To, Profit & Loss A/c	17,600 22,000	 17,600 22,000
2nd	**Payment of Second Year's Lease:** Bank A/c Dr. To, Lease Rent A/c	13,640	 13,640
	Depreciation for Second Year: Depreciation A/c Dr. To, Computer A/c	10,560	 10,560
	Transfer to Profit & Loss Account: Profit & Loss A/c Dr. To, Depreciation A/c Lease Rent A/c Dr. To, Profit & Loss A/c	10,560 13,640	 10,560 13,640
3rd	**Payment of Third Year's Lease:** Bank A/c Dr. To, Lease Rent A/c	6,820	 6,820
	Depreciation for Third Year: Depreciation A/c Dr. To, Computer A/c	6,336	 6,336
	Transfer to Profit & Loss Account: Profit & Loss A/c Dr. To, Depreciation A/c Lease Rent A/c Dr. To, Profit & Loss A/c	6,336 6,820	 6,336 6,820
4th	**Payment of Fourth Year's Lease:** Bank A/c Dr. To, Lease Rent A/c	3,410	 3,410
	Depreciation for Fourth Year: Depreciation A/c Dr. To, Computer A/c	3,802	 3,802
	Transfer to Profit & Loss Account: Profit & Loss A/c Dr. To, Depreciation A/c Lease Rent A/c Dr. To, Profit & Loss A/c	3,802 3,410	 3,802 3,410
	Sale of Lease assets: Bank A/c Dr. Loss on Sale A/c Dr. To, Computer A/c	3,000 2,702	 5,702

In the books of Sumit

	Particulars		Dr. ₹	Cr. ₹
	Purchase of Computer:		**No Entry**	
	Payment of First Year's Lease:			
	Lease Rent A/c	Dr.	22,000	
	To, Bank A/c			22,000
	Depreciation for First Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit and Loss A/c	Dr.	22,000	
	To, Lease Rent A/c			22,000
	Payment of Second Year's Lease:			
	Lease Rent A/c	Dr.	13,640	
	To, Bank A/c			13,640
	Depreciation for Second Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit and Loss A/c	Dr.	13,640	
	To, Lease Rent A/c			13,640
	Payment of Third Year's Lease:			
	Lease Rent A/c	Dr.	6,820	
	To, Bank A/c			6,820
	Depreciation for Third Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit and Loss A/c	Dr.	6,820	
	To, Lease Rent A/c			6,820
	Payment of Fourth Year's Lease:			
	Lease Rent A/c	Dr.	3,410	
	To, Bank A/c			3,410
	Depreciation for Fourth Year:		**No Entry**	
	Transfer to Profit & Loss Account:			
	Profit and Loss A/c	Dr.	3,410	
	To, Lease Rent A/c			3,410
	Sale of Lease Assets:		**No Entry**	

AS -20: EARNING PER SHARE (EPS)

Disclosure under AS-20:

(a) The applicability of the standard is mandatory with effect from accounting year commencing on or after 01-04-2001 in respect of enterprises whose equity shares or potential equity shares are listed on a recognized stock exchange in India.

(b) However under Schedule III of the Companies' Act, 2013 every company is required to disclose EPS in accordance with AS-20, whether listed on a recognized stock exchange or not.

(c) Presentation of EPS is required to be made both on the basis of consolidated financial statement, as well as individual financial statements of the parent company.

(d) Presentation should be made in terms of Basic and Diluted EPS on the face of 'the Profit & Loss Account for each class of equity share that has a different right to share in the net profit for the accounting period. For equity shares having different nominal value but carrying same voting rights should be covered into equivalent number of shares of the same nominal value.

(e) Both Basic and Diluted EPS should be presented with equal prominence for all periods even if the amounts are negative (a loss per share).

(f) In addition to above, following are also disclosed:

1. the amount used as the numerator and a reconciliation of those amounts to the net profit/loss for the accounting period.
2. the weighted average number of equity shares used as the denominator and a reconciliation of those denominator to each other.
3. the nominal value of shares along with EPS figure.

(g) Disclosure may also be made of terms and conditions of contracts generating potential equity which affect the basic and diluted EPS both on the weighted average number of shares outstanding and any consequent adjustments to net profit attributable to equity shareholders, following the computation of the denominator in accordance with AS-20.

Basic EPS:

(a) Basic EPS is worked out by dividing the net profit /loss for the accounting period by the equity share using weighted average number of equity shares outstanding during the same period.

(b) Net profit or loss should be arrived at after considering all income and expense recognized during the period including tax expense extraordinary as reduced by preference dividend in respect of non cumulative and cumulative for the period

(c) Disclosure as an alternative may be presented for basic and diluted on the basis of earning excluding extraordinary items (net of tax expenses).

Impact of bonus element in rights issue on EPS denominator:

In a right issue the exercise price in often less than fair value of shares thus it includes a bonus element and moreover, an adjustment is needed to recompute the fair value in relation to theoretical ex-right value per share.

Diluted EPS indicates the potential variability or risk attached to the basic EPS as a consequence of the issue of potential equity shares and potential dilutive securities having significant impact on lowering EPS. However, no potential equity shares be included in the computation of any diluted per share amount in case of continuing loss from operation, even though the entity reports an overall net profit.

(i) Adjustments should be made both in numerator and denominator consequent upon the conversion of potential dilution to arrive at diluted EPS in keeping with the nature of conversion including tax implication thereon in the respective year.

(ii) Potential equity shares are:

(a) debt instruments/preference share convertible into equity shares

(b) share warrants

(c) employees and other stock option plans which entitles them to receive equity shares as part of their remuneration and other similar plans

(d) contingently issuable shares under contractual arrangements e.g. acquisition of a business/assets, loan converted to equity on default

(e) share application pending allotment if not statutorily required to be kept separately and is being utilized for business is treated as potential (dilutive) equity share.

Illustration 26.

Weighted avg. number of equity shares has been illustrated in AS-20 in the following line:

Accounting year: 2016-17				
Date	Description	Shares Issued (Nos)	Buyback (Nos)	O/S
01/04/2016	Op. Balance	1800	-	1800
30/09/2016	Issued for Cash	600	-	2400
29/02/2017	Buyback	-	300	2100
31/03/2017	Cl. Balance	2400	300	2100

Compute the weighted average number of shares.

Solution:

Weighted average number

(a) (1800 x 6/12) + (2400 x 5/12) + (2100 x 1/12) i.e. 2075 shares

or

(b) (1800 x 12/12) + (600 x 7/12) - (300 x 2/12) i.e. 2075 shares

= 1800 + 250 + 25

Illustration 27.

Net profit for 2014-15: ₹ 18,00,000; Net profit for 2015-16: ₹ 60,00,000; No. of equity shares as on 31.12.15: ₹ 20,00,000.

Bonus issued on 1-1-16 : 2 equity shares for each Equity Share outstanding at 31-12-16 i.e. ₹ 40,00,000. Compute the EPS for 2015-16 and the Adjusted EPS of 2014-15.

Solution:

EPS for 2015-16: (₹ 60,00,000)/(20,00,000+40,00,000) = ₹1.00

Adjusted EPS for 2014-15: (earliest period reported) [₹18,00,000/60,00,000] = ₹ 0.30

Illustration 28.

Compute EPS:

(a) Net profit for 2014-15 ₹ 11,00,000

Net profit for 2015-16 ₹ 15,00,000

(b) Nos. of shares outstanding prior to Right Issue: 5,00,000 shares

(c) Right Issue: one new share for 5 outstanding i.e. 1,00,000 new shares

(d) Right price: ₹ 15

(e) Last date of right option: 1st March 2016

(f) Fair value prior to the right option on 1st march 2016: ₹ 21 per equity share

Computation:

1) Theoretical ex-right fair value per share:

[(₹ 21 x 5,00,000) + (₹ 15 x 1,00,000)] / (5,00,000+ 1,00,000)

i.e. 1,20,00,000/6,00,000 = ₹ 20

2) Adjustment factor:- fair value prior to exercise of rights/theoretical ex-right value. i.e. 21/20=1.05

3) Computation of EPS:

Year 2014-15 EPS as originally reported	
₹ 11,00,000/5,00,000 shares	₹ 2.20
EPS restated for right issue	
₹ 11,00,000/(5,00,000 x ₹ 1.05)	₹ 2.10
Year 2015-16 EPS-for 2016 including rights	
₹ 15,00,000/(5,00,000 x 1.05 x 2/12) + (6,00,000 x 10/12)	₹ 2.25

AS -21: ACCOUNTING FOR AMALGAMATION

Objective

The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by a parent/ holding enterprise to provide financial information about the economic activities of its group to show the economic resources controlled by the group, the obligations of the group and results the group achieves with its resources.

Scope

1. This Standard should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.
2. It should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.
3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate statements.
4. This Standard does not deal with:
   (a) methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation;
   (b) accounting for investments in associates; and
   (c) accounting for investments in joint ventures.

Relevant terms:

Control:

(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

Subsidiary: Subsidiary is an enterprise that is controlled by another enterprise.

Parent: A parent is an enterprise that has one or more subsidiaries.

Group: A group is a parent and all its subsidiaries.

Consolidated financial statements: These are the financial statements of a group presented as those of a single enterprise.

Equity: It is the residual interest in the assets of an enterprise after deducting all its liabilities.

Minority Interest: It is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent.

Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an integral part thereof. Consolidated cash flow statement is presented in case a parent presents its own cash flow statement.

Presentation of Consolidated Financial Statements

Users of the financial statements of a parent are usually concerned with, and need to be informed about, the financial position and results of operations of not only the enterprise itself but also of the group as a whole. For this the parent **should present a separate financial statement of the parent** and **consolidated financial statements**, which present financial information about the group as that of a single enterprise without regard to the legal boundaries of the separate legal entities.

Scope of Consolidated Financial Statements

A parent should consolidate all subsidiaries, domestic as well as foreign.

A subsidiary should be excluded from consolidation when:

(a) control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or

(b) it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent. In consolidated financial statements, investments in such subsidiaries should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

Consolidation Procedures:

- In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries should be combined on a line by line basis by adding together like items of assets, liabilities, income and expenses.
- Steps of consolidation :

  (a) the cost to the parent of its investment in each subsidiary and the parent's portion of equity of each subsidiary, at the date on which investment in each subsidiary is made, should be eliminated;

  (b) any excess of the cost of investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made, should be described as goodwill to be recognised as an asset in the consolidated financial statements and in the reverse case the difference should be treated as a capital reserve in the consolidated financial statements;

  (c) Minority interest: should be calculated and shown in the consolidated financial statements separately in separate head. It means the portion of net assets of subsidiary on the date of consolidation not controlled by the parent or through its subsidiary.

  Minority interest = paid up equity capital held by outsider + share of reserve and surplus on the date of consolidation. Preference share capital not held by parent or group is also considered.

(d) minority interests in the net income of consolidated subsidiaries for the reporting period should be identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent;

(e) When minority interest comes in negative, this should be adjusted against majority interest. In other words, negative minority interest will not be shown in consolidated balance sheet. If the subsidiary subsequently reports profits, all such profits should be allocated to majority interest until minority share of losses previously absorbed by the majority is recovered.

(f) If an enterprise makes two or more investments in another enterprise at different dates and eventually obtains control of the other enterprise, the consolidated financial statements are presented only from the date on which holding-subsidiary relationship comes in existence. If small investments are made over a period of time and then an investment is made that results in control, the date of the latest investment, as a practicable measure, may be considered as the date of investment.

(g) Intragroup balances and intragroup transactions and resulting unrealised profits should be eliminated in full. Unrealised losses resulting from intragroup transactions are also eliminated unless cost cannot be recovered.

(h) Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full.

Consolidation at different reporting date :

Financial statement of parents and its subsidiary used for consolidation are generally of same date, however when reporting dates are different and it is not practical to prepare the financial statements of subsidiary of the same date, the different reporting date financial statement can be consolidated making adjustment for the effects of significant transactions that occur between those dates and parent financial statements provided difference is not more than **six months.**

If parent and its subsidiaries are following different accounting policies, the consolidated financial statement should be prepared using uniform accounting policies, if it is not practicable, then the items in which different accounting policies have been followed should be disclosed.

Disposal of investment in a subsidiary:

The difference between the proceeds from the disposal of investments in a subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognized in the consolidated statement.

Successive purchase of shares in a subsidiary by the parent/ purchase in lot:

If an enterprise purchases two or more times the investment of other enterprises and gradually obtains control of the other enterprise the consolidated financial statement is prepared from the date on which holding subsidiary relationship is established. Further, in such cases goodwill or capital reserve on consolidation should be determined on step by step basis, however if small investments are made over a period of time, then the date of latest major investment which resulted in control, should be considered as date of investment.

If there are **arrears of cumulative preference share** of a subsidiary then the holding company share of profits is calculated after charging the arrear of cumulative preference dividend of a subsidiary, whether declared or not.

Disclosure:

(a) a list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;

(b) in consolidated financial statements, where applicable:

   (i) the nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than 50% of the voting power of the subsidiary;

   (ii) the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and

(iii) the names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

Transitional Provisions

On the first occasion that consolidated financial statements are presented, comparative figures for the previous period need not be presented. In all subsequent years full comparative figures for the previous period should be presented in the consolidated financial statements.

AS-22: ACCOUNTING FOR TAXES ON INCOME

The need for establishing a standard arises due to difference between profit computed for accounting and that for tax purpose. As per this standard, the income tax-expense should be treated just like any other expenses on accrual basis irrespective of the timing of payment of tax.

Tax expense = current tax + deferred tax

Current tax is the amount of income-tax determined to be payable (recoverable) in respect of the taxable income (tax loss) for a period.

Deferred tax is the tax effect of timing difference.

The difference accounts for:

(a) treatment of revenue and expenses as appearing in the profit and loss Ale and as considered for the tax purpose.

(b) the amount of revenue or expenses as recognized in the P/L A/c and as allowed for tax purpose.

The difference as arising in the above context gives rise to 'deferred tax' and it needs to be ensured that the tax charges in future accounting period is not vitiated.

The difference in accounting profit and taxable profit can be broadly categorized into two:

(a) *Permanent difference:* which originates in one period and do not reverse in subsequent periods, e.g. personal expenses disallowed, interest/penalty disallowed as expense or tax-free agricultural income, various deduction under section 10, benefit/reliefs under section 80 in computing taxable income.

Permanent differences do not result in deferred taxes.

(b) *Timing difference:* which originates in one period and is capable of reversal in subsequent period(s):

- difference in net block of fixed assets as per accounts and as per tax due to difference in the rate and method of depreciation;
- provision for doubtful debts and advances, provision for warranties, provision for VRS, provision for asset write-off, disallowed payments under 43B of Income Tax Act, provision for excise liabilities, provision for diminution in value of investments, scientific research expenditure (not weighted deduction which is a permanent difference), amortization of deferred revenue expenditure, lease income.

Situations which leads to Deferred Tax:

Deferred tax is the tax effect due to timing difference. They arise due to the following reasons:

- Accounting Income less than Tax Income
- Accounting Income more than Tax Income
- Income as per Accounts but loss as per IT Act
- Loss as per Accounts but income as per IT Act

Impact of such timing differences may lead to:

- Deferred Tax Liability (DTL): postponement of tax liability, which states Save Now, Pay Later.

Profit and Loss A/c………..Dr.

To Deferred Tax Liability A/c

- Deferred Tax Asset (DTA): pay you tax liability in advance, which states Pay Now, Save Later.

  Deferred Tax Asset A/c……….Dr.

  To Profit and Loss A/c

In the year of reversing time difference, either DTL is written back to profit and loss or the DTA is reversed by debiting profit and loss account.

For the recognition of DTA, prudence should be applied. Such recognition is based on " reasonable certainty" that sufficient taxable income would be available in the future to realize the DTA.

In case of unabsorbed depreciation and carry forward losses, DTA should only be recognized to the extent that there is "virtual certainty" that in future sufficient taxable income would be available to realize the DTA.

Reasonable certainty shall be deemed to be in existence if the probability of future taxable income is greater than 50%.

Virtual certainty shall be deemed to be in existence only when the evidence suggests that there will be sufficient taxable income in the future.

Disclosure under AS-22 Mandatory :

(a) Break up of the deferred tax asset/liability.

(b) DTL should be shown after the head "Unsecured Loans" and DTA after the head "Investments" with a separate heading.

Illustration 29.

From the following information for R Ltd. for the year ended 31st March, 2016, calculate the deferred tax asset/ liability as per AS-22

Accounting Profit	₹10,00,000
Book Profit as per MAT(Minimum Alternate Tax)	₹9,00,000
Profit as per Income Tax Act	₹1,00,000
Tax Rate	30%
MAT Rate	10%

Solution:

Tax as per accounting profit : 10,00,000 x 30% = 3,00,000

Tax as per Income Tax profit : 1,00,000 x 30% = 30,000

Tax as per MAT : 9,00,000 x 10% = 90,000

Tax expense = Current tax + Deferred tax

3,00,000 = 30,000 + Deferred tax

Therefore, Deferred Tax Liability as on 31.3.2016 = ₹ 3,00,000 – ₹ 30,000 = ₹ 2,70,000.

Amount of tax to be debited in Profit and Loss Account for the year 31.03.2016:

= Current tax + Deferred tax liability + Excess of MAT over current tax

= 30,000 + 2,70,000 + (90,000 – 30,000)

= 3,60,000

Illustration 30.

Z Ltd,has provided depreciation as per accounting records ₹ 40 lakhs but as per tax records ₹60 lakhs. Unamortized preliminary expenses, as per tax records is ₹20,000. there is adequate evidence of future profit sufficiency. How much deferred tax asset/liability should be recognized as transition adjustment? Tax rate 30%.

Solution:

As per Para 13 of AS-22, deferred tax should be recognized for all the timing differences. In this situation, the timing difference i.e. the difference between taxable income and accounting income is :

Excess depreciation as per tax ₹ (60 – 40) lakhs	=	₹ 20.00 lakhs
Less: Expenses provided in taxable income	=	₹ 0.20 lakhs
Timing difference		₹ 19.80 lakhs

As tax expense is more than the current tax due to timing difference of ₹19.80 lakhs, therefore deferred tax liability = 30% of ₹19.80 lakhs = ₹5.94 lakhs.

Profit and Loss A/c…………Dr.	5.94	
To Deferred Tax Liability A/c		5.94

Illustration 31.

Om Limited is working on different projects which are likely to be completed within 3 years period. It recognizes revenue from these contracts on percentage of completion method for financial statements during 2015, 2016 and 2017 for ₹11,00,000, ₹16,00,000 and ₹21,00,000 respectively. However, for income-tax purpose, it has adopted the completed contract method under which it has recognized revenue of ₹7,00,000, ₹18,00,000 and ₹23,00,000 for the years 2015, 2016 and 2017 respectively. Income-tax rate is 40%. Compute the amount of deferred tax asset/ liability for the years 2015, 2016 and 2017.

Solution:

Om Limited

Calculation of Deferred Tax Asset/Liability

Year	Accounting Income	Taxable Income	Timing Difference (balance)	Deferred Tax Liability (balance)
2015	11,00,000	7,00,000	4,00,000	1,40,000
2016	16,00,000	18,00,000	2,00,000	70,000
2017	21,00,000	23,00,000	NIL	NIL
	48,00,000	48,00,000		

AS-23: ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS (CFS)

An enterprise that presents CFS should account for investments in Associates as per this standard.

This standard is not applicable for preparing and presenting stand-alone Investors' financial statement (in such cases AS 3 is followed).

An Associate is an enterprise in which the investor has significant influence (power to participate in the financial/ operating policy decisions of the investee but not control over those policies) and which is neither a subsidiary nor a joint venture of the Investor. The 'control' for the purpose of AS-23 is similar to that of AS-21.

Significant influence may be evidenced in one or more ways in the following line:

a) Representation on the Board of Directors or Governing Body of the Investee.

b) Participation in policy making process

c) Material transaction between investor and investee.

d) Interchange of managerial personnel

e) Provision of essential technical information

But it does not extend to power to govern the financial and/or operating policies of an enterprise.

Significant influence may be gained through share ownership, statute or agreement:

a) For share ownership, 20% or more in voting power in investee (held directly or indirectly through subsidiary) indicates significant influence but that is not the ultimate, the significant influence must be clearly demonstrated.

b) A substantial or majority ownership by another investor in the investee does not necessarily preclude an investor to have significant influence.

c) Voting power is determined on the basis of current outstanding securities and not potential equity.

Non applicability of AS-23:

1) Investment in associates are accounted for using the 'equity method' in the CFS except when,

    a) the investment is made and held exclusively with a view to subsequent disposal in the near future, or

    b) the associate operates under severe long-term restrictions that significantly impairs its ability to transfer funds to investor. Investments in such a situation is accounted for in accordance with AS-3 in CFS.

2) Equity method of accounting is also not applicable if

    a) it has no investment in Association

    b) it has investment in Association but has no subsidiaries, CFS is not required

    c) it has subsidiaries and associates but these are not material, hence CFS is not prepared.

    d) It is not listed enterprise hence not mandatory to present CFS or has not chosen voluntarily to present CFS.

Equity method of accounting recognizes the investment initially recorded at cost identifying goodwill/capital reserve at the time of acquisition. The carrying amount of investment is thereafter adjusted for the post-acquisition charge in the investor's share of net assets of the investee and consolidated P/L A/c reflect the investor's shares in the result of operation of the investee. Further any permanent decline in the value of investment is reduced to arrive at the carrying amount for each such investment.

Except inconsistent with AS-23, other accounting treatment would follow AS-21 Disclosure under AS-23

a) Reasons for not applying Equity Method in accounting for investments in associates in CFS .

b) Goodwill/capital reserve as included in the carrying amount of investment in Associates disclosed separately.

c) Description of associates, proportion of ownership interest and if different proportion of voting power held disclosed in CFS.

d) Investment using equity method should be classified as long-term investment in consolidated balance sheet, similarly investor's share in profit/loss in consolidated P/L Account and also investor's share of extraordinary or prior period items should be disclosed separately.

e) The names of associates of which reporting date is different from that of the financial statements of the investor and difference in reporting date should be disclosed in CFS.

f) Difference in the accounting policies if not practicable for appropriate adjustment in Associate's financial statement for being adjusted in CFS, the fact as such with description of difference in accounting policies should be disclosed.

g) In compliance with AS-4, Contingencies and events occurring after the balance sheet date, the investor discloses in the CFS:

(i) its share of contingencies and capital commitments of an Associate for which the investor is contingently liable, and

(ii) those contingencies that arise because the investor is severely liable for the liabilities of the associate.

Illustration 32.

X holds, 25% share in Y Ltd at a cost of ₹5 lakhs as on 31.03.2017. Out of Y's shares capital and reserve ₹20 Lakh each.

For the year ended 31.03.2017 Y made a profit of ₹80,000 and 50% distributed as dividend. Compute the value (carrying amount) as at 31.03.2017 to be shown in the CFS.

Solution:

	₹ in Lakhs
Cost of shares in Y Ltd.	5.00
Share of Reserve	5.00
Share of profit	0.20
	10.20
Less: dividend received	0.10
Value of investment as at 31.03.17	10.10

Illustration 33.

Style Ltd. acquired 30% of Ugly Ltd.'s shares on April 10,2017, the price paid was ₹ 20,00,000.

	₹
Equity shares (Paid up)	5,00,000
Securities Premium	15,00,000
Reserve	5,00,000
	25,00,000

Further, Ugly Ltd reported a net income of ₹3,00,000 and paid dividends of ₹1,00,000. Style Ltd. has subsidiary on 31.3.17. Calculate the amount at which the investment in Ugly Ltd should be shown in the consolidated Balance Sheet of Style Ltd. as on 31.3.17.

Solution:

As per AS-23, when the investor company prepares the consolidated Balance Sheet, the investment in associate i.e. Ugly Ltd. shall be carried by equity method and goodwill and capital reserve to be identified and disclosed separately.

Value of the investment as per equity method

= 20,00,000 + 30% (3,00,000 – 1,00,000) = ₹20,40,000.

Goodwill identified = (20,00,000 – 30% of 25,00,000) = ₹ 12,50,000

AS-24: DISCONTINUING OPERATION

AS-24 requires disclosure to be made when the discontinuation is in process and not merely once it has been fully completed for reporting information, to enhance the ability of the user of the financial statements to study projection of cash flow, earnings generating capacity and financial information differentiating between 'continuing' and 'discontinuing' operation.

Prerequisites to determine 'discontinuing operation' –

1. The enterprise in term a single plan:
   (a) disposing substantially in its entirety e.g. by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholder, or
   (b) disposing in piecemeal manner e.g. selling off the assets-and settling its liabilities individually or
   (c) terminating through abandonment
2. That represent, a separate major line of business or geographical area of operation, and
3. That can be distinguished operationally for financial reporting purpose.

A restructuring event or transaction that does not meet with the definition of a 'discontinuing operation' within the ambit of AS-24, should not be called or treated as discontinuing operation. Typical example of instances which by itself does not mean 'discontinuing operation' but may lead to such in combination with other circumstances:

a) gradual or evolutionary phasing out of a product line or class of service
b) abrupt discontinuing of several products within an ongoing line of business
c) shifting of some production or marketing activities for a particular line of business from one location to another
d) closing of a factory to achieve productivity improvements or other cost savings. 'discontinuing operation' are expected to occur infrequently, but resulting income or expenses arising thereof needs to be disclosed in terms of AS-5 to explain the performance of the enterprise for the period.

Above all any transaction or event or in combination in order to be treated as 'discontinuing operation.' must be in terms of an overall plan falling within the prerequisites of 'discontinuing operation.

AS- 17 for segment reporting would normally satisfy the definition of 'discontinuing operation', but the significance for reporting under AS-24 will depend on individual judgment e.g. an enterprise operates in a single business/ geographical segment though not reportable under AS- 17 may fall within the ambit of AS-24.

The criteria of discontinuation which can be distinguished operationally and for financial repotting purpose must fulfill the following:

a) the operating assets/liabilities of the component can be directly attributed to it.
b) revenue can be directly attributed to it
c) at least a majority of operating expenses can be directly attributed to it.

Going concern concept is not disturbed if an enterprise merely disposes off few of its segments but continues to operate its other business profitably, on the other hand if a substantial part of its operation is discontinued and there is no operation to carry as a result, it will cease to be going concern.

Discontinuing process need not necessarily arise out of binding sale agreement but relates back to the announcement of a detailed, formal plan approved by the Board of Directors /Governing Body, if precedes sales agreement and therefore require initial disclosure event/transaction. However the announcement must demonstrate the commitment to discontinue resulting into a constructive obligation for the enterprise. Requirement of initial disclosure in the financial statement for the period in which the event of discontinuing operation occur, are:

1. A description of discontinuing operation
2 The date and nature of initial disclosure event
3. Probable date or period by which the discontinuance is expected to be completed
4. Carrying amount of the total of assets to be disposed off and the total of liabilities to be settled as of the Balance sheet date

5. The amount of revenue and expenses in respect of ordinary activities attributable to the discontinuing operation during the current financial reporting period.

   the pre-tax profit/loss and tax expense (AS-22) in the above line. the amount of net cash flow attributable to the operating/investing/financing activities of the discontinuing operation during the current financial reporting period. If the initial disclosure event occurs in between the balance sheet date and the date of approval of financial statements by the board of directors/corresponding approving authority, disclosure compliance should be made as per AS-4 not under AS-24. Disclosure should continue till the discontinuance is substantially completed or abandoned, irrespective of receipt of payments from its buyer.

   In case the discontinuance plan is abandoned or withdrawn as previously reported, the fact, reasons and effects thereof including reversal of any prior impairment of loss or provision that was recognized in the plan, should be disclosed.

Disclosure under AS-24

1. By way of a note in the financial statement in respect of each discontinuing operation, in addition to disclosure on the face of the statements of profit/loss in respect of:

   (a) the amount of pre-tax profit/loss from ordinary activities, income tax expense as attributable to discontinuing operation, during the current financial reporting period; and

   (b) the amount of pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.

2. Comparative information for prior period that is presented in financial statements prepared after the initial disclosure should be restated to segregate assets, liabilities revenue expense and cash flows of continuing and discontinuing operations.

3. AS-24 does not provide for the principles to recognize and measure profit/loss in respect of discontinuing operation and therefore, other accounting standards would be applicable e.g. AS-4, AS-10 and other AS as and when applicable.

Illustration 34.

A Company belonging to the process industry carries out three consecutive processes. The output of the first process is taken as input of the second process, and the output of the second process is taken as input of the third process. The final product emerges out of the third process. It is also possible to outsource the intermediate products. It has been found that over a period of time cost of production of the first process is 10% higher than the market price of the intermediate product, available freely in the market. The company has decided to close down the first process as a measure of cost saving (vertical spin off) and outsource. Should this event be treated as discontinuing operation?

Solution:

The change made by the company is focused on outsourcing of services, in respect of one single process – in a sequence of process. The net effect of this change is closure of facility relating to process.

This has been done by the company with a view to achieving productivity improvement and savings in costs.

Such a change does not meet definition criteria in paragraph 3(a) of AS-24 namely, disposing of substantially in its entirety, such as by selling a component of the enterprise in a single transaction. The change is merely a cost-saving endeavor. Hence, this change over is not a discontinuing operation.

Illustration 35.

A FMCG company is manufacturing two brands of soap. Cinthol and Breeze. Company has gradually planned to shift all the manufacturing operation engaged in two soaps to manufacture only ‘Breeze Soap’ without closing the factory/plant producing the ‘Cinthol Soap’, rather utilizing the production facilities of ‘Cinthol Soap’ for producing the ‘Breeze Soap’. Can we consider the operation to have been discontinued ?

Solution:

Discontinuing operation is relatively large component of an enterprise which is major line of business or geographical segment, that is distinguishable operationally or for financial reporting such component of business is being disposed on the basis of an overall plan in its entirety or in piecemeal. Discontinuance will be carried either through demerger or spin-off, piecemeal disposal of assets and settling of liabilities or by abandonment.

In the given case, it is not a discontinuing operation.

Illustration 36.

B Ltd. is a software company, has subsidiary C Ltd. B Ltd.hold 70% shares in C Ltd. During 2016-17, B Ltd. sold its entire investment in C Ltd. Is it a discontinuing operation?

Solution:

As per the definition and scope of 'discontinuing operation', the sell of investments in subsidiary company does not attract the provisions of AS-24.

Hence, it is not a discontinuing operation.

Illustration 37.

C Ltd.has three major lines of business: steel, tea and power generation. It has decided to sell the tea division during the financial year 2016-17. A sale agreement has been entered into on 30th September 2016 with P Ltd. under which the tea division shall be transferred to P Ltd. on 31st March, 2015. Is it a discontinuing operation?

Solution:

This is a case of disposing of the tea division substantially and in its entirety. It will be considered as a discontinuing operation.

However, if a special resolution is passed for sale of various assets and to repay the various liabilities individually of the tea division, it is a case of "disposing by piecemeal" and not a "discontinuing operation".

Note: Any planned change in the product line may not be treated as a discontinuing operation.

AS-25: INTERIM FINANCIAL REPORTING

Interim financial reporting is the reporting for periods of less than a year, generally for a period of 3 months. As per Clause 41 of listing agreement the companies are required to publish the financial results on a quarterly basis.

AS-25 prescribe minimum content of an interim financial report and principles for recognition and measurement in a complete or condensed financial statement for an interim period or specific dates in respect of asset, liability, income and expense.

There are certain typical problems not faced while preparing annual account as the reporting period is shortened, the effect of errors in estimation and allocation are magnified e.g.

(i) accrual of tax credits in different interim period, makes determination of tax expense often difficult, one period may reveal tax profit while the other interim period have tax losses;

(ii) benefit of expenses spread beyond interim period e.g. advertising expenses, major repair and maintenance expenses;

(iii) determination of approximate amount of provisions, e.g. warranties, pension, gratuity, maybe complex 'and time consuming;

(iv) revenue may be seasonal or cyclical, hence concentration falls in certain interim periods;

(v) inter-company reconciliation, full stock-taking and valuation may be cumbersome and time consuming;

(vi) transaction based on Annual Targets e.g.: bonus or incentives would be difficult to estimate.

The standard itself does not categorize the enterprise or frequency of interim financial report and the time limit for

presentation from the end of an interim period, but if it is required to prepare and present, it should comply with AS-25.

Instances for interim financial report:

(i) quarterly report to the board of directors or bank

(ii) incase of merger and amalgamation

(iii) for IPO purpose

(iv) for consolidation of parent and subsidiary when year ends are different

(v) for declaring interim dividend' Accounting for interim transaction:

  (a) interim period is considered as integral part of annual accounting period e.g. annual operating expc!1ses are estimated and then allocated to the interim period based on estimated sales or other parameters and results of subsequent interim periods are adjusted for estimation errors (integral approach)

  (b) each interim period is considered as discrete and separate accounting period like a full accounting period e.g. no estimation or allocation and operating expenses are recognized in the concerned interim period irrespective of benefit accruing to other interim period (discrete approach).

Form and contents of interim financial statement:

(a) AS 25 doesn't prohibit an enterprise from presenting a complete set of financial statements (e.g. balance sheet, profit & loss statement, cash flow statement notes to account and accounting policies, other statements and other explanatory' materials as forming integral part of the financial statement).

(b) The recognition and measurement principles as stated in AS-25 also apply to complete set of financial statements for an interim period, full disclosure under this statement and other accounting standard will be required.

(c) Alternatively, the statement allows preparation and presentation 'of interim financial report in a condensed form, containing as a minimum, a set of condensed financial statements, providing update on the latest annual financial statements (does not duplicate the information already reported)

Contents of a condensed Interim Financial Statements as a minimum:

1. A statement that the same accounting policies are followed as in the most recent annual financial statements - for change, description of the nature and effect of the change.

   Explanatory comment, about the seasonality of the interim operations the nature and amount of items affecting assets, liability, equity, net income or cash flows that are unusual because of their nature, size or incidence.

2. The nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amount reported in prior financial year - if the those changes have a material effect in the current interim period.

3. Issues, buy-back, repayment and restructuring of debt, equity and potential equity shares.

4. Dividends, aggregate per share (in absolute or percentage) separately for equity and other shares

5. If compliance required under AS-17, segment revenue, segment capital employed and segment result for Business or Geographical segments (whichever is primary for reporting).

6. Effect of changes in the composition of the enterprise during the interim period (e.g. amalgamation, acquisition. or disposal of subsidiaries and long term investments, restructuring and discontinuing operation.

7. Material change in contingent liabilities since last annual *B/S* date.

The above selected explanatory notes should normally be reported on a financial year to date basis.

Period of Interim Financial Statement: interim reports should include interim financial statements (condensed or complete) for periods as follows:

(a) Balance Sheet:

 (1) As at the end of current interim period

 (2) As at the end of the immediately preceding financial year

(b) Statement of Profit and Loss:

 (1) For the current period

 (2) Cumulative for the current financial year to date

 (3) Comparative for the comparable interim period (current arid year to date

(c) Cash flow Statement:

 (1) Current financial year to date

 (2) Comparative for the comparable year to date for immediately preceding financial year.

Illustration 38.

S Ltd. presents interim financial report quarterly on 1.4.2017. S Ltd.has carried forward loss of ₹800 lakhs for income tax purpose for which deferred tax asset has not been recognized. S Ltd.earns ₹ 600 lakhs; ₹700 lakhs; ₹750 lakhs and ₹800 lakhs respectively in the subsequent quarters, excluding the carried forward losses. Income tax rate is 30%. Calculate the amount of tax expense to be reported in each quarter.

Solution:

The estimated payment of the annual tax on ₹2,850 lakhs earnings for the current year = ₹(2,850 – 800) lakhs = ₹2,050 lakhs.

Therefore, tax = 30% of ₹2,050 lakhs = ₹615 lakhs.

Average annual effective tax rate = (615/2,850) x 100 = 21.58%

Tax expense to be shown:	₹ lakhs
1st quarter = 600 x 21.58%	= 129.48
2nd quarter = 700 x 21.58%	= 151.06
3rd quarter = 750 x 21.58%	= 161.85
4th quarter = 800 x 21.58%	= 172.64

Illustration 39.

M Ltd. presents interim financial report(IFR) quarterly, earns ₹800 lakhs pre-tax profit in the first quarter ending 30.6.17 but expect to incur losses of ₹250 lakhs in each of the remaining three quarters. Effective income tax rate is 35%. Calculate the income-tax expense to be reported for each quarter as per AS-25.

Solution:

Tax expense to be reported in each of the quarters are:

1st quarter = 800 x 35% = ₹280.00 lakhs

2nd quarter = (250) x 35% = ₹ (87.5)lakhs

3rd quarter = (250) x 35% = ₹ (87.5)lakhs

4th quarter = (250) x 35% = ₹ (87.5) lakhs

Annual Tax Expense = ₹17.5 lakhs

AS – 26: INTANGIBLE ASSETS

An intangible asset is an identifiable non-monetary asset, without physical substance held for production or supply of goods and services for rental to others or for administrative purposes.

(i) prescribes the accounting treatment for intangible assets that are not specifically covered in other accounting standard;

(ii) recognizes an intangible asset on fulfillment of certain criteria;

(iii) deals with deferment of expenses except in a few specific instances.

However AS -26 does not apply to:

(a) Intangible assets covered by other accounting standards e.g. AS-2 (valuation of inventories), AS-7 (accounting for construction contracts), AS-22 (accounting for taxes on income), leases falling within scope of AS-19, goodwill on amalgamation (AS-14) and on consolidation (AS-21).

(b) Mineral rights and expenditure on the exploration .for or development and extraction of minerals, oils, natural gas and similar non-generative resources and intangible assets arising in insurance enterprises from contracts with policy holders however, computer software expenses, start up cost pertaining to above activities are covered by AS-26).

(c) Discount Premium on borrowings.

AS-26 applies, among other things, to expenditure on advertisement, training, startup, R&D activities, Rights under Licensing Agreement for motion picture video recording, plays, manuscript, patents and copyrights, the criteria is that expenditure should provide future economic benefits to an enterprise.

Sometimes, an asset may incorporate both tangible and intangible component and it is practically inseparable. "Judgment is required to determine the applicability of AS-10 (fixed asset) and AS-26 (intangible asset).

Example:

(1) computer software which is integral part and without that the computer-controlled machine cannot operate - treated as fixed asset.

(2) computer software, not an integral part of related' hardware - treated as. an intangible asset,

Essential criteria for recognition of an intangible asset:

(a) *identifiable:*- It must be separate from goodwill and the enterprise could rem. sell: exchange or distribute the future economic benefits attributable to the asset without disposing of future economic benefits that flow from other assets in the same revenue earning activity - but goodwill cannot be meaningfully transferred to a new owner without also selling the other assets or the operation of the business. e.g. patents, copyrights, license, brand name, import quota, computer software, lease hold right, marketing rights, technical know-how etc.

(b) *control:*- The enterprise has the power to obtain the future economic benefits, flowing from the underlying resources and also can restrict the access of others I to those benefits (not necessarily legal right and may be in some other way – I market and technical knowledge may give rise to future economic benefit).

(c) *future economic benefits:*- An enterprise should asses the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset on the basis of weight age to external evidence available at the time of initial recognition.

(d) Cost can be measured reliably :

    (i) Initially recognized at cost - purchase price, taxes duty and other directly attributable expenses to make the asset ready for its intended use, if acquired separately - purchase consideration in the form of cash or other monetary asset.

(ii) In exchange for shares or securities at fair value of those shares or securities.

(iii) In exchange or part exchange for another asset - as per AS-10.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed or allocated on a reasonable and consistent basis for creating, producing and making the asset ready for its intended use, but in no case once treated as an expense, cannot be reversed for capitalization even if the essential criteria for recognition are complied with a later date.

Normally the following cost are not recognized for internally generated intangible asset:

1) selling, administrative and other general overhead unless directly attributable.

2) clearly identified inefficiencies and initial operating loses incurred before an asset achieves planned performance.

3) expenditure on training the staff to operate the asset.

Subsequent expenditure on an internally generated intangible asset after its purchase or completion is normally treated as expense unless it is assessed to generate future economic benefits over and above the originally assessed standard of performance or it can be measured and reliably attributed to the concerned intangible asset.

Amortization is the systematic allocation of the depreciable amount (cost less residual value usually "NIL" unless determined in terms of committed value by a third party or determined by active market price) of an intangible asset over its useful life (period of time for use, number of production or other similar units expected to obtain or legal restriction).

Under AS-26, useful life shall not exceed 10 years from the date the asset is available for use unless there is persuasive evidence to establish useful life longer than 10 years provided the enterprise

(a) amortizes over the best estimated useful life

(b) estimates the recoverable amount at least annually to identify the impairment loss

(c) disclose the reasons and factors in determining a longer life.

The amortization period and the amortization method should be reviewed at least at each, financial year and if the expected life is revised, the amortization period is revised accordingly but in no case it would tantamount to inappropriate deferment to later years.

AS-5 will be relevant in this regard as to what constitutes a change in accounting policy and what constitutes a change in estimate e.g. a change from straight-line to diminishing method or vice-versa would be change in accounting policy whereas reduction in the amortization period is change in accounting estimate.

Disclosure under AS-26

A) General

1. for each class of intangible asset distinguishing between internally generated and others

   (a) useful lives and amortization rates used

   (b) amortization method used

   (c) gross carrying amount and the accumulated amortization including impairment loss at the beginning and end of the reporting period

   (d) a reconciliation of the carrying amount (opening balance/addition/ disposal/impairment/loss charged/reversed/amortization for the period and other changes)

2. class of intangible asset by grouping of a similar nature and use by the enterprise informa tion on impaired intangible asset under AS-28 change in accounting policy or accounting estimate as per AS-5 reasons for amortization beyond 10 years with list of factors considered in determining the useful life.

3. Description, the carrying amount and remaining amortization period of any individual asset what is material to the financial statement as a whole.

4. Existence and carrying amount of intangible assets whose title is restricted and the carrying amount of intangible asset pledged as security for liabilities.

5. Amount of commitments for acquisition of intangible assets.

B) R&D expenditure: R&D expense (that is directly attributable or reasonably allocated on a consistent basis) recognized as an expense during the period.

C) Other information: encouraged to disclose a description of only fully amortized intangible asset but still in use.

Specific guideline for internally generated computer software - criteria for capitalization: apart from the broad recognition principles, AS-26 provides for specific guidance on internally generated computer software.

(a) At preliminary project stage, it is not recognized as an asset since the enterprise cannot demonstrate then exists as an asset from which future economic benefit will follow (making strategic decision, determination of performance requirements alternative means to achieve specified performance requirements. determination of technology to achieve performance requirements and selection of consultant to assist in development and/or installation of the software)

(b) At development stage involving detailed program design, coding working model in operative version for all major planned function and testing to bring it to a completed version together with related documentation and training material.

    At this stage the internally generated computer software can be recognized as an asset on satisfying

    1. The technical feasibility to make it available for internal use

    2. Intention to complete to perform individual functions e.g. commitment for funding the project.

    3. Ability to use the software

    4. Usefulness of the software to generate future economic benefit

    5. Availability of technical, financial and other resources to complete the development and use

    6. Reliably measure the expenditure to the software development (b) cost has some connotation as described earlier in the standard.

(c) Accounting for software acquired or purchased should meet with the basic principle of AS-26 as discussed elsewhere in this standard.

For computer software considering the fact technological change and obsolescence.It is 3-5 years of useful life, which needs to be reasoned in the disclosure.

Expenditure for Website:

The expenditure for purchasing, developing, maintaining and enhancing hardware (servers, internet connection) related to web site are accounted for under AS-10 (fixed asset).

The expenditure may be incurred internally when developing enhancing and maintaining its own website in the context of planning, application and infrastructure development, graphical design and content development and operating stage which are directly attributable or allocable on a reasonable basis to creating, producing and preparing the asset for intended use. The nature of each activity should be evaluated to decide web site stage of development.

Accounting treatment and recognition:

(a) planning stage expenditure are akin to research cost and recognized as expense when incurred.

(b) expenditure arising onward development stage complying with the development criteria (refer to computer software) should be recognized as an Intangible asset.

Illustration 40.

On February 2015, J Ltd.bought a trademark from I Ltd. for ₹50 lakhs. J Ltd. retained an independent consultant, who estimated the trademark's remaining life to be 14 years. Its unamortized cost on I ltd. records was ₹35 lakhs. J Ltd.decided to amortize the trademark over the maximum period allowed. In J Ltd.'s Balance Sheet as on 31st December 2015, what amount should be reported as accumulated amortization?

Solution:

As per para 23 of AS-26, intangible assets should be measured initially at cost therefore. J Ltd. should amortize the trademark at its cost of ₹50 lakhs. The unamortized cost on the seller's books ₹35 lakhs is irrelevant to the buyer. Although the trademark has a remaining useful life of 14 years, intangible assets are generally amortized over a maximum period of 10 years as per AS-26. Therefore, the maximum amortization expense and accumulated amortization is ₹5 lakhs (₹50 lakhs/10).

Illustration 41.

During 2016-17, A Ltd.incurred organization costs/preliminary expenses of ₹40,000. What portion of the organization costs will A Ltd. defer to years subsequent to the 2016-17?

Solution:

As per AS-26, organization costs /preliminary expenses are those incurred in the formation of a corporation. Since uncertainty exists concerning the future benefit of these costs in future years, they are properly recorded as an expense in 2016-17.

Illustration 42.

D Ltd. is developing a new distribution system of its material, following the costs incurred at different stages on research and development of the system:

Year ended 31.3	Phase/Expenses	Amount (₹ In lakhs)
2013	Research	8
2014	Research	10
2015	Development	30
2016	Development	36
2017	Development	50

On 31.3.13, D Ltd. identified the level of cost savings at ₹ 16 lakhs expected to be achieved by the new system over a period of 5 years, in addition this system developed can be marketed by way of consultancy which will earn cash flow of ₹10 lakhs per annum. D Ltd.demonstrated that new system meet the criteria of asset recognition as on 1.4.2015.

Determine the amount/cash which will be expensed and to be capitalized as intangible assets, presuming that no active market exist to determine the selling price of product i.e. system developed. System shall be available for use from 1.4.2013.

Solution:

As per AS-26, research cost of ₹18 lakhs to be treated as an expense in respective year ended 31st March 2013 and 2014 respectively.

The development expenses can be capitalized from the date the internally generated assets (new distribution system in this given case) meet the recognition criteria on and from 1.4.2013. Therefore, cost of ₹ (30 + 36 + 50) = ₹116 lakhs is to be capitalized as an intangible asset.

However, as per para 62 of AS-26, the intangible asset should be carried at cost less accumulated amortization and accumulated impairment losses.

At the end of 31st March, 2017, D Ltd. should recognize impairment loss of ₹22.322 lakhs = (116 - 93.678) and carry the new distribution system at ₹ 93.678 lakhs in the Balance Sheet as per the calculation given below:

Impairment loss is excess of carrying amount of asset over recoverable amount. Recoverable amount is higher of two i.e. value in use (discounted future cash inflow) and market realizable value of asset.

The calculation of discounted future cash flow is as under assuming 12% discount rate.

(₹ Lakhs)

Year	Cost Savings	Inflow by introducing the system	Total cash inflow	Discounted at 12%	Discounted cash flow
2018	16	10	26	0.893	23.218
2019	16	10	26	0.797	20.722
2020	16	10	26	0.711	18.486
2021	16	10	26	0.635	16.51
2022	16	10	26	0.567	14.742
					93.678

No amortization of asset shall be done in 2013 as amortization starts after use of asset which is during the year 2017-18.

Illustration 43.

M.S. International Ltd. is developing a new production process. During the financial year ending 31st March, 2017, the total expenditure incurred was ₹50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2016. Expenditure incurred till this date was ₹22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2018 was ₹80 lakhs. As at 31st March, 2018, the recoverable amount of know-how embodied in the process is estimated to be ₹72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

(i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2017 and carrying value of intangible as on that date.

(ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2018. Ignore depreciation.

Solution:

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2017

(a) Carrying value of intangiblet as on 31.03.2017:

At the end of financial year 31st March 2017, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2016).

(b) Expenditure to be charged to Profit and Loss account: The ₹ 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2017. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2018

(a) Expenditure to be charged to Profit and Loss account:

(₹ in lakhs)

Carrying Amount as on 31.03.2017	28
Expenditure during 2017 – 2018	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

₹ 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2018.

(b) Carrying value of intangible as on 31.03.2018:

(₹ in lakhs)

Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2018	72

AS-27: FINANCIAL REPORTING OF INTEREST IN JOINT VENTURE

AS-27 is applicable for accounting in joint venture interest and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturer and investors, regardless of the structure or forms under which the joint venture activities take place,

The statement provides for display and disclosure requirement for accounting for the investment in the stand-alone and consolidated financial statements of the venturer.

A joint venture is a contractual arrangement between two or more parties undertaking an economic activity, subject to joint control (control is the power to govern the financial and operating policies of an economic activity to obtain benefit from it).

The arrangement may be:

(a) Jointly controlled operations

(b) Jointly controlled asset

(c) Jointly controlled entities

In the event an enterprise by a contractual arrangement establishes joint control over an entity which is a subsidiary of that enterprise within the meaning of AS-21(CFS), it will be treated as joint venture as per AS-27. Joint control requires all the venturers to jointly agree on key decisions, else decision cannot be taken, as such even a minority holder (owner) may enjoy joint control.

Contractual arrangement is normally made in writing touching upon:

(a) The activity, duration and reporting obligation

(b) The appointment of the board of director/governing body and the respective voting rights/capital contribution/sharing by ventures of the output, income, expenses or results of the joint venture.

Contractual arrangement and joint control together makes an activity a joint venture, (investment in Associates in which the investor has significant influence is covered by AS-23)

Some joint ventures involve use of own fixed assets and other resources on its own and obligation of its own.

For its interest in jointly controlled operations, a venturer should recognize in its separate financial statements and consequently in its CFS,

(a) the assets that it controls and the liabilities it incurs

(b) the expense it incurs and the share of income earned from the joint venture.

As the above are already recognized in stand-alone financial statements of the venturer and consequently in the CFS, there us no requirement for adjustment or other consolidation procedure, when the venturer present the CFS. Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture.

Some joint ventures involve joint control; by means of joint ownership by the venturers of one or more assets contributed/acquired for the purpose of joint venture - the asset are used to obtain economic benefit for the venturers, agreeing to share the output from the assets and sharing of expenses incurred.

