INDEX- CMA FINAL- CFR (PAPER 18)

Strategy to be followed for examination purpose:

1.Start your preparation in the sequence mentioned in Index.

2. No other book is recommended, 100% questions/theory of ICMAI study material are covered in this book along with all possible important concepts/questions which may be asked in your examination.

Section A- INDIAN ACCOUNTING STANDARDS

Note: Without studying Ind AS-1, You cannot understand how to prepare financial statement as per Ind AS. So, it is essential to study Ind AS-1 for better understanding of further topics. So, go through this Ind AS even though this Ind AS not mentioned in your syllabus.

Chapter 1.1- Ind AS 1: Presentation of Financial Statements

Introduction:

1. Ind AS 1, Presentation of Financial Statements, prescribes the principles for preparation of General-Purpose Financial Statements, their structures and minimum content requirements as well as guidelines for specific disclosure in India.
2. This standard deals with elements of financial statements structure and content which is addressed by **division 2 of Schedule III of co. act 2013.**

Important Definitions:

1. **Ind AS** are standards prescribed under section 133 of companies act 2013.
2. **Other comprehensive income (OCI): -** comprises items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind AS.
3. **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.
4. **Total comprehensive income (TCI): -** 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.

Detail study:

A complete set of financial statements comprises:

- a balance sheet as at the end of the period
- a statement of profit and loss for the period
- statement of changes in equity for the period
- a statement of cash flows for the period
- notes, comprising significant accounting policies and other explanatory information.

General Features of a Financial Statement: -

1. Presentation of True and Fair View

2. Going concern assumption

3. Accrual basis of accounting

4. Materiality and Aggregation

5. Frequency of Reporting

6. Off setting

7. comparative Information

8. Consistency of presentation

1. Presentation of True and Fair View: - It is presumed to achieve by the application of all relevant Ind AS, along with additional disclosures.

Departure from complying with the prescriptions laid down in the standards: - In extremely rare circumstance, the entity may find it appropriate to make a departure from complying with the prescriptions laid down in the standards. This may happen in cases where the management concludes that complying with a requirement in an Ind AS would be misleading and deviation from a particular requirement required by the regulatory framework.

In the above case it is required to disclose that the entity has complied with all Ind AS, except for that particular requirement. That entity is also required to give a description of the title of the standard and the accounting treatment required under the standard, the nature of departure and the reasons justifying the compliance with requirement would be misleading.

2. Going concern assumption: - An entity is required to make an assessment of its ability to continue as going concern and prepare the financial statements on going concern basis unless the management.

- **Either intends to liquidate the entity or cease trading, or**
- **Has no realistic alternative but to do so**

If going concern assumption is not valid, the entity shall prepare the financial statement by adopting any other appropriate basis of accounting supported by disclosure covering:

- **The basis on which financial statement are prepared, and**
- **The reasons why the entity is not regarded as a going concern.**

Note: - Going concern assessment is based on assessment information of at least 12 months from the end of the current financial period.

Question 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.

3. Accrual basis of accounting: - while preparing the financial statement the entity shall adopt accrual basis of accounting except for cash flow statements.

4. Materiality and Aggregation: Omissions or misstatements of items are material is they could individually or collectively influence the economics decisions that users make on the basis of the financial statements.
Materiality depends on the size or nature of the item or a combination of both, to be judged based on particular facts and in particular circumstances. Following points must be considered while preparing financial statements: -

- **Where a line item is not, in itself, individually material then it can be aggregated with other items.**
- **Each material class of similar items should be presented separately in the financial statements, and**
- **That item of dissimilar nature or function should also be presented separately.**

5. 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 the following, 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.

6. Offsetting: - items of assets and liabilities, income and expenses are set off against each other only when such set off is required or permitted by respective Ind AS. Off setting is allowed as per their respective Ind AS.

Example- Netting of selling expenses with sale proceeds of the assets sold is allowed. Similarly netting off of foreign exchange gains or losses are also allowed.

Question 2. Selling Price = 100 million
Cost = 85 million
Accumulated depreciation = 15 million
Selling Expense = 2 million
Should the company present gain and selling expense separately.

Answer. Gain on sale of PPE Rs 30 million and selling expense Rs 2 million can be set off.

Question 3. 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 set off 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.

7. Comparative information: -

An entity shall present comparative information in respect of the preceding period for all amounts reported in the current period's financial statements. An entity shall present 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 Balance Sheet is prepared when: -

- There is a need to apply an accounting policy retrospectively, or
- To make a retrospectively restatement of items in its financial statements (in case of prior period errors), or
- When an entity re-classifies items in the financial statements.
- When first time Ind AS is applied.

Under above circumstances, the entity shall also present an additional Balance sheet as at the beginning of the earliest comparative period.

Change in Presentation or Classification: -

- When there is change in presentation or classification of items of financial statements comparative information are also reclassified and the nature, amount and the reason of reclassification are disclosed.
- When reclassification of comparative period is impracticable, an entity should disclose the reasons for not reclassifying the amounts and the nature of adjustment that would have been made if the amount had been reclassified.

Question 4. X ltd. found a material error in the financial statement for year 21-22. How should X ltd. present its financial statement for the year 2024-25.

Solution: - If the error occurred before the earliest prior period presented (i.e. 2013-14), it is required to restate the opening balance of assets, liabilities and equity for the earliest prior period presented (i.e. 1.04.2013) as per Ind AS 8 and Ind AS 1. Therefore, X ltd shall restate its Balance Sheet as on 31.03.2013 and it shall present 3 Balance sheets, as on:

- 1.04.2023
- 31.03.2024
- 31.03.2025

8. Consistency of Presentation: - An entity is required to retain the same presentation and classification to ensure consistency of presentation unless the change is due to

- Change in the nature of entity operation or
- Would be appropriate or an Ind AS require such change.

Note- in case of change due to any of the above requirement, such change shall also apply to comparative information of the earlier year.

Disclosure under Ind AS-1:

1. Significant Accounting Policies: An entity shall disclose the summary of significant accounting policies and measurement bases used in preparing the financial statements.

2. Sources of estimated uncertainty: An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation of uncertainty at the end of the reporting period.

3. Capital Management Policies: An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital.

4. Information regarding puttable financial instruments.

5. other disclosures: An entity shall disclose in the notes:

(i) 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

(ii) 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 statement:

(i) the domicile and legal form of the entity, its country of incorporation and the address of its registered office;

(ii) a description of the nature of the entity's operations and its principal activities;

(iii) the name of the parent and the ultimate parent of the group; and

(iv) if it is a limited life entity, information regarding the length of its life

Presentation of Balance Sheet

- An entity shall present the balance sheet by classifying the assets and liabilities into current and non-current categories.
- The standard does not specify the order of presentation or format to be used but prescribes only certain minimum line items. **But ICAI and MCA together they have given us format of financial statements.**

DIVISION II of the schedule III of the companies Act 2013, Part 1 – BALANCE SHEET

Particulars	**Notes no**	**Figures at the end of current reporting period**	**Figures at the end of previous reporting period**
1. Non-current assets:			
a. Property, plant and equipment			
b. Capital Work in progress (WIP)			
c. Investment property			
d. Goodwill			
e. Other intangible assets			
f. Intangible assets under developments			
g. Biological plant other than bearer plant			
h. Financial assets:			
i. investments			
ii. trade receivables			
iii. loans			
iv. others			
i. Deferred tax asset(net)			
j. Other non-current assets			
2. Current assets:			
a. Inventories			
b. Financial assets:			
i. Investments			
ii. Trade receivables			
iii. Cash and cash equivalents			
iv. Bank balance other than (iii) (Earned mark amt)			
v. Loans			
vi. Others			
c. Current tax assets(net) – (Advance tax- tax payable)			
d. Other current assets			
3. Non- current assets held for sale (as per Ind AS 105)			

Total assets			
Equity and liabilities: **Equity:** a. Equity share capital b. Other equity **Liabilities**: **1. Non-current liabilities:** a. Financial liabilities: i. Borrowings ii. Trade payables iii. Other financial liabilities b. Provisions c. Deferred tax liability(net) d. Other non-current liabilities **2. Current liabilities** a. Financial liabilities: i. Borrowings ii. Trade payables iii. Other financial liabilities b. Provisions **c.** Current tax liability(net)- **(Tax payable- advance tax)** d. Other current liabilities **3. Liabilities directly associated with non-current asset held for sale**			
Total equity and liabilities			

Important note: -

1. Financial assets: - it is a contractual right to receive cash or another financial asset. For example, Debtors, Bills receivable, accrued income, investment in shares/debentures/ securities, loan given to directors/employees/customers etc.

2. Financial liabilities: - it is a contractual obligation to pay cash or other financial assets or to exchange other financial assets in lieu of payment. For example, Creditors, Bills payable, debentures, Redeemable preference shares, outstanding interest on loan/ debentures, dividend payable, unclaimed dividend etc.

Question 5: State whether following items are financial asset, financial liability or none:

ITEMS	Financial assets	Financial liabilities	None
1. income tax payable			
2. dividend payable			
3. proposed dividend			
4. Advance paid for purchase of fixed assets			
5. Prepaid expenses			
6. Outstanding expenses			
7. Advance income received			

Detail discussion on items of non-current assets:

1. **Property, plant and equipment: -** PPE includes all fixed assets including bearer plant, finance leased asset.
2. **Investment property: -**It includes Land and/or building held for earning rentals or for capital appreciation or both.
3. **Other intangible assets:** It includes brands, trademarks, computer software, mastheads and publishing titles, mining rights, copyrights, patents, other intellectual property rights, service and operating rights, recipes, formulae, models, designs and prototypes, licenses and franchise etc.
4. **Biological assets other than bearer plants:** as per Ind AS-41 Agriculture, a biological asset includes living animal or plant other than bearer plant.
5. **Non-current-Financial assets:**
   i. **Investments –** long term investments in equity instruments, preference shares, government or trust securities, bonds, debentures, mutual funds, Investments in subsidiary, joint venture and associates.
6. **Non-current trade receivables: -**
   i. Debtors and bills receivables if they are non-current.
   ii. Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
7. **Non-current loans: -** It includes, loans to related parties, loans to employees, other loans expected to be realized with in period more than 12 months.
8. **Other non-current financial assets:** it includes bank deposits for more than 12 months remaining maturity, non-current portion of a finance lease receivables, security deposits.
9. **Deffered tax assets(net) –** it is difference between DTA and DTL.
10. **Other non-current assets: -** capital advances against PPE or any other assets which do not meet the definition of financial assets.

<u>Detail discussion on items of current assets</u>:

1. **Inventories:** - it includes raw materials, WIP, finished goods, stock- in-trade, stores and spares, loose tools, goods in transit.
2. **<u>Financial assets: -</u>**

A. **Current investment—** same items mentioned in non-current investment if they are intended to be sold within remaining maturity period of less than 12 months or within the company's operating cycle.

B. **Current trade receivables –** debtors, bills receivables

C. **Cash and cash equivalents: -** it includes
   a. Balance with banks
   b. Cheques, drafts on hand
   c. Cash on hand
   d. Demand deposits
   e. Highly liquid investments
   f. Term deposits with maturity period of less than 3 months

D. **Bank balance other than cash and cash equivalents: -** it includes earmarked balances with banks (e.g. unpaid dividend), bank balance to the extent held as margin money.

E. **Current loans: -** It includes, loans to related parties, loans to employees, other loans expected to be realized with in period of 12 months.

F. **Other current financial assets: -** Accrued interest on investment, accrued income, insurance claim receivables.

G. **Current tax assets(net) –** if amount of tax already paid (i.e. advance tax) exceeds income tax payable.

H. **Other current assets: --** prepaid expenses.

Detail discussion on items of equity: -

a. **Equity share capital:** It includes equity share capital and irredeemable other securities/ convertible securities into equity shares. For each class of equity share capital following disclosures are required:
   i. The number and amount of shares authorized.
   ii. The number of shares issued, subscribed and fully paid and subscribed but not fully paid.
   iii. Par value per share.
   iv. Name of shareholders holding more than 5% shares and specifying the number of shares held.
   v. Share forfeiture amount.
   vi. Calls in arrears.

b. **Other equity:** it includes all type of reserves. For example. General reserves, capital reserves, security premium, buy back reserves, retained earnings, profit and loss (debit balance), employees stock option outstanding etc.

c. **Other equity:** it includes all type of reserves. For example. General reserves, capital reserves, security premium, buy back reserves, retained earnings, profit and loss (debit balance), employees stock option outstanding etc.

<u>Detail discussion on items of non-current liabilities: -</u>

A. Financial liabilities (long term):

i. **Borrowings (long term):** it includes debentures, bonds, term loan, secured loan, unsecured loan, long term maturity of finance lease, public deposits, redeemable preference share capital, bank loan etc. if they have been taken for long term periods.

ii. **Trade payables (long term):** it includes creditors and bills if treated as non-current liabilities.

iii. **Other financial liabilities (long term): -** to be specified

B. Provisions (long term): provident fund, gratuity fund, provision for employees, provision for warranty (if long term).

C. Other non-current liability (long term): - to be specified.

Detail discussion on items of Current liabilities: -

a. Financial liabilities (short term):

i. **Borrowings (short term): -** it includes bank overdraft, short term loan, short term public deposits, other loans for short term period.

ii. **Trade payables (short term):** creditors and bills payable

iii. **Other financial liabilities (short term): -** It includes current maturities of long-term debts, share application money pending allotments to be refunded (and interest accrued thereon), unpaid/unclaimed dividend, dividend payable, outstanding expenses.

b. **Other current liabilities:** it includes advance income received (unearned income), advance from customers, calls in advance.

c. **Provisions (short term): -** it includes provision for repairs, provision for warranty (if short term)

d. **Current tax liabilities: -** if income tax payable exceeds advance tax paid for the year.

Question 6. State the major heads and sub-heads under which the following items will be shown:

No.	Items	Head	Sub-head
1.	Share application pending allotment became refundable		
2.	Income tax reserve		
3.	Income tax payable		
4.	Dividend payable		
5.	Unclaimed dividend		
6.	Proposed dividend		
7.	Share option outstanding account		
8.	Finance lease obligations		
9.	Current maturity of finance lease obligation		
10.	Debentures/ Bonds		
11.	Current maturity of debentures		
12.	Loan repayable on demand		
13.	Provision for expense		

Question 7. State the major heads and sub-heads under which the following items will be shown:

No.	Items	Head	Sub-head
1.	Calls in arrear		
2.	Provident fund/gratuity fund		
3.	PF payable		
4.	ESI/ Gratuity payable		
5.	Provision for employees		
6.	Loose tools/ Spare parts		
7.	Tools and equipment		
8.	Bank deposits for 3 years		
9.	Drafts/cheques in hand		

Question 8. State the major heads and sub-heads under which the following items will be shown:

No.	Items	Head	Sub-head
1.	Capital commitments		
2.	Contingent liabilities		
3.	Forfeited share capital		
4.	Reserve capital		
5.	Capital reserve		
6.	Interest accrued on investments		
7.	Deposits with electricity supply company		
8.	Mining rights		
9.	Provision for doubtful debts		
10.	Long term loan from debtors/customers/Directors		
11.	Short term loan from debtors/customers/Directors		

Question 9. State the major heads and sub-heads under which the following items will be shown:

No.	Items	Head	Sub-head
	Workmen compensation fund/reserve		
	Profit and loss account (Dr balance)		
	Bank overdraft		
	Computer software		
	Development of software in progress		
	Machinery		
	Capital advances paid for purchase of machinery.		

Question 10. Prepare the Balance Sheet of Payal Textiles Ltd. as required under Schedule III of the Companies Act, 2013, as per Ind as 1as on 31 March 2025. Following balances are given:

Accounts	Dr. Rs.	Cr. Rs.
Secured Term Loans	—	10,00,000
Creditors	—	11,45,000
6% Debentures Account	—	27,00,000
income Tax payable	—	1,70,000
Security Premium Account	—	4,75,000
General Reserves	—	20,50,000
Bills payable	—	2,00,000
Provision for (Doubtful) Debts	—	20,200
Provision for Depreciation	—	5,00,000
Equity Share Capital (30,000 x 10)	—	3,00,000
8% Preference Share Capital (10,000 x 100)	—	10,00,000
Advances given to employee (long term)	3,72,000	—
Bills receivables	55,000	—
Cash and Bank	2,75,000	—
Loose Tools	50,000	—
Investments property	2,25,000	—
Profit and Loss Account (Losses)	3,00,000	—
Debtors	12,25,000	—
Security deposits to electricity Board	58,000	—
Stores Items	4,00,000	—
Machinery	56,50,000	—
Capital Work-in-Progress	2,00,000	—
Finished Goods Stock	7,50,200	—
	95,60,200	**95,60,200**

Important point for exam: -

Breach of the loan agreement before the end of Reporting Period: - When there is a breach of the loan agreement before the end of reporting period and the liability has become payable on demand at the end of reporting period, such loans are not classified as current if the banks have agreed for restructuring before financial statements are approved for issues and will be repaid later than 12 months from the reporting period.

STATEMENT OF PROFIT AND LOSS: -

DIVISION II of the schedule III of the companies Act 2013, Part 2-statement of profit and loss

	Particulars	**Note no.**	**at the end of current reporting period**	**at the end of previous reporting period**
i. ii.	Revenue from operations Other income			
iii.	**Total income**			
iv. a. b. c. d. e. f. g.	Expenses: Cost of material consumed Purchase of stock in trade Changes in inventories of finished goods, stock in trade and WIP Employees benefit expense Finance costs Depreciation and amortization expense Other expenses			
	Total expenses (iv)			
v.	**Profit/(loss) before exceptional items and tax(iii-Iv)**			
vi.	Exceptional items			
vii.	**Profit/(loss) before tax**			
viii.	Tax expense: i. Current tax ii. Deferred tax			
ix.	**Profit (loss) for the period from continuing operation (vii – viii)**			
x.	Profit (loss) from discontinued operation			

xi.	Tax expense of discontinued operation			
xii	Profit (loss) from discontinued operation after tax(x-xi)			
xiii	Profit (loss) for the period (ix + xii)			
xiv	**<u>Other comprehensive income (OCI):</u>** **A.** items that will not be reclassified to profit or loss **Less:** income tax relating to items that will not be reclassified to profit or loss **B**. items that will be reclassified to profit or loss **Less:** income tax relating to items that will be reclassified to profit or loss			
XV	Total comprehensive income for the period (xiii + xiv) (i.e. profit(loss) for current period and OCI)			
XVI	Earnings per share (for continuing operation) i. Basic ii. Dilluted			
xvii	Earnings per share (for discontinued operation) i. Basic ii. Dilluted			
xviii	Earnings per share (for discontinued & continuing operation) i. Basic ii. Dilluted			

Important note:

- No items of income or expenses should be presented as extraordinary items in the financial statements.
- This statement should begin with operating items, then non-operating items and should end with items of other comprehensive income and their related tax effects.
- **Reclassification Adjustments: -** Some Ind AS specify the timing and amount of income and expenses recognized in OCI to be reclassified into profit & loss. These adjustments are termed as reclassification adjustments.