In respect of jointly controlled assets, each venturer recognize in its separate financial statement and consequently in its CFS:

(a) Share of the jointly controlled assets under distinct head of each asset and not as an investment

(b) Any liability incurred (e.g. financing its share of the assets)

(c) Share of joint liability in respect of the venturer

(d) Any income from sale or use of its share of the output in the joint venture and share of expenses.

(e) Expense is incurred in respect of its in the joint ventures e.g. financing the venturer's interests in the asset and selling its share of output The treatment of jointly controlled assets, recognizes the substance and economic reality (legal from of the joint venture) separate financial statements may not be prepared for the joint venture itself.

A jointly controlled entity involves the establishment of a corporation, partnership or lither entity in which each venturer has an interest as per contractual arrangement.

(a) in a separate/stand alone financial statement of each venturer, the interest in a jointly controlled entity should be accounted for as an investment as per AS-13 only the resources contributed, forms a part of the investment and the share' of joint venture result is treated in the income statement of the venturers.

(b) proportionate consolidation for joint venture is applied in case where the preparation and presenting a CFS is required, reflecting the substance and economic reality of the arrangement in the CFS. Many of the procedure in this regard are similar to AS-21 and require to be followed for treatment and disclosure.

Joint venture interest in the financial statements, of an investor is treated appropriately in terms of AS-13, AS-21 or AS-23 in CFS but for separate financial statements is should be accounted for as per *AS-13*.

Disclosure under AS-27:

In separate and CFS in respect of:

(a) Aggregate amount of contingent liabilities unless the probability of loss is remote separately from other contingent liabilities in relation to:

  1. Its interest in joint venture and its share in each of the contingent liabilities incurred jointly

  2. Its share of the contingent liability of the joint ventures themselves for which it is contingently liable.

  3. Those liabilities which arise because of the venturer is contingently liable for the liability of other venturers.

(b) Aggregate of commitments in respect of joint venture separately from other commitments in respect of:

  1. Capital commitment of its own and shares in the capital commitment incurred jointly with other ventures in relation to the joint venture.

2. Share of capital commitment of the joint ventures themselves

(c) A list of all joint ventures and description of interest in significant joint venture and for jointly controlled entities the properties of ownership interest name of the country of incorporation/residence.

Illustration 44.

N Ltd has 80% shares in a joint venture with Suzuki Ltd. N Ltd. sold a plant WDV ₹20 lakhs for ₹30 lakhs. Calculate how much profit N Ltd. should recognize in its book in case joint venture is:

(a) jointly controlled operation;

(b) jointly controlled asset;

(c) jointly controlled entity.

Solution:

As per AS-27, in case of jointly controlled operation and jointly controlled assets joint venture, the venture should recognize the profit to the extent of other venturer's interest.

In the given case, N Ltd. should recognize profit of:

= ₹(30 – 20)lakhs = ₹10 x 20%= ₹2 lakhs only.

However, in case of jointly controlled entities N Ltd. should recognize full profit of ₹10 lakhs in its separate financial statement. However, while preparing consolidated financial statement it should recognize the profit only to the extent of 20% i.e. ₹ 2 lakhs only.

AS-28: IMPAIRMENT OF ASSETS

An asset is impaired if its carrying amount exceeds the amount to be recovered through use or sale of the asset and given the situation the standard requires the enterprise to recognize an impairment loss i.e. the amount by which the carrying amount of an asset exceeds its recoverable amount.

Impairment loss is a normal expense and thus will have impact on distributable profit and other provisions of the company's act and applicable enactment (Acceptance of Deposit Rules, BIFR etc)

Impairment loss may be discussed in the following areas:

1) Impairment loss on a specific asset;

2) Impairment loss for a cash generating unit;

3) Impairment loss for discontinuing operation.

Impairment Loss = Carrying amount of the Asset – Recoverable amount.

Carrying amount is the amount at which asset is shown in the Balance Sheet.

Recoverable amount of an asset is higher of:

- Net selling price
- Value in use

Net Selling Price= Expected realizable value of an asset – cost of disposal

Net Selling price can be obtained from:

- Active market for the asset
- Binding sale agreement
- Best estimate based on information

Value in Use= Present value of estimated future cash flow arising from the use of asset + residual value at the end of its useful life.

Present value is calculated by applying discount rate to future cash flows.

Estimated cash flows includes :

- Cash inflows from continuing use of the asset
- Projected cash outflows to generate cash inflows from continuing use of the asset.
- Net cash flows if any to be received(or paid) for the disposal of the asset at the end of its useful life.

Estimated cash flows excludes:

- Cash flows from financing activities
- Payment /refund of income tax

Discount rate: It is the cost of capital to be applied to calculate the present value of estimated cash flows and is based on the following factors:

- Pre-tax rate
- Current market assessment of time value of money after considering specific risk of the asset.
- Enterprises weighted average cost of capital or incremental financial cost.
- The current rate of inflation is also considered.

AS-28 does not apply to:

- inventories (as per AS 2);
- construction contract assets (as per AS 7);
- deferred tax assets (as per AS 22);
- investments covered by AS-13 and financial instruments, because other AS provide for recognizing and measuring these assets.

1) Assessment for impairment of assets needs to be made at the B/S date: as to any indication in this context based on external or internal source of information.

External sources:

- Market value changes with passage of time or normal use (typewriter on invention of computer)
- Adverse effect in the light of technological, market, economic, or legal environment in which the enterprise operates.
- Change in market rate of interest or returns on investment affect the discount rates used to assess an assets value in use (if the effect is not a short-term phenomenon).
- Carrying amount of the net asset, exceeds its market capitalization (determined by future growth, profitability, threat of new products/entrants etc).

Internal sources:

- Obsolescence /physical damage is evident.
- Indication obtained internally that economic performance of an asset has worsened or likely to worse than expected.
- Continuous cash loss may indicate that one or more of the business division is impaired.

Assessment for impairment should be made on individual asset basis, except when;

(i) The asset value in use cannot be estimated to be close to the net se1ling price i.e. future cash flow from continuing use of the asset cannot be estimated to be negligible or there is no plan to dispose of the assets in near future.

(ii) The asset does not generate cash inflows from continuing use that are largely independent of those from other assets.

In the exceptional case as above, the value in use/recoverable amount can be determined with regard assets cash generating units (generate cash inflows from outside the reporting enterprise and independent of cash inflows from other assets / group of assets.

2) Impairment Loss to a cash generating unit :

Cash generating unit (CGU): The smallest group of an asset for which cash flows can be determined independently.

Even if the cash flows can determined independently, aggregation of cash generating units becomes necessary in some situations.

To determine impairment loss of a CGU, we have to follow 'bottom up' or 'top down' test.

3) Impairment Loss for discontinuing operation :

In this type of situation, the impairment loss shall depend on the way the discontinuing operation is disposed off:

(a) substantially in its entirety;

(b) as piecemeal sales;

(c) by abandonment.

Illustration 45.

X Ltd. purchased a machinery on 1.1.201 for ₹20 lakhs. WDV of the machine as on 31.3.17 ₹12 lakhs. The Recoverable amount of the machine is ₹11 lakhs. What is the impairment loss?

Solution:

Impairment Loss = Carrying amount – Recoverable Amount

= ₹12 lakhs – ₹11 lakhs = ₹ 1 lakh.

llustration 46.

Carrying amount ₹200 lakhs. Net Selling Price ₹210 lakhs. Value in use ₹ 220 lakhs. What is the impairment loss?

Solution:

Carrying amount ₹200 lakhs

Recoverable amount ₹ 220 lakhs (being the higher of net selling price and value in use)

Since, recoverable amount is more than carrying amount of the asset, there will arise no impairment loss.

llustration 47.

C Ltd.acquired a machine for ₹3.2 crores on 1.1.2014. It has a life of 5 years with a salvage value of ₹40 lakhs. Apply the test of impairment on 31.3.2017:

(a) Present value of future cash flow ₹ 1.3 crores

(b) Net selling price ₹ 1.2 crores

Solution:

Carrying amount of the asset: [3.2 – (3.2 – 0.4) x 39/60] = 1.38 crores.

Time period for use of the asset: 1.1.2014 to 31.3.2017 = 39 months

Total life period of the asset = 5 years = 60 months.

Recoverable amount: being the higher of present value and net selling price = ₹1.3 crores.

Impairment Loss = ₹(1.38 – 1.3) crores = ₹0.08 crores.

AS 29: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS (Revised)

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements. The objectives of this Standard is also to lay down appropriate accounting for contingent assets.

Scope

1. This Standard should be applied in accounting for provisions and contingent liabilities and in dealing with contingent assets, except:

    (a) those resulting from financial instruments that are carried at fair value;

    (b) those resulting from executory contracts, except where the contract is onerous;

    (c) those arising in insurance enterprises from contracts with policy-holders; and

    (d) those covered by another Accounting Standard.

2. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.

3. Executory contracts are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent. This Standard does not apply to executory contracts unless they are onerous.

4. This Standard applies to provisions, contingent liabilities and contingent assets of insurance enterprises other than those arising from contracts with policy-holders.

5. This Standard defines provisions as liabilities which can be measured only by using a substantial degree of estimation. The term 'provision' is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.

6. Other Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

7. This Standard applies to provisions for restructuring (including discontinuing operations). Where a restructuring meets the definition of a discontinuing operation, additional disclosures are required by AS 24,

Provision is a liability, which can be measured only by using a substantial degree of estimation that means to become provision it must be a liability.

A liability is present obligation of the enterprise arising from past events , settlement of which is expected to result in an outflow of resources embodying economic benefits. That means to become a liability there must be present obligation.

Present obligation - An obligation is a present obligation if based on evidence available, its existence on the balance sheet date is considered probable ie. more likely than not.

As per US GAAP "Probable" indicates "Likely to occur" whereas this is not the case in AS-29 which refers probable as - 'more likely than not'.

Example of provision: Mitra Ltd. manufactures and sells radios under the terms of the contract of sale, the manufacturer repairs or replaces, manufacturing defects that become apparent within two years from the date of the sale and makes good. Now, it is probable (more likely than not) that there will be some claims under these warranties.

Provisions for Onerous Contracts - As a consequence of limited revision of AS-29 "Provisions, Contingent Liabilities and Contingent Assets" the scope of this Accounting Standard has been widened to include in its ambit the

"Onerous Contract". Now in respect of accounting periods commencing on or after April 1, 2006 Provision for Onerous Contract are required in Accounts. **'Onerous Contract'** is a contract in which the unavoidable costs of meeting the obligation under the contract exceed the economic benefits expected to be recovered under it.

Requirement

- In the above case there is present obligation as a result of past obligating event —the past event is the sale of the radios, which gives rise to a present obligation.
- An outflow of resources embodying economic benefits in settlement is probable for the warranties as a whole.
- No doubt for recognition of provision, reliable estimate of warranties has to be made.

Contingent liability is:

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

  (i) a reliable estimate of the amount of the obligation cannot be made.

A **contingent asset** is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

Present obligation - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Possible obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

Provision for Restructuring Cost

It should be noted that the AS-29 does not prescribe the accounting of restructuring cost. It only prescribes the recognition and measurement criteria for 'provision for restructuring cost'.

Restructuring - As per AS-29 "restructuring" is a programme that is planned and controlled by management and materially changes either —

- The scope of a business undertaken ; or
- The manner in which that business is conducted.

Examples of restructuring —

- Sale or termination of line of business.
- closure of business locations in a country or region
- Relocation of business activities from one country or region to another.
- Change in management structure etc.

Restructuring cost - Provision for restructuring cost should include only the Direct Expenditures arising from restructuring and not associated with the ongoing activities of the enterprises.

Exclusions from restructuring cost —

- The cost of retraining or relocating continuing staff;
- Marketing cost;
- Investment in new system and distribution network;
- Expected loss on sale of assets due to restructuring. However, these assets will be subject to impairment as per AS-28.

Recognition

Provisions

A provision should be recognised only when:

(a) an enterprise has a present obligation as a result of a past event;

(b) it must exist on balance sheet date;

(c) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(d) a reliable estimate can be made of the amount of the obligation.

For contingent liability the existence of possible obligation should be 'Not Probable' whereas for 'Provisions' it should be 'Probable'.

Any event will be tested for provision and contingent liability in the same way and therefore "Provision" is recognised for the best estimate of the amount to settle the obligation as it is "Probable".

Provision should be used only for those expenditures for which the provision was created.

Accounting treatment: The amount of provision should be shown as an expense in profit and loss statement. Any expenses relating to provision should be shown in profit and loss statement net of reimbursement.

The amount of provision outstanding at the end should be shown in liability side without netting off reimbursement, the reimbursement expected is to be shown as an asset in the balance sheet.

Contingent liability

An enterprise should not recognise the contingent liability, it should be disclosed in financial statement.

Conditions to be fulfilled for disclosure in financial statement —

- There should be present obligation arising out of past event, but not recognised as a provision.
- It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.
- The possibility of an outflow of resources embodying economic benefits is not remote.
- If amount of the obligation cannot be measured with sufficient reliability to be recognised as provision.

Contingent Asset

An enterprise should not recognise a contingent asset because it may result in the recognition of income that may never be realized. If realisation is virtually certain then it is recognised. Contingent assets are not required to be disclosed in financial statement, generally it is disclosed in Board of Directors report.

Transitional Provisions - All the existing provisions for decommissioning, restoration and similar liabilities should be discounted prospectively, with the corresponding effect to the related item of property, plant and equipment.

Disclosure of provision in financial statements —

- Opening balance
- Addition to and use of the provision
- Unused amount written back
- Closing balance

Other required disclosures are —

- brief description of provision
- Major assumption on future events made at the time of measuring the provision and indication of uncertain items.
- Any expected reimbursement is to be recognised as an asset.

Disclosure of contingent liability at the balance sheet date —

- description of the nature of the contingent liability;
- where required, an estimate of the amount as per measurement principles as prescribed for provision;
- indications of the uncertainties relating to outflow;
- possibility of any reimbursement;
- Where any of the information required as above is not disclosed because, that fact should be stated.

1.3 INTERNATIONAL FINANCIAL REPORTING STANDARDS

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

IFRS — The Global Standard

- International Financial Reporting Standards (IFRS) are accounting standards issued by the International Accounting Standards Board (IASB). These are global accounting standards that are issued with the intention of ensuring uniformity in accounting across the globe.
- These areintended to provide investors and other stake-holders the ability to compare the financial performance of publicly listed companies.
- 'IFRSs' is the trademark of the International Accounting Standards Committee Foundation. The Foundation owns the copyright to IFRS in all languages.
- IFRSs are now mandated for use by more than 140 countries, including the European Union and by more than two-thirds of the G20 nations. The G20 and other international organisations including the World Bank, IMF, Basel Committee etc. have consistently supported the work of the IASB and its mission of global accounting standards.

Features of IFRS

The characteristics of IFRS are:

- These are global accounting standards.
- These standards are 'principle based', and not 'rule-based'.
- IFRS are developed and maintained by the IASB.
- These are issued with the intention of applying these standards across the globe on a consistent basis.
- It ensures high quality transparent reporting that would ensure comparability among the entities across the globe.
- Every standard has a specific structure to ensure uniformity and facilitate reading, interpretation and application. They are: Introduction, Standards, Basis of Conclusion (BC), Implementation Guidelines (IG), Illustrative Examples (IE), and Dissenting Opinions of board members.

Constituents of IFRS

The term IFRS constitutes in its fold:

- International Accounting Standards (IAS);
- International Financial Reporting Standards (IFRS);
- SIC Interpretations; and
- IFRIC Interpretations.

International Accounting Standards (IAS): The international accounting standards (IAS) were an older set of standards stating how particular types of transactions and other events should be reflected in financial statements. In the past, International Accounting Standards were issued by the Board of the International Accounting Standards Committee (IASC);

International Financial Reporting Standards (IFRS): Since 2001, the new set of standards has been known as the International Financial Reporting Standards (IFRS) and has been issued by the International Accounting Standards Board (IASB).

SIC Interpretations: These were interpretations that were issued by the erstwhile Standard Interpretations Committee (SIC). In total 33 SICs were issued during the period 1997 to 2001.

IFRIC Interpretations: These are publications issued by IFRS Interpretations Committee on specific issues that arisen within the context of current International Financial Reporting Standards (IFRSs). These provide appropriate accounting treatment and authoritative guidance on those issues. In total 21 IFRICs have been issued during the period 2004 to 2013.

IFRS — The Present Global Scenario

- Most of the world has been reporting under the International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). However, many jurisdictions that maintain their own local GAAP claim that their local GAAP is "based on" or "similar to" or "converged with" IFRSs. In some cases the wording changes seem minor, and in other cases the wording is quite different. Sometimes, the jurisdiction's local GAAP is not in English. Often, not all IASs/IFRSs have been adopted locally. Often there is a time lag in adopting an IFRS as local GAAP.
- After this, only two significant countries, viz., India and USA, were not using IFRS. However, USA allows IFRS for foreign private issuers with securities traded on US exchanges. There is renewed optimism that the US may allow even US companies to voluntarily adopt IFRS in the future. Besides since long, the US standard-setters and the IASB have been converging and working together on numerous accounting standards. This has resulted in the US GAAP slowly inching forward closer to IFRS.
- India has fulfilled its promise of compliance with international financial reporting standards (IFRSs) by adopting an amended version of IFRS, known as the Indian Accounting Standards (Ind ASs).

Process of introduction and implementation of IFRS

- On the basis of the approach adopted for transition from national standards to the common global accounting standards, there are two avenuesany one of which may be followed by a particular economy. These two processes are –'Adoption' or 'Convergence'.
- Accordingly, the countries/ economies across the globe are either 'Adopting IFRS' or getting 'Converged with IFRS'.
- **Adoption of IFRS** refers to the process under which the standard setting body of the economy/ country willing to make transition to the globally common accounting standards wouldaccept the IFRS (as issued by the IASB)in its original form,and would fully comply with the necessary guidelines issued by IASB in this regard.
- **Convergence with IFRS** refers to the process under which the standard setting body of the economy/ country that is willing to make transition to the common global accounting standards would develop its own set of accounting standards after taking into consideration the IFRS as issued by the IASB and making necessary modifications thereto. Such convergence ensures that the specific accounting practices of the concerned economy/ country gets maintained. However, such modification of standards conflicts with the aim of a single set of high quality accounting standards that are globally accepted. Accordingly, convergence should be considered a means of making the transition to full adoption of IFRS, and not an end in itself. Permission from the Foundation for the use of IFRS in local standards is required.

List of International Standards

- As on Jan. 1, 2016, there are 16 International Financial Reporting Standards (IFRS), 23 International Accounting Standards (IAS), 11 IFRIC interpretations, and 5 SIC interpretations.
- The list of IFRS as on 01.01.2016 is given in the Table below:

IFRS Code	IFRS Title
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations

IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interest in Other Entities
IFRS 13	Fair Value Measurement
IFRS 14	Regulatory Deferral Accounts
IFRS 15	Revenue from Contracts with Customers
IFRS 16	Leases

- The list of IAS as on 01.01.2016 is given in the following Table:

IAS Code	IAS Title
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 3	Consolidated Financial Statements [superseded by IAS 27 and IAS 28]
IAS 4	Depreciation Accounting [superseded by IAS 36]
IAS 5	Information to Be Disclosed in Financial Statements [superseded by IAS 1]
IAS 6	Accounting Responses to Changing Prices [superseded by IAS 15]
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 9	Accounting for Research and Development Activities [superseded by IAS 38]
IAS 10	Events after the Reporting Period
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 13	Presentation of Current Assets and Current Liabilities [superseded by IAS 1]
IAS 14	Segment reporting [superseded by IFRS 8]
IAS 15	Information Reflecting the Effects of Changing Prices [Not Applicable]
IAS 16	Property, Plant and Equipment
IAS 17	Leases [will be superseded by IFRS 16]
IAS 18	Revenue [will be superseded by IFRS 15]
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 22	Business Combinations [superseded by IFRS 3]
IAS 23	Borrowing Costs [superseded by IAS 39 and IAS 40]
IAS 24	Related Party Disclosures
IAS 25	Accounting for Investments
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Separate Financial Statements

IAS 28	Investments in Associates and Joint Ventures
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions [superseded by IFRS 3]
IAS 31	Interests in Joint Ventures [superseded by IFRS 11 and IFRS 12]
IAS 32	Financial Instruments: Presentation
IAS 33	**Earnings per Share**
IAS 34	Interim Financial Reporting
IAS 35	Discontinuing Operations [superseded by **IFRS 5**]
IAS 36	Impairment of Assets
IAS 37	**Provisions, Contingent Liabilities** and Contingent Assets Intangible Asset
IAS 38	Intangible Asset
IAS 39	Financial Instruments: Recognition and Measurement[superseded by **IFRS 9**]
IAS 40	Investment Property Financial Instruments: Recognition and Measurement
IAS 41	Agriculture

1.4 APPLICABILITY OF INDIAN ACCOUNTING STANDARDS

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.

1.5 OVERVIEW OF INDIAN ACCOUNTING STANDARDS (Ind AS)

[Ind AS 40 (amended), Ind AS 17 has been replaced by Ind AS 116 and Ind AS 11 & 18 has been replaced by Ind AS 115]

Ind AS 1: Presentation of Financial Statements

Financial reporting includes presentation and disclosure of financial position through Balance Sheet, Profit and Loss Account and Cash Flow Statements. The main objective of financial statement is to reflect true and fair information to the users.

A Complete set of Financial Statement includes:

(i) A balance Sheet at the end if the period

(ii) Statement of Profit and Loss Statement for the period

(iii) Statement of changes in Equity

(iv) Statement of Cash Flows

(v) Significant Accounting Policies and other explanatory notes as a separate statement

(vi) Comparative information with the previous periods

(vii) A balance sheet at the beginning of the earliest comparative period if the company applies an accounting policy retrospectively or makes retrospective statement.

Objectives

This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability - both with financial statements of previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Scopes

(a) An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with Indian Accounting Standards (Ind ASs).

(b) Consolidated Financial Statements in accordance with Ind AS 110 'Consolidated Financial Statements'

(c) Separate financial statements in accordance with Ind AS 27 'Separate Financial Statements'.

(d) This Ind AS does not apply to interim Financial Statements prepared in accordance with Ind AS 34 except para 15 to 35 of Ind AS 1.

Ind AS 2: Inventories

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

In case of service providers, inventories include the cost of service for which the entity has not yet recognised the revenue.

Inventories shall be measured at the lower of cost and net realisable value.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. It refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.

Objectives

(a) The objective of this Standard is to prescribe the accounting treatment for inventories.

(b) A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised.

(c) This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value.

(d) It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scopes

This Standard applies to all inventories, except:

(a) financial instruments ;

(b) biological assets related to agricultural activity and agricultural produce at the point of harvest;

This Standard does not apply to the measurement of inventories held by:

(a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.

(b) Commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Ind AS 7: Statement of Cash Flows

Cash flow information is useful in assessing the ability of the entity to generate —

cash and cash equivalents and enables users to develop models to assess and compare the present cash flows of different entities.

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities. An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business.

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Operating activities are the principal revenue-producing activities.

Investing 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 contributed equity and borrowings of the entity.

Objectives

(a) Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.

(b) The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

(c) The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows.

Scopes

An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

Ind AS – 8: Accounting Policies, Changes in Accounting Estimates and Errors

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

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

Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

Objectives

(a) to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, accounting treatment and disclosure of changes in accounting estimates and corrections of errors.

(b) to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.

Scopes

(a) Selecting and applying accounting policies, and

(b) accounting for changes in accounting policies,

(c) changes in accounting estimates, and

(d) corrections of prior period errors

Ind AS 10: Events after the Reporting Period

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue.

Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period i.e. adjusting events; and

(b) those that are indicative of conditions that arose after the reporting period i.e. non-adjusting events.

Objectives

(a) When an entity should adjust its financial statements for events after the reporting period; and

(b) The disclosures that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period;

(c) The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate.

Scopes

This Standard shall be applied in the accounting for, and disclosure of, events after the reporting period.

Ind AS 12: Income Taxes

Income taxes are an expense incurred in operating most businesses and to be reflected in operating results.

The income taxes are paid on the income as computed by tax laws of the country.

Accounting income calculated in profit and loss account is not always be the same as taxable income as per income tax law.

There might be a difference between the amount of 'net income' in the financial statements and 'taxable income' in the tax return.

In accounting the accrual basis is followed for calculating the income (Loss) whereas in case of tax law it does not follow the accrual system of accounting. It results in a tax difference.

The items which cause difference usually get reserved/ adjusted over a period of time, until they reversed/adjusted an asset and liability must be recorded on the Balance Sheet. The account used to do this balancing is called 'Deferred Tax Asset/ Liability'.

Objectives

The objective of this Standard is to prescribe the accounting treatment for income taxes.

The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

(a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet; and

(b) transactions and other events of the current period that are recognised in an entity's financial statements.

Scopes

(a) This Standard shall be applied in accounting for income taxes.

(b) For the purposes of this Standard, income taxes include all domestic and foreign taxes which are based on taxable profits, withholding taxes, which are payable by a subsidiary, associate or joint arrangement on distributions to the reporting entity.

(c) This Standard does not deal with the methods of accounting for government grants or investment tax credits.

(d) However, this Standard deals with the accounting for temporary differences that may arise from such grants or investment tax credits.

Ind AS 16: Property, Plant and Equipment

Property, Plant and Equipments are known as fixed assets. These fixed assets are tangible property.

These tangible assets are:

- held for use in production or supply of goods and services, for rental to other , or for administrative purposes
- expected to be used during more than one period and
- not held for sale in the normal course of business.

Objectives

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can get information about an entity's investment in its property, plant and equipment and the changes in such investment.

The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised.

Scopes

This Standard prescribes the accounting for Property, Plant and Equipment except when another Ind AS required or permits different accounting treatments.

This Standard does not apply to:

(a) Property, Plant and Equipment classified as held for sale in accordance with Ind AS 105, 'Non-current Assets held for sale and Discontinued Operation'.

(b) Biological assets relating to agricultural activity under Ind AS 41, 'Agricultural'.

(c) Mineral rights, mineral reserves and similar non-generative resources.

(d) The recognition and measurement of exploration and evaluation of assets.

However, this Standard does apply to items of property, plant and equipment used to develop or maintain the assets described in (b), (c) and (d) above.

Ind AS 116: Lease

Two entities are involved in a lease, lessee and lessor.

This Standard sets out for both the entities the principles for

- the recognition,
- measurement,
- presentation and
- disclosure of leases,

so that users of financial statements may assess the effect of lease on financial position, financial performance and cash flows of the entities.

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

Classification of lease into operating lease and financial lease is made in lessor's accounts and not in lessee's accounts.

Lessee:

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

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

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

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

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

(iv) an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

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

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

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

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

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

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

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

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

After the commencement date, a lessee shall measure the lease liability by:

(a) increasing the carrying amount to reflect interest on the lease liability;

(b) reducing the carrying amount to reflect the lease payments made; and

(c) remeasuring the carrying amount to reflect any reassessment or lease modifications .

A lessee shall either present in the balance sheet, or disclose in the notes:

(a) right-of-use assets separately from other assets.

(b) lease liabilities separately from other liabilities.

A lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements.

Lessor:

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

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

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

At the commencement date, a lessor shall recognise assets held under a finance lease in its balance sheet and present them as a receivable at an amount equal to the net investment in the lease.

The lessor shall use the interest rate implicit in the lease to measure the net investment in the lease.

At the commencement date, a manufacturer or dealer lessor shall recognise the following for each of its finance leases:

(a) revenue being the fair value of the underlying asset,

(b) the cost of sale being the cost, or carrying amount if different, of the underlying asset less the present value of the unguaranteed residual value; and

(c) selling profit or loss (being the difference between revenue and the cost of sale) in accordance with its policy for outright sales to which Ind AS 115 applies.

A lessor shall recognise finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

A lessor aims to allocate finance income over the lease term on a systematic and rational basis.

A lessor shall apply the derecognition and impairment requirements in Ind AS 109 to the net investment in the lease.

A lessor shall recognise lease payments from operating leases as income on either a straight-line basis or another systematic basis.

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

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

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

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

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

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

(a) for finance leases:

   (i) selling profit or loss;

   (ii) finance income on the net investment in the lease; and

   (iii) income relating to variable lease payments not included in the measurement of the net investment in the lease.

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

Ind AS 115: Revenue from Contracts with Customers

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

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

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

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

I. Identifying the contract.

II. Identifying performance obligation.

III. Satisfaction of performance obligation.

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

While stages I to III are for recognition of revenue stage IV is for its measurement.

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

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

The nature, timing and amount of consideration promised by a customer affect the estimate of the transaction price.

An entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis as per the standard, except for allocating discounts, and allocating variable consideration.

Ind AS 19: Employee Benefits

Employee benefits are all forms of consideration given directly to an employee or their spouses, children or other dependents and to other such as trust, insurance companies in exchange of service provided by an employee.

Employee: As per this standard employee includes whole time directors and management personnel. It is

applicable to all forms of employer-employee relationships whether it is formal or not.

Generally 'outsourcing contract' will not meet the definition of employer-employee relationship. However, contracts should be carefully examined to distinguish between a "contract of service" and a "contract for services".

A "contract for services" means a contract for rendering services, and a 'contract of service' means a relationship of an employer and employee and the person is obliged to obey orders in the work to be performed.

Objectives

The objective of this Standard is to prescribe the accounting treatment and disclosure for employee benefits. The Standard requires an entity to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Scopes

This Standard shall be applied by an employer in accounting for all employee benefits, except those to which Ind AS 10 Share-based Payment applies.

However, this Standard does not deal with reporting by employee benefit plans.

Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance

Grants may be known as subsidies, subventions or premiums. Entities may also receive other types of assistance which may be in many other forms.

These are mainly intended to encourage entities to initiate activities that they would not have otherwise undertaken.

Government grant/assistance is an action by the government to providing economic benefits specific to an entity or range of entities qualifying certain criteria.

Objectives

Ind AS-20 deals with the accounting treatment and disclosure requirements of grants received by entities from government. It also mandates disclosure requirements of other forms of government assistance.

Scopes

Non applicability:

(a) Special problems in relation with the effects of changing prices on financial statements or similar supplementary information.

(b) Government assistance provided in the form of tax benefits (including income tax holidays, investment tax credits, accelerated depreciation allowances, and concessions in tax rates)

(c) Government participation in the ownership

(d) Government grants covered by Ind AS-41.

Ind AS 21: The Effects of Changes in Foreign Exchange Rates

If a company has overseas business/trade, it will buy or sell goods or services in foreign currencies. Therefore, the value of goods or services bought or sold has to be translated in rupees for the purpose of recording in the accounts.

A company may have a subsidiary abroad and in that case the subsidiary will trade in its own local currency. It will keep books of account and prepare the annual accounts in its local currency. But at the year end, the holding company must consolidate the results of the overseas subsidiary into its group accounts, the assets and liabilities and the annual profit of the subsidiary must be translated from the foreign currency into functional currency.

For the translation from the foreign currency into functional currency, the foreign currency exchange rates are required. If foreign currency exchanges rates remained constant, there would be no accounting problem.

In actual parlance foreign exchange rates are continually changing. The accounting principles are required to be laid down in which the transactions from one currency to another currency is to be translated and what the accounting treatment should be of exchange difference arising on application of different foreign currency exchange rates. Ind AS-21 deals with these questions.

Objectives

An entity may carry on foreign activities in two ways:

(i) transactions in foreign currencies or it may have

(ii) foreign operations.

 (a) The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity; and

 (b) how to translate financial statements into a presentation currency;

 (c) The principal issues are which exchange rate(s)to use; and

 (d) how to report the effects of changes in exchange rates in the financial statements.

Scopes

This Standard shall be applied:

(a) Reporting foreign currency transactions in the functional currency;

(b) Translation of foreign operations;

(c) Translation of the presentation currency.

Non applicability:

(a) To the presentation in a statement of cash flows of the cash flows arising from transaction in a foreign currency or of a foreign operation.

(b) To long-term foreign currency monetary items for which an entity has opted for the exemption given in Ind AS 101.

Ind AS 23: Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Other borrowing costs are recognised as an expense.

Borrowing costs are interest and other costs incurred relating to borrowing of funds. It includes :

- Interest expenses calculated using the effective interest rate
- Finance charges, if the asset acquired under finance leases.

An asset that takes substantial period of time to get ready for its intended use or sale, is known as qualifying asset.

Example:

Any tangible fixed assets, which are in construction process or acquired tangible fixed assets, which are not ready for use or resale such as plants and machinery.

Objectives

The objective of this standard is to prescribe the treatment of borrowing cost in accounting and its treatment in accounts.

Scopes

An entity shall apply this Standard in accounting for borrowing costs.

The Standard does not deal with the actual or imputed cost of equity, including preferred capital not classified as a liability.

An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition, construction or production of:

(a) a qualifying asset measured at fair value; or

(b) inventories that are manufactured, or otherwise produced, in large quantities on a repetitive basis

Ind AS 24: Related Party Disclosures

Business transactions between related parties do not have the feature and character of the arm's length transactions. It affects the volume and decision of one entity for the benefit of the other entities.

Related party relationship may have an effect on the profit or loss and financial position of an entity. Related parties may also enter into transactions that unrelated parties would not. It is required to disclose the related party transaction for proper understanding of financial performance and financial position of entity.

Related Party means any party that controls or can significantly influence the management or operating policies of the company during the reporting period.

The criteria for related party relationship are as follows:

- Control;
- Common control;
- Joint control;
- Significant influence.

Ind AS 24 requires transactions between reporting entity and its related parties to be disclosed in the reporting entity's financial statements.

Objectives

The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.

Scopes

This Standard shall be applied for the following purposes:

(a) Identifying related party relationships and transactions;

(b) Identifying outstanding balances, including commitments, between an entity and its related parties;

(c) Identifying the circumstances in which disclosure of the items in (a) and (b) is required; and

(d) Determining the disclosures to be made about those items.

Ind AS 27: Separate Financial Statements

Entities having one or more subsidiary, associate or joint venture are required to prepare separate financial statement. The focus of Ind AS (converged IFRS) is on the preparation of consolidated financial statements and, hence the question arises how to deal with some accounting issues in separate financial statements.

It prescribes the accounting and disclosure requirements for investment in subsidiaries, joint ventures and associates.

Objectives

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.

Scopes

When an entity elects or is required to present separate financial statements, Ind AS 27 applies in accounting for investment in:

- Subsidiaries
- Joint Ventures
- Associates

Ind AS 27 does not mandate any entity to produce separate financial statements.

Ind AS 28: Investments in Associates and Joint Ventures

The investing company can exert significant influence over the financial and operating policies of the investee company, it will also have an active interest in its net assets and results.

In that case the nature of the relationship differs from that of a simple investment.

The operations of associate and joint venture are significant part of the investor's, management decisions and operational skills. There is a clear demonstrable requirement that makes equity method highly desirable.

Objectives

The objective of this Standard is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

Scopes

This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee.

Ind AS 29: Financial Reporting in Hyperinflationary Economies

Hyperinflation means extremely fast or out-of-control inflation. In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such extant that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, will be misleading.

Scope

This Standard deals with the measurement problems of entities that are reporting in the currency of a hyperinflationary economy. In this situation, financial information reported in historical terms would present a distorted picture of the entity's performance and financial position. This Standard sets out procedures for adjusting the financial information for the effects of hyperinflation.

Ind AS 33: Earning per Share

Earnings Per Share is a financial ratio which gives the information regarding earning available to each equity/ordinary share. It is required to assess the performance of a company.

Investors always look for growth in EPS from one year to the next. It is based on past data and it can be easily manipulated by changing the accounting policies and by merger and acquisition.

There are following two types of earnings per share (EPS), which are to be reported by the entity on the face of the statement of profit and loss account

- Basic EPS
- Diluted EPS

Objectives

(a) To prescribe principles for the determination of EPS,

(b) to improve performance, comparisons between different entities in the same reporting period and between different reporting periods of the same entity.

Scopes

(a) This standard is applicable to those companies that have issued ordinary shares to which Indian Accounting Standards apply.

(b) In an entity presents both consolidated financial statements (CFS) and separate financial statements (SFS), the disclosure required by this standard is applicable for both the financial statement.

(c) In CFS such disclosure shall be based on consolidated information and in SFS such disclosures shall be based on information given in separate financial statements.

Ind AS 34: Interim Financial Reporting

It is the reporting for periods of shorter than a full financial year, say, for a period of three months or quarterly results.

Interim Financial Report means a financial report containing either a complete set of financial statement or set of condensed financial statement for an interim period.

However interim reporting has inherent limitation, which is not the case of annual accounts as the reporting period is shortened, the effect of errors in estimations and allocation get magnified.

The main problems are:

- Proper allocation of operating expenses.
- Some operating expenses may be incurred in one interim period and yet benefit the full year operation.
- For some entities revenue may be seasonal or cyclical and therefore concentrated in certain interim period.
- Determination of appropriate amount of provisions.
- Income-tax expenses - one interim period may have profit and next interim period may have losses.

Objectives

The objective of this Standard is

- to prescribe the minimum content of an interim financial report and
- to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period.
- Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.

Scopes

This Standard does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period. However, governments, securities regulators, stock exchanges, and accountancy bodies often require entities whose debt or equity securities are publicly traded to

publish interim financial reports. This Standard applies if an entity is required or elects to publish an interim financial report in accordance with Indian Accounting Standards.

Ind AS 36: Impairment of Assets

Impairment of assets means weakening in value of assets. An asset is said to be impaired when the carrying amount of asset is more than its recoverable amount.

Carrying Amount is the amount at which assets are shown in the Balance Sheet, i.e. generally at cost less accumulated depreciation or amortisation and accumulated impairment losses.

Recoverable amount of an asset is higher the following:

(i) Fair value less cost of disposal;

(ii) Value in use i.e. estimated future cash flow arising from use of asset+ residual price at the end of its useful life.

Objectives

The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at not more than their recoverable amount.

An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. In that case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss.

The Standard also specifies when an entity should reverse the impairment loss and prescribes appropriate disclosures.

Scopes

This Standard shall be applied in accounting for the impairment of all assets, other than:

(i) Inventories (Ind AS 2, Inventories);

(ii) Contract assets and assets arising from costs to obtain or fulfil a contract that are recognised in accordance with Ind AS 115;

(iii) deferred tax assets (Ind AS 12, Income Taxes);

(iv) assets arising from employee benefits (Ind AS 19, Employee Benefits);

(v) financial assets that are within the scope of Ind AS 109, Financial Instruments;

(vi) biological assets related to agricultural activity within the scope of Ind AS 41 Agriculture that are measured at fair value less costs to sell ;

(vii) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of Ind AS 104, Insurance Contracts; and

(viii) non-current assets (or disposal groups) classified as held for sale in accordance with Ind AS 105.

Ind AS 37: Provisions, Contingent Liabilities and Contingent Assets

Provisions mean liabilities of uncertain amount and timing. A liability that can be measured using substantial degree of estimates.

As per Ind AS 37, contingent liability is a possible obligation that arises from past event and existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not wholly within the control of the entity.

As per Ind As 37, contingent asset is a possible asset that arises from past events, existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not wholly within the control of the entity.

Objectives

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount.

Scopes

This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:

(a) those resulting from executory contracts, except where the contract is onerous; and (b) those covered by another Standard.

Ind AS 38: Intangible Assets

As per Ind AS 38 Intangible Asset is an identifiable non-monetary asset without physical substance.

It must be separate and be capable of being separated from the entity, and sold/transferred. The entity must have the power to obtain future economic benefits and restrict the access of the others to the benefits those arise.

It must be a source of (i) revenue, (ii) cost savings, (iii) other future economic benefits.

Objectives

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

Scopes

Non Applicability:

(a) intangible assets that comes under the scope of another Standard;

(b) financial assets, as defined in Ind AS 32, Financial Instruments: Presentation;

(c) the recognition and measurement of exploration and evaluation assets (Ind AS 106, Exploration for and Evaluation of Mineral Resources); and

(d) expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources.

Ind AS 40 : Investment Property

This standard prescribes accounting treatment of investment property and related disclosure.

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, and it is dealt in Ind AS 40.

It is different from owner-occupied property which is held [by the owner (Ind AS 16) or by the lessee as a right-of-use asset (Ind AS 116)] for use in the production or supply of goods or services or for administrative purposes.

The following are examples of investment property:

(a) land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business.

(b) land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation.)

(c) a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases.

(d) a building that is vacant but is held to be leased out under one or more operating leases.

(e) property that is being constructed or developed for future use as investment property.

The following are examples of items that are not investment property and are therefore outside the scope of this Standard: (a) property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see Ind AS 2, Inventories), for example, property acquired exclusively with a view to subsequent disposal in the near future or for development and resale. (b) owner-occupied property (see Ind AS 16), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal. (c) property that is leased to another entity under a finance lease.

An owned investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

An investment property held by a lessee as a right-of-use asset shall be measured initially at its cost in accordance with Ind AS 116.

An entity shall adopt as its accounting policy the cost model for subsequent measurement of all of its investment property.

This Standard requires all entities to measure the fair value of investment property, for the purpose of disclosure even though they are required to follow the cost model.

After initial recognition, an entity shall measure investment property in accordance with Ind AS 16's requirements for cost model, unless it is investment property classified as held for sale (or are included in a disposal group that is classified as held for sale) which shall be measured in accordance with Ind AS 105.

Ind AS 41: Agriculture

There was a greater need of financial statements based on sound and generally acceptable principles. As the use of a historic cost model was not seen as wholly appropriate for accounting for agricultural activity, the IASB issued IAS 41 based on a fair value model.

Most of the business organization involved in agricultural activities is generally small, cash-oriented and family-oriented. These small agricultural entities also seek outside financial assistance, mainly from banks or government agencies and are required to produce financial statements.

In India, the agricultural activity is not considered a business and also exempt from income-tax being the state subject as per Indian Constitution. Therefore, no need was felt to develop the accounting standards on agricultural activity. As India is converging with the IFRS, the corresponding Ind AS-41 was issued to IAS-41.

Objectives

The objective of this Standard is to prescribe the accounting treatment and disclosures related to agricultural activity.

Scopes

This Standard shall be applied to account for the following when they relate to agricultural activity: (a) biological assets; (b) agricultural produce at the point of harvest; and (c) government grants covered by paragraphs 34 and 35 of this standard.

IND AS 101: First-time Adoption of Indian Accounting Standards

The Indian GAAP consists of existing Accounting Standards. As per the roadmap issued by the MCA, some specified Indian companies, Banks and Insurance entities have to follow the Ind AS which are converged IFRSs.

An entity following Accounting Standards as per Indian GAAP if has to follow Ind AS, there would be some challenges faced by the entity like, at what value the assets and liabilities is to be carried at the date of transition to Ind AS, if these values are to be changed whether it should be with retrospective effect or prospective in effect.

There may be certain existing assets or liabilities which may not be considered as assets or liabilities as per Ind AS, what should be the treatment of such assets or liabilities. Further, there may be assets or liabilities as per Ind AS on the transition date but these are not the assets or liabilities as per the Indian GAAP. These issues are to be addressed by Ind AS 101.

Objectives

(a) To explain the procedure of transition

(b) To remove all difficulties of retrospective applications of certain Ind AS

(c) To explain the accounting treatment of the resultant differences, in the carrying amount of various assets and liabilities, if there is any.

Scopes

(a) It is applicable to the first set of Financial Statements that contain an explicit and unreserved statement of compliance with Ind ASs.

(b) This Ind AS applies to any interim financial statement for a period that is covered by those first financial statements that are prepared under Ind As.

IND AS 102: Share-based Payment

Transactions when entities purchase goods or services from other parties, such as supplier and employees, by issuing shares or share options are very common.

Share scheme are very common feature of director and executive remuneration and in some countries tax incentives are offered to encourage more companies to offer shares to employees. Companies whose shares or share options are regarded as a valuable 'currency' commonly use share-based payment to obtain employee and professional expertise.

If a company pays its employees in cash, an expense is recognized in profit or loss, in the same way if the payment is in share option, expense may not be recognized as there is no cost incurred, as the granting of shares or options does not require to entity to sacrifice cash or other assets. Here comes the question of accounting of Share Based Payment.

Objectives

To specify the financial reporting by an entity when it undertakes a share-based payment transaction. It requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted.

Scopes

An entity shall apply it to all share-based payment transactions, in which an entity acquires or receives goods or services.

There are following three types of Share-based payments:

(a) equity-settled share-based payment transactions,

(b) cash-settled share-based payment transactions, and

(c) share based payment transaction with cash alternatives

Non-applicability of Ind AS 102:

(i) Share issued as consideration in a business combination

(ii) Certain contract transactions falling within Ind AS 32 or Ind AS 109 relating to Financial Instruments

IND AS 103: Business Combination

A business combination is a transaction or other event in which an acquirer obtains CONTROL of one or more BUSINESS.

Generally, companies doing similar type of business or involved in similar line of activities may be combined to get the economies of scale and to minimize the possibility of tough competition. Business combination results in growth. Business combination can be in the form of merger and acquisition.

A 'merger' refers to a situation where two or more than two companies of similar nature combine willingly while in case of 'acquisition' or 'take over' refers to the situation where a bigger company takes over a smaller company. It can be either through amalgamation or through absorption.

AS-14 'Amalgamations' and Ind AS-103 'Business Combination' is substantially different. Ind AS-103 lays down the accounting principles for business combination and not for asset combination.

Objectives

To improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects.

To accomplish that, this Ind AS establishes principles and requirements for how the acquirer:

(a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;

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

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

Scopes

This Ind AS applies to a transaction or other event that meets the definition of a business combination.

Non-applicability:

(a) the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.

(b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including Ind AS 38, Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.

Ind AS 104: Insurance Contracts

This Standard applies to insurance companies only, however this Standard does not apply to all entities issuing insurance contracts.

Insurance companies and other financial services entities issuing insurance contracts are usually regulated by the country specific regulations. In India The IRDA prescribes accounting for all insurance companies which do not allow much scope for accounting to be done as per Standard or Generally Accepted Accounting Principles (GAAP).

Objectives

(a) to specify the financial reporting for insurance contracts by any entity that issues such contracts.

This Ind AS requires:

(i) limited improvements to accounting; and

(ii) disclosure, that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the financial statement.

Scopes

An entity shall apply this Ind AS to:

(a) insurance contracts that it issues and reinsurance contracts that it holds.

(b) financial instruments that it issues with a discretionary participation feature.

Ind AS 107, Financial Instruments: Disclosures, requires disclosure about financial instruments, including financial instruments that contain such features.

This Ind AS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers.

An entity shall not apply this Ind AS to:

(a) product warranties issued directly by a manufacturer, dealer or retailer.

(b) employers' assets and liabilities under employee benefit plans and retirement benefit obligations reported by defined benefit retirement plans.

(c) contractual rights or contractual obligations that are contingent on the future use of, or right to use, a nonfinancial item, as well as a lessee's residual value guarantee embedded in a finance lease.

(d) financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts.

(e) contingent consideration payable or receivable in a business combination.

(f) direct insurance contracts that the entity holds. However, a cedant shall apply this Standard to reinsurance contracts that it holds.

Ind AS 105: Non-current Assets Held for Sale and Discontinued Operations

Non-current Assets Held for Sale is required to be shown separately in the Balance sheet from that of other assets. The value would be recovered from sale and not to be treated as assets which are in use in operation of the entity. The results of discontinued operations to be presented separately in the statement of profit and loss.

The information provided helps the users of financial statements to make projections of an entity's cash flows, earning-generating capacity and financial position.

Objectives

(a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and

(b) The results of discontinued operations to be presented separately in the statement of profit and loss.

Scopes

The classification, presentation and measurement requirements of this Ind AS apply to all recognised non-current assets and disposal groups, except for those assets listed in paragraph 5 which shall continue to be measured in accordance with the Standard noted.

Assets classified as non-current in accordance with Ind AS 1, Presentation of Financial Statements, shall not be reclassified as current assets until they meet the criteria to be classified as held for sale in accordance with this

Ind AS. Assets of a class that an entity would normally regard as non-current that are acquired exclusively with a view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with this Ind AS.

Ind AS – 106 : Exploration for and Evaluation of Mineral Resources

Exploration and evaluation expenditures are incurred by an entity in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting mineral resources are demonstrable.

Objective

Objective The objective of this Indian Accounting Standard (Ind AS) is to specify the financial reporting for the exploration for and evaluation of mineral resources. In particular, the Ind AS requires:

(a) limited improvements to existing accounting practices for exploration and evaluation expenditures.

(b) entities that recognise exploration and evaluation assets to assess such assets for impairment in accordance with this Ind AS and measure any impairment in accordance with Ind AS 36, Impairment of Assets.

(c) disclosure that identify and explain the amounts in the entity's financial statements arising from the exploration for and evaluation of mineral resources and help users of those financial statements understand the amount, timing and certainty of future cash flows from any exploration and evaluation assets recognised.

Scopes

An entity shall apply this Ind AS to exploration and evaluation expenditures that it incurs. This Ind AS does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral resources. An entity shall not apply this Ind AS to expenditures incurred:

(a) before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.

(b) after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

Ind AS 108: Operating Segments

In today's global economy, most entities produce and market a variety of products and services and also operate in many geographical areas of the world. Each of the products and geographical areas are naturally subject to different rates of profitability, risks and opportunities and so on. It is therefore to be aware of the risks and return involved in each geographical area and for each product /service. This information will enable to make appropriate decisions regarding the utilization of the entity's resources.

This Ind AS deals with providing segment information and to establish principles for reporting financial information by segment. This information will enable the users of the financial statements to:

- Understand the entity's past performance
- Assess the entity's risk and return
- Make more informed decision

Objective

Basic objective of Ind AS-108 is that an entity should disclose information to enable users of its financial statements to evaluate the financial effects of the types of business activities in which it is engaged and the economic environments in which it operates.

Scopes

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

If an entity that is not required to apply this Ind AS chooses to disclose information about segments that does not comply with this Ind AS, it shall not describe the information as segment information.

If a financial report contains both the consolidated financial statements of a parent that is within the scope of this Ind AS as well as the parent's separate financial statements, segment information is required only in the consolidated financial statements.

Ind AS – 32,107,109: Financial Instruments

Financial instrument is a document having a monetary value such as draft, cheques, bill of exchange and promissory notes.

However for the purpose of these Ind ASs, 'Financial Instruments' includes wide ranges of assets and liabilities of entities and is not limited to investments or merely capital market instruments and draft, cheques, bill of exchange and promissory notes. It includes receivables, loans, cash, deposits, investments, payables, debentures, bonds etc.

A financial instrument is a legally enforceable agreement between two or more parties expressing contractual rights to the payment of money. It is contractual right of one person to the agreement and contractual liability of another person to the agreement, consequently it will be the financial asset for the person who has right to receive the money and financial liability for the person who has obligation to pay money.

Objectives

The objective of these Ind AS is to require entities to provide disclosures in their financial statements that enable users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The principles include principles for recognising, measuring and presenting financial assets and financial liabilities in Ind AS 32, Financial Instruments: Presentation, and Ind AS 109, Financial Instruments.

Other objective is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

Scopes

This Standard shall be applied by all entities to all types of financial instruments except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with Ind AS 110 Consolidated Financial Statements, Ind AS 27 Separate Financial Statements orInd AS 28 Investments in Associates and Joint Ventures.

(b) rights and obligations under leases to which Ind AS 17 Leases applies. However:

    (i) lease receivables recognised by a lessor are subject to the derecognition and impairment requirements of this Standard;

    (ii) finance lease payables recognised by a lessee are subject to the derecognition requirements of this Standard; and

    (iii) derivatives that are embedded in leases are subject to the embedded derivatives requirements of this Standard.

(c) employers' rights and obligations under employee benefit plans, to which Ind AS 19 Employee Benefits applies.

(d) financial instruments issued by the entity that meet the definition of an equity instrument in Ind AS 32 (including options and warrants) or that are required to be classified as an equity instrument.

(e) rights and obligations arising under

(i) an insurance contract as defined in Ind AS 104 Insurance Contracts, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract, or

(ii) a contract that is within the scope of Ind AS 104 because it contains a discretionary participation feature. However, this Standard applies to a derivative that is embedded in a contract within the scope of Ind AS 104 if the derivative is not itself a contract within the scope of Ind AS 104. Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or India AS 104 to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

(f) any forward contract between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination within the scope of Ind AS 103 Business Combinations at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.

(g) loan commitments other than those loan commitments described in paragraph 2.3. However, an issuer of loan commitments shall apply the impairment requirements of this Standard to loan commitments that are not otherwise within the scope of this Standard. Also, all loan commitments are subject to the derecognition requirements of this Standard.

(h) financial instruments, contracts and obligations under share-based payment transactions to which Ind AS 102 Share-based Payment applies, except for contracts within the scope of paragraphs 2.4–2.7 of this Standard to which this Standard applies.

(i) rights to payments to reimburse the entity for expenditure that it is required to make to settle liability that it recognises as a provision in accordance with Ind AS 37 Provisions, contingent Liabilities and Contingent Assets, or for which, in an earlier period, it recognised a provision in accordance with Ind AS 37.

(ii) rights and obligations within the scope of Ind AS 115 Revenue from Contracts with Customers that are financial instruments, except for those that Ind AS 115 specifies are accounted for in accordance with this Standard. The impairment requirements of this Standard shall be applied to those rights that Ind AS 115 specifies are accounted for in accordance with this Standard for the purposes of recognising impairment gains or losses.

The following loan commitments are within the scope of this Standard:

(a) loan commitments that the entity designates as financial liabilities at fair value through profit or loss. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.

(b) loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in instalments.

(c) commitments to provide a loan at a below-market interest rate. This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of

contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. However, this Standard shall be applied to those contracts that an entity designates as measured at fair value through profit or loss in accordance with paragraph 2.5. A contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contract was a financial instrument, may be irrevocably designated as measured at fair value through profit or loss even if it was entered into for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. This designation is available only at inception of the contract and only if it eliminates or significantly reduces a recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from not recognising that contract because it is excluded from the scope of this Standard.

Ind AS 110 : Consolidated Financial Statements

Standard allows to present financial statements of a parent and its subsidiary as a single economic entity.

Consolidated Statement of profit and loss and consolidated Balance Sheet are prepared for disclosure of the total profit/loss of the group and total assets and liabilities of the group.

The consolidated financial statements (CFS) presents the true and fair view of the position of the entity as one economic entity for the financial year and are considered as the primary financial statements whereas the standalone financial statement projects only the position of the company in its individual performance and does not provide true and fair view to the shareholder about the overall performance of the company with its subsidiaries and associates.

Objectives

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

Scopes

An entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

(a) A parent need not present consolidated financial statements if it meets all the following conditions:

    (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

    (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with Ind ASs.

(b) post-employment benefit plans or other long-term employee benefit plans to which India AS 19, Employee Benefits, applies.

(c) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this Ind AS, to measure all of its subsidiaries at fair value through profit or loss.

Ind AS 111: Joint Arrangements

Ind AS-111 prescribes the accounting for a joint arrangement.

Joint arrangements are economic arrangement between two or more parties sharing joint control and make the decision jointly about the business activities. The purpose of the joint arrangement might be share costs or might be motivated by profit.

The investor will be required to either apply the equity method of accounting or recognize, on a line-by-line basis, its share of the underlying assets, liabilities, revenues and expenses. The accounting treatment required will depend on the substance of the arrangement and the nature of the investor's interest in it.

A joint arrangement is an arrangement of which two or more parties have joint control and have the following characteristics:

- The parties are bound by a contractual arrangement; and
- It gives two or more of the parties joint control of the arrangement.

Objectives

The objective of this Indian Accounting Standard (Ind AS) is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e. joint arrangements). For the purpose of meeting the above stated 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.

Scopes

This Ind AS shall be applied by all entities that are a party to a joint arrangement.

Ind AS 112: Disclosure of Interests in Other Entities

Ind AS-112 is related to the disclosures only and there is no principal laid down for measurement, recognition and presentation of investment made in other entities.

The disclosure requirements in this Standard are intended to improve transparency as to the judgments made in deciding whether or not to consolidate and the financial impact if management decides a different conclusion.

Objectives

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.

For the purpose of meeting the above stated objective, 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).

Scopes

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.

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 in paragraphs 24–31 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.

Ind AS 113: Fair Value Measurement

IFRSs (Ind ASs) measurements are mainly driven by fair value. Before IFRS-13 there was no comprehensive Standard on fair value. There was inconsistency in application of Fair value. These inconsistencies have led to diversity in practice and lack of comparability of information reported in financial statements.

IFRS-13 (Ind AS-113) fair value measurement sets out a single source of comprehensive guidance on how to measure the fair value of both financial and non-financial assets and liabilities.

IFRS-13 (Ind AS-113) includes descriptions of certain valuation approaches and techniques, it is not a valuation standard and does not prescribe how valuations should be performed.

Objectives

This Ind AS:

(a) defines fair value;

(b) sets out a framework for measuring fair value; and

(c) requires disclosures

Scopes

Non Applicability of measurement and disclosure requirements:

(a) Share-based payment transactions

(b) Leasing transactions

(c) Measurements that have some similarities to fair value but are not fair value.

Ind AS 114: Regulatory Deferral Accounts

Some entities provide goods or services to customers at a price, subject to regulation by the government. For example, supply of gas etc. Rate regulations ensure that specified cost are recovered by the supply, simultaneously the prices charged to customer are fair and reasonable. These twin objectives mean that prices charged to customers at a particular time do not necessarily cover the cost incurred by the supplier at that time. In this case the recovery of such cost is deferred. Similarly these rate regulated entities are permitted to defer income that non-rate-regulated entities would recognise the income in profit or loss.

Objectives

The objective of this Standard is to specify the financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation.

In meeting this objective, the Standard requires:

(a) limited changes to the accounting policies that were applied in accordance with previous generally accepted accounting principles for regulatory deferral account balances, which are primarily related to the presentation of these accounts; and

(b) disclosures that:

 (i) identify and explain the amounts recognised in the entity's financial statements that arise from rate regulation; and

 (ii) help users of the financial statements to understand the amount, timing and uncertainty of future cash flows from any regulatory deferral account balances that are recognised.

Scopes

An entity is permitted to apply the requirements of this Standard in its first Ind AS financial statements if and only if it: (a) conducts rate-regulated activities; and (b) recognised amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP. An entity shall apply the requirements of this Standard in its financial statements for subsequent periods if and only if, in its first Ind AS financial statements, it recognised regulatory deferral account balances by electing to apply the requirements of this Standard.

A more detailed discussion on Ind AS:

Indian Accounting Standard 1 — Presentation of Financial Statements

Objective

This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability

- both with financial statements of previous periods and
- with the financial statements of other entities.
- It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Scope

- An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with Indian Accounting Standards (Ind ASs).
- Consolidated Financial Statements in accordance with Ind AS 110 'Consolidated Financial Statements'
- Separate financial statements in accordance with Ind AS 27 'Separate Financial Statements'.
- This Ind AS does not apply to interim Financial Statements prepared in accordance with Ind AS 34 except para 15 to 35 of Ind AS 1.

Definitions

General purpose financial statements (referred to as 'financial statements') are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

Indian Accounting Standards (Ind ASs) are Standards prescribed under Section 133 of the Companies Act, 2013.

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.

Notes contain information in addition to that presented in the balance sheet (including statement of changes in equity which is a part of balance sheet), statement of profit and loss and statement of cash flows.

Owners are holders of instruments classified as equity**.**

Profit or Loss is the total of income less expenses, excluding comprehensive income.

Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognised in other comprehensive income in the current or previous periods.

Total comprehensive income is the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

Total comprehensive income comprises all components of 'profit or loss' and of 'other comprehensive income'.

Other comprehensive income comprises items of income and expense (including reclassification adjustments) that is not recognised in profit or loss as required or permitted by other Ind ASs.

The components of other comprehensive income include:

(a) changes in revaluation surplus — Ind As 16 & 38;

(b) reameasurements of defined benefit plans — Ind AS 19;

(c) gains and losses arising from translating the financial statements of a foreign operation — Ind AS 21;

(d) gains and losses from investments in equity instruments designated at fair value through other comprehensive income — Ind AS 109;

(e) gains and losses on financial assets measured at fair value through other comprehensive income — Ind AS 109;

(f) the effective portion of gains and losses on hedging instruments in a cash flow hedge and the gains and losses on hedging instruments that hedge investments in equity instruments measured at fair value through other comprehensive income — Ind AS 109;

(g) for particular liabilities designated as at fair value through profit or loss, the amount of the change in fair value that is attributable to changes in the liability's credit risk — Ind AS 109;

(h) changes in the value of the time value of options when separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the changes in the intrinsic value — Ind AS 109;

(i) changes in the value of the forward elements of forward contracts when separating the forward element and spot element of a forward contract and designating as the hedging instrument only the changes in the spot element, and changes in the value of the foreign currency basis spread of a financial instrument when excluding it from the designation of that financial instrument as the hedging instrument — Ind AS 109.

Purpose of financial statements

The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity's:

(a) assets;

(b) liabilities;

(c) equity;

(d) income and expenses, including gains and losses;

(e) contributions by and distributions to owners in their capacity as owners; and

(f) cash flows.

This information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

A complete set of financial statements comprises:

(a) a balance sheet as at the end of the period ;

(b) a statement of profit and loss for the period;

(c) statement of changes in equity for the period;

(d) a statement of cash flows for the period;

(e) notes, comprising a summary of significant accounting policies and other explanatory information; and

(f) comparative information in respect of the preceding period;

(g) a balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements

(h) An entity shall present a single statement of profit and loss, with profit or loss and other comprehensive income presented in two sections. The sections shall be presented together, with the profit or loss section presented first followed directly by the other comprehensive income section.

General features

- Financial statements shall present a true and fair view of the financial position, financial performance and cash flows of an entity. Presentation of true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of Ind ASs, with additional disclosure when necessary, is presumed to result in financial statements that present a true and fair view.
- An entity whose financial statements comply with Ind ASs shall make an explicit and unreserved statement of such compliance in the notes.
- An entity shall not describe financial statements as complying with Ind ASs unless they comply with all the requirements of Ind ASs.
- An entity **cannot** rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material.
- In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

When an entity departs from a requirement of an Ind AS, it should be a part of its disclosure. It should disclose:

(a) that management has concluded that the financial statements present a true and fair view ;

(b) that it has complied with applicable Ind ASs, except that it has departed from a particular requirement to present a true and fair view;

(c) the title of the Ind AS from which the entity has departed, the nature of the departure, including the treatment that the Ind AS would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and

(d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

(e) When an entity has departed from a requirement of an Ind AS in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures.

In the extremely rare circumstances in which management concludes that compliance with a requirement in an Ind AS would be so misleading that it would conflict with the objective of financial statements set out in the Framework, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:

(a) the title of the Ind AS in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the Framework; and

(b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to present a true and fair view.

Going concern

An entity shall prepare financial statements on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

When management is aware, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Example : 1

Is there any specific disclosure requirement as per Ind AS-1 for a Company in Liquidation?

Answer:

For a Company in liquidation, the fundamental accounting assumption of Going Concern is apparently not valid.

The Carrying Amounts of assets and liabilities would reflect the Realisable Value.

As per Ind AS-1, when an Entity does not prepare Financial Statements on a going concern basis, it shall disclose –

(a) that fact,

(b) the basis on which it prepared the Financial Statements, and

(c) the reason why the Entity is not regarded as a going concern.

Accrual basis of accounting

An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

When the accrual basis of accounting is used, an entity recognises items as assets, liabilities, equity, income and expenses, when they satisfy the definitions and recognition criteria for those elements in the Framework.

Materiality and aggregation

An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial except when required by law.

Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items in the financial statements. If a line item is not individually material, it is aggregated with other items either in those statements or in the notes. An item that is not sufficiently material to warrant separate presentation in those statements may warrant separate presentation in the notes.

An entity need not provide a specific disclosure required by an Ind AS if the information is not material except when required by law.

Offsetting

An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an Ind AS.

An entity reports separately both assets and liabilities, and income and expenses. Measuring assets net of valuation allowances — for example, obsolescence allowances on inventories and doubtful debts allowances on receivables — is not offsetting.

In addition, an entity presents on a net basis gains and losses arising from a group of similar transactions, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading. However, an entity presents such gains and losses separately if they are material.

Example: 2

Om Ltd has a vacant land measuring 10,000 sq.mts. which it had no intention to use in the future. The Board of Directors decided to sell the land to tide over its liquidity problems. The Company made a profit of ₹ 10 Lakhs by selling the said Land. There was a fire in the factory and a part of the unused factory valued at ₹ 8 Lakhs was destroyed. The Loss was setoff against the Profit from Sale of Land and a Profit of ₹ 2 Lakh was disclosed as Net Profit from Sale of Assets. Analyse.

Answer:

An Entity shall not offset Assets and Liabilities or Income and Expenses, unless required or permitted by an Ind AS.

When items of Income or Expense are material, an Entity shall disclose their nature and amount separately. Disposal of items of Property, Plant and Equipment is one example of such material item.

Disclosing Net Profits by setting off Fire Losses against Profit from Sale of Land is not correct. As per Ind AS-1, Profit on Sale of Land, and Loss due to Fire should be disclosed separately.

Frequency of reporting

An entity shall present a complete set of financial statements (including comparative information) at least annually.

When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:

(a) the reason for using a longer or shorter period, and

(b) the fact that amounts presented in the financial statements are not entirely comparable.

Comparative information

Except when Ind ASs permit or require otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements.

Any narrative or descriptive information should be included if it is relevant to under standard the financial statements.

An entity shall present, as a minimum, two balance sheets , two statements of profit and loss, two statements of cash flows and two statements of changes in equity, and related notes.

Additional comparative information

An entity may present comparative information in addition to the minimum comparative financial statements required by Ind ASs, as long as that information is prepared in accordance with Ind ASs.

For example, an entity may present a third statement of profit and loss (thereby presenting the current period, the preceding period and one additional comparative period). However, the entity is not required to present a third balance sheet, a third statement of cash flows or a third statement of changes in equity (ie an additional financial statement comparative). The entity is required to present, in the notes to the financial statements, the comparative information related to that additional statement of profit and loss.

Change in accounting policy, retrospective restatement or reclassification

An entity shall present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if:

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

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

In the circumstances described in paragraph 40A, an entity shall present three balance sheets as at:

(a) the end of the current period;

(b) the end of the preceding period; and

(c) the beginning of the preceding period.

If an entity changes the presentation or classification of items in its financial statements, it shall reclassify comparative amounts unless reclassification is impracticable. When an entity reclassifies comparative amounts, it shall disclose (including as at the beginning of the preceding period):

(a) the nature of the reclassification;

(b) the amount of each item or class of items that is reclassified; and

(c) the reason for the reclassification.

When it is impracticable to reclassify comparative amounts, an entity shall disclose:

(a) the reason for not reclassifying the amounts, and

(b) the nature of the adjustments that would have been made if the amounts had been reclassified.

Consistency of presentation

An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

- it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in Ind AS 8; or
- an Ind AS requires a change in presentation.

Structure and content

Identification of the financial statements

- An entity shall clearly identify the financial statements and distinguish them from other information in the same published document. Ind ASs apply only to financial statements, and not necessarily to other information presented in an annual report, a regulatory filing, or another document. Therefore, it is important that users can distinguish information that is prepared using Ind ASs from other information that may be useful to users but is not the subject of those requirements.
- An entity shall display the following information prominently, and repeat it when necessary for the information presented to be understandable:
  - the name of the reporting entity or other means of identification;
  - whether the financial statements are of an individual entity or a group of entities;
  - the date of the end of the reporting period;
  - the presentation currency; and
  - the level of rounding used in presenting amounts in the financial statements.

Balance Sheet

As a minimum, the balance sheet shall include line items that present the following amounts:

(a) property, plant and equipment;

(b) investment property;

(c) intangible assets;

(d) financial assets (excluding amounts shown under (e), (h) and (i));

(e) investments accounted for using the equity method;

(f) biological assets within the scope of Ind AS 41 Agriculture;

(g) inventories;

(h) trade and other receivables;

(i) cash and cash equivalents;

(j) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations;

(k) trade and other payables;

(l) provisions;

(m) financial liabilities (excluding amounts shown under (k) and (l));

(n) liabilities and assets for current tax, as defined in Ind AS 12, Income Taxes;

(o) deferred tax liabilities and deferred tax assets, as defined in Ind AS 12;

(p) liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105;

(q) non-controlling interests, presented within equity; and

(r) issued capital and reserves attributable to owners of the parent.

Current/non-current distinction

An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet in accordance with paragraphs that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.

Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

(a) not more than twelve months after the reporting period, and

(b) more than twelve months after the reporting period.

For some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is reliable and more relevant than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.

An entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and more relevant. The need for a mixed basis of presentation might arise when an entity has diverse operations.

Current assets

An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the reporting period; or

(d) the asset is cash or a cash equivalent (as defined in Ind AS 7) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

(e) An entity shall classify all other assets as non-current.

(f) This Standard uses the term ‘non-current’ to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.

The **operating cycle** of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents. When the entity’s normal operating cycle is not clearly identifiable, it is assumed to be twelve months. Current assets include assets (such as inventories and trade receivables) that are sold, consumed or realised as part of the normal operating cycle even when they are not expected to be realised within twelve months after the reporting period. Current assets also include assets held primarily for the purpose of trading and the current portion of non-current financial assets.

Current liabilities

An entity shall classify a liability as current when:

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

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

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

(iv) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

- An entity shall classify all other **liabilities as non-current.**
- Some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. An entity classifies such operating items as current liabilities even if they are due to be settled more than twelve months after the reporting period.
- Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting period or held primarily for the purpose of trading. Financial liabilities that provide financing on a long-term basis and are not due for settlement within twelve months after the reporting period are **non-current liabilities.**
- An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

  (a) the original term was for a period longer than twelve months, and

  (b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are approved for issue.

If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity, the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

Where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

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

Information to be presented either in the balance sheet or in the notes

- An entity shall disclose, either in the balance sheet or in the notes, further sub-classifications of the line items presented, classified in a manner appropriate to the entity's operations.
- An entity shall disclose the following, either in the balance sheet or the statement of changes in equity, or in the notes:

(i) for each class of share capital:

- the number of shares authorised;
- the number of shares issued and fully paid, and issued but not fully paid;
- par value per share, or that the shares have no par value;

- a reconciliation of the number of shares outstanding at the beginning and at the end of the period;
- the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;
- shares in the entity held by the entity or by its subsidiaries or associates; and shares reserved for issue under options and contracts for the sale of shares, including terms and amounts; and

(ii) a description of the nature and purpose of each reserve within equity.

An entity whose capital is not limited by shares e.g., a company limited by guarantee, shall disclose information showing changes during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

Statement of Profit and Loss

The statement of profit and loss shall present, in addition to the profit or loss and other comprehensive income sections:

(a) profit or loss;

(b) total other comprehensive income;

(c) comprehensive income for the period, being the total of profit or loss and other comprehensive income.

An entity shall present the following items, in addition to the profit or loss and other comprehensive income sections, as allocation of profit or loss and other comprehensive income for the period:

(a) profit or loss for the period attributable to:

  (i) non-controlling interests, and

  (ii) owners of the parent.

(b) comprehensive income for the period attributable to:

  (i) non-controlling interests, and

  (ii) owners of the parent.

Information to be presented in the profit or loss section of the statement of profit and loss

In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

(a) revenue, presenting separately interest revenue calculated using the effective interest method;

(b) gains and losses arising from the derecognition of financial assets measured at amortised cost;

(c) finance costs;

(d) impairment losses ;

(e) share of the profit or loss of associates and joint ventures accounted for using the equity method;

(f) if a financial asset is reclassified out of the amortised cost measurement category so that it is measured at fair value through profit or loss, any gain or loss arising from a difference between the previous amortised cost of the financial asset and its fair value at the reclassification date;

(g) if a financial asset is reclassified out of the fair value through other comprehensive income measurement category so that it is measured at fair value through profit or loss, any cumulative gain or loss previously recognised in other comprehensive income that is reclassified to profit or loss;

(h) tax expense;

(i) a single amount for the total of discontinued operations.

Information to be presented in the other comprehensive income section

The other comprehensive income section shall present line items for amounts of other comprehensive income in the period, classified by nature (including share of the other comprehensive income of associates and joint ventures accounted for using the equity method) and grouped into those that, in accordance with other Ind ASs:

(a) will not be reclassified subsequently to profit or loss; and

(b) will be reclassified subsequently to profit or loss when specific conditions are met.

An entity shall present additional line items, headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial performance.

An entity shall not present any items of income or expense as extraordinary items, in the statement of profit and loss or in the notes.

Profit or loss for the period

An entity shall recognise all items of income and expense in a period in profit or loss unless an Ind AS requires or permits otherwise.

Other comprehensive income for the period

An entity shall disclose the amount of income tax relating to each item of other comprehensive income, including reclassification adjustments, either in the statement of profit and loss or in the notes.

An entity shall disclose reclassification adjustments relating to components of other comprehensive income.

Other Ind ASs specify whether and when amounts previously recognised in other comprehensive income are reclassified to profit or loss. Such reclassifications are referred to in this Standard as reclassification adjustments.

A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss.

These amounts may have been recognised in other comprehensive income as unrealised gains in the current or previous periods. Those unrealised gains must be deducted from other comprehensive income in the period in which the realised gains are reclassified to profit or loss to avoid including them in total comprehensive income twice.

Information to be presented in the statement of profit and loss or in the notes

- **When items of income or expense are material, an entity shall disclose their nature and amount separately.**
- Circumstances that would give rise to the separate disclosure of items of income and expense include:
  - (a) write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
  - (b) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
  - (c) disposals of items of property, plant and equipment;
  - (d) disposals of investments;
  - (e) discontinued operations;
  - (f) litigation settlements; and
  - (g) other reversals of provisions.

An entity shall present an analysis of expenses recognised in profit or loss using a classification based on the nature of expense method.

Statement of Changes in Equity

An entity shall present a statement of changes in equity. The statement of changes in equity includes the following information:

- total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests;
- for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with Ind AS 8;
- for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from:
  - profit or loss;
  - other comprehensive income;
  - transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control; and
  - any item recognised directly in equity such as amount recognised directly in equity as capital reserve.

Information to be presented in the statement of changes in equity or in the notes

- For each component of equity an entity shall present, either in the statement of changes in equity or in the notes, an analysis of other comprehensive income by item .
- An entity shall present, either in the statement of changes in equity or in the notes, the amount of dividends recognised as distributions to owners during the period, and the related amount of dividends per share.
- Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period.
- Ind AS 8 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transition provisions in another Ind AS require otherwise. Ind AS 8 also requires restatements to correct errors to be made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance of retained earnings, except when an Ind AS requires retrospective adjustment of another component of equity.
- Paragraph 106(b) requires disclosure in the statement of changes in equity of the total adjustment to each component of equity resulting from changes in accounting policies and, separately, from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.

Example: 3

A loss of ₹8,00,000 on account of embezzlement of cash was suffered by the Company and it was debited to Salary Account, discuss.

Answer:

Embezzlement of Cash during the course of business is a Business Loss. It is a business hazard which can occur once in a while.

Loss due to embezzlement of Cash cannot be merged with any other head. Being a material item, it should to be disclosed under a distinct head in the P&L A/c and not under Salary A/c.

Example: 4

A Ltd as part of overall cost cutting measure, announced a Voluntary Retirement Scheme (VRS) to reduce its number of employee. During the first half year, the Company paid a compensation of ₹ 144 Lakhs to those who

availed the scheme. The Chief Accountant has reflected this payment as part of regular Salaries & Wages paid by the Company. Is this correct?

Answer:

VRS Payments as an overall cost-cutting measure may be considered as a part of routine business activities.

The nature and the amount involved may make it a material item requiring separate disclosure.

The Entity shall present additional line Items, Headings and Sub-Totals in the Statement of Profit and Loss, when such presentation is relevant to an understanding of the Entity's financial performance.

VRS payments should not be reflected as Salaries and Wages paid since they do not form part of regular Salaries and Wages given to Employees. The treatment given by the Company is not proper.

Statement of Cash Flows

Cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. Ind AS 7 sets out requirements for the presentation and disclosure of cash flow information.

Notes

The notes shall:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies used;

(b) disclose the information required by Ind ASs that is not presented elsewhere in the financial statements; and

(c) provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.

An entity shall present notes in a systematic manner. An entity shall cross-reference each item in the balance sheet and in the statement of profit and loss, and in the statements of changes in equity and of cash flows to any related information in the notes.

An entity normally presents notes in the following order, to assist users to understand the financial statements and to compare them with financial statements of other entities:

(i) statement of compliance with Ind ASs ;

(ii) summary of significant accounting policies applied ;

(iii) supporting information for items presented in the balance sheet, and in the statement of profit and loss, and in the statements of changes in equity and of cash flows, in the order in which each statement and each line item is presented; and

(iv) other disclosures, including:

An entity may present notes providing information about the basis of preparation of the financial statements and specific accounting policies as a separate section of the financial statements.

Disclosure of accounting policies

An entity shall disclose in the summary of significant accounting policies:

the measurement basis (or bases) used in preparing the financial statements, and the other accounting policies used that are relevant to an understanding of the financial statements.

An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Sources of estimation uncertainty

An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period.

Capital

An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

Qualitative information about its objectives, policies and processes for managing capital, including:

(i) a description of what it manages as capital;

(ii) when an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and

(iii) how it is meeting its objectives for managing capital.

Summary quantitative data about what it manages as capital. Some entities regard some financial liabilities as part of capital. Other entities regard capital as excluding some components of equity.

Puttable financial instruments classified as equity

For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):

- Summary quantitative data about the amount classified as equity;
- its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;
- the expected cash outflow on redemption or repurchase of that class of financial instruments; and
- information about how the expected cash outflow on redemption or repurchase was determined.

Other disclosures

- An entity shall disclose in the notes the amount of dividends proposed or declared before the financial statements were approved for issue but not recognised as a distribution to owners during the period, and the related amount per share; and
- the amount of any cumulative preference dividends not recognised.

An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:

- the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);
- a description of the nature of the entity's operations and its principal activities; the name of the parent and the ultimate parent of the group; and
- if it is a limited life entity, information regarding the length of its life.

Indian Accounting Standard 2 — Inventories

Objective

The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard deals with the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

This Standard applies to all inventories, except:

a. financial instruments ; and

b. biological assets (i.e living animals or plants) related to agricultural activity and agricultural produce at the point of harvest.

This Standard does not apply to the measurement of inventories held by:

a. producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised in profit or loss in the period of the change.

b. commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Broker-traders are those who buy or sell commodities for others or on their own account.

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

In case of service providers, inventories include the cost of service for which the entity has not yet recognised the revenue.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. It refers to the net amount that an entity expects to realise from the sale of inventory in the ordinary course of business.

Fair value reflects the price at which an orderly transaction to sell the same inventory in the principal (or most advantageous) market for that inventory would take place between market participants at the measurement date.

The former is an entity-specific value; the latter is not. Net realisable value for inventories may not equal fair value less costs to sell.

Measurement of inventories

Inventories shall be measured at the lower of cost and net realisable value.

Cost of inventories comprises

- all costs of purchase,
- costs of conversion and
- other costs incurred in bringing the inventories to their present location and condition.

Costs of purchase of inventories includes

- purchase price,
- import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and
- transport, handling and
- other costs directly attributable to the acquisition of finished goods, materials and services.
- **Trade discounts, rebates and other similar items are deducted in determining the costs of purchase Costs of conversion** of inventories include
- costs directly related to the units of production, such as direct material, direct labour and other direct expenses; and
- systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods
- **Fixed production overheads** are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.
- **Variable production overheads** are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
- The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities.
- **Normal capacity** is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance.
- The actual level of production may be used if it approximates normal capacity.
- The amount of fixed overhead allocated to each unit of production is not increased as a consequence of **low production or idle plant**. Unallocated overheads are recognised as an expense in the period in which they are incurred.
- In periods of **abnormally high production**, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost.

Example: 1

Avishkar Ltd.'s normal production capacity is 1,00,000 units and the Fixed Overheads are estimated at ₹5,00,000. Give the treatment of Fixed Production Overhead under Ind AS – 2, if actual production during a period was –

(i) 84,000 unites;

(ii) 1,00,000 units;

(iii) 1,20,000 units.

Answer:

Fixed Production Overhead Rate (based on Normal Capacity) = ₹5,00,000/1,00,000 units = ₹5 p.u. Fixed Overhead is treated as under —

Particulars	Situation (i)	Situation (ii)	Situation (iii)
1. Normal Production	1,00,000 units	1,00,000 units	1,00,000 units
2. Actual Production	84,000 units	1,00,000 units	1,20,000 units
3. Difference in Production (1 – 2)	16,000 units (short)	Nil	20,000 units (Excess)

4. Recovery Rate to be used as per Ind AS – 2	Normal Rate = ₹5 per unit	Normal Rate = ₹5 per unit	Revised Rate = ₹5,00,000/1,20,000 units = ₹4.167 p.u.
5. Recovered Cost	84,000 × ₹5 = ₹4,20,000	1,00,000 units × ₹5 = ₹5,00,000	1,20,000 units × ₹4.167 p.u. = ₹5,00,000
6. Balance treated as Period Cost	₹80,000	Nil	Nil

- when **joint products** are produced or when there is a main product and a **by-product** and the costs of conversion of each product are not separately identifiable — they are allocated between the products on a rational and consistent basis.
- The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production.
- In case of by-products which are by their nature immaterial, then they are often measured at net realisable value and this value is **deducted from the cost** of the main product.

Other costs

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition.

Following costs are excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

Example: 2

In a production process, Normal Waste is 4% of input. 6,000 MT of input were put in process resulting in a wastage of 300 MT. Cost per MT of input is ₹1,250. The entire quantity of waste is on stock at the year-end. Compute the value of Inventory.

Answer:

Abnormal Amounts of Waste Materials, Labour or other Production Costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

Normal Waste is 4% of 6,000 MT i.e. 240 MT and Abnormal Waste is 300 MT – 240 MT = 60 MT.

Cost of Normal Waste 240 MT will be included in determining the cost of inventories at the year-end.

Cost of Abnormal Waste 60 MT 5 ₹1,250 i.e. ₹75,000 will be charged to Profit and Loss Account.

Ind AS 23, Borrowing Costs, identifies limited circumstances where borrowing costs are included in the cost of inventories.

- An entity may purchase inventories on **deferred settlement** terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase prices for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

Example: 3

A firm (dealer of T.V) has purchased 100 T.Vs on deferred payment basis for ₹5,000 per month per T.V. The amount is to be paid in twelve monthly equal instalments. The cash cost per unit of T.V. is ₹56,000. At the end of year, 25 T.Vs were in the stock. What should be the Cost of Inventories?

Answer:

Interest Expense = Deferred Payment Price (-) Cash Cast = (5,000 × 12 Months) – 56,000 = ₹4,000.

Inventory should be valued only at Cash ₹56,000 p.u. Interest Expense ₹4,000 should not be included in Valuation of Inventory.

Conclusion:

(i) Value of Inventory = ₹56,000 × 20 units = ₹14,00,000

(ii) Cost of Inventory sold to be recognised as Expense in the Statement of P&L = ₹56,000 × 75 units = ₹42,00,000

(iii) Interest Expense to be recognised as an Expense in the Statement of P&L = ₹4,000 × 100 units =₹4,00,000.

- In accordance with Ind AS 41, *Agriculture*, inventories comprising **agricultural produce** that an entity has harvested from its biological assets are measured on initial recognition at their fair value less costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

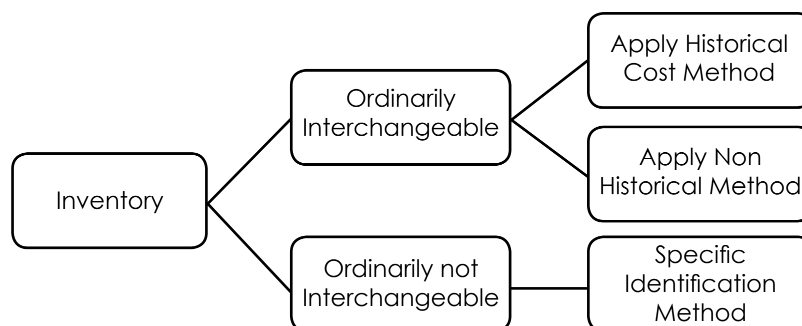
Techniques for the measurement of cost

Techniques for the measurement of the cost of inventories, such as the **Standard cost** method or the **Retail method**, may be used. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation which are regularly reviewed /revised in the light of current conditions.

The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items with similar margins.

The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost Formulas



- The cost of inventories of items that are **not ordinarily interchangeable** and goods or services produced and segregated for specific projects shall be assigned by using **specific identification of their individual costs**. This is the appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced.
- Specific identification of costs is inappropriate when there are large numbers of items of **inventory that are ordinarily interchangeable**. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on profit or loss. The cost of inventories, other than

those dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

- The **FIFO** formula assumes that the items of inventory that were purchased or produced first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced.
- In case of **Weighted average** cost formula the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

Net realisable value

- The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.
- Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items.
- Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made, of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.
- Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realisable value of the excess is based on general selling prices.
- Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exists or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised net realisable value.

Recognition as an expense

When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

Disclosure

The financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the carrying amount of inventories carried at fair value less costs to sell;

(d) the amount of inventories recognised as an expense during the period;

(e) the amount of any write-down of inventories recognised as an expense in the period;

(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period;

(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and

(h) the carrying amount of inventories pledged as security for liabilities.

Indian Accounting Standard 7 — Statement of Cash Flows

Objective

- Providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows.
- Assessing the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.
- The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents.

Scope

- **An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.**
- **This standard requires all entities to present a cash flow statement.**
- Users of an entity's financial statements are interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be the case with a financial institution. Entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all entities to present a statement of cash flows even the Banks and Financial Institutions.

Benefits of cash flow information

- A statement of cash flows, when used in conjunction with the rest of the finance statements, provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities.
- Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities.
- It also enhances the comparability.

- Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

Definitions

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and outflows of cash and cash equivalents.

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Investing 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 contributed equity and borrowings of the entity.

Cash and cash equivalents

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, **three months or less** from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preference shares acquired within a short period of their maturity and with a specified redemption date.

Bank borrowings are generally considered to be financing activities. However, where bank overdrafts which are repayable on demand form an integral part of an entity's cash management, bank overdrafts are included as a component of cash and cash equivalents.

Presentation of a statement of cash flows

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

Operating activities

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

1. cash receipts from the sale of goods and the rendering of services;
2. cash receipts from royalties, fees, commissions and other revenue;
3. cash payments to suppliers for goods and services;
4. cash payments to and on behalf of employees;
5. cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;

6. cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and
7. cash receipts and payments from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities.

The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.

An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by financial institutions are usually classified as operating activities since they relate to the main revenue-producing activity of that entity.

Investing activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognized asset in the balance sheet are eligible for classification as investing activities.

Examples of cash flows arising from investing activities are:

1. cash payments to acquire property, plant and equipment, intangibles and other long-term assets.
2. cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
3. cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
4. cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
5. cash advances and loans made to other parties (other than advances and loans made by a financial institution);
6. cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);
7. cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
8. cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Financing activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity.

Examples of cash flows arising from financing activities are:

1. cash proceeds from issuing shares or other equity instruments;
2. cash payments to owners to acquire or redeem the entity's shares;

3. cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;
4. cash repayments of amounts borrowed; and
5. cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities

An entity shall report cash flows from operating activities using either:

- **the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or**
- **the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.**

Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) from the accounting records of the entity; or

(b) by adjusting sales, cost of sales (interest and similar income and interest expense and similar charges for a financial institution) and other items in the statement of profit and loss for:

  (i) changes during the period in inventories and operating receivables and payables;

  (ii) other non-cash items; and

  (iii) other items for which the cash effects are investing or financing cash flows.

- **Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:**
- changes during the period in inventories and operating receivables and payables;
- non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and
- all other items for which the cash effects are investing or financing cash flows.

Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the statement of profit and loss and the changes during the period in inventories and operating receivables and payables.

Reporting cash flows from investing and financing activities

An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows are permitted to be reported on a net basis.

Reporting cash flows on a net basis

If nothing is mentioned as per Ind AS 7, cash flows will be presented on Gross Basis. Gross basis means the receipts would be shown separately and the payments will be shown separately.

Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

- **cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and**

Examples are:

- the acceptance and repayment of demand deposits of a bank;

- funds held for customers by an investment entity; and
- rents collected on behalf of, and paid over to, the owners of properties.
- **cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.**

Examples are advances made for, and the repayment of:

- principal amounts relating to credit card customers;
- the purchase and sale of investments; and
- other short-term borrowings, for example, those which have a maturity period of three months or less.

Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:

- cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;
- the placement of deposits with and withdrawal of deposits from other financial institutions; and
- cash advances and loans made to customers and the repayment of those advances and loans.

Foreign currency cash flows

Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

Interest and dividends

Cash flows from interest and dividends received and paid shall each be disclosed separately.

Cash flows arising from interest paid and interest and dividends received in the case of a financial institution should be classified as cash flows arising from operating activities.

In the case of other entities, cash flows arising from interest paid should be classified as cash flows from financing activities while interest and dividends received should be classified as cash flows from investing activities. Dividends paid should be classified as cash flows from financing activities.

The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with Ind AS 23, Borrowing Costs.

Taxes on income

Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a statement of cash flows. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

Investments in subsidiaries, associates and joint ventures

When accounting for an investment in an associate, a joint venture or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

An entity that reports its interest in an associate or a joint venture using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.

Changes in ownership interests in subsidiaries and other businesses

- The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.
- An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:
- the total consideration paid or received;
- the portion of the consideration consisting of cash and cash equivalents;
- the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and
- the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

Classification of cash flow as financing activity

Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities , unless the subsidiary is held by an investment entity, as defined in Ind AS 110, and is required to be measured at fair value through profit or loss.

Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions , unless the subsidiary is held by an investment entity and is required to be measured at fair value through profit or loss.

Non-cash transactions

Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows as these items do not involve cash flows in the current period. Accordingly, the resulting cash flows are classified in the same way as other transactions with owners described in paragraph 17.

Examples of non-cash transactions are:

- the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;
- the acquisition of an entity by means of an equity issue; and
- the conversion of debt to equity.

Components of cash and cash equivalents

An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the balance sheet.

Other disclosures

An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

There are various circumstances in which cash and cash equivalent balances held by an entity are not available for use by the group.

Examples include cash and cash equivalent balances held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries.

Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:

(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;

(b) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and

(c) the amount of the cash flows arising from the operating, investing and financing activities of each reportable segment (see Ind AS 108, Operating Segments).

Example 1:

An entity sold a machinery (Book Value ₹1,00,000) for ₹72,000. The loss of ₹28,000 debited to the Profit & Loss Account. Is this transaction as Operating Activity?

Answer:

Operating Activities are the principal revenue generating activities. Investing Activities relate to the acquisition and disposal of long-term assets and other investments that are not Cash Equivalents. However, Cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as per Para 68A of Ind AS 16, are Cash Flows from Operating Activities. Cash receipts from rents and subsequent sales of such assets are also Cash Flows from Operating Activities.

The amount of ₹72,000 i.e. the sale proceeds should be shown as an Inflow under Investing Activities. ₹28,000 i.e. loss on sale of asset should be added back to derive Operating Cash Flow, under Indirect Method.

Example 2:

Golden Ltd acquired Fixed Assets viz. Plant and Machinery for ₹60 Lakhs. During the same year, it also sold Furniture and Fixtures for ₹15 Lakhs. Can the Company disclose, Net Cash Outflow towards Purchase of Fixed Assets in the Statement of Cash Flows?

Answer:

Acquisition and Disposal of Fixed Assets is not prescribed for Net-Basis reporting.

The Company **cannot** disclose Net Cash Flow in respect of acquisition of Plant and Machinery and disposal of Furniture and Fixtures.

Indian Accounting Standard 8 — Accounting Policies, Changes in Accounting Estimates & Errors

Objective

The objective of this Standard is —

- to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies,

- accounting treatment and disclosure of changes in accounting estimates and corrections of errors.
- the standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.
- Disclosure requirements for accounting policies, except those are set out in Ind AS 1, Presentation of Financial Statements.

Scope

This Standard shall be applied in —

- selecting and applying accounting policies, and
- accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.
- tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are accounted for and disclosed in accordance with Ind AS 12 'Income Taxes'.

Definitions

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

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

Indian Accounting Standards (Ind ASs) are Standards prescribed under Section 133 of the Companies Act, 2013.

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

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

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

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

Impracticable Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

(a) the effects of the retrospective application or retrospective restatement are not determinable;

(b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

(c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:

(i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and

(ii) would have been available when the financial statements for that prior period were approved for issue from other information.

Prospective application of a change in accounting policy and of recognising the effect of a change in an accounting estimate, respectively, are:

(i) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

(ii) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

Assessing whether an omission or misstatement could influence economic decisions of users, and so be material, requires consideration of the characteristics of those users. The Framework for the Preparation and Presentation of Financial Statements in accordance with Indian Accounting Standards issued by the Institute of Chartered Accountants of India states that 'users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making economic decisions.

Accounting policies

Selection and application of accounting policies

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

Ind ASs set out accounting policies that result in financial statements containing relevant and reliable information about the transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from Ind ASs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Ind ASs are accompanied by guidance that is integral part of Ind AS to assist entities in applying their requirements. Such guidance is mandatory.

In absence of an Ind AS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy that results in information that is:

(a) relevant to the economic decision-making needs of users; and

(b) reliable, in that the financial statements:

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

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

  (iii) are neutral, i.e free from bias;

  (iv) are prudent; and

  (v) are complete in all material respects.

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

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

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

- In making the judgment, management may also **first consider the most recent pronouncements of International Accounting Standards Board** and **in absence thereof those of the other standard-setting bodies** that use a similar conceptual framework to develop accounting standards, **other accounting literature and accepted industry practices, to the extent that these do not conflict with the above judgment.**

Consistency of accounting policies

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an Ind AS specifically requires or permits categorisation of items for which different policies may be appropriate. If an Ind AS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

An entity shall change an accounting policy only if the change:

(a) is required by an Ind AS; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the above criteria.

Which are not changes in accounting policies?

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

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

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

Applying changes in accounting policies

(a) an entity shall account for a change in accounting policy **resulting from the initial application of an Ind AS** in accordance **with the specific transitional provisions**, if any, in that Ind AS. If the changes in accounting policies are due to a new Ind AS then the standard itself will provide a transitional period for implementation of policies and there will be a proper guideline.

(b) when an entity changes an accounting policy upon initial application of an Ind AS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

Early application of an Ind AS is not a voluntary change in accounting policy.

In the absence of an Ind AS that specifically applies to a transaction, other event or condition, management may apply an accounting policy from the most recent pronouncements of International Accounting Standards Board and in absence thereof those of the other standard-setting bodies that use a similar conceptual framework to develop accounting standards. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

Retrospective application

When an accounting policy is applied retrospectively the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

Limitations of retrospective application of policies:

When retrospective application is required for initial application of an Ind AS that does not include specific transitional provisions applying to that change, a change in accounting policy shall be applied retrospectively **except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.**

The entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods **as far back as is practicable.**

Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing balance sheets for that period.

The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity. Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.

The limitations lead the companies to follow the same accounting policies consistently to ensure relevance and reliability of financial statements.

When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, applies the new policy **prospectively from the start of the earliest period practicable.** It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period.

Disclosure

When initial application of an Ind AS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the Ind AS;

(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

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

(d) when applicable, a description of the transitional provisions;

(e) when applicable, the transitional provisions that might have an effect on future periods;

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

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

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

(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(h) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might

have an effect on future periods, an entity shall disclose:

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

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

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

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

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

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:

(a) this fact; and

(b) known or reasonably estimable information relevant to assessing the possible impact that application of the new Ind AS will have on the entity's financial statements in the period of initial application.

Changes in accounting estimates

As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. For example, estimates may be required of:

(a) bad debts;

(b) inventory obsolescence;

(c) the fair value of financial assets or financial liabilities;

(d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and

(e) warranty obligations.

- ❖ The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
- ❖ An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience.
- ❖ By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.
- ❖ A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate.
- ❖ When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.

Accounting Treatment for a change in the estimates:

The effect of change in an accounting estimate shall be recognised prospectively by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

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

Example: A change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

Disclosure

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

Errors

Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period.

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

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

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

Limitations on retrospective restatement

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

When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, **the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable**.

When it is **impracticable to determine the cumulative effect, at the beginning of the current period,** of an error on all prior periods, the **entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.**

Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.

Disclosure of prior period errors

Entity shall disclose the following:

(a) the nature of the prior period error;

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

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

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

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

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

Example 1:

There was a Material Prior Period Error by way of understatement of Salary Expense ₹15 Lakhs. How will you disclose it in the Financial Statements for the Financial Year 2016-2017, if the Salary Expense related to - (a) Financial Year 2015-2016 or (b) Financial Year 2013-2014?

Answer:

Prior Period relating to 2015-16:

Treatment: Financial Statements of 2016-2017, which will have comparative figures of Financial Year 2015-2016 will **re-state comparative amounts** of Salary Expense correctly.

Prior Period relating to 2013-14:

Treatment: Since comparative figures of 2013-2014 are not presented as comparative figures now, the difference of ₹15 Lakhs will be shown by **re-stating the Opening Balances** of Equity, at reduced amount.

Financial statements of subsequent periods need not repeat these disclosures.

Impracticability in respect of retrospective application and retrospective restatement

In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period.

For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) would have been available when the financial statements for that prior period were approved for issue from other information.

For some types of estimates (e.g a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with Ind AS 19, Employee Benefits, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were approved for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Indian Accounting Standard 10 — Events after the Reporting Period

Events after the Reporting Period

Objective

The objective of this Standard is to prescribe:

(i) Whether an entity should adjust its financial statements for events after the reporting period or not;

(ii) the disclosures that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period.

(iii) The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate.

Scope

This Standard shall be applied in the accounting for, and disclosure of, events after the reporting period.

Definitions

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue.

Two types of events can be identified:

(a) those that **provide evidence of conditions that existed at the end of the reporting period** (adjusting events after the reporting period); and

(b) those that are indicative of conditions that **arose after the reporting period** (non-adjusting events after the reporting period).

The standard clearly states that the events can be favourable as well as unfavourable.

Notwithstanding anything contained above, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the agreement by lender before the approval of the financial statements for issue, to not demand payment as a consequence of the breach, shall be considered as an adjusting event.

The process involved in approving the financial statements for issue will vary depending upon the management structure, statutory requirements and procedures followed in preparing and finalising the financial statements.

❖ In some cases, an entity is required to submit its financial statements to its shareholders for approval, after the financial statements have been approved by the Board for issue. In such cases, the financial statements are approved for issue on the date of approval by the Board, not the date when shareholders approve the financial statements.

❖ In some cases, the management of an entity is required to issue its financial statements to a supervisory board (made up solely of non-executives) for approval. In such cases, the financial statements are approved for issue when the management approves them for issue to the supervisory board.

Example

On 18 March 20X2, the management of an entity approves financial statements for issue to its supervisory board. The supervisory board is made up solely of non-executives and may include representatives of employees and other outside interests. The supervisory board approves the financial statements on 26 March 20X2. The financial statements are made available to shareholders and others on 1 April 20X2. The shareholders approve the financial statements at their annual meeting on 15 May 20X2 and the financial statements are then filed with a regulatory body on 17 May 20X2.

The financial statements are approved for issue on 18 March 20X2 (date of management approval for issue to the supervisory board).

Events after the reporting period include all events up to the date when the financial statements are approved for issue, even if those events occur after the public announcement of profit or of other selected financial information.

Recognition and measurement

Adjusting events after the reporting period

An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period.

The following are examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets or recognises a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of Ind AS 37.

(b) the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted.

    For example:

    (i) the bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period; and

    (ii) the sale of inventories after the reporting period may give evidence about their net realisable value at the end of the reporting period.

(c) the determination after the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

(d) the determination after the reporting period of the amount of profit-sharing or bonus payments, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments as a result of events before that date.

    • These is a legal or constructive obligation at the end of the reporting period;

    • The obligation is based on profit sharing or bonus payments.

(e) the discovery of fraud or errors that show that the financial statements are incorrect.

Non-adjusting events after the reporting period

An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period.

An example of a non-adjusting event after the reporting period is a decline in fair value of investments between the end of the reporting period and the date when the financial statements are approved for issue. The decline in fair value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure.