Question 11. 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.

Question 12. From the under mentioned Trial Balance of COC education Ltd. prepare statement of Profit and Loss for the year ended 31 March 2025 and the Balance on that date:

Debit balances	**Rs**	**Credit balances**	**Rs**
Property, plant and equipment's	5,00,000	Equity share capital	7,00,000
Investment property	3,00,000	General reserve	80,000
Goodwill	4,00,000	Security premium	30,000
Biological assets	50,000	12% debentures	4,00,000
Investments in 40,000 equity shares of Tata Ltd (long term)	6,00,000	Creditors	1,10,000
		Bills payables	65,000
Opening stock of stock in trade	60,000	Sales	13,00,000
Purchase of goods	3,80,000	Discount received	30,000
Cash in hand	30,000	Share application money	
Bank balance	45,000	pending allotments	1,20,000
Demand deposits	70,000	Money received against	
Advance tax paid	60,000	share warrant	76,000
Debtors	65,000		
bills receivables	32,000		
wages	39,000		
salaries	1,70,000		
interest on debentures paid	24,000		
other expenses	86,000		
	29,11,000		**29,11,000**

Additional adjustments:

1. Dividend proposed during the year Rs 40,000.

2. Transfer Rs 50,000 to general reserves.

3. Value of investment property was to be increased by Rs 1,00,000.

4. Interest on debentures are outstanding for 6 months.

5. Income tax is payable @ 30%.

6. Charge depreciation @ 10% P.a on PPE.

7. 1/5 of goodwill to be amortised during current year.

8. Salary Rs 35,000 was prepaid.

9. Closing stock of goods was Rs 1,20,000.

Chapter 1.2- Ind AS-8
(Accounting Policies, Changes in Accounting Estimates & Errors)

1.1 INTRODUCTION: -- Ind AS 1, Presentation of Financial Statements, lays down the foundation for an entity regarding how the financial statements need to be presented. Ind AS 1 gives equal importance to the disclosure, in notes, of significant accounting policies and other explanatory information besides balance sheet, statement of profit and loss and statement of cash flows.

Accounting policies, estimates and correction of errors play a major role in the presentation of financial statements. That is why Ind AS 1 states that an entity cannot rectify inappropriate accounting policies either by disclosure of the accounting policies used or by notes or explanatory material. If there is any change in accounting policies, that needs to be dealt with due diligence and not just by mere note or explanation.

Further, Ind AS 1 makes it compulsory for the entity to present a third balance sheet as at the beginning of the preceding period, if it applies an accounting policy retrospectively, which has a material effect on the information in the balance sheet at that date.

Further, Ind AS 1 provides detail guidance about the proper disclosure of accounting policies and estimates.

Therefore, in the current chapter we are going to see, how to select the accounting policies, how to make the changes in accounting policies if needed, how to deal with changes in the estimates, how to rectify errors, etc., as all these elements will have impact on the true and fair position of the financial statements.

1.2 OBJECTIVE: -

i. To prescribe the criteria for selecting and application accounting policies

ii. To prescribe the accounting treatment and disclosure of changes in accounting policies

iii. To prescribe the accounting treatment and disclosure of changes in accounting estimates

iv. To prescribe the accounting treatment and disclosure of corrections of errors

v. To provide better base for inter-firm and intra-firm comparison

1.3 SCOPE: - This standard shall be applied in

• selecting and applying accounting policies;

• accounting for changes in accounting policies;

• accounting for changes in accounting estimates; and

• accounting for corrections of prior period errors.

However, tax effects of retrospective application of accounting policy changes and correction of prior period errors are not dealt with in this standard. The tax effects of these items are dealt with Ind AS 12, 'Income Taxes'.

1.4 DEFINITIONS

1. **Accounting policies** are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
2. **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.
3. **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.

1.5 ACCOUNTING POLICIES:

1.5.1 Selection and Application of Accounting Policies

Let us take few examples of accounting policies:

(a) Basis of accounting – Cash or accrual or hybrid?
(b) Method of determination of cost of inventories – FIFO or specific identification or Weighted Average?
(c) When should revenue be recognised?
(d) Methods of preparing cash flow statement.

Ind AS 1 narrates the importance of accounting policies but Ind AS 8 goes a step further and gives guidance to the entity as to how to select and apply accounting policies.

As per Ind AS 8, if any of the Ind AS already specifies the guidelines about following a particular policy, then entity must follow that standard and apply the policy as per the guidance provided.

In the absence of an Ind AS that specifically applies to a transaction or event or condition, management shall use its judgement 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 financial statements. It means they
  (i) represent faithfully the financial position.
  (ii) Reflect economic substance not merely legal form.
  (iii) Are neutral i.e., free from bias.
  (iv) Are prudent
  (v) Are complete in all material respects.

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

(i) Check if there are any other Ind AS available which are dealing with similar and related issues.
(ii) Check the basic framework of Ind AS, which provides the general principles.
(iii) Check the pronouncement of International Accounting Standard Board (IASB)
(iv) Check the pronouncement of other Standard setting Bodies having a similar conceptual framework.
(v) Check the accounting literature and accepted industries practices.

In exam, if question comes 'How to select and apply an accounting policy when specific Ind AS is not available on the particular transaction/condition/event'? -------- write above description.

Example for relating above description with a situation……

Before the wake of online transactions of capital markets, the trading of shares used to take place mainly through brokers and stock exchanges. However, OTC online terminals changed the face of the capital markets, giving direct access to the layman to trading transactions. Even if the basic nature of business was same, the technology changes the face of the business and many giant financial institutions became the dominant players in the market as brokerage firms. In view of the changing circumstances, SEBI and ICAI had come up with new guidelines and new standards which will cater to the need of new business models, such as trading in derivatives. However, there was a period of transformation when new transactions were slowly creeping in but the guidelines were in the preparatory phase.

1.5.2 Is it Compulsory to apply accounting policies?

- Ind AS 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 AS to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

It means Ind AS leaves the judgement to the entity to decide whether it would be material or not material to apply any accounting policy. 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.

1.5.4 Changes in accounting policies: -- Frequent changes in accounting policies will make it impossible for a stakeholder to make the economic decisions properly.
For example, suppose an entity has been following the FIFO method of determination of cost for inventories. In the current year, it shifts from FIFO to weighted average method. Assuming that cost is less than NRV, it means the opening stock is valued at FIFO method whereas closing stock is valued at Weighted Average Method, if retrospective application of the change is impracticable. This will directly impact the gross profit measurement of the entity. Additionally, the opening inventories and closing inventories will not be comparable.

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 entity's financial position, financial performance or cash flows.

The following are not changing in accounting policies:

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

Example: -- A company owns several hotels and provides significant ancillary services to occupants of rooms. These hotels are, therefore, treated as owner-occupied properties and classified as property, plant and equipment in accordance with Ind AS 16. The company acquires a new hotel but outsources entire management of the same to an outside agency and remains as a passive investor. The selection and application of an accounting policy for this new hotel in line with Ind AS 40 is not a change in accounting policy simply because the new hotel rooms are also let out for rent. This is because the way in which the new hotel is managed differs in substance from the way other existing hotels have been managed so far.

(b) If an entity is not applying the accounting policy currently and starts applying the accounting policy newly, that will also not be treated as change in accounting policy.

Example: - An entity has classified as investment property, an owner-occupied property previously classified as part of property, plant and equipment where it was measured after initial recognition applying the revaluation model. Ind AS 40 on investment property permits only cost model. The entity now measures this investment property using the cost model. This is not a change in accounting policy.

(c) A change in depreciation method should be accounted for as a change in accounting estimate in accordance with Ind AS 8. Similarly, as per Ind AS 38, a change in amortisation method should be accounted for as a change in accounting estimate in accordance with Ind AS 8. These changes are, therefore, not changes in accounting policies.

Question 1. Can an entity voluntarily change one or more of its accounting policies?

Solution. A change in an accounting policy can be made only if the change is required or permitted by Ind AS 8. As per Ind AS 8, 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.

Therefore, an entity cannot change voluntarily one or more of its accounting policies

Question 2. Entity ABC acquired a building for its administrative purposes and presented the same as property, plant and equipment (PPE) in the financial year 2019- 20. During the financial year 2021- 22, it relocated the office to a new building and leased the said building to a third party. Following the change in the usage of the building, Entity ABC reclassified it from PPE to investment property in the financial year 2021- 22. Should Entity ABC account for the change as a change in accounting policy?

Solution Ind AS 8 provides that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

As per Ind AS 16, 'property, plant and equipment' are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
(b) are expected to be used during more than one period."

As per Ind AS 40, '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, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or
(b) sale in the ordinary course of business."

As per the above definitions, whether a building is an item of property, plant and equipment (PPE) or an investment property for an entity depends on the purpose for which it is held by the entity. It is thus possible that due to a change in the purpose for which it is held, a building that was previously classified as an item of property, plant and equipment may warrant reclassification as an investment property, or vice versa. Whether a building is in the nature of PPE or investment property is determined by applying the definitions of these terms from the perspective of that entity. Thus, the classification of a building as an item of property, plant and equipment or as an investment property is not a matter of an accounting policy choice. Accordingly, a change in classification of a building from property, plant and equipment to investment property due to change in the purpose for which it is held by the entity is not a change in an accounting policy.

Question 3. Whether change in functional currency of an entity represents a change in accounting policy?

Solution. Ind AS 8 provides that the application of an accounting policy for transactions, events or conditions that differ in substance from those previously occurring are not changes in accounting policies.

As per Ind AS 21, 'functional currency' is the currency of the primary economic environment in which the entity operates.

Ind AS 21 requires the management to use its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions.

As per Ind AS 21, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions. Thus, functional currency of an entity is not a matter of an accounting policy choice.

In view of the above, a change in functional currency of an entity does not represent a change in accounting policy and Ind AS 8, therefore, does not apply to such a change. Ind AS 21 requires that when there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

1.5.5.1 How to apply the changes in accounting policies?

While discussing the process for application of changes of accounting policies, Ind AS 8, deals with two situations:

1. 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.
2. **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.**

Note: 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, event or condition, if management has applied an accounting policy from the most recent pronouncements of IASB or other standard-setting bodies and there is amendment in such pronouncement, if the entity chooses to change the accounting policy, **that change is accounted for and disclosed as a voluntary change in accounting policy.**

Example for understanding above description:

Suppose in absence of any specific Ind AS to a particular transaction, a company follows an accounting policy as per the relevant IFRS which addresses that transaction and, subsequently there is an amendment to that IFRS, then, the company may change its accounting policy as per that amendment. In such cases, it will be considered as if the company is making the change voluntarily and, accordingly, change in the accounting policy should be applied retrospectively.

Question 4. An entity developed one of its accounting policies by considering a pronouncement of an overseas national standard-setting body in due accordance with Ind AS 8. Would it be permissible for the entity to change the said policy to reflect a subsequent amendment in that pronouncement?

Solution: -- 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 or 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. As such a change is a voluntary change in accounting policy, it can be made only if it results in information that is reliable and more relevant and does not conflict with the sources in Ind AS 8.

1.5.5.2 Retrospective application

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

The intention of the standard is, as far as possible, that the companies should follow the same accounting policies consistently year after year to ensure the relevance and reliability of financial statements. The advantages of making the process of change in accounting policy so difficult are as follow:

- **i.** Companies will not make the frequent changes in their accounting policies just to do the window dressing of their financial statements.
- **ii.** The comparison of financial statements over the time and over the industry will be possible, in a reliable way.

When retrospective application is required, 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.**

Example for understanding above description:

A company has been established 25 years ago. Now, is it supposed to incorporate the changes in accounting policy for last 25 years? Will it be practicable? Will it be worth doing it? Will it be material? Such questions arise when one wants to change the accounting policy, since, voluntary change in policy is required to be applied retrospectively. The term 'Impracticability' is defined under Ind AS 8 as follows:

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. After going through the above-mentioned definition of impractical, it is clear that the Ind AS 8 provides some relief if there are practical difficulties in applying the policy retrospectively.

Ind AS 8 talks about two types of effects which one need to understand:

- **i.** Period Specific: Period specific means for each financial year.
- **ii.** Cumulative: Cumulative is the sum total of the period specific effects.

When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, then 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.

Thus, if it is impracticable for an entity to change the policy from day 1, because it is impracticable to determine period-specific effects for one or more comparative prior periods presented, it can apply the changed policy from the earliest period for which it would be practicable to make the changes in policies retrospectively which may be the current 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 (for example, to comply with an Ind AS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.
- When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date 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.

Question 5. Whether an entity can change its accounting policy of subsequent measurement of property, plant and equipment (PPE) from revaluation model to cost model?

Solution Ind AS 16 provides that an entity shall choose either the cost model or the revaluation model as its accounting policy for subsequent measurement of an entire class of PPE.

A change from revaluation model to cost model for a class of PPE can be made only if it meets the condition specified in Ind AS 8 i.e., the change results in the financial statements providing reliable and more relevant information to the users of financial statements. For example, an unlisted entity planning IPO may change its accounting policy from revaluation model to cost model for some or all classes of PPE to align the entity's accounting policy with that of listed markets participants within that industry so as to enhance the comparability of its financial statements with those of other listed market participants within the industry. Such a change – from revaluation model to cost model is not expected to be frequent.

Where the change in accounting policy from revaluation model to cost model is considered permissible in accordance with Ind AS 8, it shall be accounted for retrospectively, in accordance with Ind AS 8.

1.5.6 Disclosure regarding the Changes in Accounting Policies

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 required 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, an entity shall disclose:

(a) the nature of the change in accounting policy;
(b) the reasons for change;
(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.

Note: • Financial statements of subsequent periods need not repeat these disclosures.
• The disclosures will be part of Notes.

When an entity has not applied a new Ind AS that has been issued but is not yet effective, the entity shall disclose:

(a) the title of the new Ind AS;
(b) the nature of the impending change;
(c) the date by which application of the Ind AS is required;
(d) the date as at which it plans to apply the Ind AS initially;

Question 6. Whether an entity is required to disclose the impact of any new Ind AS which is issued but not yet effective in its financial statements as prepared as per Ind AS?

1.6 CHANGE IN ACCOUNTING ESTIMATES:

1.6.1 Meaning: -- 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 judgements based on the latest available, reliable information. For example, estimates may be required of bad debts, inventory obsolescence, the fair value of financial assets or financial liabilities, the useful life or expected future economic benefits of assets, warranty obligation etc.

Note 1. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Note 2. Changes in estimates cannot be related to prior periods and is not the correction of an error.

Note 3. A change in the basis of measurement is a change in accounting policy and is not a change in accounting estimate.

When it is difficult to distinguish whether a change is change in accounting policy or change in accounting estimate, the change is treated as a change in an accounting estimate.

Question 7. Whether a change in inventory cost formula is a change in accounting policy or a change in accounting estimate?

Solution. As per Ind AS 8, accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements. Further, Ind AS 2, 'Inventories', specifically requires disclosure of 'cost formula used' as a part of disclosure of accounting policies adopted in measurement of inventories. Accordingly, a change in cost formula is a change in accounting policy.

1.6.4 Accounting treatment for a change in estimate

- The effect of change in an accounting estimate, except to the extent that the change results in change in assets, liabilities or equity, 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. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods.
- 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.
- Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate.

1.6.5 Disclosure of changes in estimates

i. Effect of change in estimate on the current period

ii. If applicable and practicable, effect of change in estimate on the future periods

iii. If applicable but impracticable, the fact and reason should be disclosed.

1.7 ERRORS:

1.7.1 Meaning: - Ind AS 8 deals with the treatment of errors that have taken place in past, but were not revealed at that time. Subsequently, when they are revealed, it is necessary to correct such errors in the financial statements and make sure that the financial statements present relevant and reliable information in the period in which they are revealed.

As per the definition given in Ind AS 8, 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.

- Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS 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.

1.7.2 Common types of Errors

(i) **Mathematical Mistakes:** In accounting terms, generally the errors are called as error of commission. Wrong calculations, carry forward of wrong balances and errors in totals are few examples of mathematical errors.

(ii) **Mistakes in applying policies:** Specific standards may prescribe method of applying specific policies for particular nature of transaction. For example, as a general rule, assets and liabilities and income and expenses should not be offset, unless otherwise specifically required or permitted in an Ind AS. If a receivable from another entity and payable to that entity are offset without any currently existing legally enforceable right to set off the recognised amounts, then, it will be an error while applying the policies, since it is against the principles of offset prescribed in Ind AS 32, 'Financial Instruments: Presentation'.

(iii) **Misinterpretations of facts:** Ind AS 10 deals with treatment of the events after the reporting period. Whether the event is an adjusting event or a non-adjusting event depends on whether that event provides evidence of a condition existing at the end of the reporting period. Sometimes, this requires judgement of the management and may result into misinterpretation of facts, if not dealt with properly.

(iv) **Omissions:** The mistakes that happened due to omission to record a material transaction, perhaps, due to oversight.

(v) **Frauds:** Major theft undetected in the past.

The abovementioned errors and any other error may happen while recognising the transaction, or while measuring the transaction, or while presenting it in financial statements or it might be possible that proper disclosure is not done.