Dividends

If an entity declares dividends to holders of equity instruments (as defined in Ind AS 32, Financial Instruments: Presentation) after the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.

If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognised as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements.

It depends on the fact whether the event existed at the end of the period or not.

Going concern

An entity shall not prepare its financial statements on a going concern basis if management determines after the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.

Deterioration in operating results and financial position after the reporting period may indicate a need to consider whether the going concern assumption is still appropriate. If the going concern assumption is no longer appropriate, the effect is so pervasive that this Standard requires a fundamental change in the basis of accounting, rather than an adjustment to the amounts recognised within the original basis of accounting.

Ind AS 1 specifies required disclosures if:

(a) the financial statements are not prepared on a going concern basis; or

(b) management is aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The events or conditions requiring disclosure may arise after the reporting period.

Disclosure

Date of approval for issue

- **An entity shall disclose the date when the financial statements were approved for issue and who gave that approval. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.**
- It is important for users to know when the financial statements were approved for issue, because the financial statements do not reflect events after this date.

Updating disclosure about conditions at the end of the reporting period

If an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information.

In some cases, an entity needs to update the disclosures in its financial statements to reflect information received after the reporting period, even when the information does not affect the amounts that it recognises in its financial statements. One example of the need to update disclosures is when evidence becomes available after

the reporting period about a contingent liability that existed at the end of the reporting period. In addition to considering whether it should recognise or change a provision under Ind AS 37, an entity updates its disclosures about the contingent liability in the light of that evidence.

Non-adjusting events after the reporting period

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

The following are examples of non-adjusting events after the reporting period that would generally result in disclosure:

(a) a major business combination after the reporting period (Ind AS 103, Business Combinations, requires specific disclosures in such cases) or disposing of a major subsidiary;

(b) announcing a plan to discontinue an operation;

(c) major purchases of assets, classification of assets as held for sale in accordance with Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations, other disposals of assets, or expropriation of major assets by government;

(d) the destruction of a major production plant by a fire after the reporting period;

(e) announcing, or commencing the implementation of, a major restructuring;

(f) major ordinary share transactions and potential ordinary share transactions after the reporting period (Ind AS 33, Earnings per Share, requires an entity to disclose a description of such transactions, other than when such transactions involve capitalisation or bonus issues, share splits or reverse share splits all of which are required to be adjusted under Ind AS 33);

(g) abnormally large changes after the reporting period in asset prices or foreign exchange rates;

(h) changes in tax rates or tax laws enacted or announced after the reporting period that have a significant effect on current and deferred tax assets and liabilities (see Ind AS 12, Income Taxes);

(i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees; and

(j) commencing major litigation arising solely out of events that occurred after the reporting period.

Distribution of Non-cash Assets to Owners

Sometimes an entity distributes assets other than cash (non-cash assets) as dividends to its equity holders.
In those situations, an entity may also give its owners a choice of receiving either non-cash assets or a cash alternative.

Indian Accounting Standards (Ind ASs) do not provide guidance on how an entity should measure distributions to its owners (commonly referred to as dividends). Ind AS 1 requires an entity to present details of dividends recognised as distributions to owners either in the statement of changes in equity or in the notes to the financial statements.

This Appendix applies to the following types of non-reciprocal distributions of assets by an entity to its owners acting in their capacity as owners:

(a) distributions of non-cash assets (e.g. items of property, plant and equipment, businesses as defined in Ind AS 103, ownership interests in another entity or disposal groups as defined in Ind AS 105); and

(b) distributions that give owners a choice of receiving either non-cash assets or a cash alternative.

This applies only to distributions in which all owners of the same class of equity instruments are treated equally.

Non-applicability

This Appendix does not apply to a distribution of a non-cash asset that is ultimately controlled by the same party or parties before and after the distribution. This exclusion applies to the separate, individual and consolidated financial statements of an entity that makes the distribution.

Therefore, for a distribution to be outside the scope of this Appendix on the basis that the same parties control the asset both before and after the distribution, a group of individual shareholders receiving the distribution must have, as a result of contractual arrangements, such ultimate collective power over the entity making the distribution.

This Appendix does not apply when an entity distributes some of its ownership interests in a subsidiary but retains control of the subsidiary. The entity making a distribution that results in the entity recognising a non-controlling interest in its subsidiary accounts for the distribution in accordance with Ind AS 110.

This Appendix addresses only the accounting by an entity that makes a non-cash asset distribution. It does not address the accounting by shareholders who receive such a distribution.

Issues

When an entity declares a distribution and has an obligation to distribute the assets concerned to its owners, it must recognise a liability for the dividend payable.

Consequently, this Appendix addresses the following issues:

(a) When should the entity recognise the dividend payable?

(b) How should an entity measure the dividend payable?

(c) When an entity settles the dividend payable, how should it account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable?

Accounting Principles

When to recognise a dividend payable

The liability to pay a dividend shall be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity, which is the date:

(a) when declaration of the dividend, e.g. by management or the board of directors, is approved by the relevant authority, e.g. the shareholders, if the jurisdiction requires such approval, or

(b) when the dividend is declared, e.g. by management or the board of directors, if the jurisdiction does not require further approval.

Measurement of a dividend payable

An entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed.

If an entity gives its owners a choice of receiving either a non-cash asset or a cash alternative, the entity shall estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative.

At the end of each reporting period and at the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable, with any changes in the carrying amount of the dividend payable recognised in equity as adjustments to the amount of the distribution.

An entity should account for any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable when an entity settles the dividend payable.

Presentation and disclosures

An entity shall present the difference described above as a separate line item in profit or loss.

An entity shall disclose the following information, if applicable:

(a) the carrying amount of the dividend payable at the beginning and end of the period; and

(b) the increase or decrease in the carrying amount recognised in the period as result of a change in the fair value of the assets to be distributed.

If, after the end of a reporting period but before the financial statements are approved for issue, an entity declares a dividend to distribute a non-cash asset, it shall disclose:

(a) the nature of the asset to be distributed;

(b) the carrying amount of the asset to be distributed as of the end of the reporting period; and

(c) the fair value of the asset to be distributed as of the end of the reporting period, if it is different from its carrying amount, and the information about the method(s) used to measure that fair.

Example 1:

As at 31st March, Cost of Investments is ₹ 1,50,000, Market Value ₹ 1,80,000. Its value declines to ₹ 80,000 on 25th April. How should the Entity consider the above in its Financial Statements?

Answer:

Decline in Fair Value of Investments does not normally relate to the condition of the Investments at the end of the reporting period, but reflects circumstances that have arisen **subsequently.**

The Entity does should **not adjust** the amounts recognised in its Financial Statements for the Investments, or

Should not update the amounts disclosed for the Investments as at the end of the reporting period.

The Entity may need to give **Additional Disclosure.**

Example 2:

State the accounting requirements in case of Settlement after the Reporting Period, of a Court Case, that confirms that the Entity had a present obligation at the end of the Reporting Period.

Answer:

It is an Adjusting Event.

The Entity **shall adjust** any previously recognised provision related to this Court Case in accordance, or **shall recognise** a new provision.

The Entity does not merely disclose a Contingent Liability because the settlement provides additional evidence that would be considered accordingly.

Indian Accounting Standard 101— First-time Adoption of Indian Accounting Standards

Objective

The objective of this Ind AS is to ensure that an entity's first Ind AS financial statements, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:

(a) is transparent for users and comparable over all periods presented;

(b) provides a suitable starting point for accounting in accordance with Indian Accounting Standards (Ind ASs); and

(c) can be generated at a cost that does not exceed the benefits.

Scope

An entity shall apply this Ind AS in:

(a) its first Ind AS financial statements; and

(b) each interim financial report for part of the period covered by its first Ind AS financial statements.

This Ind AS does not apply to changes in accounting policies made by an entity that already applies Ind ASs.

Definitions

First Ind AS financial statements

The first annual financial statements in which an entity adopts Indian Accounting Standards (Ind ASs), by an explicit and unreserved statement of compliance with Ind ASs.

First-time adopter

An entity that presents its first Ind AS financial statements.

Opening Ind AS Balance Sheet

An entity's Balance Sheet at the date of transition to Ind ASs.

Date of transition to Ind ASs

The beginning of the earliest period for which an entity presents full comparative information under Ind ASs in first Ind AS financial statements.

First Ind AS reportin period

The latest reporting period covered by an entity's first Ind AS Financial Statements.

Deemed cost

An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.

Fair Value

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

Previous GAAP

The basis of accounting that a first-time adopter used for its statutory reporting requirement in India immediately before adopting Ind AS's. For instance, companies required to prepare their financial statements in accordance with Section 133 of the Companies Act, 2013, shall consider those financial statements as previous GAAP financial statements.

Example 1:

Until 31st March, 2017 a Company had been preparing and presenting the financial statements in line with the Companies(AS) Rules. With effect from accounting year beginning on or after 1st April 2017, the company is required to prepare and present its Financial Statements in line with Ind AS. In this case the date of transition to Ind AS is — 1st April, 2016.

Recognition and measurement

Opening Ind AS Balance Sheet

An entity shall prepare and present an opening Ind AS Balance Sheet at the date of transition to Ind ASs.

In its opening balance sheet —

- An entity shall recognise all the assets and liabilities whose recognition is required by Ind AS;
- It shall not recognise any item as its assets or liabilities if Ind AS does not allow;
- Apply any Ind AS for the measurement of its assets and liabilities;
- An entity can reclassify its assets or liabilities which may differ from the classification that was made as per previous GAAP.

Accounting policies

❖ An entity shall use the same accounting policies in its opening Ind AS Balance Sheet and throughout all periods presented in its first Ind AS financial statements. Those accounting policies shall comply with each Ind AS effective at the end of its first Ind AS reporting period, subject to the following:
  - Exceptions that are mandatory
  - Some exemptions which are optional

❖ An entity shall not apply different versions of Ind ASs that were effective at earlier dates. An entity may apply a new Ind AS that is not yet mandatory if that Ind AS permits early application.

Example: Consistent application of latest version of Ind ASs

The end of entity A's first Ind AS reporting period is 31 March 2017. Entity A decides to present comparative information in those financial statements for one year only. Therefore, its date of transition to Ind ASs is the beginning of business on 1 April 2015 (or, equivalently, close of business on 31 March 2015). Entity A presented financial statements in accordance with its previous GAAP annually to 31 March each year up to, and including, 31 March 2016.

Application of requirements

Entity A is required to apply the Ind ASs effective for periods ending on 31 March 2017 in:

(a) preparing and presenting its opening Ind AS balance sheet at 1 April 2015; and

(b) preparing and presenting its balance sheet for 31 March 2017 (including comparative amounts for the year ended 31 March 2016), statement of profit and loss, statement of changes in equity and statement of cash flows for the year to 31 March 2017 (including comparative amounts for the year ended 31 March 2016) and disclosures (including comparative information for the year ended 31 March 2016).

If a new Ind AS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that Ind AS in its first Ind AS financial statements.

Exceptions or exemptions can be mandatory or optional.

The accounting policies that an entity uses in its opening Ind AS Balance Sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to Ind Ass, therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to Ind ASs.

This Ind AS establishes two categories of exceptions/ exemptions to the principle that an entity's opening Ind AS Balance Sheet shall comply with each Ind AS:

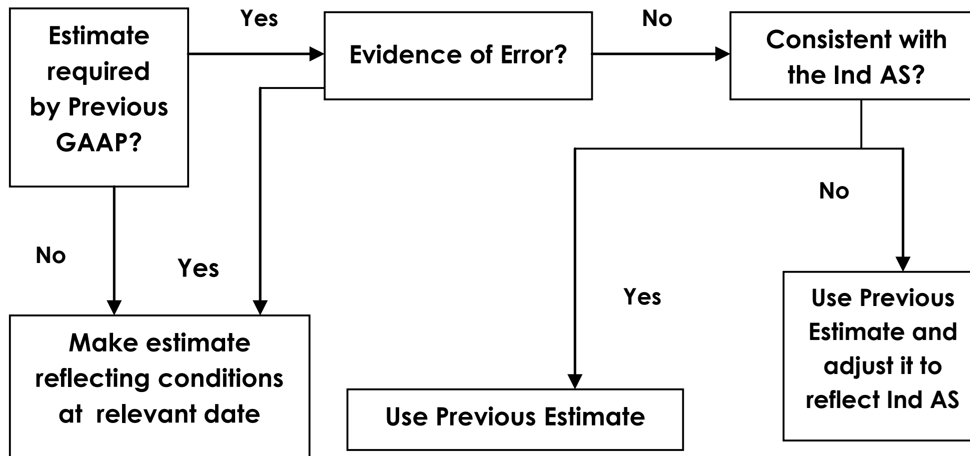
(a) Exceptions to retrospective application of some aspects of other Ind Ass these are mandatory;

(b) exemptions from some requirements of other Ind Ass these are optional.

Exceptions to retrospective application of some aspects of other Ind Ass:

An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

- **Estimates**



Derecognition of financial assets and financial liabilities

A first-time adopter shall apply the derecognition requirements in Ind AS 109 prospectively for transactions occurring on or after the date of transition to Ind ASs.

For example, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction that occurred before the date of transition to Ind ASs, it shall not recognise those assets and liabilities in accordance with Ind ASs (unless they qualify for recognition as a result of a later transaction or event).

An entity may apply the derecognition requirements in Ind AS 109 retrospectively from a date of the entity's choosing, provided that the information needed to apply Ind AS 109 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

Hedge accounting

At the date of transition to Ind ASs an entity shall:

(a) measure all derivatives at fair value; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported in accordance with previous GAAP as if they were assets or liabilities.

An entity shall not reflect in its opening Ind AS Balance Sheet a hedging relationship of a type that does not qualify for hedge accounting in accordance with Ind AS 109 However, if an entity designated a net position as a hedged item in accordance with previous GAAP, it may designate as a hedged item in accordance with Ind ASs an individual item within that net position, or a net position if that meets the requirements in Ind AS 109, provided that it does so no later than the date of transition to Ind ASs.

If, before the date of transition to Ind ASs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in Ind AS 109, the entity shall apply Ind AS 109 to discontinue hedge accounting. Transactions entered into before the date of transition to Ind ASs shall not be retrospectively designated as hedges.

Non-controlling interests

A first-time adopter shall apply the following requirements of Ind AS 110 prospectively from the date of transition to Ind ASs:

- total comprehensive income is attributed 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;
- accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- accounting for a loss of control over a subsidiary, and the related requirements of of Ind AS 105, Non-current Assets Held for Sale and Discontinued Operations.

Classification and measurement of financial assets

An entity shall assess whether a financial asset meets the conditions of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs.

- If it is impracticable to assess a modified time value of money element, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind ASs without taking into account the requirements related to the modification of the time value of money element. An entity shall disclose the carrying amount at the reporting date of the financial assets until those financial assets are derecognized.
- If it is impracticable to assess whether the fair value of a prepayment feature is insignificant on the basis of the facts and circumstances that exist at the date of transition to Ind-ASs, an entity shall assess the contractual cash flow characteristics of that financial asset on the basis of the facts and circumstances that existed at the date of transition to Ind-ASs without taking into account the exception for prepayment features. An entity shall disclose the carrying amount at the reporting date of the financial assets until those financial assets are derecognised.
- If it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind ASs shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind ASs.

Impairment of financial assets

An entity shall apply the impairment requirements of Ind AS 109 retrospectively subject to the following:

- At the date of transition to Ind ASs, an entity shall use reasonable and supportable information that is available without undue cost or effort to determine the credit risk at the date that financial instruments were initially recognised
- An entity is not required to undertake an exhaustive search for information when determining, at the date of transition to Ind ASs, whether there have been significant increases in credit risk since initial recognition.
- If, at the date of transition to Ind ASs, determining whether there has been a significant increase in credit risk since the initial recognition of a financial instrument would require undue cost or effort, an entity shall recognise a loss allowance at an amount equal to lifetime expected credit losses at each reporting date until that financial instrument is derecognized.

Embedded derivatives

A first-time adopter shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required as per Ind AS 109.

Government loans

A first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32, Financial Instruments: Presentation.

The first-time adopter shall apply the requirements in Ind AS 109, Financial Instruments, and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the government loan at a below-market rate of interest as a government grant.

Optional Exemptions

1. **Business Combination**

Ind AS 103 is not required to be applied to combinations before the date of transition. If any combination is restated all subsequent combinations are to be restated.

If the exemption is used —

i. There will not be any change in classification;

ii. Assets and Liabilities of past combination are measured at carrying amount.

iii. Assets and Liabilities measured at fair value restated at date of transition – adjusted retained earnings.

2. **Share –based payment transactions**

Apply Ind AS 102 to share-based payments vested/settled after date of transition to Ind AS.

3. **Insurance Contracts**

An entity will apply Ind AS 104 for annual periods beginning on or after date of transition to Ind AS.

Insurer changes the accounting policies for liabilities and it can reclassify some or all of the financial assets.

4. **Cumulative translation differences**

- **Need not to:**
  - Recognise some translation differences in other comprehensive income.
  - Reclassify cumulative translation differences for foreign operation from entity to profit or loss as part of gain or loss on its disposal.
- **If first time adopter uses this exemption:**
  - Cumulative translation differences set to zero for all foreign operations.
  - Gain/loss on a subsequent disposal of a foreign operation shall exclude these differences that arose before transition.
- **Long term foreign currency monetary items**
- A first time adopter may continue the policy adopted for accounting for exchange differences arising from long term monetary foreign currency items, as per previous GAAP.

5. **Deemed cost of PPE, intangible assets and investment property**

- Fair value will be used as deemed cost or
- Revaluation as deemed cost provided comparable to fair value or cost/depreciated cost at the date of revaluation or
- Carrying value as recognized in Financial Statement as per previous GAAP as at the transition date.

6. **Investment in subsidiaries, joint ventures and associates** are measured at cost. Which can be measured as per Ind AS 27 or can be deemed cost.

- **Designation of previously recognised financial instruments**
- Ind AS 109 permits a financial liability (provided it meets certain criteria) to be designated as a financial liability at fair value through profit or loss. An entity may designate an investment in an equity instrument as at fair value through other comprehensive income on the basis of the facts and circumstances that exist at the date of transition.

7. **Compound financial instruments**
   - Need not split the compound financial instruments into separate liability and equity component, if liability component not outstanding as at transition date.

8. **Designation of previously recognized financial instruments**
   - Any financial liability may be designated at fair value through profit or loss at transition date.
   - Any financial asset may be designated at fair value through profit or loss at transition date.
   - Investment in equity may be designated at fair value through other comparative income at transition date.
   - If retrospectively application of effective interest method or impairment requirement is impracticable – fair value shall be new amortised cost of financial asset on the date of transition.

9. **Fair value measurement of financial assets of financial liabilities**
   - **May apply requirement of Ind AS 109 prospectively to transactions entered into on or after the date of transition.**

10. **Decommissioning liabilities included in PPE**
    - Need not comply with the requirement for changes in such liabilities that accounted before that date of transition.
    - Liabilities are to be measured at the transition date as per Ind AS 37 and recognize its effect.

11. **Financial assets or intangible assets accounted for in accordance Service Concession Arrangements**

    Changes in accounting policies are accounted for in accordance with Ind AS 8, i.e. retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP

    If, for any particular service arrangement, it is impracticable for an operator to apply this Appendix retrospectively at the date of transition to Ind ASs, it shall recognise financial assets and intangible assets that existed at the date of transition to Ind Ass using the previous carrying amounts.

12. **Extinguishing financial liabilities with equity instruments**

    A first-time adopter may apply the Ind AS 109 from the date of transition to Ind ASs.

13. **Severe hyperinflation**
    - In hyperinflation, when date of transition to Ind AS is on or after the functional currency normalisation date, then all assets and liabilities held before the functional currency normalisation date may be taken at fair value on the date of transition.
    - Fair value may be used as a deemed cost of those assets and liabilities in the opening Ind AS statement of financial position.

14. **Leases**

    A first time adopter may determine whether an arrangement existing at the date of transition to Ind AS contain a lease on the basis of facts and circumstances existing on the date of transition.

15. **Designation of contract to buy or sell a non-financial item**

An entity may designate at the date of transition to Ind AS, contract that already exist on that date as measured at fair value through profit or loss but only if they meet the requirements of Ind AS 109 at the date and the entity designate all the similar contracts.

16. **Stripping costs in the production phase of a surface mine**

A first-time adopter may apply the Appendix B of Ind AS 16 from the date of transition to Ind ASs.

17. **Assets and liabilities of subsidiaries, joint ventures and associates in CFS**

a. **If subsidiary becomes a first time adopter later than its parent**

– Carrying amount based on parent's date of transition to Ind AS if no adjustment made for consolidated procedures and for the effects of business combination; or

– Carrying amounts required by the rest of this Ind AS, based on the subsidiary's date of transition.

b. If parent becomes a first time adopter later than its subsidiary

– Same carrying amounts as in financial statement of the subsidiary, after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary.

18. **Revenue from contracts with customers**

A first-time adopter may use one or more of the following practical expedients when applying Ind AS 115 retrospectively:

- for completed contracts, an entity need not restate contracts that begin and end within the same annual reporting period;
- for completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods; and
- for all reporting periods presented before the beginning of the first Ind AS reporting period, an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue.

19. **Non-current assets held for sale and discontinued operations**

Ind AS 105 requires non-current assets (or disposal groups) that meet the criteria to be classified as held for sale, non-current assets (or disposal groups) that are held for distribution to owners and operations that meet the criteria to be classified as discontinued and carried at lower of its carrying amount and fair value less cost to sell on the initial date of such identification. A first time adopter can:

- measure such assets or operations at the lower of carrying value and fair value less cost to sell at the date of transition to Ind ASs in accordance with Ind AS 105; and
- recognise directly in retained earnings any difference between that amount and the carrying amount of those assets at the date of transition to Ind ASs determined under the entity's previous GAAP.

20. **Joint arrangements:**

a. Transition from Proportionate Consolidation to Equity Method

b. Transition from Equity Method to accounting for assets and liabilities

c. Transitional provisions in entity's Separate Financial Statement.

Presentation and Disclosure:

Comparative information and historical summaries

Some entities present historical summaries of selected data for periods before the first period for which they present full comparative information in accordance with Ind ASs. This Ind AS does not require such summaries to comply with the recognition and measurement requirements of Ind ASs. Furthermore, some entities present comparative information in accordance with previous GAAP as well as the comparative information required by Ind AS 1. In any financial statements containing historical summaries or comparative information in accordance with previous GAAP, an entity shall:

(i) label the previous GAAP information prominently as not being prepared in accordance with Ind ASs; and

(ii) disclose the nature of the main adjustments that would make it comply with Ind ASs. An entity need not quantify those adjustments.

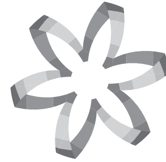
Explanation of Transition to Ind AS

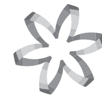
Reconciliation of

(a) equity from previous GAAP to Ind AS at transition and end of last year;

(b) last year's total comprehensive income under GAAP to Ind AS.

- Sufficient details to understand adjustments to each line item.
- Reconciliation to distinguish correction of errors identified during transition from change in accounting policy.
- Fair value as deemed cost and the amount of the adjustment.
- If adopted first time exemption option, to disclose the fact and accounting policy until such time those PPE, Intangible Assets, investment properties or intangible assets significantly depreciated/impaired/derecognized.
- Interim financial reports to include reconciliation with equity and profit or loss under previous GAAP.
- Further information to comply with Ind AS 34.

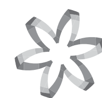




Section B

Accounting of Business Combinations & Restructuring

(Syllabus - 2016)



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 +1.21/1.1^2)	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	
To Realization A/c			159.00
(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	
To Equity Shareholders A/c			15.00
(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)

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.

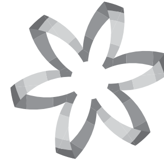
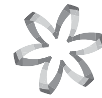
(Abstract) Consolidated Balance Sheet **₹ Lakhs**

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**

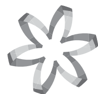
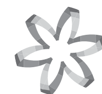
Note 1:

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

Section C
Consolidated Financial Statements
(Syllabus - 2016)

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)

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	212000x
Inventories	45000	50000	+5000	-5000	13000	58000Y
Financial Assets	78000	60000	-18000		10000	70000Z

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	212000X	512000
Goodwill			10000#
Investment in Q	138000		
Financial Assets	120000	70000Z	190000
Inventories	80000	58000Y	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 ₹ 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

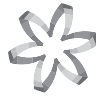
(b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

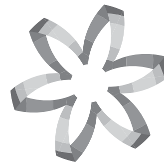
About interests in unconsolidated structured entities:

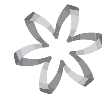
An entity shall disclose information that enables users of its financial statements:

(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.



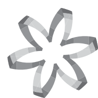




Section D

Developments in Financial Reporting and Other Item of Reporting

(Syllabus - 2016)



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.

4.2 CONCEPT OF TRIPLE BOTTOM LINE (TBL)

The phrase "triple bottom line" was first coined in 1994 by John Elkington, the founder of a British consultancy called 'Sustain Ability'. He further articulated the concept in his 1997 book '*Cannibals with Forks: The Triple Bottom Line of 21st Century Business*'.

The concept of 'Triple bottom line 'incorporates two technical terminologies – 'Triple' and 'Bottom Line'. We first understand these two for better understanding of the concept of Triple bottom line reporting.

- **Bottom Line:** In traditional accounting and common parlance, the "bottom line" refers to either the "operating result", which is usually recorded at the very last line (or, bottom) of the income statement. Over the last few decades, environmentalists and advocates of social justice have been challenged to introduce a broader concept of 'bottom line' into public consciousness by introducing full cost accounting.
- **Triple:** The Triple bottom line concept requires an organisation to measure and report on three dimensions viz. social, environmental and economic/ financial performance of the organisation.

For example, a leather tanning firm may report a financial profit, but their output may cause adverse health effect, and pollute the nearby water reserves; and the government may end up spending the taxpayer money on health care and environmental clean-up. Now the question that arises in the mind of the proponents of full-cost accounting is 'How do we perform a full societal cost benefit analysis?' in this respect, the triple bottom line adds two more "bottom lines", namely, social and environmental (ecological) concerns.

Thus, the concept of 'triple bottom line' consists of three dimensions, namely 'social equity', 'economic', and 'environmental factors'. In other words, the triple bottom line (TBL) consists of three Ps: profit, people and planet. It aims to measure the financial, social and environmental performance of the corporation over a period of time. At it's core, triple bottom line thinking ties the social and environmental impact of an organization's activities to its economic performance. Thus, it is also referred to as "TBL," "3BL," "People, Planet, Profit" and "The Three Pillars."

However, it is to be noted that TBL does not mean that companies are required to maximise returns across three dimensions of performance - in terms of corporate performance, it is recognized that financial performance is the primary consideration in assessing its business success.

4.3 CONCEPT OF TRIPLE BOTTOM LINE REPORTING

Triple bottom line reporting (TBLR) expands the traditional reporting framework to take into account social and environmental performance in addition to financial performance. The concept of Triple bottom line reporting states that reporting should incorporate the social, environmental and financial performance of an organization.

TBL reporting refers to the publication of economic, environmental and social information in an integrated manner that reflects activities and outcomes across these three dimensions of a company's performance. Triple Bottom Line Reporting requires that organisations should be reporting on three different 'bottom lines' that are quite distinct, but related from one another. They are discussed hereunder:

- The first bottom line happens to be the bottom line of the "income statement" (which is the traditional measure of operating result).
- The second bottom line is that of anorganisation's "people account" (a measure in some shape or form of how socially responsible an organisation has been throughout its operations); and
- The third bottom line is that of the organisation's "planet account" (which measures how environmentally responsible the company has been).

Thus, only a company that produces a TBL reports is taking account of the full cost involved in doing business.

4.4 BENEFITS OF TRIPLE BOTTOM LINE REPORTING

The benefits emerging from triple bottom line reporting are discussed hereunder:

- **Enhancement of reputation and brand:** Corporate reputation is a function of the way in which a company is perceived by its stakeholders. Effective communication with stakeholders on one or more of the environmental, social, and economic dimensions can play an important role in managing stakeholder perceptions and, in doing so, protect and enhance corporate reputation.
- **Securing a social license to operate:** A 'license to operate' is not a piece of paper, but informal community and stakeholder support for an organisation's operations. Business is increasingly recognising the link between ongoing business success and its 'license to operate', especially in the resources sector. Communication with stakeholders is often critical to securing and maintaining a 'license to operate'. Communities and stakeholders generally, are likely to be more supportive of companies that communicate openly and honestly about their management and performance in relation to environmental, social and economic factors.
- **Attraction and retention of high calibre employees:** Existing and prospective employees have expectations about corporate environmental, social and economic behaviour, and include such factors in their decisions regarding working for an organisation.. The publication of TBL-related information can play a role in positioning an employer as an 'employer of choice' which can enhance employee loyalty, reduce staff turnover and increase a company's ability to attract high quality employees.
- **Improved access to investor market:** A growing number of investors are including environmental and social factors within their decision-making processes. The growth in socially responsible investment and shareholder activism is evidence of this. Responding to investor requirements through the publication of TBL-related information is a way of ensuring that the company is aligning its communication with this stakeholder group, and therefore enhancing its attractiveness to this segment of the investment market.
- **Establish position as a preferred supplier:** Obtaining a differentiated position in the market place is one way to establish the status of preferred supplier. Effectively communicating with stakeholder groups on environmental, social and economic issues is central to obtaining a differentiated position in the market place.
- **Reduced risk profile:** There is an expanding body of evidence to suggest that performance in respect of economic, social and environmental factors has the capacity to affect the views of market participants about a company's exposure to, and management of risk. TBL reporting enables a company to demonstrate its commitment to effectively managing such factors and to communicate its performance in these areas. A communication policy that addresses these issues can play an important role in the company's overall risk management strategy.
- **Identification of potential cost savings:** TBL reporting often involves the collection, collation and analysis of data on resource and materials usage, and the assessment of business processes. For example, this can enable a company to better identify opportunities for cost savings through more efficient use of resources and materials.
- **Increased scope for innovation:** The development of innovative products and services can be facilitated through the alignment of R&D activity with the expectations of stakeholders. The process of publishing TBL reporting provides a medium by which companies can engage with stakeholders and understand their priorities and concerns.
- **Aligning stakeholder needs with management focus:** External reporting of information focuses management attention on not only the integrity of the data but also the continuous improvement of the indicator being reported.
- **Creation of sound basis for stakeholder dialogue:** Publication of TBL reporting provides a powerful platform for engaging in dialogue with stakeholders. Understanding stakeholder requirements and alignment of business performance with such requirements is fundamental to business success. TBL reporting demonstrates to stakeholders the company's commitment to managing all of its impacts, and, in doing so, establishes a sound basis for stakeholder dialogue to take place.

In addition to the benefits obtained through superior relationships with key stakeholder groups, the decision to be publicly accountable for environmental and social performance is often recognised as a powerful driver of internal behavioural change. The availability of relevant information on economic, environmental and social performance that previously may not have been collected and evaluated in a readily understood manner may enable executives to identify and focus attention on specific aspects of corporate performance where improvement is required.

4.5 IMPLEMENTATION OF TRIPLE BOTTOM LINE REPORTING

Prerequisites of implementation of TBL Reporting

TBL reporting would be of little relevance to the reporting company or its stakeholders if it is not **aligned to the company's overall business strategy**. A decision to move to full TBL reporting should not be taken lightly. It must have **senior management endorsement and commitment**, as it may have major resource implications, and a half-hearted approach is likely to be worse than not adopting it all.

Strategy for implementation

Critical issues for consideration in the development and implementation of TBL reporting include:

- clear definition of the role of TBL reporting in driving strategic business objectives;
- establishment of the resource and cost requirements;
- awareness of associated legal implications; and
- understanding the risks involved in publishing TBL information.

Key Challenges for Implementation

The key challenges for implementation of TBL reporting framework are:

- Awareness of relevant issues associated with TBL reporting;
- Understanding stakeholder requirements;
- Aligning TBL reporting with objectives and risks; and
- Determining and measuring performance indicators.

4.6 FORMS OF TBL REPORTING

A number of options, ranging from the inclusion of minimal TBL-related information within statutory reporting through to the publication of a full TBL report, are available to companies considering TBL reporting.

In choosing an appropriate path forward, companies are likely to take into account various factors including:

- the overall strategic objectives;
- current capacity to report;
- prioritization of stakeholder requirements; and
- the reporting activities within the industry sector.

4.7 USERS OF TBL REPORTING

All types of entities viz. Businesses, non-profits organisations and government entities alike can all use the TBL.

Businesses: The TBL and its core value of sustainability have become compelling in the business world due to accumulating anecdotal evidence of greater long-term profitability. For example, reducing waste from packaging can also reduce costs. Among the firms that have been exemplars of these approaches are General Electric, Unilever, Proctor and Gamble, 3M among others.

Non-profit Organisations: Many non-profit organizations have adopted the TBL and some have partnered with private firms to address broad sustainability issues that affect mutual stakeholders. Companies recognize that aligning with nonprofit organizations makes good business sense, particularly those nonprofits with goals of economic prosperity, social well-being and environmental protection.

Government: State, regional and local governments are increasingly adopting the TBL and analogous sustainability assessment frameworks as decision-making and performance-monitoring tools.

4.8 FINANCIAL REPORTING VIS-À-VIS TRIPLE BOTTOM LINE REPORTING

Origin: The origination of financial reporting precedes that of Triple bottom line reporting, the latter being just a few decades old.

Nature: It is mandatory for corporates to prepare and present their financial reports; while preparation of full TBL reports including social and environmental dimension is voluntary in nature.

Scope: Triple bottom line reporting is broader in scope than financial reporting, as the former includes the reporting of social and environmental performances in addition to the financial performance of an organisation.

Contents: The information contained within a TBL report is of a different nature to that included in a financial report. Thus, TBL reporting enables environmental and social risks that have the capacity to materially affect long-term financial performance to be identified and, therefore, taken into consideration when preparing financial reports.

4.9 CHALLENGES OF TRIPLE BOTTOM LINE REPORTING FRAMEWORK

The primary challenge in TBL Reporting is the calculation of the TBL**.** The 3Ps under TBL reporting framework are not measured using any common unit. Profits are expressed in monetary amounts. But is it possible to measure social capital in it? What about environmental or ecological health? Finding a common unit of measurement is one challenge.

Some proponents of TBL concept suggest monetizing all the dimensions of the TBL, including social welfare or environmental damage. While that would have the benefit of having a common monetary unit, it would be a big challenge. The challenge lies in identifying the proper method of finding the right price for lost environment and social value creation.

Solution to the Challenge

The solution advocated by some experts of the field has been to calculate the TBL in terms of an index. In this way, it would be possible to eliminate the incompatible units issue and, as long as there is a universally accepted accounting method, it would allow for comparisons between entities, e.g., comparing performance between companies, cities, development projects or some other benchmark.

An example of an index that compares a county versus the nation's performance for a variety of components is the Indiana Business Research Center's Innovation Index. However, there remains some subjectivity even when using an index regarding:

- How are the index components weighted?
- Would each "P" get equal weighting?
- What about the sub-components within each "P"?
- Do they each get equal weighting?
- Is the 'People' category more important than the 'Planet'?
- Who would take decision in these respect?

Another option would do away with measuring sustainability in monetary terms or using an index. It suggests each sustainability measure would stand alone. For example, "Acres of wetlands" would be a measure, and progress would be expressed based on wetland creation, destruction or status quo over time. The downside to this approach is the proliferation of metrics that may be pertinent to measuring sustainability. The TBL user may get 'metric fatigue'.

Having discussed the difficulties with calculating the TBL, we turn our attention to potential metrics for inclusion in a TBL calculation. Following that, we will discuss how businesses and other entities have applied the TBL framework.

4.10 CORPORATE SOCIAL RESPONSIBILITY REPORTING (CSR Reporting)

What is CSR?

The WBCSD defines Corporate Social Responsibility (CSR) as "the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large." As mentioned by United Nations Industrial Development Organization (UNIDO), "Corporate social responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple-Bottom-Line- Approach"), while at the same time addressing the expectations of shareholders and stakeholders."

CSR in India:

In India, the Companies Act, 2013 has introduced the idea of CSR to the forefront. The Ministry of Corporate Affairs, Government of India notified the Section 135 of the Companies Act, 2013 along with Companies (Corporate Social Responsibility Policy) Rules, 2014 "hereinafter CSR Rules" and other notifications related thereto which makes it mandatory (with effect from 1st April, 2014) for certain companies who fulfill the criteria as mentioned under Sub Section 1 of Section 135 to comply with the provisions relevant to Corporate Social Responsibility. As per the said section, the companies having Net worth of INR 500 crore or more; or Turnover of INR 1000 crore or more; or Net Profit of INR 5 crore or more during any financial year shall be required to constitute a Corporate Social Responsibility Committee of the Board "hereinafter CSR Committee" with effect from 1st April, 2014. The above provision requires every company having such prescribed Net worth or Turnover or Net Profit shall be covered within the ambit of CSR provisions. The section has used the word "companies" which connotes a wider meaning and shall include the foreign companies having branch or project offices in India.

What a company covered under CSR needs to do?

Once a company is covered under the ambit of the CSR, it shall be required to comply with the provisions of the CSR. The companies covered under the Sub section 1 of Section 135 shall be required to do the following activities:

I. As provided under Section 135(1) itself, the companies shall be required to constitute CSR Committee. The CSR Committee shall be comprised of 3 or more directors, out of which at least one director shall be an independent director.

II. The Board's report shall disclose the compositions of the CSR Committee.

III. All such companies shall spend, in every financial year, **at least two per cent of the average net profits** of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. It has been clarified that the average net profits shall be calculated in accordance with the provisions of Section 198 of the Companies Act, 2013. Also, proviso to the Rule provide 3(1) of the CSR Rules that the net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in accordance with the provisions of clause (a) of sub-section (1) of section 381 and section 198 of the Companies Act, 2013.

CSR Activities:

Activities may be included by the company in their CSR Policy as per Schedule VII of the Companies Act, 2013:

I. Eradicating extreme hunger and poverty;

II. Promotion of education;

III. Promoting gender equality and empowering women;

IV. Reducing child mortality and improving maternal health;

V. Combating HIV, AIDS, malaria and other diseases;

vi. Ensuring environmental sustainability;

vii. Employment enhancing vocational skills;

viii. Social business projects;

ix. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

x. Such other matters as may be prescribed.

CSR Reporting:

Rule 8 of the CSR Rules provides that the companies, upon which the CSR Rules are applicable on or after 1st April, 2014 shall be required to incorporate in its Board's report an annual report on CSR containing the following particulars:

- A brief outline of the company's CSR Policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs;
- The composition of the CSR Committee;
- Average net profit of the company for last three financial years;
- Prescribed CSR Expenditure (2% of the amount of the net profit for the last 3 financial years);
- Details of CSR Spent during the financial year;
- In case the company has failed to spend the 2% of the average net profit of the last three financial year, reasons thereof;
- A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

The disclosure of contents of Corporate Social Responsibility Policy in the Board's report and on the company's website, if any, shall be as per annexure attached to the CSR Rules.

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 [Amended]

5.5 Valuation of Goodwill

5.1 RECOGNITION & VALUATION OF FINANCIAL INSTRUMENTS (Ind AS-32, Ind AS-107 & Ind AS-109)

Ind AS 32: Financial Instruments: Presentation

Objective:

The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

Scope:

This Standard shall be applied by all entities to all types of financial instruments except:

- Share based payments
- Insurance contracts
- employers' rights and obligations under employee benefit plans, to which Ind AS 19 Employee Benefits applies.
- Interests in subsidiaries, associates and joint ventures

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Definition: A financial asset is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

  (i) to receive cash or another financial asset from another entity; or

  (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:

  (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

  (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

A. Examples of financial assets:

(a) Cash: Cash is by definition a financial asset. It includes cash held in foreign currency.

(b) An equity instrument of another entity: Suppose X purchases 200 shares in Y, the investment will meet the definition of financial asset.

(c) a contractual right to receive cash or another financial asset from another entity: A simple example of such an asset is trade receivable as it represents contractual right to receive cash.

(d) a contractual right to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity: Example of such an asset is a contract held by an entity to buy 100 kg oranges for ₹ 100/kg while the current selling price of oranges is ₹ 120/kg.

A financial liability is any liability that is:

(a) contractual obligation :

  (i) to deliver cash or another financial asset to another entity; or

  (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

  (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

  (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

A. Example of financial liability:

B Ltd. takes a ₹ 10 lakhs loan from C Ltd. B Ltd. will repay the loan in 1 year in shares of B Ltd. The number of shares is variable as it will be determined by dividing ₹ 10 lakhs by the share price at the end of 1 year.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

This standard provides rules for classification of a financial instrument into:

- Financial asset
- Financial liability
- Equity instrument

Examples of classification:

(a) Borrowing from banks: It is classified as financial liability as it is an obligation to deliver cash.

(b) bank deposits: It is classified as financial asset as it gives right to receive cash.

(c) Investment in shares of a company: It is classified as financial asset as it is equity instrument of another entity.

(d) Forward contract in the money: It is classified as financial asset as it is a favorable contract.

(e) Redeemable preference share: It is classified as financial liability as it is an obligation to deliver cash on redemption.

Ind AS 107: Financial Instruments: Disclosures

Objective:

The objective of this Indian Accounting Standard (Ind AS) is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The principles in this Ind AS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in Ind AS 32, Financial Instruments: Presentation, and Ind AS 109, Financial Instruments.

Scope:

This Standard shall be applied by all entities to all types of financial instruments except those specified in the standard:

- Interests in subsidiaries, associates and joint ventures
- Leasing commitments
- Employee benefits
- Financial instruments resulting in business combination
- Insurance contracts

Disclosure:

A. An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

B. The carrying amounts of each of the following categories, as specified in Ind AS 109, shall be disclosed either in the balance sheet or in the notes:

   (a) financial assets and liabilities measured at fair value through profit or loss, showing separately

      (i) those designated as such upon initial recognition or subsequently in accordance with Ind AS 109 and

      (ii) those mandatorily measured at fair value through profit or loss in accordance with Ind AS 109.

   (b) financial assets and liabilities measured at amortised cost.

   (c) financial assets measured at fair value through other comprehensive income, showing separately

      (i) financial assets that are measured at fair value through other comprehensive income in accordance with Ind AS 109; and

      (ii) investments in equity instruments designated as such upon initial recognition in accordance with Ind AS 109.

Ind AS 109: Financial Instruments: Recognition, Measurement and De-recognition

Objective:

The objective of this Standard is to establish principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

Scope:

This Standard shall be applied by all entities to all types of financial instruments except those specified in the standard:

- Interests in subsidiaries, associates and joint ventures
- Leasing commitments
- Employee benefits
- Financial instruments resulting in business combination
- Insurance contracts

Recognition:

(a) Initial Recognition: An entity shall recognise a financial asset or a financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument.

(b) **Examples:**

  (a) Unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.

  (b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered.

  (c) A forward contract that is within the scope of this Standard is recognised as an asset or a liability on the commitment date, instead of on the date on which settlement takes place.

  (d) Option contracts that are within the scope of this Standard are recognised as assets or liabilities when the holder or writer becomes a party to the contract.

  (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

Classification:

An entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

(a) the entity's business model for managing the financial assets and

(b) the contractual cash flow characteristics of the financial asset.

A financial asset shall be measured at amortised cost if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

About principal and interest stated in para 5 and 6:

(a) principal is the fair value of the financial asset at initial recognition.

(b) interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost or at fair value through other comprehensive income. However an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income.

An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

(a) financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.

(b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies.

(c) financial guarantee contracts. After initial recognition, an issuer of such a contract shall subsequently measure it at the higher of:

    (i) the amount of the loss allowance and

    (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognized in accordance with the principles of Ind AS115.

(d) commitments to provide a loan at a below-market interest rate. An issuer of such a commitment shall subsequently measure it at the higher of:

    (i) the amount of the loss allowance and

    (ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS115.

(e) contingent consideration recognised by an acquirer in a business combination to which Ind AS103 applies. Such contingent consideration shall subsequently be measured at fair value with changes recognised in profit or loss.

Reclassification:

When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets.

An entity shall not reclassify any financial liability.

Initial measurement:

Except for trade receivables, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Subsequent measurement of financial assets:

After initial recognition, an entity shall measure a financial asset at:

(a) amortised cost;

(b) fair value through other comprehensive income; or

(c) fair value through profit or loss.

An entity shall derecognise a financial asset when, and only when:

(a) the contractual rights to the cash flows from the financial asset expire, or

(b) it transfers the financial asset as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for derecognition.

An entity shall remove a financial liability (or a part of a financial liability) from its balance sheet when, and only when, it is extinguished — i.e. when the obligation specified in the contract is discharged or cancelled or expires.

[For Ind AS 109 and 107 Hedge accounts, Impairment and Accounting for Embedded Derivatives were not discussed]

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

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

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

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 Input CGST A/c Input SGST A/c To Bank A/c	Dr. Dr. Dr.	5,000 300 300	 5,600
Office Equipment A/c Input CGST A/c Input SGST A/c To Bank A/c	Dr. Dr. Dr.	12,000 720 720	 13,440
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.

5.3 NBFC – PROVISIONING NORMS AND ACCOUNTING

Note: IND AS is applicable to NBFCs on and from 1.4.2018.

INTRODUCTION

The financial sector in any economy consists of several intermediaries, which include the banks, investment intermediaries (viz. mutual funds, hedge funds, pension funds etc.), risk transfer entities (i.e. the insurance companies), information and analysis providers (viz. rating agencies, financial advisers, etc), investment banks, portfolio managers. All the above mentioned financial intermediaries, other than the banks, are broadly referred to as Non-Banking Financial Institutions.

Non-Banking Financial Companies (NBFCs), forms an integral part of Indian financial system, providing various financial services. In recent times, activities of NBFCs have undergone variety of changes through financial innovation. NBFC initially gets incorporated under Indian Companies Act, 2013 and later on obtains Certificate of Incorporation from RBI.

NON-BANKING FINANCIAL COMPANY (NBFC) – CONCEPT

- Non-Banking Finance Company (NBFC) is a financial institution which does not meet the legal definition of bank but carries the similar activities to that of bank like lending and making investments i.e. such an institution does not hold a banking license.

- As per Sec. 45I(f) of RBI Act, 1934, a non-banking financial company'' means:
  (i) a financial institution which is a company;
  (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
  (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 which is engaged in the business of:
  - ✓ loans and advances,
  - ✓ acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature,
  - ✓ leasing,
  - ✓ hire-purchase,
  - ✓ insurance business,
  - ✓ chit business.

However, such a company but does not include any institution whose principal business is that of:

✓ agriculture activity,

✓ industrial activity,

✓ purchase or sale of any goods (other than securities), or providing any services, and

✓ sale/ purchase/ construction of immovable property.

- Moreover, a non-banking institution which is a company and has principal business of receiving deposits, under any scheme or arrangement, in one lump sum or in installments, by way of contributions or in any other manner, is also a non-banking financial company (called a **Residuary non-banking company**).

CLASSIFICATION OF NON- BANKING FIANNCIAL COMPANIES (NBFCs)

NBFCs can be classified on the following bases:

[A] On the basis of Liability Structure

On the basis of liability structure, the NBFCs can be divided into two categories: NBFCs accepting public deposits (referred to as NBFCs-D), and NBFCs not raising public deposits (referred to as NBFCs-ND).

1. **Deposit taking NBFCs (referred to as NBFCs-D):** These NBFCs are subject to the requirements of Capital adequacy norms, Liquid assets maintenance norms, Exposure norms (including restrictions on exposure to investments in land, building and unquoted shares), Asset Liability Management (ALM) discipline and reporting requirements.

2. **Non-Deposit taking NBFCs (referred to as NBFCs-ND):** Till 2006 NBFCs-ND were subject to minimal regulations. However, since 2007, NBFCs-ND with assets of ₹ 100 crores and above are being classified as **Systemically Important Non-Deposit taking NBFCs (NBFCs-ND-SI).**

Presently, in the light of the overall increase in the growth of the NBFC sector, the threshold for defining systemic significance for NBFCs-ND (non-deposit taking NBFCs) has been revised. Accordingly, the NBFCs-ND-SI will henceforth be those NBFCs-ND which have asset size of ₹500 crore and above as per the last audited balance sheet.

Thus, now the NBFCs-ND shall be categorized into two broad categories in accordance with the revised threshold limit for systemic significance:

- NBFCs-ND (those with assets of less than ₹ 500 crore) and

- NBFCs-ND-SI (those with assets of ₹ 500 crore and above).

The prudential regulations, such as capital adequacy requirements and exposure norms along with reporting requirements, have been made applicable to the NBFCs-ND-SIs. The ALM reporting and disclosure norms have also been made applicable to them at different points of time.

NB: NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the above two categories i.e. NBFCs-ND and NBFCs-ND-SI. For this purpose, Statutory Auditors would be required to certify the asset size of all the NBFCs in the Group.

[B] On the basis of nature of primary activities performed

On this basis, the NBFCs can be classified into the following categories:

1. **Asset Finance company** is a company which carries on as its principal business the financing of physical assets supporting productive/economic and general purpose assets.

2. **Leasing company** is a company which carries on as its principal business, the business of leasing of equipments or the financing of such activity.

3. **Investment company** means any company which carries on as its principle business the acquisition of securities.

4. **Loan company** means any company which is a financial institution carrying on as its principal business the providing of finance whether by making loans or advances or otherwise for any activity other than its own but does not include an Asset Finance Company.
5. **Infrastructure finance company** is a company which carries on as its principle business, the financing of the acquisition or construction of infrastructure facilities of various kinds.
6. **Infrastructure Debt Fund** is a company registered as NBFC to facilitate the flow of long term debt into infrastructure projects.
7. **Venture capital company** means any company which carries on as its principle business the providing of start-up capital to new business ventures.
8. **NBFC-Factor** is a non-deposit taking NBFC engaged in the principal business of factoring.
9. **NBFC- Non-Operative Financial Holding Company (NOFHC)** is financial institution through which promoter / promoter groups will be permitted to set up a new bank .It's a wholly-owned Non-Operative Financial Holding Company (NOFHC) which will hold the bank as well as all other financial services companies regulated by RBI or other financial sector regulators, to the extent permissible under the applicable regulatory prescriptions.

REGULATORY APPROACH FOR NBFCs

- **NBFCs-ND Regulatory Approach (Asset size < ₹ 500 Crore):**

The regulatory approach in respect of NBFCs-ND with an asset size of less than ₹ 500 crore will be as under:

(i) **No Regulations for No Deposits and No Customer Interface:** They shall not be subjected to any regulation either prudential or conduct of business regulations if they have not accessed any public funds and do not have a customer interface.

(ii) **Conduct of business regulations if have Customer Interface:** Those having customer interface will be subjected only to conduct of business regulations if they are not accessing public funds.

(iii) **Prudential Regulations for Public Deposits:** Those accepting public funds will be subjected to only limited prudential regulations if they have no customer interface.

(iv) **Both Regulations for Deposits and Customer Interface:** Where both public funds are accepted and customer interface exist, such companies will be subjected both to limited prudential regulations and conduct of business regulations.

(v) **Compulsory Compliance of Sec. 45-IA:** Irrespective of whichever category the NBFC falls in, registration under Section 45 IA of the RBI Act will be mandatory.

- **NBFCs-ND Regulatory Approach (Asset size > ₹ 500 Crores):**

All NBFCs-ND with assets of ₹ 500 crores and above shall have to comply with prudential regulations as applicable to NBFCs-ND-SI even if they have not accessed public funds.

However, the NBFCs-ND having assets size of ₹500 crores and more shall comply with conduct of business regulations only if customer interface exists.

MANDATORY REQUIREMENTS OF MINIUM NET OWNED FUND BY NBFC:

- In terms of Section 45 IA of the RBI Act, 1934, no NBFC can commence or carry on business of a non-banking financial institution without having a Net Owned Funds (NOF) of ₹ 25 lakhs.
- Thereafter, the requirement of NOF has been increased to ₹200 lakhs for all new companies w.e.f. April 21. 1999 vide RBI Notification No. DNBS.132 CGM (VSNM) - 99 dated April 21, 1999.
- But now all NBFCs are compulsorily required to attain a minimum Net Owned Fund of ₹ 2 crore by the end of March 2017 as per the milestones given below:
  - ✓ ₹ 1 crore by the end of March 2016
  - ✓ ₹ 2 crore by the end of March 2017
- Consequently, the companies that were already in existence even before April 21. 1999 have to attain the above minimum NOF in addition to the new companies applying for grant of COR to commence business of an NBFC on and after November 10, 2014.
- In other words, it shall be mandatory for all NBFCs to attain a minimum NOF of NOF of ₹ 100 lakh by the end of March 2016 and ₹ 200 lakh by the end of March 2017.

NB: All NBFCs, the NOF of which currently falls below ₹ 200 lakh shall submit a statutory auditor's certificate certifying compliance to the revised levels at the end of each of the two financial years as given above.

If any NBFC fails to achieve the prescribed ceiling within the stipulated time period, the Bank will initiate the process for cancellation of COR against such NBFCs.

GETTING RATING TO ACCEPT OR RENEW PUBLIC DEPOSITS FOR NBFC:

In accordance with the revised regulatory framework for NBFCs, all unrated Asset Finance Company (AFC) had to get an investment grade by March 31, 2016 otherwise they would not be allowed to renew existing or accept fresh deposits thereafter. Moreover, the limit for acceptance of deposits for rated AFCs has also been reduced from 4 times to 1.5 times of NOF.

Meanwhile i.e. till March 31, 2016, the unrated AFCs or those with a sub-investment grade rating can only renew existing deposits on maturity but not allowed to accept fresh deposits till they obtain an investment grade rating.

Earlier to this amendment, the unrated AFC having NOF of ₹ 25 lakh or more and maintaining capital adequacy ratio of not less than 15% were allowed to accept or renew public deposits 1.5 times of its NOF subject to ₹10 crore as per extant NBFCs Acceptance of Public Deposit (Reserve Bank) Directions, 1998.

PRUDENTIAL NORMS FOR NBFCs

The Reserve Bank of India has issued detailed directions on prudential norms, vide

✓ Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007,

✓ Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015 and

✓ Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015. Applicable regulations vary based on the deposit acceptance or systemic importance of the NBFC.

The directions inter alia, prescribe guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs, exposure norms, disclosures in the balance sheet, requirement of capital adequacy, restrictions on investments in land and building and unquoted shares, loan to value (LTV) ratio for NBFCs predominantly engaged in business of lending against gold jewellery, besides others. Deposit accepting NBFCs have also to comply with the statutory liquidity requirements.

Enhanced prudential regulations shall be made applicable to NBFCs wherever public funds are accepted and conduct of business regulations will be made applicable wherever customer interface is involved.

The term 'Public Funds' includes:

(a) Funds raised directly or indirectly through public deposits;

(b) Commercial papers;

(c) Debentures;

(d) Inter-corporate deposits; and

(e) Bank finance.

However, the term Public Funds does not includes funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue.

APPLICATION OF PRUDENTIAL REGULATION FOR NBFCs

- **Prudential Regulations for NBFCs-ND (Assets size < ₹ 500 crores):**

  The NBFCs-ND with asset size of less than ₹ 500 crores shall be:

  (A) Exempted from the requirement of maintaining CRAR;

  (B) Exempted from complying with Credit Concentration Norms: and

  (C) Maintain a leverage ratio (Total Outside Liabilities Owned Funds) of 7 to link Asset Growth with the Capital.

- **Prudential Regulations for NBFCs-ND-SI (Asset size > ₹ 500 Crore) and all NBFCs-D:**

Tier 1 Capital:

All NBFCs-ND which have an asset size of ₹ 500 crore and above and all NBFCs-D shall maintain minimum Tier 1 Capital of 10%. The compliance to the revised Tier 1 capital will be phased in as follows:

✓ 8.5% by end of March 2016.

✓ 10% by end of March 2017.

ASSET CLASSIFICATION FOR NBFCs

Every non-banking financial company shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realisation, classify its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely:

(i) Standard assets;

(ii) Sub-standard assets;

(iii) Doubtful assets; and

(iv) Loss assets.

Standard Asset:

Standard Asset means the asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business.

Sub-standard Asset:

- As per the "Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015, a Sub-standard asset means:

  (a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;

  (b) an asset where the terms of the agreement regarding interest and/ or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms: Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 27 of these Directions.

  NB: The class of assets referred to above shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the upgradation.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Sub-standard asset means:

  (a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;

  Provided that the period 'not exceeding 18 months' stipulated in this sub-clause shall be 'not exceeding 16 months' for the financial year ending March 31, 2016; 'not exceeding 14 months' for the financial year ending March 31, 2017; and 'not exceeding 12 months' for the financial year ending March 31, 2018 and thereafter.

  (b) an asset where the terms of the agreement regarding interest and / or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms: Provided that the classification of infrastructure loan as a sub-standard asset shall be in accordance with the provisions of paragraph 27 of these Directions.

Doubtful Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Doubtful asset means:

  (a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period exceeding 18 months.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Doubtful asset means:

(a) a term loan, or (b) a lease asset, or (c) a hire purchase asset, or (d) any other asset, which remains a sub-standard asset for a period 'exceeding 18 months' for the financial year ended March 31, 2015; 'exceeding 16 months' for the financial year ended March 31, 2016; 'exceeding 14 months' for the financial year ending March 31, 2017 and 'exceeding 12 months' for the financial year ending March 31, 2018 and thereafter.

Loss Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Loss asset means:
  - (a) an asset which has been identified as loss asset by the non-banking financial company or its internal or external auditor or by the Reserve Bank of India during the inspection of the non-banking financial company, to the extent it is not written off by the non-banking financial company; and
  - (b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.
- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a Loss asset means:
  - (a) an asset which has been identified as loss asset by the non-banking financial company or its internal or external auditor or by the Reserve Bank of India during the inspection of the non-banking financial company, to the extent it is not written off by the non-banking financial company; and
  - (b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non availability of security or due to any fraudulent act or omission on the part of the borrower.

Non-performing Asset:

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a non-performing asset (NPA) means:
  - (a) an asset, in respect of which, interest has remained overdue for a period of six months or more;
  - (b) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;
  - (c) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;
  - (d) a bill which remains overdue for a period of six months or more;
  - (e) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/ advances, which facility remained overdue for a period of six months or more;
  - (f) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more;
  - (g) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;
  - (h) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/ beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", a non-performing asset (NPA) means:
  - (i) an asset, in respect of which, interest has remained overdue for a period of six months or more;
  - (ii) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;
  - (iii) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;

(iv) a bill which remains overdue for a period of six months or more;

(v) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances, which facility remained overdue for a period of six months or more;

(vi) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more; Provided that the period of 'six months or more' stipulated in sub-clauses (a) to (f) shall be 'five months or more' for the financial year ending March 31, 2016; 'four months or more' for the financial year ending March 31, 2017 and 'three months or more', for the financial year ending March 31, 2018 and thereafter.

(vii) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;

Provided that the period of 'twelve months or more' stipulated in this sub-clause shall be 'nine months or more' for the financial year ending March 31, 2016; 'six months or more' for the financial year ending March 31, 2017; and 'three months or more' for the financial year ending March 31, 2018 and thereafter.

(viii) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset:

Provided that in the case of lease and hire purchase transactions, a non-banking financial company may classify each such account on the basis of its record of recovery.

HORMONISATION OF ASSET CLASSIFICATION FOR NBFCs

In the interest of harmonisation, the asset classification norms for NBFCs-ND-SI and NBFCs-D are being brought in line with that of banks, in a phased manner, as provided below:

(1) Non-Performing Asset (NPA):

(A) Lease Rental and Hire-Purchase Assets:

(i) Overdue for 9 Months as on 31st March 2016: Lease Rental and Hire-Purchase Assets shall become NPA if they become overdue for 9 months (currently 12 months) for the financial year ending March 31,2016;

(ii) Overdue for 6 Months as on 31st March 2017: Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 6 months for the financial year ending March 31. 2017; and

(iii) Overdue for 3 Months as on 31st March 2018 and Onwards:

Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months for the financial year ending March 31, 2018 and thereafter.

(B) Assets other than 'Lease Rental and Hire-Purchase Assets':

(i) Overdue for 5 Months as on 31st March 2016: Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if they become overdue for 5 months for the financial year ending March 31, 2016;

(ii) Overdue for 4 Months as on 31st March 2017: Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 4 months for the financial year ending March 31. 2017; and

(iii) Overdue for 3 Months as on 31st March 2018 and Onwards: Assets other than Lease Rental and Hire-Purchase Assets shall become NPA if overdue for 3 months for the financial year ending March 31. 2018 and thereafter.

(2) Sub-Standard Assets:

For all loan and hire-purchase and lease assets, sub-standard asset would mean:

(i) NPA upto 16 Months on 31/03/2016: An asset that has been classified as NPA for a period not exceeding 16 months (currently 18 months) for the financial year ending March 31. 2016;

(ii) NPA upto 14 Months on 31/03/2017: An asset that has been classified as NPA for a period not exceeding 14 months for the financial year ending March 31, 2017; and

(iii) NPA upto 12 Months on 31/03/2018: An asset that has been classified as NPA for a period not exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

(3) Doubtful Asset

For all loan and hire-purchase and lease assets, doubtful asset would mean:

(i) Sub-Standard Asset for 16 Months on March 31, 2016: An asset that has remained sub-standard for a period exceeding 16 months (currently 18 months) for the financial year ending March 31, 2016

(ii) Sub-Standard Asset for 14 Months on March 31, 2017: An asset that has remained sub-standard for a period exceeding 14 months for the financial year ending March 31, 2017; and

(iii) Sub-Standard Asset for 12 Months on March 31, 2018 and thereafter: An asset that has remained sub-standard for a period exceeding 12 months for the financial year ending March 31, 2018 and thereafter.

ACCOUNTING GUIDELINES FOR NBFCs

The issues related to accounting include Income Recognition criteria, Accounting of Investments, asset classification and provisioning requirements. These hav been provided in details in the RBI Directions, namely "Non-Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015" and "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015".

RBI has prescribed that Income recognition should be based on recognised accounting principles, however Accounting Standards and Guidance Notes issued by the Institute of Chartered Accountants of India (referred to in these Directions as "ICAI" shall be followed in so far as they are not inconsistent with any of these Directions.

Income Recognition

- The income recognition of NBFCs, irrespective of their categorisation, shall be based on recognised accounting principles.
- Income including interest/ discount/ hire charges/ lease rentals or any other charges on NPA shall be recognised only when it is actually realised. Any such income recognised before the asset became non-performing and remaining unrealised shall be reversed.
- Income like interest /discount /any other charges on NPAs shall be recognised only when actually realised, RBI also requires that income recognised before asset becoming NPA should be reversed in the financial year in which such asset becomes NPA.
- The NBFCs are required to recognise income from dividends on shares of corporate bodies and units of mutual funds on cash basis, unless the company has declared the dividend in AGM and right of the company to receive the same has been established, in such cases, it can be recognized on accrual basis.
- Income from bonds and debentures of corporate bodies and from government securities/bonds may be taken into account on accrual basis provided it is paid regularly and is not in arrears.
- Income on securities of corporate bodies or public sector undertakings may be taken into account on accrual basis provided the payment of interest and repayment of the security has been guaranteed by Central Government.

Principles for accounting of Investments

- Investing is one of the core activities of NBFCs, hence RBI requires the Board of Directors to Frame investment policy of the company and implement the same.
- The investments in securities shall be classified into current and long term, at the time of making each investment;
- The Board of the company should include in the investment policy the criteria for classification of investments into current and long-term.
- The investments need to be classified into current or long term at the time of making each investment.
- There can be no inter-class transfer of investments on ad hoc basis later on. Inter class transfer, if warranted, should be done at the beginning of half year, on April 1 or October 1, and with the approval of the Board.
- The investments shall be transferred scrip-wise, from current to long-term or vice-versa, at book value or market value, whichever is lower;
- The depreciation, if any, in each scrip shall be fully provided for and appreciation, if any, shall be ignored. Moreover, the depreciation in one scrip shall not be set off against appreciation in another scrip, at the time of such inter-class transfer, even in respect of the scrips of the same category.

Valuation of Investments

- The directions also specifies various valuation guidelines in respect of Quoted and Unquoted current investments leaving the Long term Investments to be valued as per ICAI Accounting Standards.

  It requires **Quoted current investments** to be grouped into specified categories, viz. (i) equity shares, (ii) preference shares, (iii) debentures and bonds, (iv) Government securities including treasury bills, (v) units of mutual fund, and (vi) others.
- The valuation of each specified category is to be done at aggregate cost or aggregate market value whichever is lower. For this purpose, the investments in each category shall be considered scrip-wise and the cost and market value aggregated for all investments in each category. If the aggregate market value for the category is less than the aggregate cost for that category, the net depreciation shall be provided for or charged to the profit and loss account. If the aggregate market value for the category exceeds the aggregate cost for the category, the net appreciation shall be ignored. Depreciation in one category of investments shall not be set off against appreciation in another category.
- **Unquoted equity shares in the nature of current investments** shall be valued at cost or break-up value, whichever is lower. However, the RBI Directions has prescribed that fair value for the break-up value of the shares may be replaced, if considered necessary. "Breakup value" means the equity capital and reserves as reduced by intangible assets and revaluation reserves, divided by the number of equity shares of the investee company. Where the balance sheet of the investee company is not available for two years, such shares shall be valued at one rupee only.
- **Unquoted preference shares in the nature of current investments** shall be valued at cost or face value, whichever is lower.
- **Investments in unquoted Government securities or Government guaranteed bonds** shall be valued at carrying cost.
- **Unquoted investments in the units of mutual funds in the nature of current investments** shall be valued at the net asset value declared by the mutual fund in respect of each particular scheme.
- **Commercial papers** shall be valued at carrying cost.
- **A long term investment** shall be valued in accordance with the Accounting Standard issued by ICAI.
- Explanation: **Unquoted debentures** shall be treated as term loans or other type of credit facilities depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

Transactions in Government Securities

Every non-banking financial company shall undertake transactions in Government securities through its CSGL account or its demat account: Provided that no non-banking financial company shall undertake any transaction in government security in physical form through any broker.

Preparation of Balance Sheet and Profit and Loss Account

- Every non-banking financial company shall prepare its balance sheet and profit and loss account as on March 31 every year. Whenever a non-banking financial company intends to extend the date of its balance sheet as per provisions of the Companies Act, it should take prior approval of the Reserve Bank of India before approaching the Registrar of Companies for this purpose.
- Further, even in cases where the Bank and the Registrar of Companies grant extension of time, the non-banking financial company shall furnish to the Bank a proforma balance sheet (unaudited) as on March 31 of the year and the statutory returns due on the said date. Every non-banking financial company shall finalise its balance sheet within a period of 3 months from the date to which it pertains.
- Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 2013, the particulars in the schedule as set out in Division III of Schedule III.

Disclosures in the Balance Sheet

- The directions specify certain disclosure requirements in the balance sheet.
- Disclosure of provisions created without netting them from the income or against the value of assets. The provisions shall be distinctly indicated under separate heads of account as (i) Provisions for bad and doubtful debts; and (ii) Provisions for depreciation in investments.

- Provisions shall not be appropriated from the general provisions and loss reserves held. Provisions shall be debited to the profit and loss account.
- The excess of provisions, if any, held under the heads general provisions and loss reserves may be written back without making adjustment against the provisions.
- Every non-banking financial company shall append to its balance sheet prescribed under the Companies Act, 2013, the particulars in the schedule as set out in Division III of Schedule III.
- The following disclosure requirements are applicable only to systemically important (Asset Size more than ₹ 500 crores) non-deposit taking non-banking financial company:
  - ➢ Capital to Risk Assets Ratio (CRAR);
    - ✓ Exposure to real estate sector, both direct and indirect; and
    - ✓ Maturity pattern of assets and liabilities."

The formats for the above disclosures are also specified by RBI.

- Ministry of Corporate Affairs vide Notification dated 11 October 2018 made amendments in Schedule III inserting Division III for NBFC whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rule, 2015.

Division III provides a format of the Balance Sheet and Statement of Profit and Loss and sets out the minimum requirements of disclosure.

- Balance sheet items are to be classified as Financial and Non-financial and are allowed to be arranged in order of liquidity. Specific disclosure is required for derivative financial instruments and subordinated liabilities. Separate disclosure is required for Receivables which have significant increase in Credit Risk and that are Credit Impaired. Receivables and Loans are classified as follows:

Receivables shall be sub-classified as:

(a) Receivables considered good - Secured;

(b) Receivables considered good - Unsecured;

(c) Receivables which have significant increase in Credit Risk; and

(d) Receivables - credit impaired

A break up of the total loans should also be disclosed as:

(a) Secured by tangible assets

(b) Secured by intangible assets

(c) Covered by Bank/ Government Guarantee

(d) Unsecured

An NBFC shall disclose the following in the Notes under the head 'Loans':

(i) Bills purchased and bills discounted

(ii) Loans repayable on demand

(iii) lerm Loans

(iv) Leasing

(v) factoring

(vi) Others

- NBFCs are specially required to disclose Statutory Reserve in Other Reserve as part of Other Equity. Additional disclosure should be made for the conditions or restrictions for distribution from Statutory Reserve.
- Items of Revenue from Operations and Other Comprehensive Income are to be disclosed on the face of the statement of profit and loss instead of as parts of notes. In addition to disclosure of all material items in financial statements, a note for every item of Other Income or Other Expenditure should be given if it exceeds 1% of the total income.

The format of Balance Sheet and Statement of Profit and Loss of the NBFC as per Division III is shown below.

Pprt I: Balance sheet

Assets

Financial assets

(a) Cash and cash equivalents

(b) Bank Balance other than included in (a) above

(c) Derivative financial instruments

(d) Receivables

 (I) Trade Receivables

 (II) Other Receivables

(e) 1 oans

(f) Investments

(g) Other Financial assets (to be specified)

Non -financial assets

(a) Inventories

(b) Current Tax Assets (Net)

(c) Deferred Tax Assets (Net)

(d) Investment Property

(e) Biological assets other than bearer plants

(f) Property, Plant and Equipment

(g) Capital work-in-progress

(h) Intangible assets under development

(i) Goodwill

(j) Other Intangible assets

(k) Other non-financial assets (to be specified)

 Total Assets

Liabilities and Equity

Liabilities

Financial Liabilities

(a) Derivative financial instruments

(b) Payables

 (I) Trade Payables

  (i) total outstanding dues of micro enterprises and small

   • enterprises

  (ii) total outstanding dues of creditors other than micro

   • enterprises and small enterprises

 (II) Other Payables

  (i) total outstanding dues of micro enterprises and small

   • enterprises

(ii) total outstanding dues of creditors other than micro

- enterprises and small enterprises

(c) Debt Securities

(d) Borrowings (Other than Debt Securities)

(e) Deposits

(f) Subordinated Liabilities

(g) Other financial liabilities (to be specified)

Non-financial Liabilities

(a) Current tax liabilities (Net)

(b) Provisions

(c) Deferred tax liabilities (Net)

(d) Other non-financial liabilities (to be specified)

EQUITY

(a) Equity Share capital

(b) Other Equity

Total Liabilities and Equity

PART II - STATEMENT OF PROFIT AND LOSS Revenue from operations

(i) Interest Income

(ii) (Dividend Income

(iii) Rental Income

(iv) Fees and commission Income

(v) Not gain on fair value changes

(vi) Net gain on derecognition of financial instruments under amortised cost category

(vii) Sale of products(including Excise Duty)

(viii) Sale of services

(ix) Others (to be specified)

(I) Total Revenue from operations

(II) Other Income (to be specified)

(III) Total Income (I+II)

Expenses

(i) Finance Costs

(ii) Fees and commission expense

(iii) Net loss on fair value changes

(iv) Not loss on derecognition of financial instruments under amortised cost category

(v) Impairment on financial instruments

(vi) Cost of materials consumed 32

(vii) Purchases of Stock -in -trade

(viii) Changes in Inventories of finished goods, stock -in - trade and work -in - progress

(ix) Fmployee Benefits Expenses

(x) [Depreciation , amortization and impairment

(xi) Others expenses (to be specified)

(IV) Total Expenses (IV)

(V) Profit / (loss) betore exceptional items and tax (III - IV)

(VI) Exceptional items

(VII) Profit/(loss) before tax (V -VI)

(VIII) Fax Expense:

(1) Current Tax

(2) Deferred Tax

(IX) Profit / (loss) for the period from continuing operations (VII -VIII)

(X) Profit/floss) from discontinued operations

(XI) Tax Expense of discontinued operations

(XII) Profit/(loss) from discontinued operations(After tax) (X -XI)

(XIII) Profit/(loss) for the period (IX+XII)

(XIV) Other Comprehensive Income

(A) (i) Items that will not be reclassified to profit or loss (specify items and amounts)

(ii) Income tax relating to items that will not be reclassified to profit or loss

Subtotal (A)

(B) (i) Items that will be reclassified to profit or loss (specify items and amounts)

(ii) Income tax relating to items that will be reclassified to profit or loss

Subtotal (B)

Other Comprehensive Income (A + B)

(XV) Total Comprehensive Income tor the period (XIII+XIV) (Comprising Profit (Loss) and other Comprehensive) Income for the period)

(XVI) Earnings per equity share (tor continuing operations)

- Basic (₹)
- Diluted (₹)

(XVII) Earnings per equity share (for discontinued operations)

- Basic (₹)
- Diluted (₹)

(XVIII) Earnings per equity share (tor continuing and discontinued operations)

- Basic (₹)
- Diluted (₹)

PROVISION REQUIREMENTS FOR NBFCs

[A] Provision against sub-standard assets, doubtful assets and loss assets

Every NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets as provided hereunder:

1. On loans, advances and other credit tacilities including bills purchased and discounted

Loss Assets	The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for;

Doubtful Assets	(a) 100% provision to the extent to which the advance is not covered by the realisable value of the security to which the non-banking financial company has a valid recourse shall be made. The realisable value is to be estimated on a realistic basis;	
	(b) In addition to item (a) above, depending upon the period for which the asset has remained doubtful, provision to the extent of 20% to 50% of the secured portion (i.e. Estimated realisable value of the outstanding) shall be made on the following basis:	
	Period for which the asset has been considered as doubtful:	Per cent of provision
	- Up to one year	20
	- One to three years	30
	- More than three years	50
Sub-standard assets	A general provision of 10 per cent of total outstanding shall be made	

2. On Lease and Hire Purchase assets

As per the RBI Directions, the provisioning requirements in respect of hire purchase and leased assets shall be as under:

- In respect of hire purchase assets, the total dues (overdue and future instalments taken together) as reduced by: (a) the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges: and (b) the depreciated value of the underlying asset, shall be provided for.

  Explanation: For the purpose of this paragraph, (1) the depreciated value of the asset shall be notionally computed as the original cost of the asset to be reduced by depreciation at the rate of twenty per cent per annum on a straight line method; and (2) in the case of second hand asset, the original cost shall be the actual cost incurred for acquisition of such second hand asset.

- **Additional provision for hire purchase and leased assets:** In respect of such assets, additional provision shall be made as under:

(a) Where hire charges or lease rentals are overdue upto 12 months	Nil
(b) Where hire charges or lease rentals are overdue for more than 12 months but upto 24 months	10 per cent of the net book value
(c) Where hire charges or lease rentals are overdue for more than 24 months but upto 36 months	40 per cent of the net book value
(d) Where hire charges or lease rentals are overdue for more than 36 months but upto 48 months	70 per cent of the net book value
(e) Where hire charges or lease rentals are overdue for more than 48 months	100 per cent of the net book value

  - On expiry of a period of 12 months after the due date of the last instalment of hire purchase/ leased asset, the entire net book value shall be fully provided for.

Notes:

1. The amount of caution money/ margin money or security deposits kept by the borrower with the non-banking financial company in pursuance of the hire purchase agreement may be deducted against the provisions stipulated under clause (i) above, if not already taken into account while arriving at the equated monthly instalments under the agreement. The value of any other security available in pursuance to the hire purchase agreement may be deducted only against the provisions stipulated under clause (ii) above.

2. The amount of security deposits kept by the borrower with the non-banking financial company in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the provisions stipulated under clause (ii) above.

3. It is clarified that income recognition on and provisioning against NPAs are two different aspects of prudential norms and provisions as per the norms are required to be made on NPAs on total outstanding balances including the depreciated book value of the leased asset under reference after adjusting the balance, if any, in the lease adjustment account. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.

4. An asset which has been renegotiated or rescheduled as referred to in paragraph (2) (1) (xxv) (b) of these Directions shall be a sub-standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.

5. The balance sheet to be prepared by the NBFC may be in accordance with the provisions contained in subparagraph (2) of paragraph 11.

6. All financial leases written on or after April 1, 2001 attract the provisioning requirements as applicable to hire purchase assets.

7. In case of NBFC-MFIs, if the advance covered by Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) guarantee becomes non-performing, no provision need be made towards the guaranteed portion. The amount outstanding in excess of the guaranteed portion should be provided for as per the extant guidelines on provisioning for non-performing advances.

[B] Provision against Standard Assets

- As per the "Non-systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", every Non-Banking Financial Company shall make provision for standard assets at 0.25 percent of the outstanding, which shall not be reckoned for arriving at net NPAs.

- As per the "Systemically Important Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2015", every Non-Banking Financial Company shall make provisions for standard assets at 0.25 per cent by the end of March 2015; 0.30 per cent by the end of March 2016; 0.35 per cent by the end of March 2017 and 0.40 per cent by the end of March 2018 and thereafter, of the outstanding, which shall not be reckoned for arriving at net NPAs. Thus, the provision for standard assets for NBFCs-ND-SI and for all NBFCs-D has now been increased to 0.40% (at present 0.25%). The compliance to the revised norm will be phased in as given below:

  ✓ 0.30% by the end of March 2016

  ✓ 0.35% by the end of March 2017

  ✓ 0.40% by the end of March 2018

- The provision towards standard assets need not be netted from gross advances but shall be shown separately as 'Contingent Provisions against Standard Assets' in the balance sheet.

Illustration 3.

While closing its books of accounts on 31stMarch, a NBFC has its advances classified as follows-

Particulars	₹ Lakhs	Particulars	₹ Lakhs
Standard Assets	8,400	Unsecured Portion of Doubtful Debts	87
Sub-Standard Assets	910	Loss Assets	24
Secured Portions of Doubtful Debts:			
- Up to one year	160		
- One year to three years	70		
- more than three years	20		

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	8,400	0.40	33.6
Sub- Standard Assets	910	10%	91
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32

- 1 year to 2 years	70	30%	21
- more than three years	20	50%	10
Unsecured Portions of Doubtful Assets	87	100%	87
Loss Assets	24	100%	24
Total			298.6

Note: Percentage of provision for Standard Asset is 0.25 as per Non-Banking Financial Company - Non Systemicaliy Important Non-Deposit taking Company.

Illustration 4.

While closing its books of account on March 31* of a financial year, a Non-banking Finance company has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	16,800
Standard Assets	1,340
Secured Positions of Doubtful Debts:	
- Up to one year	320
- one year to three years	90
- more than three years	30
Unsecured Portions of Doubtful debts	97
Loss Assets	48

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	16,800	0.40	67.2
Sub Standard Assets	1,340	10%	134
Secured Portion of Doubtful Debts:			
- Up to one year	320	20%	64
- 1 year to 2 years	90	30%	27
- more than 3 years	30	50%	15
Unsecured Portion of Doubtful debts	97	100%	97
Loss Assets	48	100%	48
Total			452.4

Illustration 5.

Whilo closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

Particulars	₹ Lakhs
Standard Assets	10,000
Sub Standard Assets	1,000
Secured Positions of Doubtful Debts:	
- Up to one year	160
- one year to three years	70
- more than three years	20
Unsecured Portions of Doubtful debts	90
Loss Assets	30

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan (₹ Lakhs)	Provision (%)	Provision (₹ Lakhs)
Standard Assets	10.000	0.40	40
Sub-Standard Assets	1,000	10%	100
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32
- 1 year to 2 years	70	30%	21
- more than three years	20	50%	10
Unsecured Portions of Doubtful Assets	90	100%	90
Loss Assets	30	100%	30
Total			323

Illustration 6.

Samvedan Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase) business. It provides you with the following information regarding major hire purchase deals as on 31.3.14. few machines were sold on hire-purchase basis. The hp price was set as ₹ 100 lakhs as against cash price of ₹ 80 lakhs. The amount was payable as ₹ 80 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.3.15, but could not collect the second installment which was due on 31.3.16. the company was finalizing accounts for the year ending 31.3.16. till 15.5.16, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10.42%.

Required:

(a) What should be the principal outstanding on 1.4.15? Should the company recognise finance charge for the year 2015-16 as income?

(ii) What should be the net book value of assets as on 31.3.16 so far Samvedan Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

(iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

Solution:

(i) Since, the hire-purchaser paid the first installment due of 31.3.15, the notional principal outstanding on 01.04.2015 was ₹ 50.25 lakhs. [WN: I]

(i) In the year ended 31.3.16, the installment due of ₹ 16 lakhs has not been received. However, it was due on 31.3.16 i.e. on the Balance Sheet date, and therefore, it will be classified as Standard Asset. Samvedan Ltd. will recognise ₹ 5.24 lakhs as interest income included in that due installment as this should be treated as finance charge.

(iii) The net book value of the assets as on 31.3.2015

Particulars	₹ Lakhs
Overdue installment	16
Installments not due (₹ 16 lakhs x 3)	48
	64
Less: 1 inance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
	65.49
Less: Provision as per NBFC prudential norms	7.49
∴ Net Book Value of assets for Samvedan Ltd.	48.00

(iii) Amount of Provision

Particulars	₹ Lakhs
Overdue installment	16
Installments not due (₹ 16 lakhs x 3)	48
	64

Less: 1 inance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
	55.49
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20%)	48
Provision as per NBFC prudential norms	7.49

Since, the installment of ₹ 16 lakhs not paid, was due on 31.03.2016 only, the asset is classified as standard asset. therefore, no additional provision has been made for it.

Workings:

It is necessary to segregate the installments into principal outstanding and interest components by using IRR @10.42%

Time	Opening outstanding amount (a)	Cash flow (b)	Interest @ 10.42% (c) = (a) × 10.42%	Principal repayment (d) = (b) – (c)	Closing outstanding (e) = (a) – (d)
31.3.14	—	60	—	—	60
31.3.16	60	16	6.25	9.75	50.25
31.3.16	50.25	16	5.24	10.76	39.49
31.3.17	39.49	16	4.11	11.89	27.6
31.3.18	27.6	16	2.88	13.12	14.48
31.3.19	14.48	16	1.52	14.48	0

5.4 VALUATION OF SHARES [AMENDED]

INTRODUCTION

A share is the smallest unit of ownership of acompany. It happens to be one of the sources by which a company raises funds from the market. The value of a share does not remain static over its life-time. Rather it changes over the period due to various circumstances. Thus, knowing the value of share at a particular point of time is of great importance.

PURPOSE OF SHARE VALUATION

The shares of a company are required to be valued for various purposes. Some of the most important purposes include the following:

1. For selling shares of a shareholder to a purchaser (which are not quoted in the stock exchange)
2. For acquiring a block of shares which may or may not give the holder thereof a controlling interest in the company.
3. To shares by employees of the company where the retention of such shares is limited to the period of their employment.
4. To formulate schemes of merger and acquisition.
5. To acquire interest of dissenting shareholders under a scheme of reconstruction.
6. For granting loans on the basis of security of shares
7. To compensate shareholders on the acquisition of their shares by the government under a scheme of nationalization.
8. For conversion of securities, say preference shares into equity shares.
9. Toresolveadeadlockinthemanagementofacompanyonthebasisofthecontrollingblockofsharesgiven to either of the parties.

FACTORS AFFECTING VALUATION OF SHARES

The different factors that affect the valuation of shares are:

1. Nature of the industry to which the company belongs
2. The companies past performance
3. Economic conditions of the country
4. Other political and economic factors (e.g., possibility of nationalization, excise duty on goods produced, etc.)
5. Demand and supply of shares
6. Income yielding capacity of the company
7. The availability of sufficient assets over liabilities
8. Proportion of liabilities and capital
9. Rate of proposed dividend and past profit of the company
10. Yield of other related shares of the Stock Exchange.

METHODS OF SHARE VALUATION

There are three basic methods of valuing shares. They are as follows :

1. Asset-backing or Intrinsic Value Method.
2. Yield-basis or Earning Capacity Method.
3. Fair Value Method or Dual Method.

A. Asset-Backing Method:

Since the valuation is made on the basis of the assets of the company, it is known as Asset-Basis or Asset- Backing Method. At the same time, the shares are valued on the basis of real internal value of the assets of the company and that is why the method is also termed Intrinsic Value Method or Real Value Basis Method.

This method may be made either:

(i) On a going concern basis; or

(ii) On Break-up value basis.

In case of the former, the utility of the assets is to be considered for the purpose of arriving at the value of the assets, but, in the case of the latter, the realizable value of the assets is to be taken. Under this method, value of the net assets of the company is to be determined first. Thereafter, the net assets are to be divided by the number of shares in order to find out the value of each share. At the same time, value of goodwill (at its market value), investment (non-trading assets) are to be added to net assets. Similarly, if there are any preference shares, those are also to be deducted with their arrear dividends from the net assets.

Net Assets or the Funds Available for Equity Shareholders are ascertained as under:

(a) Ascertain the total market value of fixed assets and current assets;

(b) Compute the value of goodwill (as per the required method);

(c) Ascertain the total market value of non-trading assets (like investment) which are to be added;

(d) All fictitious assets (viz, Preliminary Expenses, Discount on issue of Shares/Debentures, Debit-Balance of P&L A/c etc.) must be excluded;

(e) Deduct the total amount of Current Liabilities, Amount of Debentures with arrear interest, "if any, Preference Share Capital with arrear dividend, if any.

(f) The balance left is called the Net Assets or Funds Available for Equity Shareholders. The following chart will make the above principle clear:

Computation of Net Assets		
Particulars	**₹**	**₹**
Net Assets		
Fixed Assets (Market Value)		XXX
Investments (Market Value)		XXX
Current Assets (Market Value)		XXX
Goodwill if any (Market Value)		XXX
		XXXX
Less:		
Current Liabilities	XXX	
Debentures	XXX	
Preference Share Capital (with arrear dividend)	XXX	XXXX
Net Assets/Funds Available for Equity Shareholders		XXXX
		XXXX

$$\therefore \text{ Intrinsic Value of each Share} = \frac{\text{Funds Available for Equity Shareholder's}}{\text{Number of Equity Shares}}$$

Alternatively:

Net Assets = Equity Share Capital + Other Equity +/– Profit/Loss on Revaluation

Applicability of the Method

(i) The permanent investors determine the value of shares under this method at the time of purchasing the shares;

(ii) The method is particularly applicable when the shares are valued at the time of Amalgamation, Absorption and Liquidation of companies; and

(iii) This method is also applicable when shares are acquired for control motives.

B. Yield-Basis Method:

Yield is the effective rate of return on investments which is invested by the investors. It is always expressed in terms of percentage. Since the valuation of shares is made on the basis of Yield, it is called Yield-Basis Method.

Under Yield-Basis method, valuation of shares is made on either of the following basis:

(i) Profit Basis; or (ii) Dividend Basis.

(i) Under Profit Basis: Under this method, at first, profit should be ascertained on the basis of past average profit; thereafter, capitalized value of profit is to be determined on the basis of normal rate of return, and, the same (capitalized value of profit) is divided by the number of shares in order to find out the value of each share.

The following steps are followed for the purpose of valuation:

$$\therefore \text{ Capitalised Value of Profit} = \frac{\text{Profit}^1}{\text{Normal rate of Return}} \times 100$$

$$\text{Value of each Equity Share} = \frac{\text{Capitalised Value of Profit}}{\text{Number of Shares}}$$

$$\text{Or, Value of each Equity Share} = \frac{\text{Profit}}{\text{Normal rate of Return} \times \text{Number of Equity Shares}} \times 100$$

(ii) Under Dividend Basis: Valuation of shares may be made either (a) on the basis of total amount of dividend, or (b) on the basis of percentage or rate of dividend:

(a) on the basis of Total Value of Dividend:

$$\text{Capitalised Value of Profit} = \frac{\text{Dividend Profit, i.e. Total amount of Dividend}}{\text{Normal Rate of Return, i.e. Yield}} \times 100$$

$$\therefore \text{ Value of each Equity Share} = \frac{\text{Capitalised Value of Profit}}{\text{Number of Equity Shares}}$$

$$\text{Or, Value of each Equity Shate} = \frac{\text{Divisible Profit} \times 100}{\text{Normal Rate of Return} \times \text{No. of Equity Shares}}$$

(b) On the basis of percentage or Rate of Dividend:

$$\text{Value of each Equity Share} = \frac{\text{Rate of Dividend}}{\text{Normal Rate of Return}} \times \text{Paid-up Value of each Equity Share}$$

When the Rate of Dividend is not given

$$\text{Rate of Dividend} = \frac{\text{Profit}}{\text{Equity Share Capital (Paid-up)}} \times 100$$

Whether Profit Basis or Dividend Basis method is to be followed for ascertaining the value of shares depends on the shares that are held by the respective share holders. In other words, the share holders holding minimum number of shares (i.e., minority holding) may determine the value of shares on dividend basis in order satisfy the rate of dividend which is recommended by the Board of Directors, i.e. such shareholders have no such power to control the affairs of the company.

On the contrary, the shareholders holding maximum number of shares (i.e., majority holding) have got more controlling rights over the affairs of the company including the recommendation for the rate of dividend among others. Under the circumstances, valuation of shares should be made on profit basis. In short, Profit Basis should be followed in the case of Majority Holding, and Dividend Basis should be followed in the case of Minority Holding.

C. Fair Value Method:

There are some valuers who do not accept either the Intrinsic Value or the Yield Value for ascertaining the value of shares. They prescribe the Fair Value Method which happens to be the arithmetic mean of Intrinsic Value Method and Yield Value Method. The same provides a better indication about the value of shares than the earlier two methods.

$$\therefore \text{ Fair Value} = \frac{\text{Intrinsic Value} + \text{Yield Value}}{2}$$

WORKED OUT PROBLEMS

Illustration 7.

The following abridged Balance Sheet as on 31st March, 2017 pertains to S Ltd.

Liabilities	₹in lakhs	Assets	₹in lakhs
Share Capital :		Goodwill, at cost	420
180 lakh Equity shares of ₹10 each, fully paid up	1,800	Other Fixed Assets	11,166
90 lakh Equity shares of ₹10 each, ₹8 paid up	720	Current Assets	2,910
150 lakh Equity shares of ₹5 each, fully paid-up	750	Loans and Advances	933
Reserves and Surplus	5,457		
Secured Loans	4,500		
Current Liabilities	1,242		
Provisions	960		
	15,429		15,429

You are required to calculate the following for each one of three categories of equity shares appearing in the above mentioned Balance Sheet:

(i) Intrinsic value on the basis of book values of Assets and Liabilities including goodwill;

(ii) Value per share on the basis of dividend yield.

Normalrateofdividendintheconcernedindustryis15%, where as Glorious Ltd. has been paying 20% dividend for the last four years and is expected to maintain it in the next few years; and

(iii) Value per share on the basis of EPS.

For the year ended 31st March, 2017 the company has earned ₹1,371 lakh as profit after tax, which can be considered to be normal for the company. Average EPS for a fully paid share of ₹10 of a Company in the same industry is ₹2.

Solution:

(A) Calculation of Intrinsic value [Based on book value]

	₹
Goodwill	420
Fixed Assets	11,166
Current Assets	2,910
Loan Advances	933
Total	15,429
Less: Provision	960
Current liabilities	1,242
Secured loans	4,500
Net Assets available for Equity share holder	8,727
Add: Notional calls [90x2]	180
Total Assets	8,907
÷ Equity share capital [1,800 + 900 + 750)	3,450

Intrinsic value per Rupee	2.58
Paid up value ₹10 x 2.58 =	25.8
Paid up value ₹8 x 2.58 =	20.64
Paid up value ₹5 x 2.58 =	12.90

(B) Dividend Yield = $\frac{\text{Dividend Rate}}{\text{Normal rate of Return}} \times$ Paid up Share Capital

Paid up value 10 = $\frac{20\%}{15\%} \times 10 = ₹\ 13.33$

Paid up value 8 = $\frac{20\%}{15\%} \times 8 = ₹\ 10.67$

Paid up value 5 = $\frac{20\%}{15\%} \times 5 = ₹\ 6.67$

(C) Earning per Rupee of Share Capital = $\frac{\text{Earning after tax}}{\text{Paid up Share Capital}}$

$= \frac{1,371}{3,270} = 0.419$

Earning per fully paid shares of ₹10 = 0.419 × ₹4.19

Earning per share of ₹10 each, ₹ 8 paid-up = ₹0.419×8 = ₹3.35

Earnng per share of ₹5, fully paid-up = ₹0.419 × 5= ₹2.10

Value of fully paid share of ₹10 = ₹ $\frac{4.19}{2} \times 10$ = ₹ 20.95

Value of share of ₹10, ₹8 paid-up = ₹ $\frac{4.19}{2} \times 10$ = ₹ 16.75

Value of fully paid-up share of ₹5 = ₹ $\frac{4.19}{2} \times 10$ = ₹ 10.50.

Illustration 8.

The following is the Balance Sheet (as on 31st December, 2017) of N Ltd.:

Liabilities	₹ in Lakh	Assets	₹ in Lakh
Equity Share Capital:		**Fixed Assets:**	
80,000 Equity shares of ₹10 each fully paid up	8,00,000	Goodwill	1,00,000
50,000 Equity shares of ₹10 each 8 paid up	4,00,000	Plant and Machinery	8,00,000
36,000 Equity shares of ₹5 each fully paid up	1,80,000	Land and Building	10,00,000
30,000 Equity shares of ₹5 each 4 paid-up	1,20,000	Furniture and Fixtures	1,00,000
		Vehicles	2,00,000
Other Equity:		Investments	3,00,000
General reserve	1,40,000	**Current Assets:**	
Profit and Loss account	3,50,000	Stock	2,10,000
Non-current liabilities:			
3,00010% Preference shares of ₹100 each fully paid	3,00,000		
12% debentures	2,00,000	Debtors	1,95,000

15% Term Loan	1,50,000	Prepaid Expenses	40,000
Deposits	1,00,000	Advances	45,000
Current Liabilities:		Cash and Bank balance	2,00,000
Bank Loan	50,000		
Creditors	1,50,000		
Outstanding expenses	20,000		
Provision for tax	2,00,000		
Accrued Preference Dividend	30,000		
	31,90,000		**3190,000**

Additional Information:

(1) In 2013 a new machinery costing ₹50,000 was purchased, but wrongly charged to revenue (no rectification has yet been made for the same).

(2) Stock is overvalued by ₹10,000 in 2016. Debtors are to be reduced by ₹5,000 in 2017, some old furniture (Book value ₹10,000) was disposed of fort ₹6,000.

(3) Fixed assets are worth 5 per cent more than their actual book value. Depreciation on appreciated value of Fixed assets except machinery is not to be considered for valuation of goodwill.

(4) Of the investment 20 per cent is trading and the balance is non-trading. All trade investments are to be valued at 20 per cent below cost. Trade investment were purchased on 1st January, 2017. 50 per cent of the non-trade investments were acquired on 1st January, 2016 and the rest on January, 2017. A uniform rate of dividend of 10 percent is earned on all investments.

(5) Expected increase in expenditure without commensurate increase in selling price ₹20,000.

(6) Research and Development expenses anticipated in future ₹30,000 per annum.

(7) In a similar business a normal return on capital employed is10%.

(8) Profit (after tax) are as follows:

In 2015 — ₹2,10,000, in 2016 — ₹1,90,000 and in 2017 — ₹2,00,000.

(9) Current income tax rate is 50%, expected income tax rate will be 40%. From the above, ascertain the intrinsic value for different categories of Equity shares. For this purpose goodwill may be taken as 3 years purchase of super profits. Depreciation is charged on machinery @10% on reducing system.

Solution:

Computation of Value of Shares:

	₹
Value of Net Assets (As computed for Goodwill)	17,72,073
Value of Goodwill [Refer W.N.3]	1,10,406
Non-trade investments	2,40,000
Net Assets available for Equity Shareholders	21,22,479

Computation of Number of Equivalent Equity Shares:

Equity shares	No. of Equivalent Shares
80,000 shares + 50,000 shares = 1,30,000 shares of ₹10 each 1,30,000 x $\frac{10}{10}$	1,30,000
36,000 shares + 30,000 shares = 66,000 shares of ₹5 each 66,000 x $\frac{5}{10}$	33,000
Total Equivalent Equity Shares of ₹10 each	1,63,000

Calculation of intrinsic value of different categories of Equity Shares of N Ltd.

Value of Net Assets = ₹ 21,22,479

Net assets available to deemed fully paid-up Equity Shareholders

= Net Assets as computed above + Notional Cash from partly paid-up shares

= ₹ 21,22,479 + (50,000 x 2 + 30,000 x 1)

= ₹ 21,22,479 + 1,00,000 + 30,000

= ₹ 22,53,479

Computation of intrinsic value per share*

(i) Value of ₹10 fully paid Equity Share = $\frac{22,53,479}{1,63,000}$ = ₹13.82 per share(approx).

(ii) Value of ₹8 paid-up Equity Share = 13.82 - 2 = ₹11.82 per share(approx.)

(iii) Value of ₹5 fully paid-up Equity Share = 13.21 x $\frac{5}{10}$ = ₹6.91per share(approx.)

(iv) Value of ₹4 paid-up Equity Share = 6.91 – 1 = ₹5.91 per share(approx.)

Working Notes:

1. Calculation of Average Capital Employed

Fixed Assets:	
Plant and Machinery (including ₹36,450 for a Machine charged in 2013)	8,36,450
Land and Building	10,00,000
Furniture & Fixtures (1,00,000 - 4,000)	96,000
Vehicles	2,00,000
	21,32,450
Add : Appreciation @ 5%	1,06.623
	22,39,073

Trade Investment (3,00,000 × $\frac{20}{100}$) × $\frac{80}{100}$		48,000
Current Assets:		
Stock		2,10,000
Debtors (1,95,000-5,000)		1,90,000
Prepaid Expenses		40,000
Advances		45,000
Cash & Bank Balance		2,00,000
		29,72,073
Less : Outside Liabilities:		
Accrued Preference Dividend*	30,000	
3,000 10% Preference shares of ₹100 each fully paid*	3,00,000	
12% Debentures	2,00,000	
15% Term Loan	1,50,000	
Deposits	1,00,000	
Bank Loan	50,000	
Creditors	1,50,000	
Outstanding Expenses	20,000	
Provision for Tax	2,00,000	12,00,000
Capital employed at the end of the year i.e. Net Assets		17,72,073
Less: 1 of the current year's Accounting Profit after Tax:		
Profit before Tax#	3,80,950	
Less : Tax 40% of ₹3,80,950	1,52,380	
	2.28,570	
50% of ₹2,28,570		1,14,285
Average capital employed		16,57,788

*** Preference Share Capital and accrued preference dividend are liabilities.**

2. Future Maintainable Profits Statement of Average Profit

Particulars	**2015**	**2016**	**2017**
Profit after Tax	2,10,000	1,90,000	2,00,000
Profit before Tax (PAT × $\frac{1}{0.50}$)	4,20,000	3,80,000	4,00,000
Add: Capital expenditure charged to revenue	—	50,000	—
Less : Depreciation of the Machinery	5,000	(4,500)	(4,050)
Dividend on Non-Trade Investments	(12,000)	(24,000)	(24,000)
Over-valuation of closing stock	-	(10,000)	—
Add : Overvaluation of opening stock	-	-	10,000

Add: Loss on sale of furniture	-	-	-
(Presumed to be extra ordinary items)	-	-	4,000
Less: Provision for debtors			(5,000)
	4,53,000	3,41,500	3,80,950
Total profit for the three years		11,75,450	
Average Profit = $\frac{₹11,75,450}{3}$		3,91,817	
Less: Depreciation @ 10% on increase in the value of machinery			
$8,36,450 \times \frac{5}{100} \times \frac{10}{100} = ₹41,823 \times \frac{10}{100}$ i.e.	4,182		
Expected increase in expenditure	20,000		
Annual R & D Expenses anticipated in future	30,000	54,182	
Future Maintainable profit before tax		3,37,635	
Less: Tax @ 40% of 3,37,635		1,35,054	
Future Maintainable Profit After Tax		2,02,581	

3. Computation of Goodwill

	₹
Future Maintainable Profit After Tax	2,02,581
Less: Normal Profit (10% of ₹16,57,788)	1,65,779
Super Profit	36,802
Value of Goodwill = Super Profit × No. of years' purchase = ₹3,802 × 3	1,10,406

Illustration 9.