Example: The following errors occurred in preparation of A Ltd.'s financial statements for the immediately preceding financial year –

(a) Depreciation on plant and machinery understated by an amount equal to 0.30% of sales;

(b) Warranty provisions understated by an amount equal to 0.15% of sales;

(c) Allowance for bad debts understated by an amount of 0.25% of sales. Individually none of these errors may be material but could collectively influence the economic decision of the users of the financial statements. These are material prior period errors.

1.7.3 Treatment of Errors: -- Financial statements do not comply with Ind AS 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.

1.7.3.1 Potential Errors of Current Period: -- Potential current period errors discovered in that period are corrected before the financial statements are approved for issue.

1.7.3.2 Prior period errors discovered subsequently: -- 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.

Situation 1: Error discovered relates to the comparative prior period presented: Unless impracticable, an entity shall correct material prior period errors **retrospectively** in the first set of financial statements approved for issue after their discovery by **restating the comparative amounts for the prior period**(s) presented in which the error occurred;

Example: - While preparing the financial statement for the financial year 2022-2023, the prior period presented would be financial year 2021-2022, if one-year comparative period is presented. If the error occurred in the year 2021-2022 but discovered in year 2022-2023, then it should be corrected in the financial statements for the year 2022-2023 by restating the comparative amounts for the year 2021-2022. This will result in consequential restatement of opening balances for the year 2022-2023.

Situation 2: Error discovered relates to period before the earliest comparative prior period presented: If the material error occurred before the earliest prior period presented, an entity shall, unless impracticable, correct the same retrospectively in the first set of financial statements approved for issue after their discovery by restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Example: - An entity presents one-year comparative period in its financial statements. While preparing the financial statements for the financial year 2022-2023, if an error has been discovered which occurred in the year 2019-2020, i.e., for the period which was earlier than earliest prior period presented (which is 2021-2022 in this example), then, the error should be corrected by restating the opening balances of relevant assets and/or liabilities and relevant component of equity for the year 2021-2022. This will result in consequential restatement of opening balances for the year 2022-2023.

Example: - A material error in depreciation provision of the preceding year ended 31st March, 2022 was discovered when preparing the financial statements for the year ended 31st March, 2023. The amount recognised in statement of profit and loss for the year ended 31st March, 2022 was ₹1,00,000 instead of ₹50,000. In this case, when presenting the financial statements for the year ended 31st March, 2023, depreciation for the comparative year 2021-2022 will be restated at ₹50,000. The carrying amount i.e., net book value, of property, plant and equipment for the comparative year ending 31st March, 2023 will be increased by ₹50,000 (due to restatement of accumulated depreciation). This will result in consequential restatement of opening balance of retained earnings and property, plant and equipment for the year 2023-2024.

Question 8. An entity has presented certain material liabilities as non-current in its financial statements for periods up to 31st March, 2021. While preparing annual financial statements for the year ended 31st March, 2022, management discovers that these liabilities should have been classified as current. The management intends to restate the comparative amounts for the prior period presented (i.e., as at 31st March, 2021). Would this reclassification of liabilities from non-current to current in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

Solution: As per Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS 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.

In accordance with the above, the reclassification of liabilities from non-current to current would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 2022, the comparative amounts as at 31st March, 2021 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements, if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

Accordingly, the entity should present a third balance sheet as at the beginning of the preceding period, i.e., as at 1st April, 20X0 in addition to the comparatives for the financial year 20X0-X1.

1.7.4 Limitations on retrospective restatement

We have already discussed in detail the treatment when there are the limitations on giving retrospective effect to changes in accounting policies. Similar provisions are included in Ind AS 8 to deal with limitations on retrospective restatement of prior period errors.

Step 1: A prior period error shall be corrected by retrospective restatement if it is practicable to determine both the period specific effects and cumulative effect of the error.

The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated as far back as is practicable.

Step 2: If it is not practicable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall first find out the earliest period for which retrospective restatement is practicable and then restate the opening balances of assets, liabilities and equity for that period. Ind AS 8 further states that such period can be the current period also.

Step 3: If it is not practicable 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.

When it is impracticable to determine the amount of an error (e.g., a mistake in applying an accounting policy) for all prior periods, the entity restates the comparative information prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and equity arising before that date.

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.

1.8 DISCLOSURE OF PRIOR PERIOD ERRORS: - An entity shall disclose the following:

(a) the nature of the prior period error;
(b) for each prior period presented, to the extent practicable, the amount of the correction:
    (i) for each financial statement line item affected; and
    (ii) if Ind AS 33 applies to the entity, for basic and diluted earnings per share;
(c) the amount of the correction at the beginning of the earliest prior period presented; and
(d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

1.10 SIGNIFICANT DIFFERENCES BETWEEN IND AS -8 AND AS -5

No		Ind AS 8	AS 5
1	**Title**	Accounting policies, change in accounting estimates and errors.	Net profit or loss for the period, prior period items and change in accounting policies.
2	**Objective**	Is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosures of change in accounting policies, change in accounting estimates and correction of errors.	Is to prescribe the classification and disclosure of certain items in the statement of profit and loss for uniform preparation and presentation of financial statements.
3	**Extraordinary items**	No concept of extraordinary items	Deals with the concept of extraordinary items
4.	**Definition of accounting policies**	Broaden the definition to include bases, convention, rules and practices in addition to principles	Restricts the definition to accounting principles and methods of applying those principles.
5.	**Change in accounting policies**	Does not deal with change in accounting policies on the basis of requirement by the statute.	It deals with change in accounting policies on the basis of requirement by the statute.
6.	**Accounting of change in accounting policies**	It requires to apply change retrospectively in case of absence of specific instructions in Ind AS.	Does not specify how change in accounting policies should be accounted for.
7	**Selection and application of accounting policies**	It has given the procedures for selection and application of accounting policies	It has not given the procedures for selection and application of accounting policies

TEST YOUR KNOWLEDGE

Question 9. An entity charged off certain expenses as finance costs in its financial statements for the year ended 31st March, 2021. While preparing annual financial statements for the year ended 31st March, 2022, management discovered that these expenses should have been classified as other expenses instead of finance costs. The error occurred because the management inadvertently misinterpreted certain facts. The entity intends to restate the comparative amounts for the prior period presented in which the error occurred (i.e., year ended 31st March, 2021). Would this reclassification of expenses from finance costs to other expenses in the comparative amounts be considered to be correction of an error under Ind AS 8? Would the entity need to present a third balance sheet?

Solution. As per Ind AS 8, errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind AS 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.

In accordance with the above, the reclassification of expenses from finance costs to other expenses would be considered as correction of an error under Ind AS 8. Accordingly, in the financial statements for the year ended 31st March, 2022, the comparative amounts for the year ended 31st March, 2021 would be restated to reflect the correct classification.

Ind AS 1 requires an entity to present a third balance sheet as at the beginning of the preceding period in addition to the minimum comparative financial statements if, inter alia, it makes a retrospective restatement of items in its financial statements and the restatement has a material effect on the information in the balance sheet at the beginning of the preceding period.

In the given case, the retrospective restatement of relevant items in statement of profit and loss has no effect on the information in the balance sheet at the beginning of the preceding period (1st April, 2020). Therefore, the entity is not required to present a third balance sheet.

Question 10: 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 2021-2022, if the Salary Expense related to –
(a) Financial Year 2020-2021 or (b) Financial Year 2016-2017?

Answer: Prior Period relating to 2020-21

Treatment: Financial Statements of 2021-2022, which will have comparative figures of Financial Year 2020-2021 will **re-state comparative amounts** of Salary Expense correctly.

Prior Period relating to 2016-17:

Treatment: Since comparative figures of 2016-2017 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.

1.3- Ind AS -12 (Income taxes)

Scope: The objective of this Standard is to prescribe the accounting treatment for income taxes.Income taxes for the purpose of this Standard includes all domestic and foreign taxes which are based on taxable profits.

Before we proceed further, it is essential to understand the fundamental principle in recognising deferred tax. This is mentioned in the Standard as under:

'It is inherent in the recognition of an asset or liability that the reporting entity expects to recover or settle the carrying amount of that asset or liability. If it is probable that recovery or settlement of that carrying amount will make future tax payments larger (smaller) than they would be if such recovery or settlement were to have no tax consequences, this Standard requires an entity to recognise a deferred tax liability (deferred tax asset)'.

Items of current tax or defer tax recognized in profit and loss are subject to two exceptions:

1. An item of current tax or defer tax pertaining to other comprehensive income should be recognized in other comprehensive income
2. An item of current tax or defer tax pertaining to direct equity should be recognized in direct equity

CONCEPT BUILDING QUESTION:

Question 1. COC Ltd purchased a machine costing ₹1,00,000. Depreciation is charged @ 20% P.A. on SLM basis in books of accounts and @ 25% P.A. on SLM basis as per Income tax Act.

Assume profit before depreciation and tax ₹ 80,000 per year from 1st year to 5th year. Calculate tax expense for each of 5 years as per books and income tax act.

Solution: **Computation of tax expense as per books of account:**

Year ended	1	2	3	4	5
Profit before depreciation and tax	80,000	80,000	80,000	80,000	80,000
Less: dep @ 20%	(20,000)	(20,000)	(20,000)	(20,000)	(20,000)
Profit before tax	60,000	60,000	60,000	60,000	60,000
Less: tax @ 30%	18,000	18,000	18,000	18,000	18,000
Total taxes in 5 years = 90,000					

Computation of tax expense as per income tax act:

Year ended	1	2	3	4	5
Profit before depreciation and tax	80,000	80,000	80,000	80,000	80,000
Less: dep @ 25%	(25,000)	(25,000)	(25,000)	(25,000)	--
Profit before tax	55,000	55,000	55,000	55,000	80,000
Less: tax @ 30%	16,500	16,500	16,500	16,500	24,000
Total taxes in 5 years = 90,000					

In real practice, tax expenses are shown in books of account as per following way:

Year ended	**1**
Profit before depreciation and tax	80,000
Less: dep @ 25%	(20,000)
Profit before tax Less: tax expense: Current tax (as per income tax) 16,500 Deferred tax 1,500	60,000 18,000
Profit after tax	**42,000**

Question 2. COC Ltd purchased a machine costing ₹ 2,00,000. Depreciation is charged @ 20% P.A. on SLM basis in books of accounts and @ 30% P.A. on SLM basis as per Income tax Act.

Assume profit before depreciation and tax ₹ 5,00,000. Calculate tax expense as per Ind AS 12 in books of account and make journal entries for current tax and deferred tax.

Important definitions:

(1) Tax expense: It means tax expense recognised in books as per Ind AS.

Tax expense = current tax expense +/- deferred tax expense.

(2) Current tax expense: It is the amount of tax payable on profit calculated as per income tax act.

(3) Deferred tax expense: It is temporary saving in tax or payment of additional tax due to temporary differences between carrying amount and tax base of assets and liabilities.

(4) Journal entries for current tax in books of account:

(i) For recognising current tax expense:
Current Tax expense account Dr
To provision for tax

(ii) For recognising deferred tax expense:
Deferred tax expense account Dr
To deferred tax liability account

(iii) For transferring it to Profit & loss account or OCI:
Profit & loss account / OCI Dr
To current tax expense
To deferred tax expense

(iv) For recording advance tax paid:
Advance tax account Dr
To bank account

Note: provision for tax is shown under the head 'current liability' and advance tax is shown under the head 'current assets' in the balance sheet. Alternatively, they can be net off in the balance sheet under the respective head.

Detail study of computation and accounting of deferred tax:

(5) As per Ind AS 12, balance sheet approach is used to calculate deferred tax.

(**6**) It is calculated on temporary differences between carrying amount and tax base of respective assets and liabilities.

(i) Carrying amount- it means balance of relevant assets and liabilities in the books as per Ind AS.

(ii) Tax base- it means amount of relevant asset and liability that would appear in balance sheet prepared as per income tax act.

(iii) temporary differences: it is difference between carrying amount and tax base of respective asset or liability. It can further be classified in two parts

<table>
<tr><th colspan="2">Taxable temporary differences</th><th colspan="2">Deductible temporary differences</th></tr>
<tr><td colspan="2">It leads to additional payment of tax in future</td><td colspan="2">It leads to saving of tax in future</td></tr>
<tr><td colspan="2">Deferred tax liability (DTL) is created</td><td colspan="2">Deferred tax asset (DTA) is created</td></tr>
<tr><td>If carrying amount of asset is more than tax base</td><td>If carrying amount of liability is less than tax base</td><td>If carrying amount of asset is less than tax base</td><td>If carrying amount of liability is more than tax base</td></tr>
<tr><td colspan="2"></td><td colspan="2"></td></tr>
</table>

Question 3. COC Ltd purchased a machine for ₹ 5,00,000. Depreciation is charged @ 20% p.a. on SLM basis in books and @ 30% on SLM basis in income tax. Tax rate 30%. Calculate deferred tax at the end of 1st year.

Question 4. X ltd has interest income receivable of ₹ 20,000. In income tax, interest income is taxable on cash basis. Tax rate is 30%. Calculate deferred tax asset/ liability.

Question 5. C ltd has made investment in equity shares for ₹ 50,000. It is shown at FVTPL. At the end of 1st year, fair value of investment in equity is ₹ 40,000. Calculate DTA/DTL at the end of first year.

Question 6. Ram Ltd has made a provision for division closure cost of ₹ 25,000. In income tax, closure cost is allowed only when it is actually paid. Tax rate is 30%. Calculate DTA/DTL at the end of first year.

Question 7. A ltd has received an advance income of ₹ 6,000. In income tax, income received is taxable on cash basis. Tax rate is 30%. Calculate DTA/DTL at the end of first year.

Question 8. A company creates provision for Gratuity and Leave encashment and recognises liability of ₹ 50,000. This is the only difference between taxable profits and accounting profits. The company measures current tax of ₹ 48,000 at tax rate of 25%. Compute Tax Expenses. **(ICMAI Study material)**

Answer: **DTA Rs 12,500, Tax expense Rs 35,500.**

(7) Treatment of DTA/DTL in balance sheet and SPL/OCI:

(i) Closing balance of DTA/DTL will appear in balance sheet under the head non-current asset/ non-current liability.

(ii) Amount of Deferred tax expense recorded in SPL/OCI will be calculated as follow:

Closing balance of DTA/DTL calculated as above Less: opening balance of DTA/DTL	XXX XXX
Amount transferred to SPL/OCI	**XXXX**

Question 9. COC Ltd purchased a machine costing ₹ 5,00,000. Depreciation is charged @ 20% P.A. on SLM basis in books of accounts and @ 25% P.A. on SLM basis as per Income tax Act. Tax rate is 30%. Calculate deferred tax expense for 1st year and 2nd year of business transferred to SPL/OCI.

Solution:

	End of 1st year	**End of 2nd year**
Carrying amount	4,00,000	3,00,000
Tax base	3,75,000	2,50,000
Temporary tax differences (taxable temporary difference)	25,000	50,000
Deferred tax (DTL) at the end Less: opening balance	7,500 (25,000 X 30%) ----	15,000 - 7,500
Amount transferred to SPL/OCI	**7,500**	**7,500**

Question 10. Calculate deferred tax expense for 3rd year transferred to SPL/OCI in previous question 9.

Question 11. COC Ltd purchased a machine costing ₹ 5,00,000. Depreciation is charged @ 20% P.A. on SLM basis in books of accounts and @ 25% P.A. on SLM basis as per Income tax Act. Tax rate is 30%. Calculate deferred tax expense to be shown in SPL and make entries for 5 years.

Always remember:

(8) Deferred tax expense is recognised in SPL or OCI according to the item on which it is created.

(9) DTA/DTL recognised in a year are reversed in future.

(10) Future tax rate specific to the transaction i.e., substantially enacted tax rate (i.e., tax rate announced by Government before balance sheet date for upcoming year, whose approval is still pending) is used for computing DTA/DTL.

(11) journal entries for DTL/DTA

	DTL	**DTA**
For recognising	Deferred tax expense Dr To deferred tax liability	Deferred tax asset Dr To deferred tax expense
For reversal	Deferred tax liability Dr To deferred tax expense	Deferred tax expense Dr To deferred tax asset

(12) Let's summarise: Steps to solve practical questions:

Step 1. Calculate carrying amount of asset or liability as per books.

Step 2. Calculate tax base of asset or liability as per income tax act.

Step 3. Calculate temporary differences.

Step 4. Calculate amount of DTA/DTL transferred to SPL or OCI.

(13) some important cases of tax base:

(a) An entity that follows mercantile system of accounting has trade receivables of ₹1,000. It creates a general bad debt allowance of ₹50. The carrying amount in the books of accounts of trade receivables is thus ₹950. However, in income-tax, general bad debt provision is not deductible. The tax base is … … … … … … … .

(b) An entity has given a loan of ₹10,000 which is the carrying amount. The repayment of loan has no tax consequences. The tax base is ₹ …………………..

(c) Current liabilities include accrued fines and penalties with a carrying amount of ₹100. Fines and penalties are not deductible for tax purposes. The tax base of the accrued fines and penalties is ₹ …………………...

(d) A loan payable has a carrying amount of ₹ 5,000. The repayment of the loan will have no tax consequences. The tax base of the loan is ₹ ……………

(e) A Limited has been incorporated recently. It incurred Rs 1,00,000 on its incorporation. It has been charged to revenue in the very first accounting period. The taxation laws allow deduction over a period of 5 years. The carrying amount at the end of year 1 is Nil. The tax base will be ₹ …………………

(14) Computation of deferred tax in some special cases:

(i) Asset /liability relating to any expense not deductible/ not allowed in income tax (e.g. donation given in cash, donation to unregistered trust, income tax penalties, income tax demand etc) ----

---- No DTA/DTL is recognised (always assume tax base equal to carrying amount).

(ii) Investment in subsidiary, associate or joint venture (asset)

Carrying amount = investment at cost +/- share in profit/loss of subsidiary/associate/Joint venture.

Tax base = investment at cost.

Note: in case of investment in subsidiary, no DTA/DTL is recognised on temporary differences as parent entity will be able to control the timing of its reversal.

(iii) Asset taken on lease (right to use asset and lease liability):

Carrying amount = net of ROU asset and lease liability

Tax base = Nil (because lease rent is allowed for deduction on actual payment basis in income tax)

(iv) Share based payment transaction:

Carrying amount = nil

Tax base = employee benefit expenses to be recognised till date based on intrinsic value of option.