Following is the Balance Sheet of Z Ltd. as on 31st March, 2017:

Liabilities	₹ in Lakh	Assets	₹ in Lakh
1,00,000 Equity Shares of ₹10 each	10,00,000	Preliminary expenses	5,00,000
10,000 12% Preference Shares of ₹100 each	10,00,000	Goodwill	15,00,000
General Reserve	6,00,000	Buildings Plant	10,00,000
Profit and Loss Account	4,00,000	Investment in 10% Stock	4,80,000
15% Debentures	10,00,000	Stock	6,00,000
Creditors	8,00,000	Stock-in - trade	4,00,000
		Debtors	2,20,000
		Cash	1,00,000
	48,00,000		**48,00,000**

Additional information are given below:

(a) Nominal value of investment is ₹5,00,000 and its market value is ₹5,20,000.

(b) Following assets are revalued:

(i)	Building	₹32,00,000
(ii)	Plant	₹18,00,000
(iii)	Stock-in-trade	₹4,50,000
(iv)	Debtors	₹3,60,000

(a) Average profit before tax of the company is ₹12,00,000 and 12.50% of the profit is transferred to general reserve, rate of taxation being 50%.

(b) Normal dividend expected on equity shares is 8% while fair return on closing capital employed is10%.

(c) Goodwill may be valued at three year's purchase of super profits.

(d) Ascertain the value of each equity share under fair value method.

Solution:

			₹
1.	**Calculation of Capital Employed**		₹
	Assets:		
	Buildings		32,00,000
	Plant		18,00,000
	Stock		4,50,000
	Debtors		3,60,000
	Cash		1,00,000
			59,10,000
	Less: Liabilities:		
	Creditors	8,00,000	
	10,000 12% Preference Shares of ₹100 each	10,00,000	
	Debentures	10,00,000	28,00,000
	TOTAL CAPITAL EMPLOYED		31,10,000
2.	**Calculation of Actual Profit**		
	Average Profit before Tax (given)		12,00,000
	Less: Income from Investment (5,00,000 × 10%)		50,000
			11,50,000
	Less: Income Tax @ 50%		5,75,000
	Preference dividend		1,20,000
	Actual Profit		4,55,000

3. Profit for Equity Shareholders

Actual Profit (as calculated above)	4,55,000
Less: Transfer to Reserve @ 12.50%	(56,875)
Profit available to Equity Shareholders.	3,98,125

4. Normal Profit

10% of Capital Employed

= 10% of ₹31,10,000 = ₹3,11,000

5. Super Profit = Actual Profit - Normal Profit

= ₹4,55,000 – ₹3,11,000 = ₹1,44,000

6. Goodwill = ₹1,44,000 x 3 = ₹4,32,000

7. Net Assets for Equity Shareholders

= Capital Employed + Goodwill + Investment

= ₹31,10,000 + ₹4,32,000 + ₹4,80,000

= ₹40,22,000

Value per share (Based on Intrinsic Value Method)

$$= \frac{₹\ 40,82,000}{1,00,000\ \text{Shares}} = ₹40.22$$

Value per share (Based on Yield Method)

$$\text{Yield on Equity Share} = \frac{\text{Profit for Equity Shareholders}}{\text{Equity Share Capital}} \times 100$$

$$= \frac{₹\ 3,98,125}{10,00,000} \times 100 = 39.81\%$$

$$\text{Value per share} = \frac{38.31}{8} \times 10 = ₹49.77$$

Value of Equity Share Under Fair Value Method

$$= \frac{\text{Intrusic value} + \text{yield value}}{2} = \frac{40.22 + 49.77}{2} = ₹\ 44/36\ \text{(approx)}.$$

Illustration 10.

The Balance Sheet of Q Limited as on 31.12.2017 is as follows :

Liabilities	₹ in Lakh	Assets	₹ in Lakh
1,00,000 Equity shares of ₹10 each fully paid-up	10	Goodwill	5
1,00,000 equity shares of ₹6 each fully paid-up	6	Fixed Assets	15
Reserves & Surplus	2	Other Tangible Assets	5
Liabilities	10	Intangible Assets	
		(Market Value)	3
		Misc. Expenditure to the extent	
	28		**28**

Fixed assets are worth ₹24 lakhs. Other tangible assets are valued at ₹3 lakhs. The company is expected to settle the disputed bonus claim of ₹1 lakh, not provided for in the accounts. Goodwill appearing in the Balance Sheet is purchased goodwill. It is considered reasonable to increase the value of goodwill by an amount equal to average of the book value and a valuation made at 3 years purchase of average super profit for the last 4 years.

After tax profits and dividend rates were as follows:

Year	PAT (in lakhs) %	Dividend
2014	3.00	11
2015	3.50	12
2016	4.00	13
2017	4.10	14

Normal expectation in the industry to which the company belongs to is 10%. Kamalesh holds 20,000 equity shares of ₹10 each fully paid up and 10,000 equity shares of ₹4 each fully paid up. He wants to sell away his holdings.

(i) Determine the break-up value and market value of both kinds of shares.

(ii) What should be the fair value of shares, if controlling interest is being sold?

Note : Make necessary assumptions, wherever required.

Solution:

(i) Break up value of ₹1 of share capital = $\frac{\text{Net assets available for shareholder}}{\text{Total share capital}}$

$$= \frac{₹28.98 \text{ lakhs}}{₹16.00 \text{ lakhs}} = ₹1.81$$

Breakup value of ₹10 paid up share = 2.07 × 10 = ₹18.10

Breakup value of ₹ 6 paid up share = 2.07 × 6 = ₹10.86

Market value of shares

Average dividend = $\frac{11\% + 12\% + 13\% + 14\%}{4} = 12.5\%$

Market value of ₹ 10 paid up share = $\frac{12.5\%}{10\%} \times 10 =$ ₹12.50

Market value of ₹ 6 paid up share = $\frac{12.5\%}{10\%} \times 4$ = ₹7.50

(ii) Breakup value of share will remain as before even if the controlling interest is being sold. But the market value of share will be different as the controlling interest would enable the declaration of dividend upto the limit of disposable profit.

$$\frac{\text{Avereage Profit}}{\text{Paid up value of shares}} \times 100 = \frac{₹\ 3.4 \text{ lakhs}}{₹\ 16 \text{ lakhs}} \times 100 = 21.25\%$$

Market value of shares:

Fort ₹10 paid up share = $\frac{21.25\%}{10\%} \times 10$ = ₹ 21.25

For ₹6 paid up share = $\frac{21.25\%}{10\%} \times 10 \times 6$ = 12.75

For value of shares = $\frac{\text{Break up value + Market value}}{2}$

Fair value of ₹10 paid up share = $\frac{18.10 + 21.25}{2}$ = 19.68

Fair value of ₹ 6 paid up share = $\frac{18.10 + 12.75}{2}$ = 11.81

Working Notes:

	Particulars		
1	**Calculation of average capital employed**		
	Fixed assets		24.00
	Other tangible assets		3.00
	Intangible assets		3.00
	Less: Liabilities	10	30.00
	Bonus	1	(11.00)
	Net assets (excluding goodwill/Closing capital employed)		19.00
	Less: ½ of profits [½ (4.10 - 1.0 (i.e. Disputed Bonus)]		(1.55)
	Average Capital Employed		17.45
2.	**Calculation of average super profit for 4 years**		
	Average profit = ¼ [3+3.5+4+4.1 - 1.0(i.e. Bonus)] = ¼ × 13.60		3.400
	Less: Normal Profit 10% of ₹17.45 lakhs		(1.745)
	Super Profit		1.655

3.	**Calculation of goodwill [See Assumption below]**		
	3 years' purchase of average super profit		
	= 3 ×1.655 = ₹4.965 lakhs		
	Increase in value of goodwill = ½ (Book value + 3 years super profit)		
	= ½ (5+ 4.965) = ₹4.9825 lakhs		
	Net assets as valued in W.N. 1 including book value of goodwill Add: Goodwill as per the balance sheet	5.00	19.00
	Add: Increase in goodwill (rounded off)	4.98	9.98
	Net Assets available for shareholders.		28.98

Note: Tax effect on disputed bonus and corporate dividend tax has been ignored.

Assumption: Goodwill has been calculated on the basis of average capital employed. Alternatively it may be calculated on the basis of closing capital employed. Accordingly, the closing capital employed will be ₹19lakhs, super profit will be ₹1.5 lakhs, increase in the value of goodwill will be ₹4.75 lakhs and net assets available for shareholders will be ₹28.75 lakhs. In such a case, the break-up value of ₹1of share capital will be ₹1.80(instead of 1.81)

Illustration 11.

The following is the Balance Sheet of K Ltd. as on 31st March, 2018:

Balance Sheet

Liabilities	₹ in Lakh	Assets	₹ in Lakh
3,00,000 Equity shares of ₹10 each fully paid 12.5%	30,00,000	Goodwill	3,00,000
		Building	20,00,000
Redeemable preference shares of ₹100 each fully paid	19,00,000	Plant & Machinery	22,00,000
		Furniture	10,00,000
General Reserve	15,00,000	Investments	16,00,000
Profit & Loss A/c	3,00,000	Stock	12,00,000
Secured Loan	10,00,000	Debtors	20,00,000
Creditors	30,00,000	Bank Balance	4,00,000
	1,07,00,000		**1,07,00,000**

Additional Information:

(i) Fixed assets are worth 20% more than book value. Stock is overvalued by ₹1,00,000. Debtors are to be reduced by ₹40,000. Trade investments, which constitute 10% of the total investments are to be valued at 10% below cost.

(ii) Trade investments were purchased on 1.4.2017. 50% of non-trade investments were purchased on 1.4.2016 and the rest on 1.4.2017. Non-trade investments yielded 15% return on cost.

(iii) In2016-2017Furniture with a bookvalue of ₹1,00,000 was sold for ₹50,000. This loss should be treated as non-recurring or extraordinary item for the purpose of calculating adjusted average profit.

(iv) In2015-2016new machinery costing ₹2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) Return on capital employed is 20% in similar business.

(vi) Goodwill is to be valued at two years purchase of super profits based on simple average profits of last four years.

Profits of last four years are as under:

Year	Amount (in ₹)
2014-2015	13,00,000
2015-2016	14,00,000
2016-2017	16,00,000
2017-2018	18,00,000

(vii) It is assumed that preference dividend has been paid till date.

(viii) Depreciation on the overall increased value of assets (worth 20% more than book value) need not be considered. Depreciation on the additional value of only plant and machinery to be considered taking depreciation at 10% on reducing value method while calculating average adjusted profit.

Find out the intrinsic value of the equity share. Ignore income tax and dividend tax.

Solution:

1. Calculation of Goodwill

(i) Capital Employed

	₹	₹
Fixed assets:		
Building	20,00,000	
Plant and machinery (₹22,00,000 + ₹1,45,800)	23,45,800	
Furniture	10,00,000	
	53,45,800	
Add: 20% Appreciation	10,69,160	
	64,14,960	
Trade investments (₹16,00,000 x 10% x 90%)	1,44,000	
Debtors (₹20,00,000 - ₹40,000)	19,60,000	
Stock (₹12,00,000 - ₹1,00,000)	11,00,000	
Bank Balance	4,00,000	1,00,18,960
Less: Outside liabilities:		
Redeemable preference shares of ₹100 each fully paid	19,00,000	
Secured Loan	10,00,000	
Creditors	30,00,000	(59,00,000)
Capital employed		41,18,960

(ii) Future Maintainable Profit

Calculation of Average Adjusted Profit

	2014-2015	2015-2016	2016-2017	2017- 2018
	₹	₹	₹	₹
Profit	13,00,000	14,00,000	16,00,000	18,00,000
Add: Capital Expenditure of Machinery charged to revenue		2,00,000		
Loss on sale of furniture			50,000	
	13,00,000	16,00,000	16,50,000	18,00,000
Less: Depreciation on machinery		(20,000)	(18,000)	(16,200)
Income from non-trade investments (W.N.2)			(1,08,000)	(2,16,000)
Reduction in the value of stock				(1,00,000)
Bad debts				(40,000)
Adjusted Profit	13,00,000	15,80,000	15,24,000	14,27,800
Total adjusted profit for four years				58,31,800
Average profit (₹ 58,31,800/4)				14,57,950
Less: Depreciation at 10% on Additional Value of Machinery				
(22,00,000 + 1,45,800) × 20% × 10%				(46,916)
Average Adjusted Profit				14,11,034

(iii) Normal Profit 20% on Capital Employed, i.e. 20% on ₹41,18,960 = 823792

(iv) Super Profit = Average Adjusted profit-Normal profit

= ₹14,11,034 – ₹8,23,792 = ₹5,87,242

(v) Goodwill

= 2 years purchase of super profit

= ₹5,87,242 × 2 = ₹11,74,484

2. Trade investments = ₹16,00,000 × 10% × 90% = ₹ 1,44,000

Non-trade investment = ₹ 16,00,000 - ₹ 1,60,000 = ₹ 14,40,000

Non-trade investment purchased on 1.4.2014 = 50% of ₹ 14,40,000 = ₹ 7,20,000

Non-trade investment purchased on 1.4.2015 = ₹ 14,40,000 - ₹7,20,000 = ₹7,20,000

Income from non-trade investment:

In the year 2014-2015 : 7,20,000 x 15% = ₹ 1,08,000

In the year 2015-2016 : 7,20,000 x 15% = ₹ 1,08,000

7,20,000 x 15% = ₹ 1,08,000

= ₹ 2,16,000

Calculation of Intrinsic Value of Equity Shares of K Ltd.

Net Assets available for Equity Shareholders.

	(₹)	(₹)	(₹)
Goodwill (W.N.1)			11,74,484
Sundry fixed assets			64,14,960
Trade and non-trade investments			15,84,000
(1,44,000 + 14,40,000)			
Debtors			19,60,000
Stock			11,00,000
Bank balance			4,00,000
Total Assets			1,26,33,444
Less: Outside liabilities			
Redeemable preference shares of ₹100 each fully paid	19,00,000		
Secured loan	10,00,000		
Creditors	30,00,000	59,00,000	
			(59,00,000)
Net assets available for equity shareholders			67,33,444

Value of a equity shares = $\frac{\text{Net Assets Available to Equity Shareholders}}{\text{Number of Equity Shares}}$

$= \frac{₹\ 67,33,444}{3,00,000}$ = ₹ 22.44 (approx)

5.5 VALUATION OF GOODWILL

Goodwill is an intangible fixed asset of an organisation which has to be reflected in its books of accounts on certain circumstances. For this purpose, a money value is required to be attached to this intangible asset. The process of estimating the value of goodwill using certain accepted methodologies is referred to as **valuation of goodwill**.

METHODS OF GOODWILL VALUATION

Average Profit Method:

- As per this method, the value of goodwill depends on the past profit earning capacity of the entity.
- The past profits of certain given number of years are used to determine 'Average Profit'. Such Average Profit may be either 'Simple Average Profit' or 'Weighted Average Profit'.
- Finally, the value of goodwill is determined by multiplying the Average Profit so calculated by certain 'Number of Years' Purchase'.

  ∴ Value of Goodwill = Average Profit × No. of Years' Purchase

Student Note:

The variables which influence the valuation of goodwill are discussed hereunder:

- **Profit:** The term 'profit', here, refers to the past profits earned by the firm. These past profits are required to be adjusted/ modified for any abnormal or non-recurring items (whether gain or loss), which are not expected to arise in the future under normal circumstances. The past profit figures are, thus to be used to determine the 'Future Maintainable Profits' that is expected to be earned by the entity.

- **Simple Average Profit:** When there is no definite trend in the past profits, the past profits are simply aggregated and then divided by the number of years to determine the Average Profit. Since, in this case no weights are used on the past profits, the Average Profit, so determined, is referred to as Simple Average Profit.

$$\therefore \text{ Simple Average Profit} = \frac{P1 + P2 + \cdots + Pn}{n}$$ where, P = Profit of respective year;

n = Number of years

- **Weighted Average Profit:** When there exists a clear trend (either increasing or decreasing) in the past profits, the past profits are firstly by multiplied by certain 'weights', and then the products are aggregated. Finally, the aggregate figure is divided by the 'aggregate of all the weights' to arrive at the Weighted Average Profit.

$$\therefore \text{ Weighted Average Profit} = \frac{P1.W1 + P2.W2 + \cdots\cdots + Pn.Wn}{W1 + W2 + \cdots\cdots + Wn}$$ where, P = Profit of respective year;

W = Weight of respective year;

n = Number of years

- **Number of Years' Purchase:** For valuation of goodwill, the average profit determined is usually multiplied by a figure referred to as "Number of Years' Purchase". The phrase 'Number of Years' Purchase' refers to the expected number of future years for which the firm is expected to earn the average profit from the year of purchase. In other words, it is assumed to be the time period during which the entity will enjoy the profit earning capacity.

Illustration 12.

XY Ltd, a partnership firm, earned profits during the past 5 years as follows:

Year	2011	2012	2013	2014	2015
Profits (₹)	27,000	36,000	37,200	42,000	46,800

Determine the value of goodwill in each of the following independent cases:

Case (a): It was decided to value the Goodwill on the basis of 2 years' purchase of average profit of last five years.

Case (b): It was decided to value the Goodwill on the basis of 3½ years' purchase of average profit of last five years after giving weights of 1, 2, 3, 6 and 8 to the profits chronologically.

Case (c): It was decided to value the Goodwill on the basis of 3 years' purchase of weighted average profit of last five years giving maximum weightage to the recent results.

Case (d): It was decided to value the Goodwill on the basis of 2½ years' purchase of simple average profit of last five years. In this regard the following were observed:

(i) an abnormal loss of ₹ 1,800 was charged against the profit of 2013;

(ii) Profit of 2014 included a non-recurring receipt of ₹ 2,500.

(iii) closing stock of 2015 was over-valued by ₹ 2,400.

Solution:

Case (a):

$$\text{Average profit} = \frac{₹27,000 + ₹36,000 + ₹37,200 + ₹42,000 + ₹46,800}{5} = ₹\ 37,800$$

∴ Value of Goodwill = ₹ 37,800 × 2 years' purchase = ₹ 75,600

Case (b):

$$\text{Weighted average profit} = \frac{(₹27,000 \times 1) + (₹36,000 \times 2) + (₹37,200 \times 3) + (₹42,000 \times 6) + (₹46,800 \times 8)}{1 + 2 + 3 + 6 + 8} = ₹\ 41,850$$

∴ Value of Goodwill = ₹ 41,850 × 3½ years' purchase = ₹ 1,46,475

Case (c):

$$\text{Weighted average profit} = \frac{(₹27,000 \times 1) + (₹36,000 \times 2) + (₹37,200 \times 3) + (₹42,000 \times 4) + (₹46,800 \times 5)}{1 + 2 + 3 + 4 + 5} = ₹\ 40,840$$

∴ Value of Goodwill = ₹ 40,840 × 3 years' purchase = ₹ 1,22,520

Case (d):

For valuation of goodwill under simple average method, average profit of last few years is to be multiplied by number of year of purchase. Here, the term 'profit' refers to 'Future Maintainable Profits' that the entity can expect to earn in the future. For determining such maintainable profit, past profits are required to be adjusted/ modified for any abnormal or non-recurring items (whether gain or loss), which are not expected to arise in the future under normal circumstances.

In this case,

Profit of 2013 = Profit (as given) + Abnormal loss sustained in 2013 (which cannot be expected to occur in future)

= ₹ 37,200 + ₹ 1,800 = ₹ 39,000

Profit of 2014 = Profit (as given) – Non-recurring receipt of 2014 (which cannot be expected to occur in future)

= ₹ 42,000 – ₹ 2,500 = ₹ 39,500

Profit of 2015 = Profit (as given) – Overvaluation of closing stock (rectification of profit)

= ₹ 46,800 – ₹ 2,400 = ₹ 44,400

$$\text{Simple Average profit} = \frac{₹27,000 + ₹36,000 + ₹39,000 + ₹39,500 + ₹44,400}{5} = ₹\ 37,180$$

∴ Value of Goodwill = ₹ 37,180 × 2½ years' purchase = ₹ 92,950

Super Profit Method:

- As per this method, the value of goodwill depends on the extra (i.e. super) profit earning capacity of an entity.
- Such 'Super Profit' refers to the excess profit earned by the entity over the normal profit that should be earned by a similar firm in the industry.
- Mathematically, Super Profit = Average Future Maintainable Profit – Normal Profit

  i.e. Super Profit = Average Future Maintainable Profit – (Average Capital Employed × Normal rate of return)
- Finally, the value of goodwill is determined by multiplying the Super Profit, so calculated, by certain 'No. of Years' Purchase'.

∴ Value of Goodwill = Super Profit × No. of Years' Purchase

Student Note:
The different variables which influence the valuation of goodwill under 'Super Profit method' are:
• **Super Profit:** Every firm in an industry is expected to earn a normal rate of return. If a particular firm of the industry manages to earn a rate of return that happens to be more than the normal industry rate of return, then such a firm is said to be earning 'Super Profits'. The value of goodwill, under this method, is correlated with this extra profit earning capacity of the firm.
• **Average Future Maintainable Profit:** It refers to the profit that is expected to be earned by the entity in the future under normal circumstances. For this purpose, the past profits that are required to be adjusted/ modified for any abnormal or non-recurring items (whether gain or loss).
• **Capital Employed:** Capital Employed refers to the amount of capital that has been invested in the firm. It is measured as the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the current liabilities. Alternatively, it is the aggregate of Owned Capital, Accumulated Profits and Borrowed Capital, if any.
• **Average Capital Employed:** Average Capital Employed is determined by averaging the capital employed at the beginning of the accounting period and that at the end of the accounting period. Mathematically,
$\text{Average Capital Employed} = \frac{\text{Opening Capital Employed + Closing Capital Employed}}{2}$
• **Normal Rate of Return:** It is the rate of return that is usually earned by any firm belonging to a particular industry.
• **Number of Years' Purchase:** For valuation of goodwill, the super profit is usually multiplied by a figure referred to as "Number of Years' Purchase". The phrase 'Number of Years' Purchase' refers to the expected number of future years for which the firm is expected to earn such super profits from the year of purchase.

Illustration 13.

XY Ltd, a partnership firm, earned profits during the past 4 years as follows:

Year	2012	2013	2014	2015
Profits (₹)	42,000	46,000	52,000	46,500

Firm has total assets worth ₹ 82,000 and its current liability includes only creditors of ₹ 12,800. The normal rate return is 10%. Determine the value of goodwill on the basis of 2½ year's purchase of super profits.

Solution:

Average Future Maintainable Profit = $\frac{₹42,000 + ₹46,000 + ₹52,000 + ₹46,500}{4}$ = ₹46,625

Here, Capital employed = Total assets – Current Liabilities = ₹ 82,000 – ₹ 12,800 = ₹69,200

Normal profit = Capital employed × Normal rate of return = ₹ 69,200 × 10% = ₹6,920

∴ Super profit = Average Future Maintainable Profit – Normal profit = ₹ 46,625 – ₹ 6,920 = ₹ 39,705

∴ Value of Goodwill = ₹ 39,705 × 2½ years' purchase = ₹ 99,263 (approx.)

Annuity Method:

- This method of goodwill valuation considers the 'time value of money'.
- Under this method, Value of Goodwill = Super Profit × Annuity Value

Student Note:

The different variables which influence the valuation of goodwill under 'Super Profit method' are:

- **Super Profit**: It refers to the excess profit earned by the entity over the normal profit that should be earned by a similar firm in the industry.
- **Annuity:** Annuity refers to a series of continuous cash flows (either cash inflows or cash outflows) of equal amount that occur in every period, over a specified period of time.
- **Annuity Value**: It is determined either from the Annuity Table or may be ascertained from the following formula:

  Annuity Value = $\frac{(1+r)^n - 1}{r(1+r)^n}$ where, r = Rate of Interest per period, and n = Number of periods.

Illustration 14.

From the following particulars you are required to determine value of goodwill of ABX Ltd.

Super Profit (Computed)	: ₹ 4,50,000
Normal rate of return	: 12%
Present value of annuity of ₹1 for 4 years @ 12%	: 3.0374

Solution:

Value of goodwill = Super profit × P.V of Annuity of ₹ 1for 4 years @ 12%

= ₹ 4,50,000 × 3.0374 = ₹ 13,66,830

Illustration 15.

The following details relate to M/s XYZ, a firm:

Average profit of last four years	: 7,00,000
Average capital employed by the firm	: ₹ 55,00,000
Normal rate of return	: 10%
Present value of annuity of ₹1 for 4 years @ 10%	: 3.1699

Determine the value of goodwill on the basis of annuity of super profit.

Solution:

Super Profit = Average Future Maintainable Profit – Normal Profit

= Average Future Maintainable Profit – (Average Capital Employed X Normal rate of return)

= ₹ 7,00,000 – (₹ 55,00,000 × 10%)

= ₹ 1,50,000

∴ Value of goodwill = Super profit × P.V of Annuity of ₹ 1for 4 years @ 10%

= ₹ 1,50,000 × 3.1699 = ₹ 4,75,485

Capitalisation Method:

- There are two ways of determining the value of goodwill using the capitalisation approach. They are:
  - Capitalisation of Average Profits; and
  - Capitalisation of Super Profits.
- **Capitalisation of Average Profits**: When the average profits are capitalised, then firstly, the 'Capitalised Value of the firm' is determined and there from the 'Net Assets' are deducted to arrive at value of goodwill.

  Mathematically, Capitalised Value of the firm = $\frac{\text{Average Future maintainable profit}}{\text{Normal rate of return (\%)}}$; and

  Value of Goodwill = Capitalised Value of the firm **Less** Net Assets
- **Capitalisation of Super Profits**: When the super profits are capitalised, then the value of goodwill is directly ascertained.

  Value of Goodwill = $\frac{\text{Super Profit}}{\text{Normal rate of return (\%)}}$

Student Note:
The different variables which influence the valuation of goodwill under 'Super Profit method' are: • **Capitalised Value of the firm:** It refers to the standard value of the firm i.e. what ought to be the value of the firm considering its profit earning capacity at the normal rate of return. • **Net Assets:** It refers to the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the external liabilities. In other words, it refers to the Net Worth of the entity. • **Super Profit**: It refers to the excess profit earned by the entity over the normal profit that should be earned by a similar firm in the industry.

Illustration 16.

A firm values goodwill under 'Capitalisation of profits' method. Its average profits for past 4 years has been determined at ₹ 72,000. Net Assets and Capital employed in the business is ₹4,80,000 and ₹ 5,00,000 respectively; and its normal rate of return is 12%.

Determine value of goodwill based on:

(a) Capitalisation of Average Profits

(b) Capitalisation of Super Profits

Solution:

(a) **Capitalisation of Average Profits**

In this case, Capitalised Value of the Business = $\frac{\text{Expected Average Profit}}{\text{Normal Rate of Return}} = \frac{₹\ 72{,}000}{12\%}$ = ₹ 6,00,000

∴ Value of Goodwill = Capitalised Value of the Business ***Less*** Net Assets

= ₹ 6,00,000 – ₹4,80,000 = ₹ 1,20,000

(b) **Capitalisation of Super Profits**

In this case, Value of Goodwill = $\frac{\text{Super Profit}}{\text{Normal rate of return (\%)}}$

Super profit = Average profit – Normal Profit = Average profit – (Capital employed X Normal rate of return)

= ₹ 72,000 – (₹ 5,00,000 × 12%)

= ₹ 72,000 – 60,000

= ₹ 12,000

∴ Value of Goodwill = $\frac{\text{Super Profit}}{\text{Normal rate of return (\%)}} = \frac{12{,}000}{12\%}$ = ₹ 1,00,000

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

6.1 INTRODUCTION

In recent times, different types of share plans and share option plans have become a common feature of remuneration packages for senior executives, directors and other employees in many countries. Moreover, Shares and share options may also be used to pay suppliers for providing professional services. All these mode of payment are known as **Share-based Payment**.

Share based payments cover all forms of share-based payment for the goods as-well-as for the services supplied to the reporting entity, including:

- employee share or share option schemes;
- share-based payments to parties other than employees that have supplied goods or services to the entity;
- payments to be settled in cash or other assets at amounts that depend on share values, e.g. share appreciation rights.

The accounting for Share-based Pay

Payments" fills a gap in accounting for the recognition and measurement of such transactions. These standards require an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees.

6.2 SHARE BASED PAYMENT

A **share-based payment** is a transaction in which the entity receives goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity.

Employee share-based payments are incentive payments to employees in form of shares. The expression employee share-based payments also include cash incentives to employees, the size of which is linked with value of shares. The payment in form of shares generally involve grant of options to employees to subscribe shares of employer's enterprise at a concessional price, called the exercise price.

The employees gain the excess of market price of share at the time of exercise over the specified exercise price. In case of employee share-based payments in form of cash incentive, the excess of market price on specified future date and a stated price is paid in cash. In either case, the value of incentive depends on increase in share

value, which is the generally accepted indicator financial success of a business. By linking incentives with value of shares, the employee share-based payment plans effectively integrate personal goals of employees with that of the enterprise.

The day a share-based payment plan is announced and accepted by employees is called the grant date and the day, when the employees become entitled to such payments, is called the vesting date. The period between these two dates is called the vesting period. To qualify for the incentives, the employees put in their efforts during the vesting period to fulfill specified vesting conditions, e.g. reaching a specified sales/profit target. Exercise date is the date when an option is exercised by paying the exercise price.

The value of share-based payment depends on the market value of shares on vesting date/exercise date and hence cannot be known with certainty before these dates. Nevertheless, since the share-based payments are payments for services rendered by employees during the vesting period, the value of share-based payments should be recognised as expense during the vesting period, i.e. before value of such payments are known with certainty.

Two principal issues involved in accounting for employee share-based payments are:

(i) Problem of valuation of share-based payments before vesting date; and

(ii) Problem of allocation of the estimated value of share-based payment to a particular accounting period during the vesting period for recognition as expense.

6.3 EMPLOYEE SHARE BASED PAYMENT PLANS

It is an agreement between an entity (or another group entity or a shareholder of a group entity) and another party including an employee) which entitles the other party to receive:

- Equity instruments (including shares or share options) of the entity (or another group entity); or
- Cash (or other assets) for amounts based on the price (or value) of equity instruments of the entity (or another group entity), provided specified vesting conditions (if any) are met.

  "Vest" means to become an entitlement. A party's right to shares of an entity may be free or at a pre-arranged exercise price.

Important Terminology:

Important Terminology:
• **Grant:** Grant of the option means giving an option to the employees to subscribe to the shares of the company.
• **Vesting:** It is the process by which the employee is given the right to apply for shares of the company against the option granted to him in purchase of employee in pursuance of employee stock option scheme (ESOS).
• **Vesting Period:** It is the time period during which the vesting of the option granted to the employee on pursuance of ESOS takes place.
• **Option:** Option means a right but not an obligation granted to an employee in pursuance of ESOS to apply for shares of the company at a pre-determined price.
• **Exercise Period:** It is the time period after vesting within which the employee should exercise his right to apply for shares against the option vested in him in pursuance of the ESOS.
• **Exercise Price:** It is the price payable by the employee for exercising the option granted to him in pursuance of ESOS.
• **Intrinsic Value:** It is the excess of the market price of the share under ESOS over the exercise price of the option (including up-front payment, if any).
• **Fair Value:** It is the amount for which stock option granted or a share offered for purchase could be exchanged between knowledgeable, willing parties in an arm's length transaction.

TYPES OF SHARE BASED PAYMENT PLANS

Share-based payment plans generally take three forms i.e. Employee Stock Option Plans (ESOP), Employee Stock Purchase Plans (ESPP) and Stock Appreciation Rights (SAR).

These are being defined as follows:

- **Employee Stock Option Plan (ESOP):** It is a contract that gives the employees of an enterprise the right, but not obligation, for a specified period to purchase or subscribe to the specified number shares of the enterprise at a fixed or determinable price, called the exercise price.
- **Employee Stock Purchase Plan (ESPP):** Under Employees' Stock Purchase Plans (ESPP), employees are given an option to subscribe to shares of employer in a public issue or otherwise. The exercise price is set at a specified rate of discount on the issue price/ market price on the date of exercise.
- **Stock Appreciation Rights (SAR):** These are the rights that entitle the employees to receive cash or shares for an amount equivalent to the excess of market price on exercise date over a stated price.

6.4 SHARE BASED PAYMENT TRANSACTION

A transaction in a share based payment arrangement in which the entity:

- Receives goods or services from a supplier (including an employee); or
- Incurs an obligation (to the supplier) when another group entity receives those goods or services.

TYPES OF SHARE BASED PAYMENT TRANSACTIONS

There are three types of share-based payment transactions:

- **Equity-settled share-based payment transactions:** Under this type of Share-based Payment transaction, an entity receives services, as consideration for its own equity instruments or it has no obligation to settle the transaction with the supplier.
- **Cash-settled share-based payment transactions:** Under this type of Share-based Payment transaction, the entity acquires services by incurring liabilities for amounts that are based on the price (or value) of equity instruments of the entity or another group entity.
- **Share-based payment transactions with cash alternatives:** Here an entity has a choice of issuing shares or paying cash then the entity shall recognise a liability if it determines that it has an obligation to settle the liability in cash. If on settlement the entity issues shares rather than paying cash then the value of the liability should be transferred to equity.

6.5 RECOGNITION OF SHARE BASED PAYMENT IN FINANCIAL STATEMENT

An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received.

The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.

6.6 MEASUREMENT OF SHARE BASED PAYMENT

The measurement of Share-based Payment is as under:

- **In case of equity-settled share-based payment transactions:** the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.
- **In case of cash-settled share-based payment transactions:** The entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall re-measure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.
- **In case of share-based payment transactions with cash alternatives:** For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

6.7 DISCLOSURE

The entity is required to disclose information that enables users of the Financial Statements to understand the nature and extent of share-based payment arrangements that existed during the period.

An entity shall disclose at least the following:

(a) A description of each type of share based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement,

(b) The number and weighted average exercise prices of share options for each of the following groups of options:

- outstanding at the beginning of the period
- granted during the period
- forfeited during the period
- exercised during the period
- expired during the period
- outstanding at the end of the period
- exercisable at the end of the period

(c) For share options exercised during the period, the weighted average share price at the date of exercise. For share options outstanding at the end of the period, the range of exercise prices and weighted average remaining contractual life.

(d) An entity shall disclose information that enables users of the financial statements to understand how the FV of the goods or services received or the FV of the equity instruments granted, during the period was determined.

6.8 ACCOUNTING

For equity settled transaction:

Expense/ Asset	Dr.	and Equity	Cr.

For cash settled transaction:

Expense/Asset	Dr.	and Liability/ Asset	Cr.

Example 1.

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

Solution:

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

Example 2.

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

Solution:

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

Example 3.

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

Solution:

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

Example 4.

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

Solution:

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

Example 5.

Share-based payment transaction in which the entity cannot identify specifically some or all of the goods or services received: An entity granted shares with a total fair value of ₹100,000 to parties belonging to differently abled classes in the locality for enhancing its corporate image and the fair value of the goods or services received there for cannot be estimated reliably. Ind AS 102 will apply and Asset would be debited and Equity would be credited by ₹ 100000, the fair value of the equity instruments granted.

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.

<table>
<tr><td colspan="3">Whether vesting condition requires only specified period of service?</td></tr>
<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.

Illustrations 1.

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.

a: Is there any share based payment transaction as per Ind AS 102?

A: Yes.

b: Is the transaction equity settled or cash settled?

A: Equity settled.

c: At what value the transaction will be recognized?

A: At fair value on the Grant date, ie at ₹ 30.

d: When will the transaction be recognized?

A: In future at the time of Financial reporting in every relevant year proportionately to services received.

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

A: Calculation of Remuneration expense and Cumulative remuneration expense for 3 years

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense for the year (₹)
1	400*100*30*1/3	400000	400000
2	400*100*30*2/3	800000	400000
3	400*100*30*3/3	1200000	400000

f: Additional information to (e): On the basis of a weighted average probability, the entity estimates that 20 per cent of employees will leave during the three-year period and therefore forfeit their rights to the share options.

A:

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense for the year (₹)
1	400×100×30×80% × 1/3	320000	320000
2	400×100×30×80% × 2/3	640000	320000
3	400×100×30×80% × 3/3	960000	320000

g: Additional information to f) (Category A): 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.

A:

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense for the year (₹)
1	400×100×30×84% × 1/3	336000	336000
2	400×100×30×87% × 2/3	696000	360000
3	348×100×30×3/3	1044000	348000

Illustration 2.

(Category D) Grant with a performance condition, in which the length of the vesting period varies:

At the beginning of year 1, X Ltd. grants 200 shares each to 400 employees, conditional upon the employees' remaining in employment with the company during the vesting period. The shares will vest at the end of year 1 if the entity's earnings increase by more than 15 per cent; at the end of year 2 if the entity's earnings increase by more than an average of 12 per cent per year over the two-year period; and at the end of year 3 if the entity's earnings increase by more than an average of 10 per cent per year over the three-year period. The shares have a fair value of ₹ 40 per share at the start of year 1. No dividends need be considered.

By the end of year 1, the entity's earnings have increased by 13 per cent, and 32 employees left. The entity expects further 30 employees to leave during year 2. By the end of year 2, the entity's earnings have increased by only 11 per cent and 27 employees left during the year. The entity expects a further 25 employees to leave during year 3. By the end of year 3, 22 employees left and the company's earnings increased by 9 per cent, resulting in an average increase over 10 per cent per year.

Answer:

The share based payments to be accounted as follows:

Year	Calculation (#)	Cumulative remuneration expense (₹)	Remuneration expense for the year (₹)
1	338×200×40 × 1/2	13,52,000	13,52,000
2	316×200×40 × 2/3	16,85,333	3,33,333
3	419×200×40 × 3/3	25,52,000	8,66,667

\# 400 – (32 + 30) = 338

400 – (32 + 27 + 25) = 316

400 – (32 + 27 + 22) = 319

Illustration 3.

Grant with a performance condition, in which the number of equity instruments varies (Category D).

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

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

Answer:

Year	Calculation (#)	Cumulative remuneration expense (₹)	Remuneration expense for the year (₹)
1	168*240*40*1/3	537600	537600
2	173*360*40*2/3	1660800	1123200
3	170*360*40*3/3	2448000	787200

#	At the end of	No. of employee	No. of share options	
	Year 1	200 – (32) = 168	240	since revenue increase is 12% (10 - 15)%
	Year 2	200 – (22 + 5) = 173	360	since revenue increase is 18% (>15%)
	Year 3	200 – (22 + 8) = 170	360	since revenue increase is 16% (>15%)

Illustration 4.

Grant with a performance condition, in which the exercise price varies (Category D).

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

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

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

Answer:

Year	Calculation	Cumulative remuneration expense (₹)	Remuneration expense for the year (₹)
1	10,000 options × ₹16 × 1/3	53,333	53,333
2	10,000 options × ₹16 × 2/3	106,667	53,334
3	10,000 options × ₹12 × 3/3	120,000	13,333

Illustration 5.

For grants of equity instruments with market conditions, the entity recognises the goods or services received from a counterparty who satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied.

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

Answer:

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

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

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:

Particulars		Dr.	Cr.
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:

Particulars		Dr.	Cr.
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*21 – 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)			

Study Note - 7

REPORTING THROUGH XBRL (EXTENSIBLE BUSINESS REPORTING LANGUAGE)

This Study Note includes

7.1 Concept of XBRL
7.2 Meaning of XBRL
7.3 Definition of XBRL
7.4 Important XBRL Related Concepts
7.5 Myths Regarding XBRL
7.6 Features of XBRL Reporting
7.7 Benefits of XBRL Reporting
7.8 Users of XBRL
7.9 XBRL International
7.10 XBRL in India

7.1 CONCEPT OF XBRL

XBRL stands for 'e**X**tensible **B**usiness **R**eporting **L**anguage'. XBRL is the open international standard for digital business reporting. It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet.

The basic idea behind XBRL is that instead of treating financial information as a block of text or numeric items, a unique electronically readable tag is attached to each individual financial term. It is not just the data or text that floats around, these individual items move along with an electronic tag. Thus, it is not just the 'content' but also the 'context' is being transmitted XBRL is the international standard for digital reporting of financial, performance, risk and compliance information, although it is also used for many other types of reporting. It offers major benefits to all those who have to create, transmit, use or analyse such business information.

It has been developed and refined over more than a decade ago and supports almost every kind of conceivable reporting. Moreover, it also provides a wide range of features that enhance the quality and consistency of reports, as well as their usability. It provides benefits in the preparation, analysis and communication of business information and is fast becoming an accepted reporting language across the globe.

The change from paper, PDF and HTML based reports to XBRL ones is a little bit like the change from film photography to digital photography, or from paper maps to digital maps. The new format allows you to do all the things that used to be possible, but also opens up a range of new capabilities because the information is clearly defined, platform-independent, testable and digital. Just like digital maps, digital business reports, in XBRL format, simplify the way that people can use, share, analyse and add value to the data. Millions of XBRL documents are getting generated every year, replacing older, paper-based reports with more useful, more effective and more accurate digital versions. [Source: www.xbrl.org]

XBRL is today used for multiple purposes, some of which include:

- Accounting (individual transactions tagged with XBRL Global Ledger);
- Internal Reporting (for drafting of management reports);
- External Reporting (for drafting of financial statements, regulatory reports, corporate tax filings, statistical reports etc.)

7.2 MEANING OF XBRL

XBRL is a language for the electronic communication of business and financial data which is revolutionising the business reporting around the world. The term XBRL includes four terminologies – Extensible, Business, Reporting and Language. These terms are briefly discussed hereunder:

(a) **Extensible**: This term implies that the user can extend the application of a particular business data beyond its original intended purpose. The major advantage in it is that the extended use can be determined even by the users and not just the ones who merely prepare the business data. This is achieved by adding tags which are both human and machine readable – describing what the data is.

(b) **Business:** This platform is relevant to any type of business transaction. It is to be noted that XBRL focus is on describing the financial statements for all kinds of entities.

(c) **Reporting**: The intention behind promoting the use of XBRL is to have all companies report their financial statements in a consolidated manner using the specified formats.

(d) **Language**: XBRL is based on 'e**X**tensible **M**arkup **L**anguage' (XML). It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet. It prescribes the manner in which the data can be "marked-up" or "tagged" to make it more meaningful to human readers as well as to computers-based system.

7.3 DEFINITION OF XBRL

As per **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015**, Extensible Business Reporting Language" (XBRL), means a standardised language for communication in electronic form to express, report or file financial information by the companies under the Act (i.e. Companies Act, 2013).

7.4 IMPORTANT XBRL RELATED CONCEPTS

1. XML

XML stands for 'e**X**tensible **M**arkup **L**anguage'. It is a markup language for documents containing structured information. A markup language is a mechanism to identify structures in a document.

XML defines a set of rules for encoding documents in a format that is both human-readable and machine-readable. It is a textual data format with strong support (via Unicode) for different human languages.

There are hundreds and thousands of computers programming languages and one among them is XML. Also XML markup language has types of programming languages. There are nearly 200 types of XML markup languages, and XBRL happens to be one of them. XBRL is XML-based and therefore is expected to be widely available in software applications.

Hyper Text Mark-up Language (HTML) is a markup language for describing web documents. HTML is a cornerstone technology used to create web pages as well as to create user interfaces for mobile and web applications. However, this mark-up language suffered from certain limitations, they being – Limited number of Tags, forgiving Browsers, Browser developers may be tempted to add new tags that only work with their product, Cannot customize layout from client side, Product comparison to mention a few. These limitations of HTML gave birth to XML.

It was the World Wide Web Consortium (W3C) where XML group (originally known as the SGML Editorial Review Board) worked and invented XML. The work was started in 1996. On 10th February, 1998 XML version 1.0 recommendation was released.

2. TAXONOMY

Taxonomies are the reporting-area specific hierarchical dictionaries used by the XBRL community. They define the specific tags that are used for individual items of data (such as "net profit"), their attributes and their interrelationships.

As per **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015**, taxonomy means in XBRL, an elechonic dictionary for reporting the business data as approved by the Central Govemment in respect of any documents or forms indicated in these rules.

Different taxonomies will be required for different business reporting purposes. Some national jurisdictions may need their own reporting taxonomies to reflect local accounting and other reporting regulations. Many different organisations, including regulators, specific industries or even companies, may require taxonomies or taxonomy extensions to cover their own specific business reporting needs.

Taxonomies which have been officially recognized by XBRL International are listed under '**Recognized Taxonomies**'. Some of the recognized taxonomies are:

- India Banking GAAP Taxonomy 2010
- BRAZIL GAAP Commercial and Industrial Taxonomy
- Indonesia Stock Exchange (IDX) Taxonomy 2014
- Japan EDINET Taxonomy 2010
- Canadian Financial Reporting According to Canadian GAAP
- General Purpose Financial Reporting for Profit-Oriented Entities Chilean Laws
- Taxonomie Comptes Annuels (TCA) (France)
- US Governance, Risk and Compliance (GRC) Open Compliance and Ethics Group (OCEG) Taxonomy
- Tata Index for Sustainable Human Development Taxonomy
- MIX Microfinance Taxonomy
- RSC – CCI Scoreboard for Corporate Social Responsibility Taxonomy 2010

7.5 MYTHS REGARDING XBRL

This section clarifies certain myths regarding XBRL. In other words, it is discussed what XBRL is not:

(a) **XBRL is not a set of Accounting Standards**: It needs to be clearly understood that XBRL does not represent a set of accounting standards, which remain the prerogative of the regulatory standards bodies. XBRL is merely a platform on which reporting standards content will reside and be represented.

(b) **XBRL is not a chart of accounts:** It is not a detailed universal chart of accounts. Formulation of a company's chart of accounts is an exercise conducted by its management with regard to its specific business intricacies. XBRL can facilitate the implementation of such structures through its ability to transport data between disparate software applications that might be used within an organizations operational structures.

(c) **XBRL is not a GAAP translator:** It does not provide a mechanism for facilitating a drilldown of existing GAAP information into lower levels of information that would be necessary for translating financial statements from one GAAP to another. The business-reporting document contains the same GAAP information, be it in an XBRL format or an MS word or PDF format.

(d) **XBRL is not a proprietary technology**: XBRL is freely licensed and available to the public.

(e) **XBRL is not a Transaction Protocol**: XBRL deals with business reporting information, not with data capture at the transaction level. It is designated to address issues related to generation and usage of information contained within business reports and begin at the accounting classification level.

7.6 FEATURES OF XBRL REPORING

1. **Clear Definitions**

   XBRL allows the creation of reusable, authoritative definitions, called taxonomies, which capture the meaning contained in all of the reporting terms used in a business report, as well as the relationships between all of the terms. Taxonomies are developed by regulators, accounting standards setters, government agencies and other groups that need to clearly define information that needs to be reported upon. XBRL doesn't limit what kind of information is defined: it's a language that can be used and extended as needed.

2. **Testable Business Rules**

   XBRL allows the creation of business rules that constrain what can be reported. Business rules can be logical or mathematical, or both. These business rules can be used to:

   - Prevent poor quality information being sent to a regulator or third party, by being run by the preparer while the report is in draft stage.
   - Prevent poor quality information being accepted by a regulator or third party, by being run at the point that the information is being received. Business reports that fail critical rules can be sent back to the preparer for review and resubmission.
   - Identifying or highlighting questionable information, allowing prompt follow up, correction or explanation.
   - Creation of ratios, aggregations and other kinds of value-added information, based on the fundamental data provided.

3. **Multi-lingual Support**

   XBRL allows concept definitions to be prepared in as many languages as necessary. Translations of definitions can also be added by third parties. This means that it's possible to display a range of reports in a different language to the one that they were prepared in, without any additional work. The XBRL community makes extensive use of this capability as it can automatically open up reports to different communities.

4. **Strong Software Support**

   XBRL is supported by a very wide range of software from vendors large and small, allowing a very wide range of stakeholders to work with the standard.

7.7 BENEFITS OF XBRL REPORING

The benefits of reporting under XBRL over traditional form are:

1. **Automated Data Processing**: The use of XBRL offers major benefits to the preparers and users of business and financial information by enabling this data to be exchanged and processed automatically by the software. XBRL identification tags reduce and eliminate the need for the data entry operator to manually key data into the software.
2. **More accurate and efficient**: XBRL makes reporting more accurate and more efficient by using comprehensive definitions and accurate data tags. Such data tags allow the preparation, validation, publication, exchange, consumption and analysis of business information of all kinds.
3. **Data Review:** Organisations can use software to automatically validate data electronically received through XBRL. The software can help analyse the data and identify problems that accountants and auditors can examine.
4. **Improved reporting quality:** XBRL provides its users with increased data integrity and uniformity. It also allows for increased transparency of public owned companies' financial records for view by 'interested' parties.

5. **Interchangeable**: Information in reports prepared using the XBRL standard is interchangeable between different information systems in entirely different organisations. This allows for the exchange of business information across a reporting chain. The users who intend to report information, share information, publish information and allow straight through information processing rely on XBRL.

6. **Cost and time savings:** Currently all companies file their reports with regulators using formats like the Portable Document Format (PDF) which has its inherent limitations. Moreover, the costs of sending, receiving, storing, validating and auditing the financial records in this format are comparatively higher. XBRL reduces the involved time and also the cost.

7. **Tagging of transactions**: In addition to allowing the exchange of various business reports, XBRL has the capability to allow the **tagging of transactions** that can themselves be aggregated into XBRL reports. These transactional capabilities allow system-independent exchange and analysis of significant quantities of supporting data. XBRL allows unique tags to be associated with reported facts, which leads to the following advantages:

   - publishing of reports with the confidence that the information contained in them can be consumed and analysed accurately;
   - testing of the reports against a set of business and logical rules, in order to capture and avoid mistakes at their source;
   - using the information in the way that best suits the users' needs, including by using different languages, alternative currencies and in their preferred style
   - providing confidence to the users that the data provided to them conforms to a set of sophisticated pre-defined definitions.

7.8 USERS OF XBRL

XBRL is the international standard for digital reporting. It offers benefits to all those who have to create, transmit, use or analyse such information. XBRL is used in many different ways, for many different purposes. The significant users of XBRL include:

1. **Companies:** Companies are required to provide relevant information to various stakeholders, and to accurately move information amongst them.

2. **Not-for-profit Organisations**: Several not-for-profit organisations, like universities, municipalities etc. opt for reporting under XBRL format.

3. **Accountants:** Accountants use XBRL in support of clients reporting requirements and are required to prepare and present financial statements using XBRL.

4. **Analysts:** Analysts that need to understand relative risk and performance.

5. **Investors:** Investors that need to compare potential investments and understand the underlying performance of existing investments.

6. **Regulatory Authorities:** The different regulatory authorities that use XBRL include:

   - **Financial regulators** that need significant amounts of complex performance and risk information about the institutions that they regulate.
   - **Securities regulators and stock exchanges** that need to analyse the performance and compliance of listed companies and securities, and need to ensure that this information is available to markets to consume and analyse.
   - **Business registrars** that need to receive and make publicly available a range of corporate data about private and public companies, including annual financial statements.

7. **Government agencies:** Government agencies that are in the process of simplifying the process of businesses reporting, reducing red tape (either by harmonising data definitions or consolidating reporting obligations, or both), or improving government reporting by standardising the way that consolidated or transactional reports are prepared.
8. **Tax authorities:** The tax authorities need financial statements and other compliance information from companies in order to process and review their corporate tax affairs.
9. **Statistical and monetary policy authorities:** These authorities that need financial performance information from many different organisations.
10. **Specialist Data Providers:** Specialist data providers that use published information for the purpose of creating comparisons, ratings and other value-added information products for various market participants.

7.9 XBRL INTERNATIONAL

XBRL is managed by ***XBRL International Inc.(XII)***. XBRL International is a global not-for-profit consortium of approximately 600 companies and agencies worldwide working together to build the XBRL language, and promote and support its adoption. It is comprised of jurisdictions which represent countries, regions or international bodies and which focus on the progress of XBRL in their area. The number of established jurisdictions has grown from 7 to 22 over the years. Around 5 jurisdictions, including India are presently in the provisional stage.

It operates mainly through the *XBRL Steering Committee* and has over the years produced a variety of specifications and taxonomies for digitizing financial information in accordance with the accounting rules and other regulations prevailing in different countries. The consortium members meet periodically in international conferences and conduct committee work regularly throughout the week.

This collaborative effort began in 1998 and has produced a variety of specifications and taxonomies to support the goal of providing a standard, XML-based language for digitizing business reports in accordance with the rules of accounting in each country or with other reporting regimes such as banking regulation or performance benchmarking

Presently, XBRL is used around the world, in more than 60 countries.

7.10 XBRL IN INDIA

The XBRL global initiative is led by a non-profit organisation called XBRL International Inc. (XII), which has members from various agencies from more than 164 countries. In India, the Ministry of Corporate Affairs (MCA) has switched over its reporting format to XBRL for Annual Report and Cost Audit report filings. The Reserve Bank of India (RBI) has also moved to XBRL reporting for the Banking Industry while the Securities & Exchange Board of India (SEBI) has mandated reporting by Mutual Funds though XBRL mode. The responsibilities of forming a XBRL national jurisdiction and the implementation of the standards for financial reporting in India have been entrusted to the Institute of Chartered Accountants of India (ICAI).

XBRL India

XBRL India is the Indian Jurisdiction of XBRL International. Its main objective is to promote and encourage the adoption of XBRL in India as the standard for electronic business reporting in India. XBRL India is working closely with regulators, stock exchanges and software companies for promotion of XBRL as a Standard Business Reporting Language. XBRL India is developing taxonomies for specific industries in consultation with the respective regulators viz. Insurance, Power and NBFCs.

Adoption of XBRL in India

XBRL adoption is widespread in India, with the Ministry of Corporate Affairs (annual report and cost audit report filings), the Reserve Bank of India and the Securities and Exchange Board (mutual funds) also having XBRL reporting mandates. The implementation and regulatory framework of XBRL in India is governed by these regulatory agencies.

[A] Adoption of XBRL by Ministry of Corporate Affairs (MCA)

The Ministry of Corporate Affairs (MCA) mandated submission of XBRL in 2011. It is a known fact that introducing new systems requires some time for the market to adapt and settle and it is more challenging when the systems itself undergo significant change before it has been well accepted. The journey of XBRL adoption by MCA brings across the experiences – initial startup, significant change and then stability.

Before the issuance of Companies Act, 2013

In India, the Ministry of Corporate Affairs (MCA) for the first time made it mandatory for certain class of companies to file their Balance Sheets and Profit and Loss Account for the year 2010-11 onwards by using XBRL taxonomy by issuing Circular No. 16/2012 dated 6.7.2012. As per the **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011**, the following classes of companies were required to file the Financial Statements in XBRL Form only from the year 2010-2011:

(i) All companies listed in India and their subsidiaries;

(ii) All companies having a paid up capital of ₹ 5 crore (₹ 50 million) and above; or

(iii) All companies having turnover of ₹ 100 crore (₹ 1 billion) or above, excluding power and banking companies, insurance companies, Non-Banking Financial Companies and overseas subsidiaries of these companies.

The circular also contained, by way of an annexure, a host of valuable information about XBRL in the form of Frequently Asked Questions (FAQs) about XBRL. As per the said circular, taxonomies for Indian companies are developed based on the requirements of Schedule VI of Companies Act, Accounting Standards, SEBI Listing requirements, etc. Taxonomies for manufacturing and service sector (referred as Commercial and Industrial, or C&I) and banking sector, is acknowledged by XBRL International. The Institute of Chartered Accountants of India (ICAI), the standards setting body developed taxonomy for Commercial and Industrial companies as per the provisions of Revised Schedule VI to the Companies Act, 1956. It has been developed as per the IFRS architecture 2011.

After the issuance of Companies Act, 2013

In exercise of the powers conferred by sections 469(1) and 469(2) read with section 398 of the Companies Act, 2013, and in supersession of the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, except as respects things done or omitted to be done before such supersession, the Central Government issued the **Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015** on 09.09.2015.

Companies required to follow XBRL Reporting

The following class of companies shall file their financial statement and other documents under section 137 of the Companies Act, 2013, with the Registrar in e-form AOC-4 XBRL given in Annexure-I for the financial years commencing on or after April 1, 2014 using the XBRL taxonomy given in Annexure II, namely:

(i) all companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or

(ii) all companies having paid up capital of rupees five crore or above;

(iii) all companies having turnover of rupees hundred crore or above; or

(iv) all companies which were hitherto covered under the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011.

Companies exempt from XBRL Reporting

As per the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 the following companies are exempt from XBRL filing of their financial statement and other documents:

(i) Banking companies

(ii) Insurance companies

(iii) Power Sector companies; and

(iv) Non-Banking Financial companies.

XBRL & Filing of Cost Audit Report

A company required to furnish cost audit report and other documents to the Central Government under Section 148(6) of the Companies Act, 2013 and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure-III to the said Rule for the financial years on or after April 1, 2014 in e-Form CRA-4 specified under the Companies (Cost Records and Audit) Rules, 2014

[B] Adoption of XBRL by Reserve Bank of India (RBI)

The Reserve Bank of India (RBI), India's central bank, oversees a host of critical activities including monetary policy, bank supervision and foreign exchange management. RBI is internationally well regarded for its regulatory acumen that played a key role in the Indian financial sector remaining virtually unscathed during the Asian Financial Crisis and the ongoing international banking and credit crisis. Reserve Bank of India is responsible for implementing the XBRL standard for banks' reporting. RBI had opted for XBRL as the reporting technology for the Basel II reporting norms so as to capture quality information that can be reused across the regulatory functions. Within RBI, XBRL implementation is being regularly monitored by a High Level Steering Committee appointed by the Governor.

[C] Adoption of XBRL by Securities and Exchange Board of India (SEBI)

Securities and Exchange Board of India (SEBI) is in the process of setting up a SEBI Unified Platform for Electronic Reporting and Dissemination (SUPER-D), which will be a XBRL technology based platform for reporting by listed companies, Mutual Funds and other SEBI registered intermediaries. The platform will also be used to disseminate requisite information relating to listed companies, mutual funds and other intermediaries, to the public. SEBI has started a XBRL Pilot Project for filing / reporting by Mutual Funds with SEBI. Under this XBRL MF Pilot Project, SEBI invited all the registered Mutual Fund/Assets Management Companies to participate on voluntary basis as filers for doing XBRL filings of the specified reports to SEBI. These XBRL filings have to be done in addition to the filings under the current system.

[D] Adoption of XBRL by Bombay Stock Exchange (BSE)

As a part of regulatory compliances, BSE collects data/disclosures in specified formats from its listed companies. With a view to making reporting more accurate and more efficient, BSE has moved towards the XBRL based reporting. BSE became the first stock exchange in India to introduce and implement XBRL based reporting in association with its partner in this endeavor, Microvista Technologies. With implementation of XBRL, BSE is in the club of international stock exchanges that have implemented XBRL based reporting. Keeping in line with continuous improvement, BSE has now made it mandatory for filing of Corporate Governance report and Shareholding Pattern in XBRL mode. Moreover, the BSE is making its taxonomies available online to promote the development of software by the private sector.

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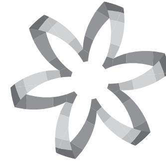
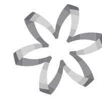
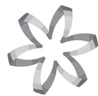
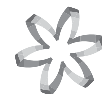




Section E
Government Accounting in India
(Syllabus - 2016)





Study Note - 8

GOVERNMENT ACCOUNTING

This Study Note includes

8.1 Government Accounting – an Overview

8.2 General Principles of Government Accounting

8.3 Comparison between Government Accounting and Commercial Accounting

8.4 Government Accounting & Reporting

8.5 Comptroller and Auditor General of India (C&AG)

8.6 Public Accounts Committee (P.A.C)

8.7 Review of Accounts

8.8 Government Accounting Standards Advisory Board (GASAB)

8.9 Government Accounting Standards Issued by Government Accounting Standards Advisory Board (GASAB)

8.10 Indian Government Accounting Standards (IGAS)

8.11 Indian Government Financial Reporting Standards (IGFRS)

8.1 GOVERNMENT ACCOUNTING – AN OVERVIEW

Accounting is the process of recording, classifying and summarizing the financial transactions and communicating the results of its operations and also the financial position to its stake-holders.

Government accounting refers to the system of financial accounting that is applicable to government, its departments, offices and institutions. The accounting system that is put to use in government offices or institutions for the purpose of recording and reporting the financial transactions is referred to as government accounting. It is also referred to as Public Finance Accounting.

According to **Oshisami and Dean,** "Governmental Accounting is the process of recording, analyzing, classifying, summarizing, communicating, and interpreting information about government in aggregate and in detail, reflecting all transactions involving the receipts, transfer, and disposition of government funds and property." -

By the given definition, it is clear that the government account is the systematic and scientific process of recording, presenting, analyzing, summarizing, classifying and communicating the financial transaction of the government offices. It is concerned with keeping a record of government revenue and their proper utilization in different development and administration work. It presents the receipt and payment position of the public fund. It reveals how public funds have been generated and utilized for the welfare of the general public.

It is the systematic process of collecting, recording, classifying, summarizing and interpreting the financial transactions relating to the revenues and expenditures of government institutions/ offices. Thus, simply stated, government accounting is concerned with systematic and scientific recording of government revenues and expenditures.

Therefore, government accounting may be defined as an accounting system used in government institution for the purpose of recording, classifying, summarizing and communicating the financial information regarding the collection and utilization of public funds and properties. It is concerned with keeping records of government revenues and their expenditure in different development and administrative works.

FEATURES OF GOVERNMENT ACCOUNTING

Government Accounting is a unique application area which has certain characteristics of its own. Some of the main features of Government Accounting are discussed as under:

1. **Specific system of accounting:** It is a specific accounting system which is followed by government in its departments, offices and institutions.

2. **Reporting of utilisation of public funds:** The government and its institutions are public institution whose main objective is to provide services to the society and also to maintain law and order in the country. So, the accounting system used by such institutions has to reveal how public funds and properties have been used for that purpose. It is to be noted that government accounting is not done for revealing any profit and loss.

3. **Government Regulations:** Government accounting is maintained according to government rules and regulations. The financial policies, rules and regulations as determined from time to time provide the system of government accounting.

4. **Double Entry System:** Government accounting is based on the principles and assumptions of double entry system of book keeping system. Accordingly, every financial transactionentered into by a government/ government office/ institution are recorded showing their double effects. It implies that for each government financial transaction one aspect of the transaction is debited and the other aspect is credited.

5. **Budget Heads:** All the expenses of government offices are classified into different budget heads and expenditures are made only on approved budget heads.

6. **Budgetary Regulation:** Government expenditures are governed by budgetary regulations. In other words, no government office can make expenditure more than the amount allocated in the budget. Thus, in effect, government accounting gets regulated by the budget.

7. **Mode of Transaction:** All government transactions are supposed to be performed through banks.

8. **Fund-based Accounting:** Apeculiar characteristic of governmental accounting is the employment of separate funds. The government is engaged in an ever-growing number of operations and activities which are quite unrelated to each other. The particular sources of revenue or income often are dedicated to use for a particular phase of the government's operations. The accounts must segregate these specially dedicated resources and isolate them from all other transactions in a separate "fund."

9. **Auditing:** The audit the books of accounts maintained by government departments, offices or institutions are to be audited by a recognised department of the government so as to ensure proper governance and also to prevent misuse and misappropriation of public funds.

OBJECTIVES OF GOVERNMENT ACCOUNTING

The objectives of government accounting are the financial administration of the activities of the government to promote maximisation of welfare in the form of various services. The specific objectives can be stated as under:

1. To record financial transactions of revenues and expenditure relating to the government organizations.
2. To provide reliable financial data and information about the operation of public fund.
3. To record the expenditures as per the appropriate Act, Rules, and legal provisions as set by the government.
4. To avoid the excess expenditures beyond the limit of the budget approved by the government.
5. To help in the preparation of various financial statements and reports.
6. To facilitate the auditing by the concerned government department.
7. To prevent misappropriation of government properties by maintaining the systematic records of cash and store items.
8. To facilitate for estimating the annual budget by providing historical financial data of government and expenditures.

8.2 GENERAL PRINCIPLES OF GOVERMENT ACCOUNTING

The general principles of government accounting are highlighted hereunder:

1. **Classification of expenditures**: The Government Expenditures are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of account. The method of budgeting and accounting under the service heads is not designed to bring out the relation in which Government stands to its material assets in use, or its liabilities due to be discharged at more or less distant dates.

2. **Based on budget**: government accounting is based on the annual budget of the government. In its budget for a year, Government is interested to forecast with the greatest possible accuracy what is expected to be received or paid during the year, and whether the former together with the balance of the past year is sufficient to cover the later.

   Similarly, in the compiled accounts for that year, it is concerned to see to what extent the forecast has been justified by the facts, and whether it has a surplus or deficit balance as a result of the year's transactions. On the basis of the budget and the accounts, Government determines:

   (a) whether it will be justified in curtailing or expanding its activities; and

   (b) whether it can and should increase or decrease taxation accordingly.

3. **End products of government accounting**: In the field of Government accounting, the end products are the monthly accounts and the annual accounts. The monthly accounts serve the needs of the day-to-day administration, while the annual accounts present a fair and correct view of the financial stewardship of the Government during the year.

4. **Period of Accounts**: The annual accounts of the central, state and union territory government shall record transactions, which take place during financial year running from 1st April to 31st March.

5. **Cash basis of accounting**: With the exception of such book adjustments as may be authorized by these rules on the advice of the Comptroller and Auditor General of India (C&AG),the transactions in government accounts shall represents the actual cash receipt and disbursement during a financial year.

6. **Form of Accounts**: The accounts of Government are kept in three parts namely, Consolidated Fund, Contingency Fund and Public Account.

8.3 COMPARISON BETWEEN GOVERNMENT ACCOUNTING AND COMMERCIAL ACCOUNTING

Although the basic principles of financial accounting that are applicable in regular commercial activities apply to the government accounts, there are certain features of governmental accounting which make it quite different from that of regular commercial accounting. The differences between commercial and government accounting have been presented hereunder:

1. **Meaning:** The accounting system applied in the government departments, offices and institutions is referred to as government accounting. While, the system of accounting applied by non-government organizations (whether profit-oriented or non-profit oriented) is known as commercial accounting.

2. **Objective:** Government accounting is maintained by the government offices for recording and reporting the utilisation and position of public funds. Commercial accounting is maintained by business organizations to know the profit or loss for an accounting period and disclose the financial position of the entity.

3. **Scope**: The government accounting happens to be more elaborate that that followed in commercial accounts.

4. **Budget:** Government accounting is directly influenced by the government budgeting system, while commercial accounting does not follow the government budgeting system.

5. **Basis:** Government accounting is prepared on cash basis. On the other hand, commercial accounting may be done on cash basis or accrual basis, or sometimes even on hybrid basis.

6. **Level of Accounting:** Government accounting has the system of central level and operating level accounting. Commercial accounting has no provision of central level and operating level accounting.
7. **Rules and Provisions:** Government accounting is strictly maintained by following the financial rules and provisions as set by the concerned government. Commercial accounting is maintained by following the applicable rules and the 'Generally Accepted Accounting Principles' (GAAP).
8. **Information:** Government accounting provides information to the government about the receipts, deposit, transfer and utilisation of public funds. Commercial accounting provides information to the various stake-holders about the operating result and financial position of the business.
9. **Auditing:** The audit the books of accounts maintained by government departments, offices or institutions are to be audited by a recognised department of the government(namely, the Auditor General Office); while the books of accounts maintained under commercial accounting is audited by any professional auditor.

8.4 GOVERMENT ACCOUNTING AND REPORTING

Controller General of Accounts (CGA) is the apex accounting body in the Government of India. It is the principal Accounts Adviser to the Government of India and is responsible for establishing and maintaining a technically sound management accounting system. The accounts of the Civil Ministries are compiled and maintained by the Pay and Accounts Offices, the basic accounting units.

The Pay and Accounts Offices maintain line item wise accounts of all the transactions involving Consolidated Fund of India, Contingency Fund of India and Public Account of India. Various subsidiary accounts such as Loan accounts, Fund accounts etc. are also maintained by these units.

The accounts compiled by the Pay and Accounts Offices are consolidated on a monthly basis in the Principal Accounts Offices at the Ministry's headquarters. The consolidated accounts of the Ministry are rendered to the Controller General of Accounts. The accounts received from various Ministries are consolidated in the office of the Controller General of Accounts to generate the accounts of the Government of India as a whole.

These monthly accounts are reviewed and a critical analysis of expenditure, revenue collection, borrowings and deficit is prepared for Finance Minister.

Role of CGA: Consolidating monthly accounts of the Government of India and reporting on the fiscal deficit is the primary responsibility of the CGA. The monthly accounts are compiled in the CGA office and a monthly review indicating flow of expenditure, revenue collection, internal and external borrowing and fiscal deficit is prepared for Minister of Finance. A summary of the monthly accounts is also placed on the web. He prepares a critical analysis of expenditures, revenues, borrowings and the deficit for the Finance Minister every month. He also prepares annual Appropriation Accounts and Union Finance Accounts for presentation to the parliament. Ministries, Departments approach the Controller General of Accounts for advice on accounting procedures for new schemes, programmes or activities undertaken by them. The advice rendered by the CGA generally covers aspects related to maintenance of accounts, collection of receipts and it's crediting into Government account, release of payment and it's accounting, creation and operation of funds within Government accounts, banking arrangements for making payments and collecting receipts etc. The advice of the Controller General of Accounts is binding on the Ministries/Departments.

Government Accounting & Information Technology: In a continuous effort towards improving the efficiency and the quality of the services rendered by the Department, Information Technology has been introduced at almost all levels of operations.

At the three levels, namely the Controller General of Accounts, Principal Accounts Offices and the field Pay and Accounts Offices software packages, namely GAINS (Government Accounting Information System), CONTACT (Controller's Accounts) and IMPROVE (Integrated Multimodule Processor for Voucher Entries), are being used to consolidate Government of India Accounts.

The monthly accounts are now published on the Web on the last day of the month following the month of account (i.e. the accounts for Oct 2017 will be available on the last day of November 2017). Efforts are continuing to automate a number of other processes at various levels.

The Systems Group, in the office of the Controller General of Accounts, assists the Controller General of Accounts in the policy formulation and use of Information technology in the accounting offices of the Government. The software support to the organisation is provided by the National Informatics Centre under the Ministry of Planning.

Features of Government Accounting in India

One of the most distinctive features of the Government accounts in India is the minute detail with which the financial transactions are recorded in the account books. All transactions are classified on a six tier functional classification with Major Heads representing a broad function of the Government at the top and an object head representing the activity at the bottom. The intermediate levels represent sub-functions, programmes, schemes and sub-schemes. The functional classification is applicable to receipts as well as payments.

Since the Country follows a Plan based model of economy, the expenditure of Government is divided into Plan and Non-Plan. As the name suggests, the Plan expenditure is directly related to expenditure on schemes and programmes envisages in the plans. The Non-Plan expenditure is the expenditure incurred on establishment and maintenance activities.

Further distinction is made between the expenditure, which under the provisions of the Constitution, is subject to the vote of the legislature and the rest which is charged upon the Consolidated Fund of India.

Since the budget is on an annual basis, the accounts have to conform to it. The accounts are maintained on cash basis. Only the actual receipts realised and the payments made during the year are recorded.

Article of the Constitution provides for creation of a Consolidated Fund of India, Contingency Fund and Public Account.

Accounts of the Government

The Constitution of India provides for the manner in which the accounts of the Government have to be kept. The accounts of Government are kept in three parts namely, Consolidated Fund, Contingency Fund and Public Account. They are discussed as under:

1. **Consolidated Funds of India**

   The Consolidated Funds **is** constituted under Article 266 (1) of the Constitution of India. All revenues received by the Government by way of taxes like Income Tax, Central Excise, Customs and other receipts flowing to the Government in connection with the conduct of Government business i.e. Non-Tax Revenues are credited into the Consolidated Fund. Similarly, all loans raised by the Government by issue of Public notifications, treasury bills (internal debt) and loans obtained from foreign governments and international institutions (external debt) are credited into this fund. All expenditure of the government is incurred from this fund and no amount can be withdrawn from the Fund without authorization from the Parliament. This is the largest of all the three funds.

2. **Public Accounts of India**

   The Public Accounts of India is constituted under Article 266 (2) of the Constitution. The transactions to be recorded in it relate to debt other than those included in the Consolidated Fund of India. The transactions under Debt, Deposits and Advances in this part are those in respect of which Government incurs a liability to repay the money received or has a claim to recover the amounts paid. The transactions relating to 'Remittance' and 'Suspense' shall embrace all adjusting heads. The initial debits or credits to these heads will be cleared eventually by corresponding receipts or payments. The receipts under Public Account do not constitute normal receipts of Government. Parliamentary authorization for payments from the Public Account is therefore not required.

3. Contingency Funds of India

The Contingency Fund of India Fund set by the Government of India under Article 267 of the Constitution of India. It records the transactions connected with Contingency.It is held on behalf of President by the Secretary to the Government of India, Ministry of Finance, Department of Economic Affairs. The corpus of this fund is ₹ 500 crores. Advances from the fund are made for the purposes of meeting unforeseen expenditure which are resumed to the Fund to the full extent as soon as Parliament authorizes additional expenditure. Thus, this fund acts more or less like an imprest account of Government of India.

8.5 COMPTROLER AND AUDITOR GENERAL OF INDIA (C&AG)

The Comptroller and Auditor General (C&AG) of India is an authority, established by the Constitution under Constitution of India/Part V Chapter V/Sub-part 7B/Article 148, who audits all receipts and expenditure of the Government of India and the state governments, including those of bodies and authorities substantially financed by the government. The CAG is also the external auditor of Government-owned corporations and conducts supplementary audit of government companies, i.e., any non-banking/ non-insurance company in which Union Government has an equity share of at least 51 per cent or subsidiary companies of existing government companies. Comptroller and Auditor General (C&AG) is the guardian or care-taker of the national purse. He is appointed by the President of India for a tenure of 6 years.

The constitution has instituted the British system of responsible government in India. The substance of responsibility is that the executive i.e. the Prime Minister and the Cabinet remains answerable for all their activities to the popularly elected chamber of the legislature. The responsibility becomes empty unless financial activities of the government are subject to parliamentary scrutiny. For this it is imperative that there should be an independent authority to examine and scrutinize the financial transactions of the government. Since he is the impartial head of the audit and accounts system of India, it is essential that he should be independent of executive control.

With this object in view, the Government of India Act of 1935, made the Auditor General of India irremovable except "in like manner and on like grounds as a judge of the Federal Court." The office of the Comptroller and Auditor General is an adaptation of the office of the Auditor General under the Act of 1935.Articles 148 to 151 of the Indian constitution create and regulate the office of Comptroller and Auditor General of India. The office of the Comptroller and Auditor General is considered as "pivotal" to the control of entire financial system of the country. Dr. B. R. Ambedkar felt that the Comptroller and Auditor General of India shall be the most important officer under the constitution of India.

ROLE, FUNCTION AND DUTIES OF THE COMPTROLLER & AUDITOR GENERAL (C&AG)

The role, function and duties of the Comptroller and Auditor General (CAG) are elaborated by the Comptroller and Auditor General's (Duties, Powers and Conditions of Service)Act, 1971 (56 of 1971).An amendment of this act in 1976 has relieved him from preparing the accounts of the government. As per Sec. 10 of the said Act, the role/ duties of the C&AG has been discussed as under:

1. **Comptroller and Auditor General to compile accounts of Union and States:** The role of the C&AG includes:

   - **Compilation of accounts**: Compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such accounts; and
   - **Keeping accounts**: Keeping such accounts in relation to any of the matters specified in the above clause as may be necessary.

   However, the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for compiling:

   (i) the said accounts of the Union (either at once or gradually by the issue of several orders); or

   (ii) the accounts of any particular services or departments of the Union;

(iii) relieve him from the responsibility for keeping the accounts of any particular class or character.

Moreover, the Governor of a State with the previous approval of the President and after consultation with Comptroller and Auditor General, by order, relieve him from the responsibility for compiling:

(i) the said accounts of the State (either at once or gradually by the issue of several orders); or

(ii) the accounts of any particular services or departments of the State.

2. **Comptroller and Auditor General to prepare and submit accounts to the President Governors of States and Administrators of Union territories having Legislative Assemblies**: The Comptroller and Auditor-General shall from the accounts compiled by him or by the Government or any other person responsible in that behalf prepare in each year accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrator of the Union territory having a Legislative Assembly, as the case may be on or before such dates as he may, with the concurrence of the Government concerned, determine.

   However, the President may, after consultation with the Comptroller and Auditor-General, by order, relieve him from the responsibility for the preparation and submission of the accounts relating to annual receipts and disbursements for the purpose of the Union or of a Union territory having a Legislative Assembly. Further the Governor of a State may, with the previous approval of the President and after consultation with the Comptroller and Auditor-General, by order, relieve him from the responsibility for the preparation and submission of the accounts relating to annual receipts and disbursements for the purpose of the State.

3. **Comptroller and Auditor General to give information and render assistance to the Union and States**: The Comptroller and Auditor-General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union government, to the State Governments or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require, and render such assistance in the preparation of their annual financial statements as they may reasonably ask for.

4. **General provisions relating to audit**: It shall be the duty of the Comptroller and Auditor-General:

   - to audit all expenditure from the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
   - to audit all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
   - to audit all trading, manufacturing, profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State; and in each case to report on the expenditure, transactions or accounts so audited by him.

5. **Audit of receipts and expenditure of bodies or authorities substantially financed from Union or State Revenues**: Where anybody or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union territory having a Legislative Assembly, the Comptroller and Auditor-General shall, subject to the provisions of any law for the time being in, force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

   However, Comptroller and Auditor-General may with the previous approval of the President or the Governor of a State or the Administrator of a Union territory having a Legislative Assembly, as the case may be, audit all receipts and expenditure of any body or authority where the grants or loans to such body or authority from the Consolidated Fund of India or of any State or of any Union territory having a Legislative Assembly, as the case may be in a financial year is not less than rupees one crore.

6. **Functions of Comptroller and Auditor General in the case of grants or loans given to other authorities or bodies**: Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor-General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given. For this purpose the C&AG shall have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

   However, the President, the Governor of a State or the Administrator of a Union territory having a Legislative Assembly, as the case may be, may, where he is of opinion that it is necessary so to do in the public interest, by order, relieve the Comptroller and Auditor-General, after consultation with him, from making any such scrutiny in respect of anybody or authority receiving such grant or loan.

   Except where he is authorised so to do by the President, the Governor of a State or the Administrator of Union territory having a Legislative Assembly, as the case may be, the Comptroller and Auditor-General shall not have, while exercising the powers conferred on him by sub-section (1), right of access to the books and accounts of any corporation to which any such grant or loan as is referred to in subsection (1) is given if the law by or under which such corporation has been established provides for the audit of the accounts of such corporation by an agency other than the Comptroller and Auditor-General:

   Moreover, such authorisation shall be made except after consultation with the Comptroller and Auditor-General and except after giving the concerned corporation a reasonable opportunity of making representations with regard to the proposal to give to the Comptroller and Auditor-General right of access to its books and accounts.

7. **Audit of receipts of Union or of States**: It shall be the duty of the Comptroller and Auditor-General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.

8. **Audit of accounts of stores and stock**: The Comptroller and Auditor-General shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union or of a State.

9. **Powers of Comptroller and Auditor General in connection with audit ofaccounts**: The Comptroller and Auditor General shall in connection with the performance of his duties under this Act, have authority:

   - to inspect any office of accounts under the control of the union or of a State, including treasuries, and such offices responsible for the keeping of initial or subsidiary accounts, as submit accounts to him;
   - to require that any accounts, books, papers and other documents which deal with or form the basis of or an otherwise relevant to the transactions to which his duties in respect of audit extend, shall be sent to such place as he may appoint for his inspection;
   - to put such questions or make such observations as he may consider necessary, to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which it is his duty to prepare.

   The person in charge of any office or department, the accounts of which have to be inspected and audited by the Comptroller and Auditor-General, shall afford all facilities for such inspection and comply with requests for information in as complete a form as possible and with all reasonable expedition.

10. **Audit of Government companies and corporations**: The duties and powers of the Comptroller and Auditor-General in relation to the audit of the accounts of Government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 1956 (1 of 1956).

    The duties and powers of the Comptroller and Auditor-General in relation to the audit of the accounts of corporations (not being companies) established by or under law made by Parliament shall be performed and exercised by him in accordance with the provisions of the respective legislations.

The Governor of a State or the Administrator of a Union territory having a Legislative Assembly may, where he is of opinion that it is necessary in the public interest so to do, request the Comptroller and Auditor-General to audit the accounts of a corporation established by law made by the Legislature of the State or of the Union territory, as the case may be, and where such request has been made, the Comptroller and Auditor-General shall audit the accounts of such corporation and shall have, for the purposes of such audit, right of access to the books and accounts of such corporation. However, no such request shall be made except after consultation with the Comptroller, and Auditor-General and except after giving reasonable opportunity to the corporation to make representations with regard to the proposal for such audit.

11. **Laying of reports in relation to accounts of Government companies and corporations:** The reports of the Comptroller and Auditor-General, in relation to audit of accounts of a Government company or a corporation referred to in section 19, shall be submitted to the Government or Governments concerned. The Central Government shall cause every report received by it under sub-section (1) to be laid, as soon as may be after it is received, before each House of Parliament. The State Government shall cause every report received by it under sub-section (1) to be laid, as soon as may be after it is received, before the Legislature of the State.

12. **Audit of accounts of certain authorities or bodies**: Where the audit of the accounts of anybody or authority has not been entrusted to the Comptroller and Auditor-General by or under any law made by Parliament, he shall, if requested so to do by the President, or the Governor of a State or the Administrator of a Union territory having a Legislative Assembly, as the case may be, undertake the audit of the accounts of such body or authority on such terms and conditions as may be agreed upon between him and the concerned Government and shall have, for the purposes of such audit, right of access to the books and accounts of that body or authority. However, no such request shall be made except after consultation with the Comptroller and Auditor-General.

8.6 PUBLIC ACCOUNTS COMMITTEE (P.A.C)

The Public Accounts Committee (P.A.C.) is a committee of selected members of Parliament, constituted by the Parliament of India.

In the Indian parliamentary form of governance, the legislature has the power to ensure "that the appropriated money is spent economically, judiciously and for the purpose for which it was sanctioned". Even though the Comptroller and Auditor General of India (C&AG) is to audit the accounts of the government and to ensure the propriety of the money spent, yet its report is further examined by the special committee of the parliament, is known as Public Account Committee.

The Committee entrusted with the responsibility of examining the accounts of the Government. The Government expenditures are thoroughly examined and ensured that the Parliamentary limits are not breached. It examines the report of Accounts of the union government submitted by the Comptroller and Auditor General of India (C&AG), to the President for the purpose of auditing of the revenue and the expenditure of the Government of India. The Public Accounts Committee in India thus ensures Parliamentary control over government expenditure.

The Public Accounts Committee was first set up in India in 1921 under the Montague Chelmsford Reforms. The basic function of the committee had been to ensure that the expenditure had been incurred for the intended purposes as authorised by the authority concerned. Presently, it is formed every year with a strength of not more than 22 members, out of which 15 members are from Lok Sabha (the lower house of the Parliament), and 7 members are from Rajya Sabha (the upper house of the Parliament). The term of office of the members is one year.

Constitution of Public Accounts Committee (P.A.C)

The Committee consists of not more than 22 members comprising15 members elected by Lok Sabha every year from amongst its members according to the principle of proportional representation by means of single transferable vote, and not more than 7 members of Raj ya Sabha elected by that House in like manner are associated with the Committee. Thus, the present P.A.C is a joint committee of the two Houses.

The Chairman is appointed by the Speaker of Lok Sabha from amongst its members of Lok Sabha. Since 1967, the chairman of the committee is selected from the opposition. Earlier, it was headed by a member of the ruling party.

However, it is to be noted that, a Minister is not eligible to be elected as a member of the Committee. If a member after his election to the Committee is appointed a Minister, he ceases to be a member of the Committee from the date of such appointment.

Role of Public Accounts Committee (P.A.C)

1. **Role regarding examination of the C&AG report:** The chief function of P.A.C. is to examine the audit report of Comptroller and Auditor General (C&AG) after it is laid in the Parliament. C&AG assists the Committee during the course of investigation.

2. **Role regarding unauthorized expenditures or excess expenditures**: In examining the report of the Comptroller and Auditor General of India (C&AG), the committee has to satisfy itself that:

   - the expenditures made by the government, were authorized by the Parliament; and

   - the expenditures under any head has not crossed the limits of parliamentary authorization.

   It is to be noted that, every expenditure made by the government must be sanctioned by the Parliament. Thus, it is the role of the committee to bring to the notice of the Parliament instances of unauthorized expenditures or expenditures beyond sanctioned limits.

3. **Role regarding spending of money by ministries**: The committee not only ensures that ministries spend money in accordance with parliamentary grants, it also brings to the notice of the Parliament instances of extravagance, loss, in fructuous expenditure and lack of financial integrity in public services. However, the committee cannot question the polices of the government. It only concerns itself with the execution of policy on its financial aspects.

4. **Scrutinizing the audit reports of public corporations:** A new dimension has been added to the function of the P.A.C. by entrusting it with the responsibility of scrutinizing the audit report of public corporations.

5. **Scrutinising the working process of ministries and public corporations**: In examining the accounts and audits of the ministries and public corporations, the Committee gets the opportunity to scrutinize the process of their working. It points out the weakness and shortcomings of the administration of ministries and public corporations Criticisms of the P.A.C. draw national attention. This keeps the ministries and public corporations sensitive to the criticisms of the P.A.C. Thus, it is wrong to suppose that the P.A.C. is only an instrument of financial control, it is as well an instrument of administrative control.

8.7 REVIEW OF ACCOUNTS

The accounts of Government Companies set up under the provisions of the Companies Act (including Government Insurance Companies and deemed Government Companies) are audited by the Comptroller and Auditor General of India (C&AG) under the provisions of Section 143 of the Companies Act, 2013. Under these provisions, the C&AG:

(i) shall appoint statutory auditor of a Government company,

(ii) may conduct supplementary or test audit of accounts of a Government Company, and

(iii) may comment upon the report of the statutory auditor. In addition he issues directions to the statutory auditors regarding the manner in which the accounts of a Government Company are to be audited.

The accounts certified by the Statutory Auditors (Chartered Accountants) appointed by the Central Government on the advice of the CAG under the Companies Act, 2013 are subjected to supplementary or test audit by officers of the CAG and CAG gives his comments or supplements the report of the Statutory Auditors. The Companies Act, 2013 empowers the CAG to issue directions to the Statutory Auditors on the manner in which the Company's accounts shall be audited.

8.8 GOVERMENT ACCOUNTING STANDARDS ADVISORY BOARD (GASAB)

The accounting systems, the world over, are being revisited with an emphasis on transition from rule to principle based standards and migration from cash to accrual based system of accounting. The GASAB, as a nodal advisory body in India, is taking similar action to formulate and improve standards of government accounting and financial reporting and enhance accountability mechanisms.

The Government Accounting Standards Advisory Board (GASAB) was constituted by the Comptroller and Auditor General of India (C&AG) with the support of Government of India through a notification dated August 12, 2002. This Board was constituted to establish and improve the standards of governmental accounting and financial reporting, and enhance the accountability mechanisms. The decision to set-up GASAB was taken in the backdrop of the new priorities emerging in the Public Finance Management and to keep pace with International trends. The new priorities focus on good governance, fiscal prudence, efficiency & transparency in public spending.

Structure of GASAB

The Board has high level representation from the important accounting heads in Government, Ministry of Finance, Department of Post, Finance Secretaries of states, RBI and heads of premier accounting & research organizations. The board consists of the following members:

1. Deputy Comptroller and Auditor General (Government Accounts) as Chairperson
2. Financial Commissioner, Railways
3. Member (Finance) Telecom Commission, Department of Telecom
4. Secretary, Department of Post
5. Controller General of Defence Accounts
6. Controller General of Accounts
7. Additional / Joint Secretary (Budget), Ministry of Finance, Government of India
8. Deputy Governor, Reserve Bank of India, or his nominee

9-12. Principal Secretary (Finance) of four States, by rotation

13. Director General, National Council of Applied Economic Research(NCAER), New Delhi
14. President, Institute of Chartered Accountants of India (ICAI), or his nominee
15. President, Institute of Cost and Works Accountants of India, or his nominee
16. Principal Director in GASAB, as Member secretary.

Responsibilities of GASAB

GASAB, inter alia, has the following responsibilities:

1. To formulate and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms.
2. To formulate and propose standards that improve the usefulness of financial reports based on the needs of the users.
3. To keep the standards current and reflect change in the Governmental environment.
4. To provide guidance on implementation of standards.
5. To consider significant areas of accounting and financial reporting that can be improved through the standard setting process.
6. To improve the common understanding of the nature and purpose of information contained in the financial reports.

8.9 GOVERMENT ACCOUNTING STANDARDS ISSUED BY GOVERNMENT ACCOUNTING STANDARD ADVISORY BOARD (GASAB)

The mission of the Government Accounting Standards Advisory Board (GASAB) is to formulate and recommend Indian Government Accounting Standards (IGASs) for cash system of accounting and Indian Government Financial Reporting Standards (IGFRS) for accrual system of accounting, with a view to improving standards of Governmental accounting and financial reporting which will enhance the quality of decision-making and public accountability.

GASAB has been developing two types of Accounting Standards, namely Indian Government Accounting Standards (IGAS) and Indian Government Financial Reporting Standards (IGFRS)for the Government. These standards have been developed to address the issues related with the existing cash system of accounting and its migration to the accrual system of accounting in future.

8.10 INDIAN GOVERMENT ACCOUNTING STANDARDS (IGAS)

The standards being developed to make existing cash system of accounting more transparent are called Indian Government Accounting Standards (IGAS).The Indian Government Accounting Standards (IGAS), formulated by the Government Accounting Standards Advisory Board (GASAB) and notified by the Ministry of Finance, Government of India are:

- Guarantees given by Governments: Disclosure Requirements (IGAS 1);
- Accounting and Classification of Grants-in-aid (IGAS 2)
- Loans and Advances made by Governments (IGAS 3)

The Indian Government Accounting Standards (IGAS), approved by the Government Accounting Standards Advisory Board (GASAB) and under consideration of Government of India, are:

- Foreign Currency Transactions and Loss/Gain by Exchange Rate Variations (IGAS 7);
- Government Investments in Equity (IGAS 9);
- Public Debt and Other Liabilities of Governments: Disclosure Requirement (IGAS 10).

IGAS – 1 GURANTEES GIVEN BY GOVERNMENTS: DISCLOSURE REQUIREMENTS

Introduction: The Union Government and the State Governments give Guarantees for repayment of borrowings within such limits, if any, as may be fixed upon the security of the Consolidated Fund of India or of the State, as the case may be, in terms of articles 292 and 293 of the Constitution.

Guarantees are also given by the Union Government

- for payment of interest on borrowings, repayment of share capital;
- payment of minimum annual dividend; and
- payment against agreements for supplies of materials and equipments on credit basis on behalf of the State Governments, Union territories, local bodies, railways, Government companies or corporations, joint stock companies, financial institutions, port trusts, electricity boards and co-operative institutions.

Guarantees are also given by the Union Government to the Reserve Bank of India, other banks and financial institutions:

- for repayment of principal and payment of interest;
- cash credit facility;
- financing seasonal agricultural operations; and
- for providing working capital in respect of companies, corporations, co-operative societies and co-operative banks.

Further, guarantees are also given in pursuance of agreements entered into by the Union Government with international financial institutions, foreign lending agencies, foreign Governments, contractors and consultants towards repayment of principal, payment of interest and payment of commitment charges on loans.

The Union Government also gives performance guarantees for fulfillment of contracts or projects awarded to Indian companies in foreign countries as well as foreign companies in foreign countries besides counter-guarantees to banks in consideration of the banks having issued letters of credit to foreign suppliers for supplies or services rendered by them on credit basis in favour of companies or corporations.

Furthermore, guarantees are given by the Union Government to railways, and electricity boards for due and punctual payment of dues and freight charges by the companies and corporations.

Similarly, guarantees are also given by the State Governments and Union Territory Governments (with legislature).

As the statutory corporations, Government companies, co-operative institutions, financial institutions, autonomous bodies and authorities are distinct legal entities, they are responsible for their debts. Their financial obligations may be guaranteed by a Government and thus the Government has a commitment to see that these are fulfilled.

When these entities borrow directly from the market, it reduces a Government's budgetary support to them and the magnitude of a Government's borrowings. However, it adds to the level of Guarantees given by the Governments. In consideration of the Guarantees given by the Governments, the beneficiary entities are required to pay guarantee commission or fee to the Governments. The Guarantees have an important economic influence and result in transactions or other economic flows when the relevant event or conditions actually occur. Thus, Guarantees normally constitute contingent liability of the Governments.

Objective: The objective of this Standard is to set out disclosure norms in respect of Guarantees given by the Union, the State Governments and Union Territory Governments (with legislature) in their respective Financial Statements to ensure uniform and complete disclosure of such Guarantees.

Scope: The scope of this standard is stated as under:

- This Standard applies to preparation of the Statement of Guarantees for inclusion and presentation in the Financial Statements of the Governments. Financial Statements should not be described as complying with this Standard unless these comply with all its requirements.
- The Authority in the Government which prepares the Statement of Guarantees for inclusion and presentation in the Financial Statements shall apply this Standard. The Accounting Authority is responsible for inclusion and presentation of the Statement of Guarantees in the Financial Statements as provided by the Authority in the Government.

Important Definitions:

- **Accounting Authority:** It means the Authority which prepares the Financial Statements of the Government
- **Authority in the Government:** It means the tracking (monitoring) unit or Authority for Guarantees and in its absence, the Ministry or the Department of Finance, as the case may be.
- **Automatic Debit Mechanism:** It means the arrangement whereby the Government's cash balance is affected on a specified date or on the occurrence of specified events to meet certain obligations arising out of Guarantees given by it.
- **Financial Statements:** It means the Annual Finance Accounts of the Governments.
- **Guarantee:** It means an accessory contract, by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person, whose primary liability to the promisee must exist or be contemplated.
- **Structured Payment Arrangement:** It means the arrangement whereby the Government agrees to transfer funds to the designated account in case the beneficiary entity fails to ensure availability of adequate funds for servicing the debts, as per stipulations.

Disclosure:

The Financial Statements of the Union Government, the State Governments and the Union Territory Governments (with legislature) shall disclose the following:

- maximum amount for which Guarantees have been given during the year, additions and deletions (other than invoked during the year) as well as Guarantees outstanding at the beginning and end of the year;
- amount of Guarantees invoked and discharged or not discharged during the year:
- details of Guarantee commission or fee and its realisation; and
- other material details.

The Financial Statements of the Union Government, the State Governments and the Governments of Union Territories (with legislature) shall disclose in the notes the following details concerning class or sector of Guarantees:

- limit, if any, fixed within which the Government may give Guarantee;
- whether Guarantee Redemption or Reserve Fund exists and its details including disclosure of balance available in the Fund at the beginning of the year, any payments made and balance at the end of the year;
- details of subsisting external foreign currency guarantees in terms of Indian rupees on the date of Financial Statements;
- details concerning Automatic Debit Mechanism and Structured Payment Arrangement, if any;
- whether the budget documents of the Government contain details of Guarantees:
- details of the tracking unit or designated authority for Guarantees in the Government; and
- other material details.

Effective date:

This Indian Government Accounting Standard becomes effective for Financial Statements covering periods beginning on or after 1-4-2010 for class-wise disclosures in the Financial Statements of the Union Government and sector-wise disclosures in the Financial Statements of the State Governments and Union Territory Governments (with legislature).

IGAS — 2 ACCOUNTING AND CLASSIFICATION OF GRANTS-IN-AID

Introduction: Grants-in-aid are payments in the nature of assistance, donations or contributions made by one government to another government, body, institution or individual. Grants-in-aid are given for specified purpose of supporting an institution including construction of assets.

The general principle of grants-in-aid is that it can be given to a person or a public body or an institution having a legal status of its own. Such grants-in-aid could be given in cash or in kind used by the recipient agencies towards meeting their operating as well as capital expenditure requirement.

Grants-in-aid are given by the Union Government to State Governments and by the State Governments to the Local Bodies discharging functions of local government under the Constitution. This is based on the system of governance in India, which follows three-tier pattern:

- with the Union Government at the apex,
- the States in the middle, and
- the Local Bodies (LBs) consisting of the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) at the grass root level.

Accounts of these three levels of Government are separate and consequently the assets and liabilities of each level of government are recorded separately. Grants-in-aid released by the Union Government to the State Governments are paid out of the Consolidated Fund of India as per Articles 275 and 282 of the Constitution. The Union Government releases grants-in-aid to the State/ Union Territory Government under Central Plan Schemes and Centrally Sponsored Schemes. Sometimes, the Union Government disburses funds to the State Governments in

the nature of Pass-through Grants that are to be passed on to the Local Bodies. Funds are also released directly by the Union Government to District Rural Development Agencies (DRDAs) and other specialized agencies including Special Purpose Vehicles (SPVs) for carrying out rural development, rural employment, rural housing, other welfare schemes and other capital works schemes like construction of roads, etc.

The 73rd and 74th Constitutional Amendment Acts envisage a key role for the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) in respect of various functions such as education, health, rural housing, drinking water, etc.

The State Governments are required to devolve funds, functions and functionaries upon them for discharging these functions. The extent of devolution of financial resources to these bodies is to be determined by the State Finance Commissions. Such funds received by the Local Bodies from the State Governments as grants-in-aid are used for meeting their operating as well as capital expenditure requirements. The ownership of capital assets created by Local Bodies out of grants-in-aid received from the States Government lies with the Local Bodies themselves.

Apart from Grants-in-aid given to the State Governments, the Union Government gives substantial funds as Grants-in-aid to other agencies, bodies and institutions. Similarly, the State Governments also disburse Grants-in-aid to agencies, bodies and institutions such as universities, hospitals, cooperative institutions and others. The grants so released are utilized by these agencies, bodies and institutions for creation of capital assets as well as for meeting day-to-day operating expenses.

Objective:

The objectives of this Standard are:

- to prescribe the principles for accounting and classification of Grants-in-aid in the Financial Statements of Government both as a grantor as well as a grantee.
- to prescribe practical solutions to remove any difficulties experienced in adherence to the appropriate principles of accounting and classification of Grants-in-aid by way of appropriate disclosures in the Financial Statements of Government.

Scope:

This Standard applies to the Union Government and the State Governments in accounting and classification of Grants-in-aid received or given by them. The Financial Statements should not be described as complying with this Standard unless they comply with all the requirements contained therein. This Standard encompasses cases of Pass-Through Grants such as Grants-in-aid given by the Union Government to State Governments and by the State Governments to the Local Bodies discharging functions of local government under the Constitution.

Important Definitions:
• **Accounting Authority:** It is the authority which prepares the Financial Statements of the Government • **Financial statements:** It means the Annual Finance Accounts of the Governments. • **Grants-in-aid:** The Grants-in-aid are payments, transfers of funds, in cash or in kind, in the nature of donations or contributions by one government (grantor) to another government, body, institution or individual (grantee). • **Government:** Itmeans all departments and ministries of a Government taken together, whether of the Union Government or State Government or Union Territory Government with Legislature. • **Local Bodies:** It includes Panchayati Raj Institutions and Urban Local Bodies under the provisions of Article 243 and Schedule 12 of the Constitution. • **Pass-Throuah Grants:** It means grants-in-aid given by the Union Government to the State Governments for transfer to an ultimate grantee.

Recognition:

- **Grants-in-aid in cash** shall be recognised in the books of the grantor at the time cash disbursements take place. Grants-in-aid in cash shall be recognised in the books of the grantee at the time cash receipts take place.

- **Grants-in-aid in kind** shall be recognized in the books of the grantor at the time of their receipt by the grantee. Moreover, it shall be recognized in the books of the grantee at the time of their receipt by the grantee.