Note; SBP transaction will always be recognised as an asset. Hence always DTA will be recognised on SBP transaction.

(15) Carry forward of losses as per income tax act is deductible temporary differences on which DTA is created.

(16) MAT credit as per income tax act is recognised as deferred tax asset (DTA)

(17) Assets and liabilities acquired in business combination:

(i) Carrying amount = fair value of net assets acquired.

(ii) Tax base: - it will be given in question. If not given it should be taken at net assets appearing in the book of acquiree.

(iii) DTA/DTL will be recognised through goodwill / capital reserve on assets and liabilities taken over in business combination.

(iv) in this case, tax rate for calculating DTA/DTL will be rate applicable to the acquiree entity.

(18) Condition for recognising DTA:

(a) Entity should recognise DTA only if it is probable that there would be sufficient taxable profit in future.

(b) If entity anticipates losses in future, then DTA is recognised on following amount:

1st priority	2nd priority
Lower of:	**Lower of:**
Deductible temporary differences	Reversal amount of deductible temporary differences (DTD) in future year
OR	**OR**
Profit that can be generated by implementing tax planning strategy Less: cost of implementing such strategy.	Reversal amount of any Taxable Temporary differences in future year

(19) Offsetting of deferred tax asset and deferred tax liability:
OR
Offsetting of current tax asset and current tax liability:
-- only if entity has legally enforceable right to set off the respective tax asset and liability (i.e., both are levied by same tax authority)

(20) Disclosure requirements: The major components of tax expense (income) shall be disclosed separately. Components of tax expense (in-come) may include:

(a) current tax expense (income);

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

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

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;The following shall also be disclosed separately:

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

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

Practice questions:

Question 12. Machine purchased on 1.4.2019 for ₹6,00,000.

Useful life of machine is 3 years

Scrap value at the end of expected life is NIL

Rate of depreciation is 100% as per income tax act.

Depreciation method is SLM

Profit before tax and depreciation is ₹10,00,000 in each year.

Corporate Tax rate is 30%.

Calculate profit after tax and Tax expense as per Ind AS 12 for 3 years.

Question 13. Machine purchased on 1.4.2019 for ₹9,00,000.

Useful life of machine is 3 years

Scrap value at the end of expected life is NIL

Rate of depreciation is 100% as per income tax act.

Depreciation method is SLM

Profit before tax and depreciation is ₹15,00,000, 17,00,000, 18,00,000.

Corporate Tax rate is 30%.

Substantially enacted tax rates are 40%, 35% and 30% for 1st year 2nd year and 3rd year respectively.

Calculate profit after tax and Tax expense as per Ind AS 12.

Question 14. (concept of losses in current year)

Particulars	**1st Year**	**2nd year**	**3rd year**
Profit/(loss)	(2,00,000)	1,00,000	1,40,000

Tax rate is 30%

Carry forward of losses allowed under income tax is 8 years. At the end of 1st year, it was virtually certain supported by convincing evidence that the company would have sufficient taxable income in the future against which unabsorbed depreciation and carry forward of losses can be adjusted. Calculate DTA/DTL and prepare a statement of profit and loss for the 3 years.

Question 15. PQR Ltd 's accounting year ends on 31st march. The company made a loss of ₹2,00,000 for the year ending 31.3.2021. for the year ending 31.3.2022 and 31.3.2023, it made profits of ₹1,00,000 and ₹1,20,000 respectively. It is assumed that the loss of a year can be carried forward for 8 years and tax rate is 40%. By the end of 31.3.2021, the company feels that there will be sufficient taxable income in the future years against which carry forward loss can be set off. There is no difference between taxable income and accounting income except that the carry forward loss is allowed in the year ending 2022 and 2023 for tax purposes. Prepare a statement of profit and loss for the year 2021, 2022 and 2023.

Question 16. Accounting for taxes on income U/S 115 JB (MAT)

Particulars	**1st year**	**2nd year**	**3rd year**	**4th year**	**5th year**
Tax liability (as per regular provision)	1000	1600	2200	2500	4,000
Tax liability (MAT under section 115 JB)	1800	2100	1400	2100	3,800

Calculate tax paid each year.

Question 17. From the following information for R Ltd. for the year ended 31st March, 2021, calculate the deferred tax asset/ liability as per AS-22 and amount of tax debited to profit and loss account.

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%

Question 18. A company measured accounting profit of ₹80,000 after charging depreciation of ₹12,000. On interest receivable income tax is levied on cash basis. Included in accounting profit is Interest accrued ₹5,000, which is not included in taxable profit of ₹67,000. Tax rate is 30%. For tax purpose depreciation admissible is ₹20,000. Carrying amount of fixed assets was ₹68,000 and tax base of fixed assets ₹60,000 before charging depreciation for the current year.Find:

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

(ii) Temporary Differences for fixed assets and interest accrued

(iii) current tax expenses and deferred tax expenses

(iv) deferred tax liabilities and deferred tax assets, if any. **(ICAI Study material)**

Answer: carrying amount fixed assets ₹56,000 and tax base of fixed asset ₹40,000. Current tax expense ₹20,100. Deferred tax expense ₹6,300.

Question 19. Show the tax expenses if before depreciation accounting profits are same as before depreciation taxable profits for the years as stated below:

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

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

Answer:

Deferred tax liabilities recognised in balance sheet @30% on temporary differences	7,500	15,000	22,500	15,000	7,500	0
Deferred tax expense recognised in Statement of Profit and Loss (change in liabilities)	7,500	7,500	7,500	(7,500)	(7,500)	(7,500)

1.4-- Ind AS- 16 (PROPERTY, PLANT AND EQUIPMENT)

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 an entity's investment in its property, plant and equipment and the changes in such investment.

Scope: This Standard shall be applied in accounting for property, plant, and equipment. It does not apply to:

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

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

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

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

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

Note: An entity accounting for investment property in accordance with Ind AS 40, InvestmentProperty, shall use the cost model in this Standard for owned investment property.

Meaning of Property, plant and equipment:

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 (other than land & building), or for administrative purposes; and

b) are expected to be used during more than one period (generally more than 12 months).

Note 1: Administrative purpose includes all business purpose i.e. selling and distribution, finance and accounting purpose, for safety and environmental purpose.

Note 2. Ind AS 16 also applies on bearer plant. Bearer plant means a plant that:

- is used in production of agricultural produce.
- Is expected to bear produce for more than 12 months.
- Has a remote likelihood of being sold as agricultural produce except for incidental scrap sale.

For example – mango tree, guava tree etc.

Note 3. Treatment of land and building (also called property)

<table>
<tr><th colspan="3">Property held for</th><th colspan="3">Property held for</th></tr>
<tr><td>Use in production or supply of goods or services.</td><td>OR</td><td>Administrative purpose</td><td>Rental to others (operating lease)</td><td>Capital appreciation</td><td>Undetermined use</td></tr>
<tr><td colspan="3">Treat it as owner occupied property (PPE) and apply Ind AS 16.</td><td colspan="3">Treat it as Investment property and apply Ind AS 40</td></tr>
</table>

Examples:

	Particulars	Remarks
1.	Business of giving building on rent	PPE
2.	Business of providing service of education and Entity has given its building on rent.	Investment property
3.	Any other asset except land & building given on rent.	PPE
4.	Land & building held for sale in ordinary course of business	Inventory
5.	Factory building, office building, showroom, godown, warehouse	PPE

Recognition criteria: The cost of an item of property, plant and equipment shall 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 entity; and
b) the cost of the item can be measured reliably.

Recognition of Spare parts (E.g., bearings, screws, Extra tyre in trucks etc), stand-by equipment (e.g., Fire extinguishers) and servicing equipment:

Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with Ind AS 16 when they meet the definition of property, plant and equipment.

Otherwise, such items are classified as inventory and apply Ind AS 2.

For example:

Spare parts, stand by equipment required to replace in than 12 months	**PPE**
Spare parts. stand by equipment required to replace in than 12 months	**inventory**

NOTE: 1. Treatment of Repair and maintenance: - An entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or 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.

NOTE: 2. Treatment of Major inspections or overhauls (Renovation):

- A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) 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. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Question 1. Carrying amount of aircraft = ₹200 crores (including remaining carrying amount of previous major inspection = ₹24 crores).

Company entered into a new contract of major inspections and maintenance for ₹80 crores for period of 5 years. Calculate new carrying cost of aircraft.

Measurement of PPE:

(i) Initial measurement/ Initial recognition.

(ii) Subsequent measurement/ subsequent recognition.

(i) Initial measurement: - An item of property, plant and equipment that qualifies for recognition as an asset should be initially measured at its cost.

Element of cost of an acquired asset: 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; and

c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity 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.

Note 1: Directly attributable cost includes:

Employee benefits cost arising directly from construction or acquisition of PPE,

Cost of Site Preparation, Initial delivery and handling costs,

Installation and assembly costs,

Professional Fees,

Costs of testing - whether the asset is working properly after deducting proceeds from sale of any product produced during the testing period.

Element of cost of constructed asset and bearer plant:

The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale. Therefore, any internal profits are eliminated in arriving at such costs.

Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset.

Ind AS 23 'Borrowing Costs', establishes criteria for the recognition of interest as a component ofthe carrying amount of a self-constructed item of property, plant and equipment.

Bearer plants are accounted for in the same way as self-constructed items of property, plant and equipment before they are in the location and condition necessary to be capable of operating in the manner intended by management.

Note 1. Let's summarise all items included in definition of cost of purchased/ self-constructed PPE:

Purchase price of PPE

Less: trade discount/ rebate

Add: property transfer tax, import duty, tax on purchases, E.g., Entry tax, GST (Only if non-refundable or non-adjustable)

Add: stamp duty cost

Add: Legal charges

Add: initial delivery/ transport cost

Add: handling cost

Add: installation and assembling cost.

Add: consultant fees, professional advisor fees, architect fees

Add: site preparation cost

Add: plan approval/ permission cost

Add: testing cost

Add: direct material, labour and overheads used in construction of PPE.

Add: P.V of estimated dismantling, decommissioning, restoration or demolition cost.

Add: any other directly attributable cost.

Note 2. Items which are not included in the cost of PPE:

Costs of conducting business in a new location or with a new class of customer.

Cost of relocation of staff/ employees

Costs of staff training.

Costs incurred in introducing a new product or service (opening ceremony, inauguration ceremony, advertisement cost).

Cost of openinga new facility

Administrative and selling overhead and other allocated costs

Day to day repairs & maintenance cost

Any abnormal cost of wasted material, labour or other resources.

Cash discount/ early settlement discount.

Interest on loan taken for construction of PPE, unless allowed by Ind AS 23.

Internal profit on self-constructed PPE.

Note 3. Treatment of incidental operation:

Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management.

These incidental operations may occur before or during the construction or development activities. **For example, income may be earned through using a building site as a car park until construction starts.**

Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss.

Note 4. Journal entry for accounting of PPE:

PPE account Dr

To bank/ payable

To provision for decommissioning expenses.

Cessation of capitalisation: Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management.

The following costs are not included in the carrying amount of an item of property, plant and equipment:

a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;

b) initial operating losses, such as those incurred while demand for the item's output buildsup; and

c) costs of relocating or reorganising part or all of an entity's operations.

Question 2. On 1st April 2023, COC Ltd purchased a machine for ₹10,00,000. Useful life 3 years. Method of depreciation is SLM. Decommissioning cost will be ₹2,00,000 after 3 years. Discounting rate/ implicit rate/ rate of interest is 10%. Pass journal entries for 3 years.

Question 3. X Ltd. Sets up a plant at the purchase price of ₹5,00,000 plus GST at 18% (Intra-state). Freight paid ₹20,000 plus GST at 18% (Intra-state). Paid ₹10,000 as employee expenses for installation of the planet. After the plant wasput to use maintenance cost incurred ₹5,000. Measure the initial cost to be recognized and pass journal. Estimateddismantling cost ₹ 30,000, present value ₹12,000. **(ICMAI Study material)**

Some special cases on measurement of cost:

(i) In case of payment deferred beyond normal credit terms: 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 Ind AS 23.

Question 4. On 1st April, 2022, an item of property is offered for sale at ₹10 million, with payment terms being three equal instalments of ₹33,33,333 over a two-year period (payments are made on 1st April, 2022, 31st March, 2023 and 31st March, 2024). Implicit interest rate of 5.36 % p.a. takes discounting factor upto three figures in decimals.

Show how the property will be recorded in accordance with Ind AS 16 and pass necessary journal entries. **(ICAI Study material)**

(ii) Measurement of PPE acquired in Exchange of other asset:

If exchange transaction has commercial substance:	**If exchange transaction lacks commercial substance**
Recognise PPE acquired at following value in the given priority basis:	Recognize PPE acquired at carrying amount of asset given up.
Priority 1: fair value of asset given up.	
Priority 2. Fair value of asset acquired.	
Priority 3. Carrying amount of asset given up.	

Note 1. If some cash is also paid along with the asset to acquire the PPE, then such amount of cash paid should also be added to the value of exchange asset as per priority given above.
Note 2. If some cash is received along with the asset to acquire the PPE, then such amount of cash received should also be deducted to the value of exchange asset as per priority given above.

Note 1: Meaning of commercial substance: commercial substance means those activities which affect cash flow of the entity.

Example of commercial substance- if entity acquires PPE producing 10,000 units by giving PPE producing 9,000/ 11,000 units.

Example of lack of commercial substance: - if we exchange our godown with other's entity in same area.

Note 2. If not able to classify, whether transaction has commercial substance or not-- always assume have commercial substance.

Question 5. Pluto Ltd owns land and building which are carried in its balance sheet at an aggregate carrying amount of ₹10 million. The fair value of such asset is ₹15 million. It exchanges the land and building for a private jet, which has a fair value of ₹20 million, and pays additional ₹3 million in cash. Show the necessary treatment as per Ind AS 16 and pass journal entry for the transaction**.** **(ICAI Study material).**

(ii) Subsequent measurement: An entity shall choose either the cost model or the revaluation model as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

(a) Cost Model: After recognition as an asset, an item of property, plant and equipment shall 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 is carried at a revalued amount**, being its fair value at the date of the revaluation. **Depreciation will be charged on the revalued amount in future.**

Carrying amount = Fair value on the date of revaluation – any subsequent accumulated depreciation- any subsequent accumulated impairment loss.

Accounting treatment in case of revaluation of PPE:

Case 1. If depreciation on PPE is charged directly (it means PPE is shown at net carrying amount only)

If there is revaluation gain:		**If there is revaluation loss:**
PPE account Dr To revaluation gain		Revaluation loss Dr To PPE account

Case 2. If provision for depreciation (i.e., accumulated depreciation) is maintained. (Preferable method in exam)

For calculating net carrying amount we deduct accumulated depreciation from gross carrying amount. Accounting of revaluation of PPE can be done by any of the following two methods:

Method 1. Accumulated depreciation eliminated approach:

1. For eliminating accumulated depreciation: Accumulated depreciation account Dr To PPE account	 XXX 	 XXX
2. Entry for revaluation: Same as discussed in case 1		

Method 2. Restatement approach:

In this approach, we proportionately adjust (increase/ decrease) in gross carrying amount and accumulated depreciation by following steps:

Step 1. Calculate % of revaluation gain/loss on net carrying amount.

Step 2. Pass following journal entry:

in case of gain on revaluation:	**in case of revaluation loss:**
PPE account Dr (GCA X % of revaluation gain) To accumulated dep (acc dep X % of revaluation gain) To revaluation gain (amount of gain on revaluation)	Accumulated dep Dr (acc dep X % of revaluation loss) Loss on revaluation Dr (amount of loss on revaluation) To PPE account (GCA X % of revaluation loss)

Question 6. Jupiter Ltd. has an item of property, plant and equipment with an initial cost of ₹100,000. At the date of revaluation accumulated depreciation amounted to ₹55,000. The fair value of asset, by reference to transactions in similar assets, is assessed to be ₹65,000. Find out the entries to be passed?

Solution:

Method – I: Depreciation Elimination Approach:

(a) Accumulated depreciation	Dr.	55,000	
To Asset Cost			55,000
(b) Asset Cost	Dr.	20,000	
To Revaluation reserve			20,000

The net result is that the asset has a carrying amount of Rs 65,000 (100,000 – 55,000 + 20,000).

Method – II: Restatement Approach:

Carrying amount (100,000 – 55,000) =	45,000
Fair value (revalued amount)	65,000
Surplus	20,000
% of surplus to the carrying amount (20,000 / 45,000)	44.44%

Entries to be Made:

Asset (1,00,000 x 44.44%)	Dr.	44,444	
To Accumulated Depreciation (55,000 x 44.44%)			24,444
To Revaluation Reserve			20,000

(Being the entry to increase both the original cost and the accumulated depreciation by 44.44%)

Note: (i) If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. E.g., land & building, plant & machinery, furniture & fixtures, ships, aircraft, motor vehicles, office equipment, bearer plant etc.

Question 7. Venus Ltd. is a large manufacturing group. It owns a considerable number of industrial buildings, such as factories and warehouses, and office buildings in several capital cities. The industrial buildings are located in industrial zones whereas the office buildings are in central business districts of the cities. Venus's Ltd. management wants to apply the Ind AS 16 revaluation model to subsequent measurement of the office buildings but continue to apply the historical cost model to the industrial buildings. Is this acceptable under Ind AS 16, Property, Plant and Equipment?

Answer: Venus's Ltd. management can apply the revaluation model only to the office buildings. The office buildings can be clearly distinguished from the industrial buildings in terms of their function, their nature and their general location. Ind AS 16 permits assets to be revalued on a class-by-class basis.

Treatment of surplus or deficit arising on revaluation:

First time revaluation	
Profit on revaluation	**Loss on revaluation**
Credit to revaluation surplus (OCI)	Debit to profit & loss account.

Subsequent revaluation			
Previously		**Previously**	
Profit on revaluation	**Loss on revaluation**	**Profit on revaluation**	**Loss on revaluation**
This time - Profit on revaluation		**This time- Loss on revaluation**	
Credit to revaluation surplus (OCI)	Credit to P& L account upto previous loss debited in it & Balance to revaluation surplus (OCI)	Debit revaluation surplus upto any balance existing in it. & For balance debit to P&L account.	debit to P&L account.

<u>Treatment of revaluation surplus balance</u>:

Method 1(preferable method): The revaluation surplus included in equity **will be transferred directly to retained earnings** when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired (i.e., classified as held for sale) or disposed of.

Question 8. An item of PPE was purchased for ₹9,00,000 on 1st April, 2021. It is estimated to have a useful life of 10 years and is depreciated on a straight-line basis. On 1st April, 2023, the asset is revalued to ₹9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes. Show the necessary treatment as per Ind AS 16 to calculate depreciation and revaluation surplus for 2023-2024 **assuming that entity has decided to transfer revaluation surplus to retained earning when PPE will be derecognized.**

Method 2. The revaluation surplus may be transferred as the asset is used by an entity. 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 the asset's original cost.

- **Transfers from revaluation surplus to retained earnings are not made through profit or loss.**

The effects of taxes on income, if any, resulting from the revaluation of property, plant and equipment are recognised and disclosed in accordance with Ind AS 12, Income Taxes.

Question 9. An item of PPE was purchased for ₹9,00,000 on 1st April, 2021. It is estimated to have a useful life of 10 years and is depreciated on a straight-line basis. On 1st April, 2023, the asset is revalued to ₹ 9,60,000. The useful life remains unchanged as ten years. Ignore impact of deferred taxes. Show the necessary treatment as per Ind AS 16 to calculate depreciation and revaluation surplus for 2023-2024 if entity has decided **to transfer revaluation surplus to retained earnings as the asset is used by an entity.**

Depreciation on property, plant & equipment:

Depreciation method: 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:

a) Straight-line depreciation method results in a constant charge over the useful life if the asset'sresidual value does not change.
b) Diminishing balance method results in a decreasing charge over the useful life.
c) Units of production method results in a charge based on the expected use or output.

If an entity wants to Change the method of charging depreciation, then such change should apply with prospective effect. Depreciation Method shall be accounted for as a change in an accounting estimate in accordance of Ind AS 8.

Commencement of depreciation: 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.

Cessation of depreciation: Depreciation of an asset ceases at the earlier of:

(a) the date that the asset is classified as held for sale in accordance with Ind AS 105.

(b) and the date that the asset is derecognized (i.e., sold).

Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, **under usage methods (i.e production unit method) of depreciation the depreciation charge can be zero** while there is no production.

Component accounting for the purpose of depreciation:

- The depreciable amount of an asset should be allocated on a systematic basis over its useful life. The depreciation charge for each period should be recognised in profit or loss unless it is included in the carrying amount of another asset.
- 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 entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part.
- 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 entity 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 entity 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.
- 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.

Question 10. On 1st April 2023, COC Ltd purchased a Ship costing ₹80,00,000 (including interior of ₹20,00,000). Useful life of interior 8 years and of ship is 20 years. Calculate depreciation per year by SLM method and carrying amount of ship at the end of 1st year.

Accounting of replacement of part having significant cost:

If part having significant cost is replaced, then

- Cost of new part is added to the carrying amount of the PPE, and
- Carrying amount of old part is de-recognised from carrying amount of PPE.

Carrying amount of PPE after replacement= carrying amount of PPE on date of replacement + cost of new part – carrying amount of old part replaced on date of replacement.

Note: if carrying amount of old part on replacement date is not given in question, then it should be calculated as per following method: -

Step 1- take cost of new part replaced.

Step 2. Calculate PV of this new part on date of installation of od part replaced. It is treated as cost of old part replaced.

Step 3. Deduct depreciation on above amount upto date of replacement of such part. The resultant figure is treated as carrying amount of old part on date of replacement.

Note: assume useful life of such part same as of PPE.

Question 11. Aircraft purchased for ₹10,00,000. Useful life is 10 years. Engine is replaced in aircraft after 3 years. Cost of new engine is ₹2,00,000. Discounting rate 10%. Calculate carrying amount of aircraft after replacement of engine.

Change in residual value and 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 Ind AS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

The residual value of an asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount. Depreciation is recognised even if the fair value of the asset exceeds it carrying amount, as long as the asset's residual value does not exceed it carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.

Question 12. An asset which cost ₹10,000 was estimated to have a useful life of 10 years and residual value ₹2,000. After two years, useful life was revised to 4 remaining years. Calculate the depreciation charge for the years 1,2,3.

Answer: ₹800; 800; 1600.

Effect of asset management policy on useful life of the asset:

The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified 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 judgement based on the experience of the entity with similar assets.

Question 13. An entity acquired an asset 3 years ago at a cost of ₹5 million. The depreciation method adopted for the asset was 10 percent reducing balance method.

At the end of Year 3, the entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight –line method from that date so as to reflect the revised estimated pattern of recovery of economic benefits. Show the necessary treatment in accordance of Ind AS 16. Calculate the depreciation charge for respective years.

Answer: depreciation from 1 to 3 year = ₹5,00,000; 4,50,000; 405,000; Year 4 to Year 11 ₹455,625 p.a.

Impairment of PPE:

To determine whether an item of PPE is impaired, an entity applies Ind AS 36, *Impairment of Assets*. As per Ind AS 36;

- An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.
- **Recoverable amount** is the higher of an asset's fair value less ***costs of disposal*** and its value in use.

Note: 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.

Some other important points:

1. gain or loss on sale of PPE is recorded in P& L account.
2. compensation received from insurance company due to damage in PPE is accounted for separately in P& L account.

Changes in existing decommissioning, restoration and similar liabilities (Appendix A):

Changes in existing decommissioning, restoration and similar liabilities will be calculated as follow:

Calculate P.V of revised estimated decommissioning cost on date of change	xxxx
Less: carrying amount of provision for decommissioning liability on date of change	xxxx
Increase/ decrease in liability	**xxxx**

Appendix A to Ind AS 16 provides guidance on how to account for the effect of changes in the measurement of existing decommissioning, restoration and similar liabilities due to:

a) a change in the estimated outflow of resources embodying economic benefits (e.g., cashflows) required to settle the obligation;

b) a change in the current market-based discount rate; and

c) an increase that reflects the passage of time (also referred to as the unwinding of the discount).

Accounting guidance in Appendix A to Ind AS 16: Appendix A to Ind AS 16 offers two different approaches to account for changes in decommissioning **liability depending upon whether the entity follows cost model or revaluation model**.

If the related asset is measured using the cost model:

(a) adjust increase or decrease in decommissioning liability from the cost of the asset:

(i) if there is increase in liability	(ii) if there is decrease in liability:
PPE account Dr To provision for decommissioning	Provision for decommissioning Dr To PPE account

(b) **any such decrease** in the decommissioning, restoration and similar liability **cannot exceed** the carrying amount of the asset. In case, the said decrease in the decommissioning liability is more than the carrying amount of the asset, **the excess is recognized immediately as income** in statement of profit and loss.

(c) if the changes in the decommissioning liability and the resultant **adjustment results in an addition to the cost** of an asset, the entity shall 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 entity shall test the asset for impairment** by estimating its recoverable amount, and shall account for any impairment loss, in accordance with Ind AS 36.

If the asset is measured using the revaluation model:

- **Do not debit or credit PPE. It should be treated as revaluation loss or gain.**
- **Follow same treatment as we have done previously in case of revaluation of PPE.**

First time revaluation (increase/ decrease in liability)	
Profit on revaluation (decrease in liability)	**Loss on revaluation (increase in liability)**
Provision for decommissioning account Dr To revaluation surplus (OCI)	Profit & loss account Dr To Provision for decommissioning account

Subsequent revaluation (it means previously PPE has already been revalued)			
Previously		**Previously**	
Profit on revaluation	**Loss on revaluation**	**Profit on revaluation**	**Loss on revaluation**
This time - Profit on revaluation (decrease in liability)		**This time- Loss on revaluation** (increase in liability)	
Prov for decomm. Dr To rev surplus (OCI)	Credit to P& L account up to previous loss debited in it **&** Balance to revaluation surplus (OCI)	Debit revaluation surplus up to any balance existing in it. **&** For balance debit to P&L account.	debit to P&L account.

(a) If there is **decrease** in decommissioning liability **in excess of the carrying amount** of the asset, such excess is treated as 'deemed revaluation' and is **recognised immediately in the statement of profit and loss**.

(b) Any change in liability would require the asset to be tested for impairment to ascertain if there is any change in fair value.

(c) **Change in the revaluation surplus** arising from a change in the decommissioning liability **shall be presented as a separate line item** in the Statement of Other Comprehensive Income, as required under Ind AS 1.

Question 14. H Limited purchased an item of PPE costing ₹100 million which has useful life of 10 years. The entity has a contractual decommissioning and site restoration obligation, estimated at ₹5 million to be incurred at the end of 10^{th} year. The current market-based discount rate is 8%.
The company follows SLM method of depreciation. H Limited follows the Cost Model for accounting of PPE.

Determine the carrying value of an item of PPE and decommissioning liability at each year end when

(a) There is no change in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate.

(b) At the end of Year 4, the entity expects that the estimated cash outflow on account of decommissioning and site restoration to be incurred at the end of the useful life of the asset will be ₹8 million (in place of ₹5 million, estimated in the past).

Determine in case (b), how H Limited need to account for the changes in the decommissioning liability?

Solution: The present value of such decommissioning and site restoration obligation at the end of 10th year is **₹2.32 million** [being 5 / $(1.08)^{10}$]. H Limited will recognise the present value of decommissioning liability of ₹2.32 million as an **addition to cost of PPE and** will also recognize a corresponding decommissioning liability. Further, the entity will recognise the unwinding of discount as finance charge.

The following table shows the relevant computations, **if there is no change** in the expected decommissioning expenses, expected timing of incurring the decommissioning expense and / or the discount rate:

Year	OpeningAmountof PPE	Depreciation Charge (on SLM) for 10 Years	Carrying Amount at the end of year
1	102.32	10.23	92.08
2	92.08	10.23	81.85
3	81.85	10.23	71.62
4	71.62	10.23	61.39
5	61.39	10.23	51.16
6	51.16	10.23	40.93
7	40.93	10.23	30.69
8	30.69	10.23	20.46
9	20.46	10.23	10.23
10	10.23	10.23	-
Total		**102.32**	

Year	Opening Decommissioning Liability	Unwinding of Interest @ 8%	Closing Decommissioning Liability
1	2.32	0.19	2.50
2	2.50	0.20	2.70
3	2.70	0.22	2.92
4	2.92	0.23	3.15
5	3.15	0.25	3.40
6	3.40	0.27	3.68
7	3.68	0.29	3.97
8	3.97	0.32	4.29
9	4.29	0.34	4.63
10	4.63	0.37	5.00
Total		**2.68**	

(b) The changes to the estimate of expected decommissioning obligation:

- The present value of the decommissioning liability at the end of Year 4 works out to be ₹**5.04 million** [being 8 / $(1.08)^6$].
- As against this, the carrying amount of decommissioning liability at the end of Year 4 is ₹**3.15 million** (as computed above).
- The changes in the decommissioning liability of **₹1.89 million** (being ₹5.04 million less ₹3.15 million) shall be **added to** the cost of the asset in the current period and the related provision for decommissioning liability is also adjusted.

The journal entry will be:

PPE	Dr.	1.89 million	
To Provision for decommissioning liability			1.89 million

- The following table shows the calculations for years 5 - 10:

Year	Opening Amount of PPE	Depreciation charge SLM – 10 Years	Carrying Amount of PPE at endof the year
5	63.28	10.55	52.73
6	52.73	10.55	42.19
7	42.19	10.55	31.64
8	31.64	10.55	21.09
9	21.09	10.55	10.55
10	10.55	10.55	-
Total		**63.28**	

Year	Opening Decommissioning liability	Unwindingof Interest @8%	Closing Decommissioning Liability
5	5.04	0.40	5.44
6	5.44	0.44	5.88
7	5.88	0.47	6.35
8	6.35	0.51	6.86
9	6.86	0.55	7.41
10	7.41	0.59	8.00
Total		**2.96**	

Disclosure requirements:

- **The financial statements should disclose, for each class of property, plant and equipment:**
  a) the measurement bases used for determining the gross carrying amount;
  b) the depreciation methods used;
  c) the useful lives or the depreciation rates used; and
  d) the gross carrying amount and the accumulated depreciation, accumulated impairment losses at the beginning and end of the period.
- **Entity is also required to provide a reconciliation of the carrying amount at the beginning and end of the period showing**:
  a) additions;
  b) assets classified as held for sale;
  c) acquisitions through business combinations;
  d) impairment losses recognised in profit or loss in accordance with Ind AS 36;
  e) impairment losses reversed in profit or loss in accordance with Ind AS 36;
  f) depreciation;

- **The financial statements also disclose:**
  a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
  b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
  c) the amount of contractual commitments for the acquisition of property, plant and equipment; and
- **If items of property, plant and equipment are stated at revalued amounts, the following should be disclosed:**
  e) the effective date of the revaluation;
  f) whether an independent valuer was involved;
  g) 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; and
  h) the revaluation surplus.

Practice questions:

Question 15. B Ltd. has incurred the following transactions in respect of acquiring a plant is exchange of an old plant:

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

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

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

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

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

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

(vii) Freight paid ₹8,000.

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

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

(x) ₹10,000 was paid as cost of launching the product to be produced from the plant.

Recognise the asset value and pass journal. **(ICMAI Study material)**

Answer: Machinery at initial cost ₹3,97,600.

Journal entries:

Particulars		(₹)	(₹)
Old Machinery A/c	Dr.	8,000	
To Cash A/c			8,000
(Dismantling of old sets)			
Cast A/c	Dr.	1,000	
To Old Machinery A/c			1,000
(Scrap realized)			
Machinery (New) A/c	Dr.	3,97,600	
To, Old Machinery A/c.(1,00,000 + 8,000 – 1,000)			1,07,000
To, Profit on Sale of Old Plant A/c (1,26,000 – 1,07,000)			19,000

To, Supplier A/c or Cash A/c (3,20,000 – 1,26,000)		1,94,000
To Cash A/c (Freight installation + construction of site)		61,600
To Liability for dismantling A/c		16,000

Note : (ix) Loss ₹40,000 and (x) cost of launching product ₹10,000 are charged to Profit and Loss A/c.

2. GST accounting has not been shown.

Question 16. Moon Ltd incurs the following costs in relation to the construction of a new factory and the introduction of its products to the local market. Calculate total Cost to be Capitalised as per Ind AS 16. **(ICAI Study material)**

	Particulars	₹ 000 (Cost incurred)
	Site preparation costs	150
	Direct Material	2,000
	Direct Labour cost, including Rs 10,000 incurred during an industrial strike	1,160
	Testing of various processes in factory	200
	Consultancy fees for installation of equipment	300
	Relocation of staff to new factory	450
	General overheads	550
	Estimated Costs to dismantle (at present value)	200

Answer: ₹4,000

Question 17. A Ltd. Purchased an aircraft at a price of ₹ 6,300 crores that requires major inspection and overhauling every 4 years. The estimated life of the aircraft is 15 years. The aircraft was purchased in 2015 and major inspection and overhauling made in 2019 at a cost of ₹100 crores. In 2020 A Ltd. further incurred repair and maintenance in theengine to raise it capacity by 10% amounting to ₹70 crores. One worn out component in the wing was replaced in2020 at a cost of ₹80 crores. The carrying amount of the old component was ₹30 crores. Scrap realized ₹12 crores.Find the amount to be recognized as expense and as asset in 2019 and in 2020 and also show the carrying amount.The aircraft residual value is estimated at ₹300 crores.

(ICMAI Study material)

Note – as per ICMAI Study material, assume all transactions occurred at the beginning of every year.

Answer:

	2018	2019	2020
Expense	400	425	443
Carrying amount	4,700	4,375	4,058

Question 18. X Ltd. Purchased a machine at a price of ₹1,200 Lakhs. It paid freight ₹40 lakhs and installation cost ₹80 Lakhs. IGSTpaid at 18%. Share of general overhead ascertained for the trial run of the machine ₹30 Lakhs. The labour cost anddirect expenses for trial run is ₹60 Lakhs. The machine has been put to use on 01.04.2023.

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

The machine requires major over hauling every 2 years at cost of ₹26 lakhs and included in total cost of machine mentioned above. Pass journal entries and accounting treatments for the year 23-24 and 24-25. **(ICMAI Study material)**

Answer: initial cost recognized ₹1,626 lakhs; Annual depreciation ₹173 lakhs; interest expense recognized in 1st year ₹12.3 Lakhs; interest expense recognized in 2nd year ₹12.92 Lakhs (Approx). On 31-3-2025 provision for dismantling expense stood at ₹271.22 Lakhs.

Question 19. MS Ltd. has acquired a heavy machinery at a cost of ₹1,00,00,000 (with no breakdown of the component parts). The estimated useful life is 10 years. At the end of the sixth year, one of the major components, the turbine requires replacement, as further maintenance is uneconomical. The remainder of the machine is perfect and is expected to last for the next four years. The cost of a new turbine is ₹45,00,000. The discount rate assumed is 5%.

Can the cost of the new turbine be recognised as an asset, and, if so, what treatment should be used? **(ICAI Study material)**

Answer: The new turbine will produce economic benefits to MS Ltd., and the cost is measurable. Hence, the item should be recognised as an asset.

Carrying amount of machine to ₹71,56,840. (i.e.,40,00,000 – 13,43,160 + 45,00,000).

Question 20(HOME WORK).

On 1st April, 2023, XYZ Ltd. acquired a machine under the following terms:	
List price of machine	80,00,000
Import duty	5,00,000
Delivery fees	1,00,000
Electrical installation costs	10,00,000
Pre-production testing	4,00,000
Purchase of a five-year maintenance contract with vendor	7,00,000

In addition to the above information XYZ Ltd. was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5%, if payment for the machine was received within one month of purchase. XYZ Ltd. paid for the plant on 20th April, 2023. At what cost the asset will be recognised?