Disclosure:

- In order to ascertain the extent of Grants-in-aid disbursed by the grantor to the grantee for the purpose of creation of capital assets, the Financial Statements of the grantor shall disclose the details of total funds released as Grants-in-aid and funds allocated for creation of capital assets by the grantee during the financial year, in the form of an Appendix to the Financial.
- This will enhance transparency and lead to improved disclosure of information in the Financial Statements of the grantor. Such disclosures shall also enable the users of Financial Statements to assess the quantum of future capital formation activity to be undertaken by different grantees supported by funds from the Government.

Effective Date: This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning from 1.4.2011.

IGAS — 3 LOANS AND ADVANCES MADE BY GOVERNMENT

Introduction: The Government of India has been empowered under proviso (2) of Article 293 of the Constitution of India to make loans to the States, subject to such conditions as may be laid down by or under any law made by Parliament, any sums required for the purpose of making such loans being chargeable to the Consolidated Fund of India.

The Union Government has been providing financial assistance to the State Governments, a substantial portion of which is in the form of loans. These loans are advanced to the States both in the form of plan and non-plan assistance intended for both developmental and non-developmental purposes. Loans are also provided by the Union Government to Foreign Governments, Government companies and Corporations, Non-Government institutions and Local bodies. The Union Government also disburses recoverable advances to Government servants.

The State Governments disburse loans to Government Companies, Corporations, Local Bodies, Autonomous Bodies, Cooperative Institutions, Statutory Corporations, quasi-public bodies and other non-Government/private institutions. The State Governments also disburse recoverable advances to Government servants.

Objective: The objectives of the Standard are:

- to lay down the norms for Recognition, Measurement, Valuation and Reporting in respect of Loans and Advances made by the Union and the State Governments in their respective Financial Statements to ensure complete, accurate, realistic and uniform accounting practices, and
- to ensure adequate disclosure on Loans and Advances made by the Governments consistent with best international practices.

Scope: This Standard applies to Loans and Advances given by the Government for incorporation and presentation in the Financial Statements of the Government. Financial Statements shall not be described as complying with this Standard unless they comply with all the requirements contained therein. This standard shall apply only to government accounts being maintained on a cash basis.

Important Definitions:

- **Accounting Authority:** It is the authority which prepares the Financial Statements of the Governments.
- **Accounting Period:** It means the period covered by the Financial Statements.
- **Advances:** These are loans made to Government servants.
- **Carrying amount:** It means the net amount which the debtor owes the creditor at any point of time and it reflects the historical cost of the loan and subsequent cash flows resulting in either decrease due to repayments or write-offs or increase due to additional disbursements.
- **Cash Basis of Accounting:** It means the accounting transactions of an entity represent the actual cash receipts and disbursements during a financial year as distinguished from the amount due to or by the entity during the same period.

- **Charged and Voted Loans and Advances:** All loans to State Governments and a part of the same to Union Territory Governments made by the Union Government are 'charged' loans whereas all other loans and advances are 'voted' loans and advances.
- **Consolidated Fund of India:** It is the fund referred to in clause (1) article 266 of the Constitution of India.
- **Financial Statements:** It means the Annual Finance Accounts of the respective Governments.
- **Government:** It means the Union Government or any State Government or Government of any Union territory with Legislature.
- **Historical Cost**: It is the original book value of loans and advances.
- **Loanee Entity**: It is an entity in whose favor a loan or an advance is sanctioned by the Government.
- Loanee Group: It consists of a group of loanee entities of similar nature and characteristics.
- **Loans:** These are the assistance by the Governments by providing money, goods or services directly or indirectly to the beneficiary entities which entails a contractual right to receive back equivalent moneys along with interest thereon, if any, as per terms and conditions of the loan agreements.
- **Major Heads of Account:** It represents the functions of Government as per the 'List of Major and Minor Heads of Account of Union and States.
- **Minor Heads of Account:**It represents various programmes or schemes undertaken by departments of Government to achieve the objectives of the function represented by the major head as per the 'List of Major and Minor Heads of Account of Union and States.
- **Sub-Major Heads of Account:** It represents the sub-functions of Government. It is under the Major Heads and as per the 'List of Major and Minor Heads of Account of Union and States.
- **Plan Loans:** These are the loans sanctioned by the Government for plan purposes;
- **Sector:**It consists of a grouping of specific functions or services as per the 'List of Major and Minor Heads of Account of Union and States.
- **Write-off**:These are when a competent authority remits or writes off any loan owing to its irrecoverability or otherwise, whereby irrecoverable portion of loan is transferred from the debt head of account to an expenditure head as loss to the Government.

Recognition:

- A loan shall be recognized by the disbursing entity as an asset from the date the money is actually disbursed and not from the date of sanction and if a loan is disbursed in installments then each installment shall be treated as a separate loan for the purpose of repayment of principal and payment of interest, except where the competent authority specifically allows consolidation of the installments into a single loan at the end of the concerned financial year.
- The loans converted into equity shall be treated as conversion and shall lead to a reduction in the outstanding loan amount
- The debt assumption due to invocation of guarantees shall be treated as disbursement of loan, unless otherwise so specified.

Measurement and Valuation:

- Historical Cost measurement shall be the basis for accounting and reporting on loans and advances made by Governments.
- As of the last date of accounting period of Financial Statements, the carrying amount of loans shall undergo revision an account of additional disbursement and repayments or write-offs during the accounting period.

Disclosure:

- The Financial Statements of the Union and State Governments shall disclose the Carrying Amount of loans and advances at the beginning and end of the accounting period showing additional disbursements and repayments or write-offs.
- An additional column in the relevant Financial Statements shall also reflect the amount of interest in arrears and this amount shall not be added to the closing balance of the loan which shall be in nature of an additional disclosure.
- The Financial Statements of the Union Government shall disclose the following details under 'Loans and Advances made by the Union Government' in the Annual Finance Accounts of the Union Government:
  - ✓ the summary of Loans and Advances showing Loanee group-wise details;
  - ✓ the summary of Loans and Advances showing Sector-wise details;
  - ✓ The summary of repayments in arrears from Governments and other loanee entities.
- The Financial Statements of the Union Government shall disclose the following details under 'Detailed Statement of Loans and Advances made by the Union Government in the Annual Finance Accounts of the Union Government -
  - ✓ the detailed statement of Loans and Advances showing the Major Head;
  - ✓ the detailed Statement of repayments in arrears from State or Union territory Governments;
  - ✓ the detailed Statement of repayments in arrears from other Loanee entities.
- The Financial Statements of the Union Government shall disclose the following details under 'Additional Disclosures' in the Annual Finance Accounts of the Union Government:
- The fresh Loans and Advances made during the year.
- the Financial Statements of the State Governments shall disclose the following details under 'Statement of Loans and Advances made by the State Governments' in the Annual Finance Accounts of the State Government
  - ✓ the summary of Loans and Advances showing Loanee group-wise details;
  - ✓ the summary of Loans and Advances showing Sector-wise details;
  - ✓ the summary of repayments in arrears from Loanee entities.
- The Financial Statements of the State Governments shall disclose the following details under 'Detailed Statement of Loans and Advances made by the State Government in the Annual Finance Accounts of the State Government:
  - ✓ the detailed statement of Loans and Advances showing the Major Head and Minor Head-wise details;
  - ✓ the detailed Statement of repayments in arrears from Loanee entities.
- The Financial Statements of the State Governments shall disclose the details relating to fresh Loans and Advances made during the year under 'Additional Disclosures' in the Annual Finance Accounts of the State Government.

Effective Date: This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning from 1.4.2011.

IGAS — 7 FOREIGN CURRENCY TRANSACTIONS AND LOANS OR GAIN BY EXCHANGE RATE VARIATION

Introduction: Government Accounting Rules, 1990 require that the accounts of the Government shall be maintained in Indian currency i.e., Indian rupees. Indian rupee is the reporting currency for the financial statements of the Government.

All transactions of the Union and State Governments taking place in other countries are passed periodically by the Indian Embassies/ Missions to India and brought to account finally in the Indian books after they have been converted into rupees.

All transactions taking place with foreign Governments or foreign entities or international agencies in foreign currency are also to be recorded in the reporting currency applying exchange rate on the date of transaction.

The missions and embassies of India abroad incur expenditure on their operations including the pay and other entitlements of the officials employed there. They also make payments on behalf of other Ministries and Departments relating to defense, commerce, education as well as public sector undertakings and State Governments. These involve foreign currency transactions and loss or gain due to difference between exchange rate applicable and exchange rate internally adopted by Government like official rate of exchange or salary rate of exchange. Government may use various rates of exchange internally determined for foreign currency transactions that might give rise to loss or gain for accounting purpose.

Under Article 292 of the Constitution of India, the executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by the Parliament by law and to the giving of guarantees within such limits, if any, as may be so fixed. The Union Government may have bilateral and multi-lateral transactions involving foreign currency. This may involve borrowing or lending involving repayment of principal and payment of interest denominated in foreign currency and loss or gain by exchange rate variation.

In case of foreign currency loans to various projects, particularly by the World Bank, there are different procedures for disbursement. These are (i) Reimbursement through Special Account, (ii) Reimbursement outside Special Account, and (iii) Direct payment/ Commitment procedure. The Direct payment/ Commitment procedure involves direct payment of foreign currency to contractor/ supplier/ consultants from the loan/ credit funds the World Bank, as opted by the project implementing agency. The rupee equivalent of the foreign currency paid directly from the loan/credit is recoverable from the project implementing agency. However, under externally aided projects the Union Government releases ‘additional central assistance towards disbursements under this procedure. But the rupee amount of the foreign currency paid directly from the loan/credit is recoverable from the project implementing agency.

Government may float or may enter into agreement with designated bank(s), for example, the State Bank of India to float schemes involving foreign currency denominated bonds/ deposits, such as ‘The NRI Bonds’, ‘India Millennium Deposits’ and ‘Resurgent India Bonds’ for subscription by the Non-Resident Indians, Overseas Corporate Bodies or Banksacting in fiduciary capacity on their behalf. The proceeds may not flow into the Consolidated Fund and are either kept in the Public Account as in the case of the NRI Bonds or acquired by the Reserve Bank of India. Rupees securities issued to the international financial institutions such as the Asian Development Bank, International Bank of Reconstruction and Development (World Bank), International Development Association, International Fund for Agricultural Development, African Development Bank are accounted for under ‘internal debt’ of the Central Government that may require repayment on encashment of rupee securities in convertible currencies giving rise to exchange difference.

Foreign currency transactions for acquisition of Special Drawing Rights (SDRs) at the IMF are accounted for under Special Deposit and Accounts-SDR at the IMF-Exchange Rate.

Objective: The objective of this standard is to provide accounting and disclosure requirements of foreign currency transactions and financial effects of exchange rate variations in terms of loss or gain in the financial statements. It also deals with the requirements of disclosure of foreign currency external debts and the rate applied for disclosure. The principal issues in accounting and reporting for foreign currency transactions are to decide which exchange rate to apply and how to recognise in the financial statements the financial effects of exchange rate variations in terms of loss or gain.

Scope: The Accounting Authority which prepares and presents the financial statements of the Government under the cash basis of accounting, as defined in the Government Accounting Rule 21 of GAR 1990 and Government Financial Rule 68 of GFR 2005 should apply this Standard:

(a) in accounting and disclosure for transactions in foreign currencies;

(b) in accounting and disclosure for financial effects of exchange variations in terms of loss or gainby exchange rate variation, and

(c) in disclosure of foreign currency external debts and the rate(s) applied for disclosure.

Financial statements should not be described as complying with this Standard unless they comply with all its requirements.

This Standard shall apply to foreign currency transactions of the Union Government as well as that of the State Governments.

This Standard deals with presentation of expenditure and revenue in terms of loss or gain by exchange rate variations arising from foreign currency transactions. It also deals with disclosure of foreign currency external debt.

This Standard does not deal with disclosure requirements of external guarantees. The requirements of disclosure of details of subsisting external guarantees in terms of Indian rupees on the date of financial statements have been dealt with in IGAS1 "Guarantees given by Governments: Disclosure Requirements'.

The Reserve Bank of India is the custodian of foreign currency and foreign exchange reserves and this Standard does not deal with foreign currency reserves.

Important Definitions:

- **Accounting Authority:** It is the authority which prepares the financial statements of the Government.
- **Capital Account:** It means a division of Government accounts wherein receipts and expenditure of capital nature are accounted for.
- **Closing Rate:** It is the exchange rate on the last working day of the period for which the financial statement is prepared.
- **Consolidated Fund of India or Consolidated Fund of State:** It means the Consolidated Fund referred to in Article 266 (I) of the Constitution of India.
- **Cross Currency Swap Agreement:** Itis a financial agreement between two parties to exchange a stream of principal and interest payments in one currency for a stream of principal and interest payments in another currency.
- **Direct Payment Procedure:** It involves direct payment of foreign currency to contractor / supplier / consultants, from the loan / credit funds of the World Bank, as opted by the project implementing agency.
- **Exchange Rate:** It is the ratio for exchange of two currencies.
- **Exchange Rate Variation:** It means change in the ratio for exchange of two currencies;
- **Exchange Difference:** It is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.
- **External Guarantee:** It means a guarantee against liability denominated in foreign currency.
- **Financial Statements:** It means the Annual Finance Accounts of the Governments.
- **Foreign Currency:** It means a currency other than the reporting currency of the Government.
- **Forward Rate:** It means the specified exchange rate for exchange specified by the terms of agreement for exchange of two currencies at a specified future date.
- **Government:** It means the Central (Union) Government or a State Government, or a Union Territory Government;
- **Government Accounts:** It mean the form and divisions of accounts and accounting records in which all transactions ofGovernment are accounted for.
- **Guarantee:** It is an accessory contract, by which the promisor undertakes to be answerable to the promisee for the debenture default or miscarriage of another person, whose primary liability to the promisee must exist or be contemplated.
- **Indian Currency:** It means currency which is expressed or drawn in Indian rupees.
- **Official Rate of Exchange:** It means official accounting rateof exchange between Indian rupees and foreign currencies determined and issued by the Ministry of External Affairs, Government ofIndia periodically.
- **Public Account:** It means the Public Account of India referred to in Article 266(2) of the Constitution of India;
- **Public Sector Undertaking:** It means government companies incorporated under the Companies Act, 1956 and Statutory Corporations set up under the specific Acts of Parliament and State Legislatures, as the context may imply.
- **Reporting Currency:** It means Indian Rupees.

- **Revenue Account:** It means a division of Government accounts wherein receipts and expenditure of revenue nature are accounted for.
- **Salary Rate of Exchange:** It means the rate of exchange between the reporting currency and foreign currency fixed by Ministry of External Affairs, Government of India for disbursement of salary of the officials posted at Mission abroad.
- Special Drawing Right means the international reserve asset created by the International Monetary Fund.

Foreign Currency Transactions: A Foreign currency transaction of Government is a transaction which is denominated in or requires settlement in a foreign currency. This may include:

- transactions arising due to operations of the missions and embassies abroad and receipts and payments made by them including those on behalf of other Ministries and Departments relating to defence, commerce, education as well as public sector undertakings and State Governments;
- bilateral and multi-lateral foreign currency transactions involving borrowing or lending including debt servicing;
- purchasing/ selling goods or services where purchase/ sale price is denominated in foreign currency;
- transactions arising from the schemes involving foreign currency such as 'The NRI Bonds', the flow of which goes to Government account;
- transactions for acquisition of Special Drawing Rights at the International Monetary Fund and quota contributions to IMF and the transactions under Financial Transaction Plan;
- rupees securities issued to the international financial institutions which are accounted for under the head internal debt of the Central Government but requiring repayment on encashment of rupee securities in convertible currencies.

A foreign currency transaction of Government shall be reported in the reporting currency by applying to the foreign currency amount, exchange rate between the reporting currency and the foreign currency at the date of receipts and payments.

The exchange rate at the date of receipts and payments is the rate as determined by the Government of India for the purpose viz., salary rate, official rate, etc. or else the rate as indicated by the Reserve Bank of India in its buying and selling rate as may be appropriate, issued every day.

Treatment of Loss or Gain by Exchange Rate Variation: This standard set out the following accounting treatment required by this Standard with respect to loss or gain by exchange rate variations and exchange difference on different types of foreign currency transactions.

- All losses or gains by exchange rate variation in respect of Government transactions in foreign currencies shall be recognised as revenue loss or gain.
- Government may have losses or gains by exchange rate variations on its operating activities like operation of its missions abroad as mentioned in paragraph 2 above or due to contractual commitments to bear the financial effect of exchange rate variations as part of its fiscal and economic policy.
- Loss or gain arising out of transactions for acquisition of Special Drawing Rights at the International Monetary Fund shall be reported in the financial statements.
- Exchange difference may arise out of Government's financing activities like borrowing of loans denominated inforeign currencies and issuing of rupees securities. External borrowings of the Government are recorded at the historical rate of exchange i.e., rate of exchange prevailing at the date of transaction. As most of the loans have long repayment period(s), their repayment extends over several years. Meanwhile, exchange rate(s) may undergo significant changes. If the exchange rate is higher at the time of repayment, repayment of loans in Indian rupees exceed the rupee amount of loan drawn.

In case repayment of loans, at the end of loan period the balance, if any, remaining in external debt head may be cleared adjusting the same under appropriate revenue or expense head for exchange rate fluctuations or to miscellaneous Government Account head.

Disclosure:

The financial statements shall disclose rates of exchange adopted internally by the Government for different types of foreign currency transactions including forward contract rate, if any, along with their basis as part of Statement of Accounting Policies.

The financial statements shall disclose the following details of foreign loans in the format given in paragraph 30:

(a) loans outstanding on historical cost basis at the beginning and end of the year;

(b) loans outstanding on closing rate basis at the beginning and end of the year;

(c) loans outstanding in foreign currency units at the beginning and end of the year;

(d) additions during the year in foreign currency terms and in Indian Rupee along with the rate of exchange adopted;

(e) discharge during the year showing separately the amounts in foreign currency units, on historical basis and

(f) current rate of exchange basis;

(g) loss or gain on repayment of loans due to variation of exchange rate;

(h) amount outstanding at the end of the year in foreign currency units, on historical basis and on closing rate basis;

(i) interest paid on external debt; and

(j) closing rate of exchange applied.

Financial statements shall disclose in the notes the following:

(a) category-wise gross figure of loss and gain by exchange rate variation for the financial year;

(b) loss and gain by exchange rate variation separately for Capital Head transactions and Revenue Head transactions;

(c) amount of loan and exchange difference in respect of fully repaid loans; and

(d) amount of loss or gain, if any, on cross-currency swap agreements.

Effective Date: This Indian Government Accounting Standard shall be effective for financial statements for the periods commencing from the 1st April subsequent to the date of notification of the standard by Government.

IGAS — 9 GOVERNMENT INVESTMENTS IN EQUITY

Introduction:

The Union Government, State Governments, and Governments of Union Territories with Legislatures (hereinafter called Government), make investments in entities like Government companies, Statutory Corporations, other Joint Stock Companies and Cooperative Banks/ Societies etc. In addition, the Union Government also invests in international bodies and authorities like the International Monetary Fund, Asian Development Fund, and International Finance Corporation.

Government's investments in equity include direct investment in share capital, conversion of outstanding loans (principal and interest) against the entity into equity, and conversion of dividends declared by the entity, but not received, into equity. This standard covers all such investment in equity, and does not cover investment in the loan capital of the entity.

Objective:

The objective of the Standard is to lay down the norms for recognition, measurement,and reporting of investments of the Government in the Financial Statements so that the financial statements provide a true and fair view of investments of the Government, consistent with best international practices.

Scope:

This Standard applies to investments made in different investee entities by the Government for incorporation, and presentation in the Financial Statements. This standard will apply only to Government accounts being maintained on cash basis.

It applies to investment in equity of the investee entities and not in debt, like debentures, bonds, and such other instruments which are normally accounted for by the investee entities as long term and short term debt. The Financial Statements shall not be considered as giving a true arid fair view of investments unless they comply with this Standard.

Important Definitions:

- **Accounting Authority:** It is the authority that prepares the financial statements of the Government.
- Accounting Period: It means the financial year covered by the financial statements, which is normally from 01 April to 31 March.
- **Bonus Shares:** These are the shares issued free of cost to the shareholders by an investee entity by capitalising its reserves and / or the security premiums as per the requirement of the relevant law.
- **Cash Basis of Accounting:** It is one wherein the accounting transactions of the Government represent the actual cash receipts and disbursements during a financial year as distinguished from the amount due to *or from* the investee entity during the same period.
- **Disinvestment/ divestment / retirement of-Government Equity:** It means the sale or transfer of equity shares by the Government.
- **Equity Share:** It is a share, which is not a preference share.
- **Financial Statements:** It means the Annual Finance Account of the respective Government.
- **Government:** It means the Union Government or any State Government or Government of any Union Territory with Legislature.
- **Government Investment in Equity:** It includes investment in equity shares obtained by the Government on payment of cash or in exchange of any other asset; exercise of a right granted by the investee; issuance of bonus shares by the investee entity; reinvestment of dividends; or conversion of loans into equity.
- **Historical Cost:** It is the cost of acquisition of equity shares.
- **Investee Entity:** It is an entity in which an investment is made by the Government.
- **Investee Group:** It consists of a group of investee entities of similar nature and characteristics that can be collectively and distinctively addressed such as Statutory Corporations, Joint Stock Companies, International Bodies, State Cooperative Banks/other banks, Cooperative Societies, Employees Consumer Cooperative Societies, etc.
- **Preference Shares:** It mean those shares which have the following two characteristics:
- (a) that with respect to dividends, carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate; (b) that with respect to capital, they carry, over the equity share hotter, on winding up or repayments of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up.
- **Right Shares:** These are the allotment of shares on the issue of fresh capital by an investee entity to which a shareholder, by virtue of his holding, is entitled to, certain shares on payment in the investee enterprise in proportion to the number of shares already held by him.

Recognition:

An investment in equity shall be recognised by the Government as an asset from the date on which the investment details are entered in the books of the entity.

Loans converted into equity and dividends declared but not distributed by the investee entity, converted into equity shall be treated as equity investments from the date on which such conversion takes plate, i.e. from the date on which details of conversion are entered in the books of the investee entity.

Measurement:

- The method of initial measurement of investments in the financial statements of theGovernment is the historical cost of the investment. Where investment in equity is acquired on payment of cash including on exercise of rights granted by the investee, the historical cost is the amount of cash disbursed. Historical cost of Bonus shares is nil as there is no payment of cash. In case the Government acquires equity shares in consideration of any other asset, e.g., land, the historical cost of such investment shall be the face value of the equity shares. Where the equity shares are acquired on reinvestment of dividends, the historical cost of such shares is the amount of dividends against which the shares are allotted. Historical cost of equity shares acquired on conversion of loans is the amount of the loan outstanding (principal and interest) against which such shares are allotted.
- Total market value of the investments will be calculated on the basis of the price quoted on the last day of the financial year in the primary market of trading of that particular stock or in case the quoted price is not available on that date, the price on the date at which it was last quoted before the closing of the financial year. This will be applicable to the listed companies whose shares are regularly traded on a recognised stock exchange during the year.
- Investments subsequent to initial measurement shall also be reflected in the financial statements at historical cost.
- The total amount of investments on the last date of an accounting period shall be the investments at the beginning of the period with additions and disinvestment / sale of investments during the period.

Disclosure:

The Financial Statements of the Government shall disclose the amount of investments at the beginning and at the end of the accounting period showing additional investments, disinvestments / divestments or retirement /write town of capital / transfer of share, if any.

They will reflect the additions made during the year by way of investments to the opening balance and disinvestments/ divestments there from, for arriving at the closing balance.

Types of investments are specifically mentioned and acquisitions of investments in terms of exchange of goods/ other assets are also recorded.

The amount of dividend received shall be reflected as revenue of the period.

The Financial Statements of the Government shall disclose the following details under the statement of 'Investments made by the Government':

(i) Detailed Statement of Investments made investee Entity wise.

(ii) Detailed Statement of Disinvestments / divestments / retirement of capital / transfer of shares made Investee Entity wise.

(iii) Summary of Investments: Investee group-wise (such as Statutory Corporations, Joint Stock Companies, Cooperative Banks, etc.

(iv) Additional disclosures of investee entities which have not submitted accounts and / or have suffered a loss during the preceding three consecutive years.

The detailed statement of investments, Investee entity wise in the Financial Statementswhich the entity belongs, the Ministry or Department under which the investee is functioning, whether the enterprise is in operation or not etc. Details of disinvestment / divestments / retirement of capital / transfer of share during the year are reported in the Statement of disinvestment / retirement of capital, investee entity wise. While indicating the type and number of units, the units acquired, and those allotted as bonus shares, shall be depicted separately along with year of allotment. The statements shall also disclose the total paid up capital of the entity. This would help indicate the extent of government control and whether the investment has increased or decreased.

Moreover, where the units of investments are traded in the market, the amount of investment in terms of market value may also be disclosed. The price quoted on the last day of the financial year in the primary market of trading of that particular stock orin case the quoted price is not available on that date, the price on the date at which it was last quoted before the closing of the financial year may be taken into account.

The amount of dividend received and credited to Government revenue shall also be reported entity wise. In case the dividend received pertains to previous accounting periods, the year to which the amounts actually pertain are disclosed by way of a foot note.

Additional disclosures shall include the investments and disinvestments / divestments / retirement of capital / transfer of shares made during the reporting period. In addition, disclosures shall be made by way of a note to accounts in respect of investments in entities which have made a net loss i.e., loss after interest and taxes in the previous accounting period along with remarks where further investments have been made during the reporting period. Where the accounts of the investee entities are in arrears for more than three consecutive years, the fact should be disclosed, along with remarks in cases where the G6vernment has invested in the entity during the reporting period.

Effective date:

This Indian Government Accounting Standard becomes effective for the financial statements covering periods beginning from the 01 April of the year following the notification of the Standard by the Government.

IGAS — 10 PUBLIC DEBT AND OTHER LIABILITIES OF GOVERNMENTS: DISCLOSURE REQUIREMENTS

Introduction:

In terms of Article 292 of the Constitution, the executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits, if any, as may from time to time be fixed by Parliament by Law. Article 293(1) of the Constitution provides a similar provision in respect of State Governments. Section 48A(1) of the Government of Union Territory Act 1963 and Section 47A(1) of Government of NCT of Delhi Act 1991, also provides for borrowing upon the security of the Consolidated Fund of the Union Territory concerned or Consolidated Fund of the Capital within such limits, if any, as may be fixed by Parliament by law and the stipulations indicated therein.

Objective:

The objective of the IGAS isto lay down the principles for identification, measurement and disclosure of public debt and other obligation of Union and the State Governments including Union Territories with legislatures in their respective financial statements.

It ensures consistency with international practices for accounting of public debt in order to ensure transparency and disclosure in the financial statements of Government for the benefit of various stake holders.

Scope:

- The proposed IGAS shall apply to the financial statements prepared by the Union and State Governments and Union Territories with legislature.
- The IGAS shall also cover "other obligations" as defined in paragraph 4 of this standard relating to definitions. The IGAS shall not include in its ambit, guarantees and other contingent liabilities and non-binding assurances.

Important Definitions:
• **Accounting Authority**: It means the authority who prepares the Financial Statements of the Governments. • Accounting Period: It means the period covered by the Financial Statements. • **Cash Basis of Accounting:** It is that wherein accounting transactions of the Union Government, State Government and Government of Union Territory with legislature represent the actual cash receipts and disbursement during a financial year as distinguished from the amounts due to or by the relevant Government, subject to the exceptions as may be authorized under the Government Accounting Rules 1990 or by any general or special orders issued by the Central Government on the advice of the Comptroller & Auditor General of India. • **Consolidated Fund of India**: It is the fund referred to in Article 266(1) of the Constitution of India. • **Consolidated Fund of a State:** It is the fund referred to in Article 266(1) of the Constitution of India. • **Consolidated Fund of Union Territories with Legislature**: It is the fund referred to in Section 47(1) of the Union Territories Act, 1963 and Section 46(1) of the Government of National Capital Territory of Delhi Act, 1991. • **Public Account of India:** It is the fund referred to in Article 266(2) of the Constitution of India. • **Public Account of a State:** It is the fund referred to in Article 266(2) of the Constitution of India. • **Public Account of Union Territory:** It is the Public Account referred to in Section 47A (1) and Section 46A (1) of the Government of Union Territories Act, 1963 and the Government of National Capital Territory of Delhi Act, 1991 respectively. • **Financial Statements:** It means the Annual Finance Accounts of the Union Government, State Governments and Union Territories with legislature. It would also include appropriate statements, schedules and notes to the above statements. • **Government:** It means the Union Government or any State Government or Government of any Union Territory with Legislature. • **Face Value:** It is the contract value of the Public Debt or other obligations. • **Public Debt:** It includes internal and external debts of the Central Government, State Governments and Government of the Union Territory with legislature, as applicable. • **Other Obligations:** It refers to the net outcome of the receipt and payment transactions arising in the public account. It does not include transactions categorized as Remittances, Suspense and Miscellaneous and Cash Balance.

Measurement & Valuation:

The Public Debt and Other Obligations incurred by Governments shall be accounted and reported on the basis of Face Value. For the purpose of reporting external debt, changes in the Balance at the end of the Accounting Period arising from variations in the rate of exchange shall also be reported.

Disclosure:

The financial statements of the Union Government, State Governments and the Union Territories with legislature shall disclose the following details concerning Public Debt and other obligations:

(a) the opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to internal debt;

(b) the opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to external debt, wherever applicable;

(c) the opening balance, receipts and disbursements during the year, closing balance and net change in rupee terms with respect of other obligations.

The Financial Statements of the Union Government and the State governments shall disclose the following details regarding servicing of debt and related parameters for the current year, preceding year and net change in rupee terms with respect to:

(a) Interest paid by the governments on public debt, small saving, provident funds, and reserve funds and on other obligations.

(b) Interest received on loans to State and Union Territory Governments, departmental Commercial Undertakings, PSUs and other Undertaking including Railways, Post & Telegraph.

(c) Interest received on other Loans, from investments of cash balances and other items.

External debt of the Central Government shall be classified according to source indicating the currency of transaction. Measurement of face value shall be in respect of both the currency of agreement and Indian rupees. It should also disclose the outstanding in terms of exchange rate prevailing at the end of the accounting period.

Effective date:

This Indian Government Accounting Standard becomes effective for the Financial Statements covering periods beginning on 1st April of the year after the notification of the Standard by the Government.

8.11 INDIAN GOVERNMENT FINANCIAL REPORTING STANDARDS (IGFRS)

The standards being developed for accrual system of accounting in the Government are called the Indian Government Financial Reporting Standards (IGFRS).

Accrual based Accounting Standards, i.e., Indian Government Financial Reporting Standards (IGFRS), approved by the Government Accounting Standards Advisory Board (GASAB) under consideration of Government of India:

- IGFRS 1: Presentation of Financial Statements
- IGFRS 2: Property, Plant & Equipment
- IGFRS 3: Revenue from Government Exchange Transactions
- IGFRS 4: Inventories
- IGFRS 5: Contingent Liabilities (other than guarantees) and Contingent Assets: Disclosure Requirements.[1]

Formulation of some other IGFRSs/IGASs is under progress

IGFRS 1: Presentation of Financial Statements

IGFRS 1 has prescribed the manner of presentation of financial statements by Government entities that follow accrual basis of accounting. It sets out over all requirement for the presentation of financial statements, guidance for their structure and minimum requirements for the content of financial statements presented under the accrual basis of accounting.

IGFRS 2: Property, Plant and Equipment

This standard has prescribed the accounting treatment for property, plant and equipment (PPE) so that users of financial statements can obtain information regarding an entity's investment in its property, plant and equipment and any changes in such investment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them. In addition, this standard aims at categorising assets according to their nature and also aims to provide for depreciation of assets, taking into account their usage over the life of the assets. The Accounting Standard is essentially an adaptation to Indian requirements of International Public Sector Accounting Standard (EPSAS 17) issued by IFAC on Property, Plant and Equipment. It also envisaged to provide guidance to pilot studies and the eventual development of a common reporting framework under accrual basis for the Union and the States. The IGFRS are subject to revision by GASAB based on experiences with pilot studies.

1 http://gasab.gov.in/gasab accessed on 20.06.2016

IGFRS 3: Revenue from Government Exchange Transaction

This Standard lays down the principles to be followed for recognition and measurement of revenue from exchange transactions by government entities under accrual basis of accounting, wherein transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid). It is envisaged to provide guidance to the pilot studies and eventual development of a common reporting framework under accrual basis for Union and the States. The IGFRS could be revised by GASAB based on pilot studies.

IGFRS 4: Inventories

This standard has prescribed the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories. This Standard aims at using accrual principles of accounting for inventories – both at the stage of charging as expense and depicting the closing stock in the financial statements at the end of the reporting period.

The Accounting Standard has derived inputs from Indian Accounting Standards (Ind AS 2), IPSAS 12 and IAS 2 (International Accounting Standards). The Standard is envisaged to provide guidance to the pilot studies and eventual development of a common reporting framework under accrual basis for the Union and the States. The IGFRS 4 could be revised by GASAB based on pilot studies.

IGFRS 5: Contingent Liabilities (other than guarantees) and Contingent Assets: Disclosure Requirements

This standard has laid down the principles for disclosure requirements of Contingent Liabilities (other than guarantees) and Continent Assets for both the Union and the State Governments including Union Territories with Legislatures, in their respective Financial Statements in order to ensure uniform and appropriate disclosure of such liabilities and assets. It also ensures consistency with international best practices leading to transparency and improved quality of disclosure in the financial reports of Governments for the benefit of various stakeholders. An important objective of the IGFRS is to ensure that Governments portray the risks associated with contingent liabilities and contingent assets in a transparent manner. The purpose of this standard is to provide for disclosure requirements of contingent liabilities (other than guarantees) and contingent assets of Governments in the financial

Statements. Disclosure of contingent liability is relevant from the point of view of knowing what risk of future liability the government carries. Disclosure of contingent assets is relevant in knowing what possible assets may accrue to government.

PREVIOUS TERMS QUESTION PAPERS

FINAL EXAMINATION

June 2019

P-17 (ITX)
Syllabus 2016

Corporate Financial Reporting

Time Allowed: 3 Hours | Full Marks: 100

The figures in the margin on the right side indicate the full marks.

Where considered necessary, suitable assumptions may be made and clearly indicated in the answer.

Both the sections are to be answered subject to instructions given against each.

[*All working must form part of your answers.*]

Section-A

Answer the following questions.

1. Choose the most appropriate answer from the four alternatives given: (1 Mark for right choice & 1 Mark for justification): 2x10=20

   (i) XYZ Ltd. acquired 2000 equity shares of DEF Ltd. on 01.04.2017 for a price of ₹ 3,00,000. DEF Ltd. made a net profit of ₹ 80,000 during the year 2017-18. DEF Ltd. issued Bonus shares of one shares for every five shares held out of post-acquisition profits earned during 2017-18. The share capital of DEF Ltd. is ₹ 2,50,000 consisting of shares of ₹ 100 each. If the shares of XYZ Ltd. in the pre-acquisition profit of DEF Ltd. is ₹ 56,000, the amount of Goodwill/Capital Reserve to be shown in the consolidated balance sheet as on 31.03.2018 is:

   (A) ₹ 4,000 (Goodwill)

   (B) ₹ 4,000 (Capital Reserve)

   (C) ₹ 44,000 (Goodwill)

   (D) ₹ 50,000 (Goodwill)

   (ii) Mittal Ltd. has provided the following information:

   Depreciation as per accounting records ₹ 30,00,000, Depreciation as per income tax records ₹ 75,00,000. Unamortized preliminary expenses as per income tax records ₹ 4,50,000. Tax rate 35%. There is adequate evidence of future profit sufficiency. As per AS 22 Deferred Tax Asset/Liability to be recognized will be:

   (A) ₹ 15,75,000 (DTL)

   (B) ₹ 14,17,500 (Net DTL)

   (C) ₹ 72,000 (Net DTA)

   (D) None of the above

(iii) The market price of Company Caa is ₹ 450 per share and that of Company Baa is ₹ 300. If Caa offers three-fourths a share of common stock for each share of Baa, the ratio of exchange of market prices would be:

(A) 0.667

(B) 1.000

(C) 1.125

(D) 1.500

(iv) A company has an inter-segment transfer pricing policy of charging at cost less 10%. The market prices are generally 25% above cost. Policy adopted by the company is

(A) Correct as per AS but not as per Ind AS

(B) Not Correct

(C) Correct, if total transfer is below 10% of total revenue of the Company

(D) Always correct, if applied consistently

(v) Cee Ltd. acquired a 60% interest in Jee Ltd. on January 1, 2017. Cee Ltd. paid ₹ 700 Lakhs in cash for their interest in Jee Ltd. The fair value of Jee Ltd.'s assets is ₹ 1,800 Lakhs and the fair value of its liabilities is ₹ 900 Lakhs. Compute the Non-controlling interest (NCI) at fair value.

(A) ₹ 360 Lakhs

(B) ₹ 700 Lakhs

(C) ₹ 280 Lakhs

(D) None of the above

(vi) Utkarsh Ltd. declares the following information:

	Exchange Rate (USD/IND ₹)
Purchased goods on 12.03.2018 of USD 1,00,000	68.60
Exchange rate as on 31.03.2018	69.00
Date of actual payment is 12.04.2018	69.50

What will be the gain/loss to be booked in the financial year 2018-19?

(A) ₹ 90,000 (loss)

(B) ₹ 40,000 (loss)

(C) ₹ 1,30,000 (loss)

(D) None of the above

(vii) During 2017-18, Mindblogger Ltd. incurred costs to develop and produce a mobile application computer software product, as follows:

Completion of detailed program design	₹ 23,000
Cost incurred for coding and testing to establish technological feasibility	₹ 20,000

Other coding costs after establishing technological feasibility	₹ 39,000
Other testing costs after establishing technological feasibility	₹ 31,000
Cost of producing product masters for training purposes	₹ 30,000

What amount should be capitalized as software cost?

(A)₹ 43,000

(B) ₹ 70,000

(C) ₹23,000

(D)₹1,00,000

(viii) Suchitra purchased 1000 shares in Tip-Top Ltd. of ₹ 600 per share in 2016. There was issue in 2018 of one share for every two held at price of ₹ 150 per share. If Suchitra subscribes the rights, what would be carrying cost of 1500 shares as per AS-13.

(A) ₹ 6,00,000

(B) ₹ 6,75,000

(C) ₹ 75,000

(D) Data insufficient

(ix) Future Limited undertakes a contract for construction of a Bridge on 01.04.2017 at a contract price of ₹ 1,250 Lakh. The contract was to be completed in two years. Cost incurred up to 31.03.2018 is ₹ 780 Lakh. The Company estimated that a further cost of ₹ 520 lakh would be incurred for completing the project. What amount should be credited to revenue as Contract Price for the financial year 2017-18 as per the provisions of Ind AS 11?

(A) ₹ 780 Lakh

(B) ₹ 750 Lakh

(C) ₹ 730 Lakh

(D) None of the above

(x) Statement - Preparation of CFS is not mandatory for companies having subsidiary in India. Choose correct option:

(A) Statement is correct as the Companies Act, 2013 does not require preparation of CFS.

(B) Statement is correct as AS 21 allows it if financial statement of subsidiary is attached with the stand-alone financial statements of the holding Company.

(C) Statement is incorrect as the Companies Act, 2013 requires preparation of CFS.

(D) Statement is incorrect as the Government of India by notification has imposed the requirement of preparation of CFS.

Section-B

Answer *any five* questions out of seven questions. 16x5=80

2. (a) Which is Related Party as per Ind AS 24? State objectives and scopes of the Ind AS 24. 4+4=8

(b) Following are the Extracts of Balance Sheets of Mirchiram Ltd.:

Particulars	31.03.2019(₹)	31.03.2018(₹)
Equity Share Capital	9,10,000	5,00,000
General Reserve	2,10,000	2,50,000
Profit and Loss A/c	9,50,000	(40,000)
Securities Premium	50,000	—
Capital Redemption Reserve	—	1,00,000
Capital Grant	8,00,000	Nil
Convertible Debentures (into equity shares at 25% premium)	---	2,00,000
Trade Payables	1,05,000	1,00,000
Goodwill	15,000	—
Plant and Machinery	7,65,000	5,00,000
Inventories	95,640	54,000
Trade Receivables	7,50,000	6,25,000
Less: Provision for Doubtful Debts	(1,90,000)	(1,50,000)
Voluntary Separation Payments	1,25,000	65,000

Additional Information:

(i) Depreciation on Plant and Machinery written off @ 15%.

(ii) It was decided to value Inventories at cost whereas previously the practice was to value Inventories at cost less 10%. However the closing stock on 31st March, 2019 was correctly valued at cost.

(iii) On 31st March, 2019, the business of Y Ltd. was purchased for ₹ 60,000 payable in fully paid equity shares of ₹ 10 each at a premium of 20%. The assets included Inventories ₹ 26,640, Trade Receivables ₹ 10,000 and Machine ₹ 18,360. In addition Trade Payables of ₹ 15,000 were taken over.

(iv) Debtors of ₹ 2,30,000 were written off against the Provision for Doubtful Debts A/c during the year. Grant of ₹ 10,00,000 amortised in P&L A/c. Compensation received in a suit filed by the Company ₹90,000. Voluntary Separation Payments ₹ 50,000 adjusted against General Reserve.

Required : Calculate

(A) Cash Flow Operating Activities.

(B) Cash Flow from Investing Activities.

(C) Cash Flow from Financing Activities

for preparing Cash Flow Statement as per AS-3. 8

3. (a) An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair value of the equipment are ₹ 6,00,000. The amount will be paid in 3 installments and at the termination of lease, lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹ 80,000. The (internal rate of return) IRR of the investment is 8%. The annual payments have been determined in such a way that the present value of the lease payment plus the residual value is equal to the cost of machinery. The present value of Re. 1 due at the end of 1st, 2nd and 3rd year at 8% rate of interest is 0.9259, 0.8573 and 0.7938 respectively.

(i) Calculate unearned finance income.

(ii) Segregate the finance income in the hands of lessor. 8

(b) A machine was acquired by ABC Ltd. 15 years ago at a cost of ₹ 20 crore. Its accumulated depreciation as at 31st March, 2018 was ₹ 16.60 crore. Depreciation estimated for the financial year 2018-19 is ₹ 1 crore. Estimated Net Selling Price of the machine as on 31st March, 2018 was ₹ 1.20 crore, which is expected to decline by 20 per cent by the end of the next financial year.

Its value in use has been computed at ₹ 1.40 crore as on 1st April, 2018, which is expected to decrease by 30 per cent by the end of the financial year. Assuming that other conditions of relevant accounting standard for applicability of the impairment are satisfied:

(i) What should be the carrying amount of this machine as at 31st March, 2019?

(ii) How much will be the amount of write off (impairment loss) for the financial year ended 31st March, 2019?

(iii) If the machine had been revalued ten years ago and the current revaluation reserves against this plant were to be ₹ 48 lakh, how would you answer to question (i) and (ii) above? 8

4. (a) Following are the summarized Balance Sheets of Hope Ltd. and Happy Ltd. as on 31st March, 2018.

Liabilities	**Hope Ltd (₹)**	**Happy Ltd. (₹)**	**Assets**	**Hope Ltd (₹)**	**Happy Ltd. (₹)**
Equity Share Capital (₹10 each fully paid up)	10,50,000	5,00,000	Building	9,25,000	3,00,000
General Reserve	8,16,900	2,23,300	Machinery	2,25,000	75,000
Profit & Loss A/c	1,00,000	1,00,000	Furniture	1,50,000	28,000
Trade Payables	3,81,000	1,60,000	Inventory	3,00,000	3,90,000
			Trade Receivables	4,10,000	1,05,000
			Cash at Bank	3,37,900	85,300
	23,47,900	**9,83,300**		**23,47,900**	**9,83,300**

On 1st October, 2018 Hope Ltd. decided to take over Happy Ltd. No Balance Sheet was prepared on that date. For six months period form 1st April, 2018 to 30th September, 2018, Hope Ltd. and Happy Ltd. earned a profit of ₹ 3,36,000 and ₹ 1,98,000 respectively after writing off depreciation @ 15% per annum on Building and @ 10% per annum on Machinery and Furniture for both the Companies.

Hope Ltd. and Happy Ltd. paid equity dividend @ 8% on 15th July, 2018. Tax @ 10% on such payments was also paid by each of them. Goodwill of Happy Ltd. was valued at ₹ 97,320 on the date of takeover:

For the purpose of takeover:

Inventory of both the Companies would be appreciated by 12%. Trade Receivables of Hope Ltd. and Happy Ltd. would be reduced by 5% and 6% respectively.

Hope Ltd. issued fully paid equity shares of ₹10 each to the shareholders' of Happy Ltd., on the basis of comparative intrinsic values of shares on the take-over date.

You are required to calculate total purchase consideration and intrinsic value of share of both the Companies for the purpose of calculation of share exchange ratio. All the working are to form part of your answer. 8

(b) What are the objectives of Ind AS 103? List the information an acquirer should disclose to help users of financial statement to evaluate the nature and financial effect of a business combination. 2+6=8

5. (a) Following are the Balance Sheets of three Companies as at 31st March, 2019:

Particulars	**A Limited (₹ in lakh)**	**B Limited (₹ in lakh)**	**C Limited (₹ in lakh)**
I. Equity and Liabilities			
1. Shareholders' Funds			
(a) Equity Share Capital (of ₹ 10 each)	50,000	15,000	4,500
(b) Reserves and Surplus:			
- General Reserve	62,000	6,300	---
- Statement of Profit and Loss	17,000	2,400	1,125
2. Non-current Liabilities			
(a) 10% Debentures of ₹ 100 each	---	---	2,250
(b) Loan from B Limited	---	---	150
3. Current Liabilities			
(a) Trade Creditors	25,200	5,400	1,395
(b) Bills Payables	---	---	225
Total	**1,54,200**	**29,100**	**9,645**
II. Assets			
1. Non-current Assets			
(a) Fixed Assets:			
- Tangible Assets	88,000	18,000	4,090
(b) Non-current Investment (on 1st April, 2018)			
- 900 Lakh Equity Shares in B Ltd.	13,500	---	---
- 360 Lakh Equity Shares in C Ltd.	3,250	---	---
- 5 Lakh 10% Debentures in C Ltd.	490	---	---
(c) Long-term Loans & Advances			
- Loan to C Ltd.	---	180	---
2. Current Assets			
(a) Inventories	28,500	6,000	2,270
(b) Trade Debtors	13,500	2,700	1,935
(c) Bills Receivables	390	150	---
(d) Cash and Cash Equivalents	6,570	2,070	1,350
Total	**1,54,200**	**29,100**	**9,645**

Additional Information:

(i) On 1st April, 2018 B Limited showed a balance of ₹ 5,100 Lakh in General Reserve and a credit balance of ₹ 3,800 Lakh in Statement of Profit and Loss. On the same date, B Limited showed a debit balance of ₹ 540 Lakh in Statement of Profit and Loss.

(ii) All die Bills payable appearing in C Limited's Balance Sheet were accepted in favour of B Limited out of which bills amounting to ₹ 110 Lakh were endorsed by B Limited to A Limited and bills amounting to ₹ 65 Lakh had been discounted by B Limited with its Bank.

(iii) On 28th March, 2019 C Limited remitted ₹ 30 Lakh by means of a cheque to B Limited to return part of the loan, but the cheque was not received by B Limited up to 31st March, 2019.

(iv) Stock with B Limited includes goods purchased from A Limited for ₹ 260 Lakh, which was owing also on 31st March, 2019. A Limited invoiced the goods at cost plus 30 per cent.

(v) In August, 2018 B Limited declared and distributed dividend @ 20 per cent for the year ended 31st March, 2018. B Limited credited the dividend received to its Statement of Profit and Loss Account.

You are required to prepare a Consolidated Balance Sheet of A Limited and its subsidiaries B Limited and C Limited as at 31st March, 2019. 12

(b) What are the disclosure requirements under Ind AS 112 about subsidiaries that have non-controlling interests that are material to reporting entity. 4

6. (a) (i) Write a brief note on initial measurement of financial asset or financial liability under Ind AS 109. 2

(ii) A Company has its share capital divided into shares of ₹ 10 each. On 1st April, 2017 it granted 10000 employees' stock options (ESOP) at ₹ 40, when the market price was ₹ 130. The options were to be exercised between 16th December, 2017 and 15th March, 2018. The employees exercised their options for 9500 shares only; the remaining options lapsed. The Company closes its books on 31st March every year. Show Journal entries up to the year ended 31.03.2018. 6

(b) From the following information, calculate the Fair Value of an Equity Share:

(i) 400000 Equity Shares of ₹ 10 each (paid up ₹ 8 each).

(ii) 700000 Equity Shares of ₹ 5 each fully called up (Call-in arrears @ ₹ 2 on 200000 shares).

(iii) 10000, 9% Preference Shares of ₹ 100 each fully paid up.

(iv) Reserves and Surplus ₹ 73,76,000.

(v) Tangible Fixed Assets ₹ 3,00,000. 50% of total Tangible Fixed Assets are found undervalued by 50% of market value and 50% of remaining are found overvalued by 50% of market value. 10% Investments: [Face value ₹ 80,000] ₹ 1,00,000. Of the Investments 10% is trade and the balance non-trade. All trade Investments are to be valued at 10% below cost.

(vi) External Liabilities ₹ 10,00,000.

(vii) Expected Future Maintainable Profits before tax ₹ 25,59,000.

(viii) Rate of Tax-30% (Ignore Corporate Dividend Tax).

(ix) Normal Rate of Earnings-9%. 8

7. (a) State the process of Election of Members of Public Accounts Committee. 8

(b) Write a short note on Government Accounting Standards issued by Government Accounting Standards Advisory Board (GASAB). 8

8. Write short notes on *any four* of the following: 4x4=16

(a) Corporate Social Responsibility Reporting

(b) Myth about XBRL reporting

(c) Fair value hierarchy as per Ind AS 113

(d) Meaning and Advantages of Triple Bottom Line Reporting (TBL)

(e) Derivative and an Embedded Derivative as per Ind AS 109

The Directorate of Studies is committed to keep abreast of CMA Students with the latest amendments/notifications/advancements on each subject on regular basis. Students are requested to visit CMA Students' Portal [https://icmai.in/studentswebsite/] regularly to view the updates.