Solution: In accordance with Ind AS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalized. Therefore, the initial purchase price of the asset should be:

List price	80,00,000
Less: Trade discount (10%)	(8,00,000)
	72,00,000
Import duty	5,00,000
Delivery fees	1,00,000

Electrical installation costs	10,00,000
Pre-production testing	4,00,000
Total amount to be capitalised at 1st April, 2023	**92,00,000**

Maintenance contract is a separate contract to get service, therefore, the maintenance contract cost of ₹7,00,000 should be taken as a prepaid expense and charged to the profit or loss over a period of 5 years.
In addition the settlement discount received of ₹3,60,000 (72,00,000 x 5%) is to be shown as other income in the profit or loss.

Question 21. X Limited started construction on a building for its own use on 1st April, 2022. The following costs are incurred:

Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Materials	10,00,000
Direct labour cost	4,00,000
General overheads	1,00,000

Other relevant information: material costing ₹1,00,000 had been spoiled and therefore wasted and a further ₹1,50,000 was spent on account of faulty design work. As a result of these problems, work on the building was stopped for two weeks during November 2022 and it is estimated that ₹22,000 of the labour cost relate to that period. The building was completed on 1st January 2023 and brought in use on 1st April 2023. X Ltd had taken a loan of ₹40,00,000 on 1st April 2022 for construction of the building. The loan carried an interest rate of 8% P.A. and is repayable on 1st April 2024. Calculate the cost of building that will be included in tangible current asset as an addition.

Solution: Only those costs which are directly attributable to bringing the asset into working condition for its intended use should be included. Administration and general costs cannot be included. Cost of abnormal amount of wasted material/ labor or other resources is not included as per Ind AS 16. Here, the cost of spoilt materials and faulty designs are abnormal costs. Also, the wastages and labor charges incurred are abnormal in nature. Hence, same are also not included in the cost of PPE.

Amount to be included in Property, Plant and Equipment (PPE):

Purchase price of land	30,00,000
Stamp duty & legal fee	2,00,000
Architect fee	2,00,000
Site preparation	50,000
Material (10,00,000 – 2,50,000)	7,50,000
Direct labour cost (4,00,000 – 22,000)	3,78,000
General overheads	Nil
Interest*	Nil
Total to be capitalized	**45,78,000**

Note: Assuming that period for Construction of building is not a substantial period (i.e., 9 months) here,borrowing cost are not eligible for capitalisation.

Question 22(HOME WORK). XYZ Ltd. purchased an asset on 1st January, 2020, for ₹1,00,000 and the asset had an estimated useful life of ten years and a residual value of nil. The company has charged depreciation using the straight-line method at ₹10,000 per annum. On 1st January, 2024, the management of XYZ Ltd. Reviews the estimated life and decides that the asset will probably be useful for a further four years and, therefore, the total life is revised to eight years. How should the asset be accounted for remaining years?

Solution: Change in useful economic life of an asset is change in accounting estimate, which is to be applied prospectively, i.e., the depreciation charge will need to be recalculated. On 1st January, 20X4, when the asset's net book value is ₹60,000. The company should amend the annual provision for depreciation to charge the unamortised cost (namely, ₹60,000) over the revised remaining life of four years. Consequently, it should charge depreciation for the next four years at ₹15,000 per annum.

Question 23(Important question). Alfa Ltd. has machinery at cost ₹4,800 and provision for depreciation ₹1,600 as on 01.04.2018. On that date the remaining life of the machine is 6 years with residual value of ₹800. On the same date one component of the machine is replaced, the price of the new component is ₹600 and the cost of the old component was ₹500 with accumulated depreciation ₹200. The supplier of the new component took the old component at a fair value of ₹360.
On 31.03.2019 the machine is revalued as per company policy at ₹5,000. On 31.03.2020 an impairment loss of ₹900 has been recognized for the machine. Pass journal entries and show the accounting treatments to be made in the financial statement for the years ending on 31.03.2019, 31.03.2020 and 31.30.2021. Depreciation to be charged based on straight line method. **(ICMAI Study material)**

Question 24. On 1st April, 2021, Sun ltd purchased some land for ₹10 million (including legal costs of ₹1 million) in order to construct a new factory. Construction work commenced on 1st May, 2021.Sun ltd incurred the following costs in relation with its construction:

- Preparation and levelling of the land – ₹3,00,000.
- Purchase of materials for the construction – ₹6·08 million in total.
- Employment costs of the construction workers – ₹2,00,000 per month.
- Overhead costs incurred directly on the construction of the factory – ₹1,00,000 per month.
- Ongoing overhead costs allocated to the construction project using the company's normal overhead allocation model – ₹50,000 per month.
- Income received during the temporary use of the factory premises as a car park during the construction period –₹50,000.
- Costs of relocating employees to work at the new factory – ₹300,000.
- Costs of the opening ceremony on 31st January, 2022 – ₹150,000.

The factory was completed on 30th November, 2021 (which is considered as substantial period of time as per Ind AS 23) and production began on 1st February, 2022. The overall useful life of the factory building was estimated at 40 years from the date of completion.

However, it is estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 30% of the total cost of the building.

At the end of the 40-year period, Sun Ltd has a legally enforceable obligation to demolish the factory and restore the site to its original condition. The directors estimate that the cost of demolition in 40 years' time (based on prices prevailing at that time) will be ₹20 million. An annual risk adjusted discount rate which is appropriate to this project is 8%. The present value of Re 1 payable in 40 years' time at an annual discount rate of 8% is Re 0.046.

The construction of the factory was partly financed by a loan of ₹17·5 million taken out on 1st April, 2021. The loan was at an annual rate of interest of 6%. Sun Ltd received investment income of ₹100,000 on the temporary investment of the proceeds.

Required: Compute the carrying amount of the factory in the Balance Sheet of Sun Ltd at 31st March, 2022.You should explain your treatment of all the amounts referred to in this part in your answer.

Solution: **Computation of the cost of the factory:**

Description	Included in P.P.E. ₹ 000	Explanation
Purchase of land	10,000	Both the purchase of the land and the associated legal costs are direct costs of constructing the factory.
Preparation and levelling	300	A direct cost of constructing the factory
Materials	6,080	A direct cost of constructing the factory
Employment costs of construction workers	1,400	A direct cost of constructing the factory for a seven-month period
Direct overhead costs	700	A direct cost of constructing the factory for a seven-month period
Allocated overhead costs	Nil	Not a direct cost of construction
Income from use as a car park	Nil	Not essential to the construction sorecognised directly in profit or loss
Relocation costs	Nil	Not a direct cost of constructionNot a direct
Opening ceremony	Nil	cost of construction
Finance costs	612.50	Capitalise. the interest cost incurred in a seven-month period (purchase of land would not trigger off capitalisation since land is not a qualifying asset. Infact, the construction started from 1st May, 2021)
		offset against the amount capitalised
Investment income on temporary investment of the loan proceeds	(100)	
Demolition cost recognised as a provision	920	Where an obligation must recognise as part of the initial cost
Total	**19,912.50**	

Computation of accumulated depreciation

Total depreciable amount	9,912.50	All of the net finance cost of 512.50 (612.50 – 100) has been allocated to the depreciable amount. Also, acceptable to reduce by allocating a portion to the non-depreciable land element principle
Depreciation must be in two parts: Depreciation of roof component Depreciation of remainder	 49.56 57.82	 9,912.50 x 30% x 1/20 x 4/12 9,912.50 x 70% x 1/40 x 4/12
Total depreciation	107.38	
Computation of carrying amount	**19,805.12**	**19,912.50 – 107.38**

Question 25. ABC Ltd. is installing a new plant at its production facility. It has incurred these costs:

1.	Cost of the plant (cost per supplier's invoice plus taxes)	25,00,000
2.	Initial delivery and handling costs	2,00,000
3.	Cost of site preparation	6,00,000
4.	Consultants used for advice on the acquisition of the plant	7,00,000
5.	Interest charges paid to supplier of plant for deferred credit	2,00,000
6.	Net present value of estimated dismantling costs to beincurred after 7 years	3,00,000
7.	Operating losses before commercial production	4,00,000

Please advise ABC Ltd. on the costs that can be capitalized in accordance with Ind AS 16.

Solution: According to Ind AS 16, these costs can be capitalized:

1.	Cost of the plant	25,00,000
2.	Initial delivery and handling costs	2,00,000
3.	Cost of site preparation	6,00,000
4.	Consultants' fees	7,00,000
5.	Net present value of estimated dismantling costs to be incurredafter 7 years	3,00,000
		43,00,000

Note: Interest charges paid on "Deferred credit terms" to the supplier of the plant (not a qualifying asset) of ₹2,00,000 and operating losses before commercial production amounting to ₹4,00,000 are not regarded as directly attributable costs and thus cannot be capitalized. They should be written off to the Statement of Profit and Loss in the period they are incurred.

Question 26. (Home Work) A Ltd. has an item of property, plant and equipment with an initial cost of ₹1,00,000. At the date of revaluation, accumulated depreciation amounted to ₹55,000. The fair value of the asset, by reference to transactions in similar assets, is assessed to be ₹65,000. Pass Journal Entries with regard to Revaluation?

Solution: **journal entries are:**

Particular	₹	₹
Accumulated depreciation Dr. To Asset A/c (Being elimination of accumulated depreciation against the cost of the asset)	55,000	55,000
Asset A/c Dr To Revaluation Surplus (Being increase of net asset value to Fair value)	20,000	20,000

Question 27(Home Work). B Ltd. owns an asset with an original cost of ₹2,00,000. On acquisition, management determined that the useful life was 10 years and the residual value would be ₹20,000. The asset is now 8 years old, and during this time there have been no revisions to the assessed residual value.

At the end of year 8, management has reviewed the useful life and residual value and has determined that the useful life can be extended to 12 years in view of the maintenance program adopted by the company. As a result, the residual value will reduce to ₹10,000. How would the above changes in estimates be accounted by B Ltd.?

Solution: **Calculation of accumulated depreciation till 8th year:**

Depreciable amount {Cost less residual value} = 2,00,000 – 20,000 = 1,80,000.

Annual depreciation = Depreciable amount / Useful life = 1,80,000 / 10 = 18,000.

Accumulated depreciation = 18,000 x No. of years (8) = 1,44,000.

Calculation of carrying amount at the end of the 8th year:

The asset has a carrying amount of 56,000 at the end of year 8 [i.e. 2,00,000 – 1,44,000]

Accounting of the changes in estimates:

Revision of the useful life to 12 years results in a remaining useful life of 4 years (i.e., 12 years – 8 years).

The revised depreciable amount is ₹46,000 (56,000 – 10,000)

Thus, depreciation should be charged in future i.e., from 9th year onwards at ₹11,500 per annum (46,000 / 4 years).

Question 28. X Ltd. has a machine which got damaged due to fire as on 31st January, 2023. The carrying amount of machine was ₹1,00,000 on that date. X Ltd. sold the damaged asset as scrap for ₹10,000. X Ltd. has insured the same asset against damage. As on 31st March, 2023, the compensation proceeds was still in process but the insurance company has confirmed the claim. Compensation of ₹50,000 is receivable from the insurance company. How X Ltd. will account for the above transaction?

Solution: As per Ind AS 16, impairment or losses of items of property, plant and equipment and related claims for or payments of compensation from third parties are separate economic events and should be accounted for separately.

X Ltd. should account for the above transaction as given below:

At the time of sale of scrap machine, X Ltd. should write off the carrying amount of asset from books of account and provide a loss of ₹ 90,000. (i.e., carrying amount of ₹1,00,000 – realised amount of 10,000)

As on 31st March, 2023, X Ltd. should recognise income of ₹50,000 against the compensation receivable in its profit or loss.

Question 29. An entity has a nuclear power plant and a related decommissioning liability. The nuclear power plant started operating on 1st April, 2013. The plant has a useful life of 40 years. Its initial cost was ₹1,20,000 which included an amount for decommissioning costs of ₹10,000, which represented ₹70,400 in estimated cash flows payable in 40 years discounted at a risk-adjusted rate of 5 per cent. The entity's financial year ends on 31st March. On March, 2023, the net present value of the decommissioning liability has decreased by ₹8,000. The discount rate has not yet changed.

How the entity will account for the above changes in decommissioning liability in the year 2023, if it adopts cost model?

Solution: On 31st March, 2023, the plant is 10 years old. Accumulated depreciation is 30,000(120,000 x 10 / 40 years). Due to unwinding of discount @ 5% over the 10 years, the amount of decommissioning liability has increased from 10,000 to 16,300 (approx.).

On 31st March 2023, the discount rate has not changed. However, the entity estimates that, as a result of technological advances, the net present value of the decommissioning liability has decreased by ₹8,000. Accordingly, the entity adjusts the decommissioning liability from ₹16,300 to ₹8,300. On this date, the entity passes the following journal entry to reflect the change:

Provision for decommissioning liability	Dr.	8,000	
To Asset			8,000

Following this adjustment, the carrying amount of the asset is ₹82,000 (1,20,000 – 8,000 – 30,000), which will be depreciated over the remaining 30 years of the asset's life giving a depreciation expense for the next year of ₹2,733 (82,000 / 30). The next year's finance cost for unwinding of discount will be ₹415 (8,300 × 5 per cent).

Question 30. A Ltd. purchased some Property, Plant and Equipment on 1st April, 2021, and estimated their useful lives for the purpose of financial statements to be prepared on the basis of Ind AS:

Following were the original cost, and useful life of the various components of property, plant, and equipment assessed on 1st April, 2021:

Property, Plant and Equipment	Original Cost	Estimated useful life
Buildings	₹ 15,000,000	15 years
Plant and machinery	₹10,000,000	10 years
Furniture and fixtures	₹ 3,500,000	7 years

A Ltd. uses the straight-line method of depreciation. On 1st April, 2024, the entity reviewed the following useful lives of the property, plant, and equipment through an external valuation expert:

Buildings	10 years
Plant and machinery	7 years
Furniture and fixtures	5 years

There were no salvage values for the three components of the property, plant, and equipment either initially or at the time the useful lives were revised. Compute the impact of revaluation of useful life on the Statement of Profit and Loss for the year ending 31st March, 2025.

Solution: The annual depreciation charges prior to the change in useful life were:

Buildings	1,50,00,000/15 =	10,00,000
Plant and machinery	1,00,00,000/10 =	10,00,000
Furniture and fixtures	35,00,000/7 =	5,00,000
Total =		**25,00,000 (A)**

The revised annual depreciation for the year ending 31st March, 2025, would be:

Buildings	[1,50,00,000 – (10,00,000 × 3)] / 10	12,00,000
Plant and machinery	[1,00,00,000 – (10,00,000 × 3)] / 7	10,00,000
Furniture and fixtures	[35,00,000 – (5,00,000 × 3)] / 5	4,00,000
Total		**26,00,000 (B)**

The impact on Statement of Profit and Loss for the year ending 31st March, 2025

= 26,00,000 – 25,00,000 = 1,00,000

This is a change in accounting estimate which is adjusted prospectively in the period in which the estimate is amended and, if relevant, to future periods if they are also affected. Accordingly, from 2024-2025 onward, excess of ₹1,00,000 will be charged in the Statement of Profit and Loss every year till the time there is any further revision.

Question 31. Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2024 to the managing director Mr. Y for approval. Mr. Y, who is not a CMA, had raised following query from Mr. X after going through the draft financial statements: -

The notes to the financial statements state that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. How should the finance controller respond to the query from the managing director?

Solution: Ongoing through the query raised by the Managing Director Mr. Y, the financial controller Mr. X explained the notes and reasons for their disclosures as follows:

The accounting treatment of the majority of tangible non-current assets is governed by Ind AS 16 'Property, Plant and Equipment'. Ind AS 16 states that the accounting treatment of PPE is determined on a class-by-class basis.

For this purpose, property and plant would be regarded as separate classes. Ind AS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class-by-class basis and must be applied consistently within a class.

Ind AS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss. Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.

According to Ind AS 16, all assets having a finite useful life should be depreciated over thatlife. Where property is concerned, the only depreciable element of the property is the buildings element, since land normally has an indefinite life. The estimated useful life of a building tends to be much longer than for plant. These two reasons together explain why the depreciation charge of a property as a percentage of its carrying amount tends to be much lower than for plant.

Properties which are held for investment purposes are not accounted for under Ind AS 16, but under Ind AS 40 'Investment Property'. As per Ind AS 40, investment properties should be accounted for under a cost model. ABC Ltd. had applied the cost model and thus our investment properties are treated differently from the owner-occupied property.

Question 32. Company X performed a revaluation of all of its plant and machinery at the beginning of 2023. The following information relates to one of the machineries:

	Amount ('000)
Gross carrying amount	200
Accumulated depreciation (straight-line method)	(80)
Net carrying amount	120
Fair value	150

The useful life of the machinery is 10 years and the company uses Straight line method ofdepreciation. The revaluation was performed at the end of 4 years.

How should the Company account for revaluation of plant and machinery and depreciation subsequent to revaluation? Support your answer with journal entries.

Solution: According to Ind AS 16, 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. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses.

In such a situation, the revised carrying amount of the machinery will be as follows:

Gross carrying amount	250	[(200/120) x 150]
Net carrying amount	150	
Accumulated depreciation	100	(250 – 150)

Journal entry:

Plant and machinery account Dr	50	
To accumulated depreciation		20
To revaluation reserve		30

Depreciation subsequent to revaluation:

Since the Gross Block has been restated, the depreciation charge will be ₹25 per annum (250/10 years).

Journal entry:

Accumulated Depreciation	Dr.	₹25 p.a.	
To Plant and Machinery (Gross Block)		₹25 p.a.	

(b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

The amount of the adjustment of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with Ind AS 16.

In this case, the gross carrying amount is restated to Rs 150 to reflect the fair value and accumulated depreciation is set at zero.

Journal entry:

Accumulated Depreciation	Dr.	80	
To Plant and Machinery (Gross Block)			80
Plant and Machinery (Gross Block)	Dr.	30	
To Revaluation Reserve			30

Depreciation subsequent to revaluation:

Since the revalued amount is the revised gross block, the useful life to be considered is the remaining useful life of the asset which results in the same depreciation charge of ₹25 per annum as per Option A (₹ 150 / 6 years).

Journal entry:

Accumulated Depreciation	Dr.	25 p.a.	
To Plant and Machinery (Gross Block)			25 p.a.

Question 33. Heaven Ltd. had purchased a machinery on 1.4.2001 for ₹30,00,000, which is reflected in its books at written down value of ₹ 17,50,000 on 1.4.2006. The company has estimated an upward revaluation of 10% on 1.4.2006 to arrive at the fair value of the asset. Heaven Ltd. availed the option given by Ind AS of transferring some of the surplus as the asset is used by an enterprise.

On 1.4.2008, the machinery was revalued downward by 15% and the company also re- estimated the machinery's remaining life to be 8 years. On 31.3.2010 the machinery was sold for ₹9,35,000. The company charges depreciation on straight line method. Prepare machinery account in the books of Heaven Ltd. over its useful life to record theabove transactions.

Solution: **In the book of Heaven Ltd.**

Machinery account

Date	Particulars	Amount	Date	Particulars	Amount
1.4.2001	To Bank/ Vendor	30,00,000	31.3.2002	By Depreciation (1)	2,50,000
		________	31.3.2002	By Balance c/d	27,50,000
		30,00,000			**30,00,000**
1.4.2002	To Balance b/d	27,50,000	31.3.2003	By Depreciation	2,50,000
		________	31.3.2003	By Balance c/d	25,00,000
		27,50,000			**27,50,000**
1.4.2003	To Balance b/d	25,00,000	31.3. 2004	By Depreciation	2,50,000
		________	31.3.2004	By Balance c/d	22,50,000
		25,00,000			**25,00,000**
1.4.2004	To Balance b/d	22,50,000	31.3.2005	By Depreciation	2,50,000
		________	31.3.2005	By Balance c/d	20,00,000
		22,50,000			**22,50,000**
1.4.2005	To Balance b/d	20,00,000	31.3.2006	By Depreciation	2,50,000
		________	31.3.2006	By Balance c/d	17,50,000
		20,00,000			**20,00,000**
1.4.2006	To Balance b/d	17,50,000	31.3.2007	By Depreciation (2)	2,75,000
1.4.2006	To Revaluation Reserve @ 10%	1,75,000	31.3.2007	By Balance c/d	16,50,000
		19,25,000			**19,25,000**
1.4.2007	To Balance b/d	16,50,000	31.3.2008	By Depreciation	2,75,000
		________	31.3.2008	By Balance c/d	13,75,000
		16,50,000			**16,50,000**
1.4.2008	To Balance b/d	13,75,000	1.4.2008	By Revaluation Reserve (4)	1,25,000
			31.3.2009	By Profit and Loss (5)	81,250
			31.3.2009	By Depreciation (3)	1,46,094
			31.3.2009	By Balance c/d	10,22,656
		13,75,000			**13,75,000**
1.4.2009	To Balance b/d	10,22,656	31.3.2010	By Depreciation	1,46,094
31.3.2010	To Profit and Loss A/c (bal Fig)	58,438*	31.3.2010	By Bank A/c	9,35,000
		10,81,094			**10,81,094**

Working notes:

1. Calculation of useful life of machinery on 1.4.2001:

Depreciation charge in 5 years = (30,00,000 – 17,50,000) = 12,50,000

Depreciation per year as per Straight Line method = 12,50,000 / 5 years

= ₹ 2,50,000

Remaining useful life = 17,50,000 / 2,50,000 = 7 years

Total useful life = 5 years + 7 years = 12 years

2. Depreciation after upward revaluation as on 31.3.2006 `

Book value as on 1.4.2006	17,50,000
Add: 10% upward revaluation	1,75,000
Revalued amount	19,25,000

Remaining useful life 7 years (Refer W.N.1)

Depreciation on revalued amount = 19,25,000 / 7 years = ₹ 2,75,000 lakh

3. Depreciation after downward revaluation as on 31.3.2008: `

Book value as on 1.4.2008	13,75,000
Less: 15% Downward revaluation	(2,06,250)
Revalued amount	11,68,750

Revised useful life 8 years

Depreciation on revalued amount = 11,68,750 / 8 years = ₹ 1,46,094

4. Amount transferred from revaluation reserve:

Revaluation reserve on 1.4.2006 (A)	₹ 1,75,000Remaining
useful life	7 years
Amount transferred every year (1,75,000 / 7)	₹ 25,000
Amount transferred in 2 years (25,000 x 2) (B)	₹ 50,000
Balance of revaluation reserve on 1.4.2008 (A-B)	₹ 1,25,000

5. Amount of downward revaluation to be charged to Profit and Loss Account:

Downward revaluation as on 1.4.2008 (W.N.3)	₹ 2,06,250
Less: Adjusted from Revaluation reserve (W.N.4)	(₹ 1,25,000)
Amount transferred to Profit and Loss Account	₹ 81,250

1.5-- IND AS 116- LEASES

OBJECTIVE: The objective of this standard is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity.

SCOPE: Ind AS 116 shall be applied to **ALL LEASES**, including leases of Right-of-Use (ROU) assets in a sub-lease, **except:**

(a) Leases to explore for or use minerals,oil, natural gas and similar non-regenerative resources. (Ind AS 106).

(b) Leases of biological assets held by a lessee (Ind AS 41).

(c) Licences of intellectual property granted by a lessor (Ind AS 115).

(d) Rights held by a lessee under licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (Ind AS 38).

RECOGNITION EXEMPTION: - In addition to above scope exclusions, a lessee can elect not to apply Ind AS 116's recognition requirements to:

1. **Short-term leases (Lease term of 12 months or less); and**
2. **Leases for which the underlying asset is of low-value.**

If a lessee <u>elects to apply</u> the above recognition exemption, the lessee shall recognise <u>the lease</u> <u>payments</u> associated with those leases as an expense on <u>either a straight-line basis over the</u> <u>lease term or another systematic basis.</u>

What is lease: A lease is defined as a contract, or part of contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

Note 1. Meaning of right to control: - To assess whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the customer has both of the following:

(a) **The right to obtain <u>substantially all of the economic benefits</u> from use of the identified asset; <u>and</u>**

(b) **The <u>right to direct the use</u> of the identified asset.**

Note 2: - Ind AS 16 requires lessor and lessee to determine whether a contract is or contains a lease at the inception of the contract and accounting in the book of lessor and lessee is made on the commencement date of the lease agreement**.**

Here, A 'lessee' is defined as an entity that obtains the right to use an underlying asset for a period of time in exchange for consideration.

Note 3. Commencement date is the date on which a lessor makes an underlying asset available for use by a lessee.

Identifying and separating lease components of a contract: Sometimes, there are contracts that contain rights to use multiple assets (*for e.g.*, a building and an equipment, multiple pieces of equipment, etc.). The right to use each such asset is considered as a 'separate' lease component **<u>ONLY IF BOTH</u>** the following conditions are satisfied:

- The lessee can benefit from the use of the asset either on its own *OR* together with other resources that are readily available to the lessee ***AND***

- The underlying asset is neither highly dependent on, nor highly interrelated with, the other underlying assets in the contract.

If one or both of these criteria are not met then, the right to use multiple assets is considered a 'single' lease component, i.e., not a 'separate' lease component.

Meaning of lease payments: Lease payments are defined as payments made by a lessee to a lessor relating to the right to use an underlying asset during the lease term, comprising the following:

(a) Fixed payments (including in-substance fixed payments), less any lease incentives,

(b) Variable lease payments that depend on an index or a rate,

(c) The exercise price of a purchase option if the lessee is reasonably certain to exercise that option,

(d) Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease

For the lessee, lease payments also include amounts expected to be payable by the lessee under residual value guarantees.

For the lessors, lease payment includes residual value guarantees provided by the lessee,a party related to the lessee or a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

Note 1: 'Fixed payments' are defined as payments made by a lessee to a lessor for the right to use an underlying asset during the lease term, excluding variable lease payments.

Note 2: In substance fixed lease payment: - lease payments also include any in-substance fixed lease payments which are the payments that may, in form, contain variability but that, in substance, are unavoidable.

Question 1. Entity Q enters into a seven-year lease for a piece of machinery. The contract sets out the lease payments as follows.

– If Q uses the machinery within a given month, then an amount of 2,000 accrues for that month.

– If Q does not use the machinery within a given month, then an amount of 1,000 accrues for that month.

What is considered as fixed lease payment in this case?

Solution: Q considers the contract and notes that although the lease payments contain variability based on usage, and there is a realistic possibility that Q may not use the machinery in some months, a monthly payment of Rs 1,000 is unavoidable. Accordingly, this is an in-substance fixed payment, and is included in the measurement of the lease liability.

Note 3. Variable lease payments that depends on an index or rate: - 'Variable lease payments' are defined as the portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term that varies because of changes in facts or circumstances occurring after the commencement date, other than the passage of time.

These may include, *for e.g.*, payments linked to a consumer price index, payments linked to a benchmark interest rate (such as Repo rate, London Interbank offered rate i.e., LIBOR or payments that vary to reflect changes in market rental rates. Such payments are included in the lease payments and are measured using the prevailing index or rate at the measurement date (i.e., lease commencement date for initial measurement).

Question 2. An entity enters into a 10-year lease of property. The lease payment for the first year is ₹1,000. The lease payments are linked to the consumer price index (CPI). The CPI at the beginning of the first year is 100. Lease payments are updated at the end of every second year. At the end of year one, the CPI is 105. At the end of year two, the CPI is 108. What should be included in lease payments?

Solution: At the lease commencement date, the lease payments are ₹1,000 per year for 10 years. The entity does not take into consideration the potential future changes in the index. At the end of year one, the payments have not changed and hence, the liability is not updated.

At the end of year two, when the lease payments change, the entity updates the remaining eight lease payments to ₹1,080 per year (i.e., 1,000 / 100 x 108).

Treatment of Variable lease payments that do not depend on an index or a rate:

Variable lease payments that do not depend on an index or rate and are not, in substance, fixed payment. Examples may include payments such as those based on performance (*for e.g.*, a percentage of sales) or usage of the underlying asset (*for e.g.*, the number of hours flown, the number of units produced), are not included as lease payments. Instead, they are recognised in profit or loss in the period in which the event that triggers the payment occurs (unless they are included in the carrying amount of another asset in accordance with other Ind AS).

Question 3. Entity A enters into a five-year lease of an office building. The lease payments are ₹5,00,000 per year and the contract includes an additional water charge calculated as ₹0.50 per litre consumed. Payments are due at the end of year. Explain the treatment of variable payment for water charges as per Ind AS 116.

Solution: At the commencement date, Entity A should measure the lease liability as the present value of the fixed lease payments (i.e., five annual payments of 5,00,000). Entity A should exclude the non-lease component from its lease liability because they are variable payments that depend on usage. Entity A should recognise the payments for water – as a variable lease payment – in profit or loss when they are incurred.

Residual value guarantees: 'Residual value guarantee' is defined as a guarantee made to a lessor by a party unrelated to the lessor that the value (or part of the value) of an underlying asset at the end of a lease will be at least a specified amount.

Residual value guarantee for a lessee: - Lease payments include amounts expected to be payable by the lessee under residual value guarantees. A lessee may provide a guarantee to the lessor that the value of the underlying asset it returns to the lessor at the end of the lease will be at least of a specified amount. Such guarantees are enforceable obligations that the lessee has assumed by entering into the lease agreement.

Note: - A lessee is required to remeasure the lease liability if there is a change in the amounts expected to be payable under a residual value guarantee.

Question 4. An entity (a lessee) enters into a lease and guarantees that the lessor will realise ₹20,000 from selling the asset to another party at the end of the lease. At lease commencement, based on the lessee's estimate of the residual value of the underlying asset, the lessee determines that it expects that it will owe ₹8,000 at the end of the lease. Whether the lessee should include the said payment of ₹8,000 as a lease payment?

Solution: The lessee should include the amount of ₹8,000 as a lease payment because it is expected that it will owe the same to the lessor under the residual value guarantee.

Residual value guarantee for a lessor: Ind AS 116 requires lessors to include in the lease payments, any residual value guarantees provided to the lessor by the lessee, a party related to the lessee, or a third party unrelated to the lessor that is financially` capable of discharging the obligations under the guarantee. This amount included in the lease payments is different from that for a lessee which only includes the amount expected to be payable by lessee only.

Discount rates: Discount rates are used to determine the present value of the lease payments, which are used to determine Right of Use asset and Lease liability in case of a lessee and to measure a lessor's net investment in the lease.

Discount rate for a lessee: -

Lease payments are discounted using the interest rate implicit in the lease (to be calculated from the perspective of lessor) if that rate can be readily determined. But, if that rate cannot be readily determined then, the lessee uses the incremental borrowing rate (2nd preference).

Discount rate for a lessor: Lessor to use the interest rate implicit in the lease only.

Lease accounting in the book of lessee:

Initial recognition and measurement: At the commencement date, a lessee shall **recognise a ROU Asset and a Lease Liability**.

Ind AS 116 requires lessees to recognise a liability to make lease payments and an asset representing the right to use the underlying asset (i.e., the ROU Asset) during the lease term for *ALL* leases (except for short-term leases and leases of low-value assets, if they choose to apply such exemptions).

Measurement of lease liability: At the commencement date, a lessee initially measures the Lease Liability at the present value of the remaining lease payments to be made over the lease term, discounted using the rate implicit in the lease (or if that rate cannot be readily determined, the lessee's incremental borrowing rate). Lease payments used in measuring the lease liability are amounts due to the lessor excluding any payments that a lessee makes before lease commencement.

Question 5. Entity L enters into a lease for 10 years, with a single lease payment payable at the beginning of each year. The initial lease payment is ₹100,000. Lease payments will increase by the rate of LIBOR each year. At the date of commencement of the lease, LIBOR is 2 per cent.

Assume that the interest rate implicit in the lease is 5 per cent. How lease liability is initially measured?

Solution: In the given case, the lease payments depend on a rate (i.e., LIBOR) and hence is included in measuring lease liability. As per Ind AS 116, the lease payments should initially be measured using the rate (i.e., LIBOR) as at the commencement date. LIBOR at that date is 2 per cent; therefore, in measuring the lease liability, it is assumed that each year the payments will increase by 2 per cent, as follows:

Year	Lease Payment	Discount factor @ 5%	PV of lease payments
1	1,00,000	1	100,000
2	1,02,000	0.952	97,102
3	1,04,040	0.907	94,364
4	1,06,121	0.864	91,689
5	1,08,243	0.823	89,084
6	1,10,408	0.784	86,560

7	1,12,616	0.746	84,012
8	1,14,869	0.711	81,672
9	1,17,166	0.677	79,321
10	1,19,509	0.645	77,083
			8,80,887

Therefore, the lease liability is initially measured at ₹8,80,887.

Measurement/ computation of right of use asset (ROU asset):

A lessee initially measures the ROU Asset at COST, which consists of all of the following:

Present value of lease liability

Add: initial direct costs

Add: PV of estimated cost of dismantling, restoration, decommissioning.

Add: any prepaid lease payments.

Less: lease incentive received.

Journal entry in the books of lessee:

ROU Asset Dr

To lease liability (PV of outstanding lease liability)

To lessor/bank account (any lease payment paid/payable less cash incentive received)

To bank/ account (initial direct cost incurred, any prepaid lease payment)

To provision for dismantling

Treatment and meaning of Initial direct cost: 'Initial direct costs' are defined as the incremental costs of obtaining a lease that would not have been incurred if the lease had not been obtained, except for such costs incurred by a manufacturer or dealer lessor in connection with a finance lease.

For lessee :- Ind AS 116 requires lessees to include their initial direct costs in their initial measurement of the right-of-use asset. Examples of costs included in initial direct costs are.

Commission to selling agents
Legal fees resulting from the execution of the lease
Lease document preparation costs incurred after the execution of the lease
Certain payments to existing tenants to move out
Consideration paid for a guarantee of a residual asset by an unrelated third party

For lessors, initial direct costs, other than those incurred by manufacturer or dealer lessors, are included in the initial measurement of the net investment in the lease and reduce the amount of income recognised over the lease term.

Question 6. Entity Y and Entity Z execute a 12-year lease of a railcar with the following terms on 1 January, 2023:

- The lease commencement date is 1 February 2023.
- Entity Y must pay Entity Z the first monthly rental payment of ₹10,000 upon execution of the lease.
- Entity Z will pay Entity Y ₹50,000 cash incentive to enter into the lease payable upon lease execution.

Entity Y incurred ₹1,000 of initial direct costs, which are payable on 1 February 2023. Entity Y calculated the initial lease liability as the present value of the lease payments discounted at ₹8,50,000. How would Lessee Company measure and record this lease?

Subsequent Measurement in the book of lessee:

Right-of-use assets (ROU Asset): After the commencement date, the right-of-use asset should be measured using a cost model, unless it applies the revaluation model as specified under Ind AS 16.

Cost model for right-of-use assets:

To follow the cost model, an entity measures a right-of-use asset at cost less accumulated depreciation and accumulated impairment losses; and adjusted for re-measurements of the lease liability.

Depreciation for right-of-use assets:-

ROU Assets measured under the cost model should be depreciated in accordance with the depreciation requirements given in lnd AS 16, subject to the following:

- If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, or if the cost of the ROU Asset reflects that the lessee will exercise a purchase option, the ROU Asset should be depreciated from the commencement date to the end of the useful life of the underlying asset;
- otherwise, the right-of-use asset should be depreciated from the commencement date to the earlier of the end of the useful life of the ROU Asset and the end of the lease term.

Revaluation model for right-of-use assets:

- If right-of-use assets relate to a class of property, plant and equipment to which the lessee applies the revaluation model in Ind AS 16, a lessee may elect to apply that revaluation model to all of the right-of-use assets that relate to that class of property, plant and equipment.
- However, if right-of-use assets that meet the definition of investment property under Ind AS 40 “Investment Property”, then, revaluation model cannot be applied because at present Ind AS 40 “Investment property” does not permit revaluation model and only cost model is allowed for all investment properties.

Accounting of Lease liability in the book of lessee:

A Lease Liability should be accounted for in a manner similar to other financial liabilities (i.e., on an amortised cost basis). Consequently, the lease liability is accreted using an amount that produces a constant periodic discount rate on the remaining balance of the liability (i.e., the discount rate determined at commencement, as long as a reassessment requiring a change in the discount rate has not been triggered). Lease payments reduce the lease liability when paid.

Thus, 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 or to reflect revised in-substance fixed lease payments.

Expense recognition: Lessee recognises the following items in expense for leases:

- Depreciation of the ROU Asset
- Interest expense on the Lease Liability
- Variable lease payments that are not included in the lease liability (*for e.g.*, variable lease payments that do not depend on an index or rate)
- Impairment of the ROU Asset

Question 7. Entity ABC (lessee) enters into a three-year lease of equipment. Entity ABC agrees to make the following annual payments at the end of each year:

₹ 20,000 in year one

₹ 30,000 in year two

₹ 50,000 in year three.

Assumed a discount rate of 12% (which is Entity ABC's incremental borrowing rate because the interest rate implicit in the lease cannot be readily determined). Entity ABC depreciates the ROU Asset on a straight-line basis over the lease term. How would Entity ABC would account for the said lease under Ind AS 116?

Question 8. COC Ltd enters into a property lease with Entity H. The initial term of the lease is 10 years with a 5- year renewal option. The economic life of the property is 40 years and the fair value of the leased property is ₹50 Lacs. COC Ltd has an option to purchase the property at the end of the lease term for ₹30 lacs. The first advance annual payment is ₹5 lacs with an increase of 3% every year thereafter. The implicit rate of interest is 9.04%. Entity H gives COC Ltd an incentive of ₹2 lacs (payable at the beginning of year 2), which is to be used for normal tenant improvement.

COC Ltd is reasonably certain to exercise that purchase option. How would COC Ltd measure the right-of-use asset and lease liability at the beginning of lease and also calculate depreciation to be charged each year?

Impairment of ROU asset: Lessees' ROU Assets are subject to existing impairment requirements in Ind AS 36 *Impairment of Assets*. Ind AS 36 requires an impairment indicator analysis at each reporting period. If any indicators are present, the entity is required to estimate the recoverable amount of the asset (or the cash-generating unit (CGU) of which the asset is a part). The entity has to recognise an impairment loss if the recoverable amount of the CGU is less than the carrying amount of the CGU. After an impairment loss is recognised, the adjusted carrying amount of the ROU Asset would be its new basis for depreciation.

Subsequent reversal of a previously recognised impairment loss needs to be assessed if there is any indication that an impairment loss recognised in prior periods may no longer exist or may have decreased. In recognising any reversal, the increased carrying amount of the asset must not exceed the carrying amount that would have been determined after depreciation, had there been no impairment.

Re-measurement of lease liability: Ind AS 16 requires lessee to remeasure lease liabilities upon a change in payments on account of any of the following:

(i) the reassessment of lease term on account of reasonable certainty to exercise/ not exercise of extension and/ or termination option.

(ii) the reassessment of whether the lessee is reasonably certain to exercise an option to purchase the underlying asset.

(iii) changes in in-substance fixed lease payments.

(iv) the amounts expected to be payable under residual value guarantees.

(v) future lease payments resulting from a change in an index or rate.

When to use a 'revised' discount rate on re-measurement of lease liability?

Lessees use a **revised** discount rate when lease payments are updated for

- reassessment of the lease term ***OR***
- a reassessment of a purchase option.

Note: - The revised discount rate is for the **REMAINDER** of the lease term.

Question 9. Entity W entered into a contract for lease of retail store with Entity J on January 01/01/2021. The initial term of the lease is 5 years with a renewal option of further 3 years. The annual payments for initial term and renewal term is ₹100,000 and ₹110,000 respectively payable at the beginning of every year. The annual lease payment will increase based on the annual increase in the CPI at the end of the preceding year.

Entity W's incremental borrowing rate at the lease inception date and as at 01/01/2024 is 5% and 6% respectively and the CPI at lease commencement date and as at 01/01/2024 is 120 and 125 respectively.

At the lease commencement date, Entity W did not have a significant economic incentive to exercise the renewal option. On 1st January 2024, Entity W installed unique lease improvements into the retail store with an estimated five-year economic life. Entity W determined that it would only recover the cost of the improvements if it exercises the renewal option, creating a significant economic incentive to extend.

Is Entity W required to remeasure the lease on 1st January 2024? If yes calculate the revised value of ROU asset and lease liability on the date of remeasurement and also pass journal entry for remeasurement.

Lease modification: A 'lease modification' is a **change** in the scope of a lease, or the consideration for a lease, that was not part of the original terms and conditions of the lease (for e.g., adding or terminating the right to use one or more underlying assets, or extending or shortening the contractual lease term).

The following are examples of lease modifications that may be negotiated after the lease commencement date:

- A lease extension
- Early termination of the lease
- A change in the timing of lease payments
- Leasing additional space in the same building.
- Surrendering a part of the underlying asset.

Lease modification can result in:

- A separate lease OR
- A change in the accounting for the existing lease (i.e., not a separate lease).

NOTE: - The exercise of an existing purchase or renewal option or a change in the assessment of whether such options are reasonably certain to be exercised are not lease modifications but can result in the remeasurement of Lease Liabilities and ROU Assets (Remeasurement – as discussed above).

Modification – Separate lease contract:

A lease modification is accounted for as a separate lease if both criteria are met:

a. **The modification increases the scope of the lease by adding the right to use one or more underlying assets; and**

b. **The consideration for the lease increases by an amount commensurate with the standalone price for the increase in scope.**

If both criteria are not met, remeasure lease liability and ROU asset.

Question 10. Lessee enters into a 10-year lease for 2,000 square metres of office space. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease for the remaining five years to include an additional 3,000 square metres of office space in the same building. The additional space is made available for use by Lessee at the end of the second quarter of Year 6. The increase in total consideration for the lease is commensurate with the current market rate for the new 3,000 square metres of office space. How should the said modification be accounted for?

Solution: Lessee accounts for the modification as a separate lease, separate from the original 10-year lease because the modification grants Lessee an additional right to use an underlying asset, and the increase in consideration for the lease is commensurate with the stand-alone price of the additional right-of-use asset

Accordingly, at the commencement date of the new lease (at the end of the second quarter of Year 6), Lessee recognises a ROU Asset and a lease liability relating to the lease of the additional 3,000 square metres of office space.

Question 11. (Modification that increases the scope of the lease by extending the contractual lease term): Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are ₹1,00,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 7, Lessee and Lessor agree to amend the original lease by extending the contractual lease term by four years. The annual lease payments are unchanged (i.e., ₹1,00,000 payable at the end of each year from Year 7 to Year 14). Lessee's incremental borrowing rate at the beginning of Year 7 is 7% p.a. How should the said modification be accounted for?

Solution: **1. Calculation of Lease liability as at commencement date:**

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value oflease payments (A x B = C)
1	100,000	0.943	94,300
2	100,000	0.890	89,000
3	100,000	0.840	84,000
4	100,000	0.792	79,200
5	100,000	0.747	74,700
6	100,000	0.705	70,500
7	100,000	0.665	66,500
8	100,000	0.627	62,700
9	100,000	0.592	59,200
10	100,000	0.558	55,800
Lease liability as at commencement date			**7,35,900**

2. Calculation of Lease liability immediately before modification date:

Year	Opening leaseliability (A)	Interest @ 6% (B) = [A x 6%]	Lease payments (C)	Closing liability (D) = [A+B-C]
1	7,35,900	44,154	100,000	6,80,054
2	6,80,054	40,803	100,000	6,20,857
3	6,20,857	37,251	100,000	5,58,108
4	5,58,108	33,486	100,000	4,91,594
5	4,91,594	29,496	100,000	4,21,090
6	4,21,090	25,265	100,000	3,46,355
	Lease liability as at modification date			**3,46,355**

3. Calculation of modified lease liability:

Year	Lease Payment(A)	Present value factor@ 7% (B)	Present value of lease payments (A*B=C)
7	100,000	0.935	93,500
8	100,000	0.873	87,300
9	100,000	0.816	81,600
10	100,000	0.763	76,300
11	100,000	0.713	71,300
12	100,000	0.666	66,600
13	100,000	0.623	62,300
14	100,000	0.582	58,200
Modified lease liability			**5,97,100**

Adjustment to ROU asset:

Modified Lease liability	5,97,100
Original Lease liability as at modification date	(3,46,355)
Adjustment to ROU asset	**2,50,745**

The ROU asset will be increased by ₹2,50,745 on the date of modification.

Question 12 (Modification that decreases the scope of the lease) Lessee enters into a 10-year lease for 5,000 square metres of office space. The annual lease payments are ₹50,000 payable at the end of each year. The interest rate implicit in the lease cannot be readily determined. Lessee's incremental borrowing rate at the commencement date is 6% p.a. At the beginning of Year 6, Lessee and Lessor agree to amend the original lease to reduce the space to only 2,500 square metres of the original space starting from the end of the first quarter of Year 6. The annual fixed lease payments (from Year 6 to Year 10) are ₹30,000. Lessee's incremental borrowing rate at the beginning of Year 6 is 5% p.a. How should the said modification be accounted for?

Solution: **1. Calculation of Initial value of ROU asset and lease liability:**

Year	Lease Payment(A)	Present value factor @ 6% (B)	Present value of lease payments (A x B = C)
1	50,000	0.943	47,150
2	50,000	0.890	44,500
3	50,000	0.840	42,000

4	50,000	0.792	39,600
5	50,000	0.747	37,350
6	50,000	0.705	35,250
7	50,000	0.665	33,250
8	50,000	0.627	31,350
9	50,000	0.592	29,600
10	50,000	0.558	27,900
			3,67,950

2. calculation of the lease liabilities before modification as follows:

Year	Lease Liability			
	Initial value	Lease payments	Interest expense @ 6%	Closing balance
	A	B	c = a x6%	d = a-b +c
1	3,67,950	50,000	22,077	3,40,027
2	3,40,027	50,000	20,402	3,10,429
3	3,10,429	50,000	18,626	2,79,055
4	2,79,055	50,000	16,743	2,45,798
5	2,45,798	50,000	14,748	2,10,546
6	2,10,546			

3. Carrying amount of ROU asset on the date of modification:

3,67,950 – ($\frac{3,67,950}{10}$ X 5) = 1,83,975

At the effective date of the modification (at the beginning of Year 6), Lessee re-measures the lease liability based on:

(a) a five-year remaining lease term,

(b) annual payments of ₹30,000 and

(c) Lessee's incremental borrowing rate of 5% p.a.

Year	Lease Payment(A)	Present value factor @ 5% (B)	Present value of lease payments (A x B = C)
6	30,000	0.952	28,560
7	30,000	0.907	27,210
8	30,000	0.864	25,920
9	30,000	0.823	24,690
10	30,000	0.784	23,520
Total			**1,29,900**

Lessee will determine the proportionate decrease in the carrying amount of the ROU asset on the basis of the remaining ROU Asset (i.e., 2,500 square metres corresponding to 50% of the original ROU Asset).

50% of the pre-modification ROU Asset (₹1,83,975) is ₹ 91,987.50.

50% of the pre-modification lease liability (₹2,10,546) is ₹1,05,273.

Consequently, Lessee will reduce the carrying amount of the ROU Asset by 91,987.50 and the carrying amount of the lease liability by 1,05,273.

Lessee will recognise the difference between the decrease in the lease liability and the decrease in the ROU Asset (1,05,273 – 91,987.50 = 13,285.50) as a gain in profit or loss at the effective date of the modification (at the beginning of Year 6).

Lessee will recognise the difference between the remaining lease liability of 1,05,273 and the modified lease liability of 1,29,900 (which equals 24,627) as an adjustment to the ROU Asset reflecting the change in the consideration paid for the lease and the revised discount rate.

Presentation of items related to ROU asset and lease liability in financial statement:

Balance Sheet	Statement of profit andloss	Statement of cash flows
ROU Assets: They are presented either: - Separately from other assets ***OR***	**Depreciation and Interest:** Depreciation on Right of use asset and interest expense accreted on lease liabilities are presented separately (i.e., they CANNOT be combined). This is because interest expense on the lease liability is a component of **finance costs**	**Principal portion of the leaseliability:** - These cash payments are presented within financingactivities
- Together with other assetsas if they were owned, with disclosures of the balance sheet line itemsthat include ROU Assets and their amounts - ROU Assets that meet the definition of investment property are presented as investment property **Lease Liabilities:** They are presented either: - Separately from other liabilities *OR* - Together with other liabilities with disclosure of the balance sheet line items that includes lease liabilities and their amounts		**Interest portion of the lease liability:** - These cash payments are presented within financingactivities **Short-term leases and leases of low-value assets:** - Lease payments pertaining to them (i.e., not recognised on the balance sheet as per Ind AS 116) are presented within operating activities **Variable lease payments not included in the lease liability:** - These are also presented within operating activities

Accounting in the book of lessor:

Lessor: - A **'lessor'** is defined as an entity that provides the right to use an **underlying asset** for a period of time in exchange for consideration.

At inception of lease, lessors classify all leases as **FINANCE LEASE** or **OPERATING LEASE**.

Whether a lease is a finance lease or an operating lease **depends on the substance of the transaction** rather than the form of the contract.

(a) Finance lease: - a **'Finance Lease'** is defined as a **lease** that transfers substantially all the risks and rewards incidental to ownership of an **underlying asset**.

Ind AS 116 lists a number of examples that individually, or in combination, would normally lead to a lease being classified as a finance lease:

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

(b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable;

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

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

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

Recognition of finance lease: - 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**.

For finance leases (other than those involving manufacturer and dealer lessors), initial direct costs are included in the initial measurement of the finance lease receivable.

(b) Operating lease: - an **'Operating Lease'** is defined as a **lease** that does not transfer substantially all the risks and rewards incidental to ownership of an **underlying asset.**

Accounting of operating lease in the book of lessor:

- lessor shall recognise lease income on SLM basis over the lease term.
- Lessor shall continue to recognise respective asset in his books of account and charge depreciation on it.
- **Journal entries at the yearend in the book of lessor: -**

(a) When given on lease**: no entry**

(b) At the yearend: -

(i) bank account Dr
To lease income

(ii) depreciation account Dr
To asset account

(iii) profit and loss account Dr
To depreciation account

(iv) lease income account Dr
To profit & loss account

Accounting of finance lease in the book of lessor:

(i) Lessor shall initially do the following on commencement date:

- Derecognise the asset under lease at carrying amount.
- Recognise lease receivable (asset) at the amount equal to net investment in lease.
- Balancing figure (if any) will be recognised as profit or loss.

Journal entry at the commencement date:

	Debit	Credit
Lease receivable account Dr	Net investment	
Loss on sale (SPL) Dr		
To asset account		Carrying amount
To gain on sale (SPL)		

(ii) no depreciation will be charged by the lessor on this asset in future.

(iii) interest income (finance income) is booked over the lease term on lease receivable to unwind the discount.

(iv) Journal entry at the end of year:

(a) for unwinding discount on lease receivable: Lease receivable account Dr To finance income (SPL)		
(b) for receipt of lease instalment: Bank account Dr To lease receivable		

Note:

(i) Gross investment in lease = total lease payment by the lessee + unguaranteed residual value.

(ii) Net investment in lease = PV of Gross investment in lease (Using lessor's implicit rate of return) **less deferred selling profit (as per ICMAI Study material only).**

Note: - Deferred selling profit is calculated as the lease receivableless the carrying amount of the underlying asset, net of unguaranteed residual.

(iii) unguaranteed residual value = total expected residual value by the lessor – GRV by the lessee.

(iv) unearned finance income = Gross investment – net investment in lease.

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

Question 13. COC Ltd given his building on finance lease for the period of 3 years on annual lease payment of ₹1,00,000 at the end of one year. Guaranteed residual value by the lessee is ₹20,000. Expected unguaranteed residual value is ₹30,000. Discounting rate is 10%. Carrying amount of building in the book of COC Ltd is ₹2,50,000. Pass journal entries for the first year of lease. Also calculate Unearned finance income.

Solution: PV of lease receivable ₹2,63,620; PV of UGRV ₹22,530; Net investment ₹2,86,150;

Finance income on lease receivable 1st year- ₹28,615; 2nd year- ₹21,477; 3rd year- ₹13,758.

Unearned finance income ₹63,850**.**

Accounting of finance income in the book of dealer lessor: Dealer lessor will also recognise sales and cost of goods sold (COGS) in his journal entry along with recognition of lease receivable and derecognition of asset.

Journal entry on lease commencement date in the book of lessor:

	Debit	Credit
Lease receivable account Dr COGS account Dr To asset account To sales account	(Net investment) CA of asset- PV of UGRV	 Carrying amount (CA) NI - PV of UGRV
Note: balancing figure will be the gain/loss in lease.		

Question 14. A Dealer-Lessor enters into a 10-year lease of equipment with Lessee. The equipment is not specialised in nature and is expected to have alternative use to Lessor at the end of the 10-year lease term. Under the lease:

- Lessor receives annual lease payments of ₹15,000, payable at the end of the year.
- Lessor expects the residual value of the equipment to be ₹50,000 at the end of the 10-year lease term
- Lessee provides a residual value guarantee that protects Lessor from the first ₹30,000 of loss for a sale at a price below the estimated residual value at the end of the lease term (i.e., ₹50,000)
- The equipment has an estimated remaining economic life of 15 years, a carrying amount of ₹1,00,000 and a fair value of ₹1,11,000.
- The lease does not transfer ownership of the underlying asset to Lessee at the end of the lease term or contain an option to purchase the underlying asset
- The interest rate implicit in the lease is 10.078%.

How should the Lessor account for the same in its books of accounts?

Answer:

Net investment in the lease	Dr.	1,11,000	
Cost of goods sold	Dr.	92,340	
To Revenue			1,03,340
To Property held for lease			1,00,000

Interest income recognised in first year ₹11,187.

Disclosure in the book of lessor: The objective of the disclosures is for lessors to disclose information in the notes that, together with the information provided in the balance sheet, statement of profit or loss and statement of cash flows, gives a basis forusers of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessor. A lessor shall disclose the following amounts for the reporting period:

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

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

Concept of deferred selling profit (exception to above treatment in the book of lessor):

Question 15. Lessor Y leases out an equipment (carrying amount ₹1,36,000 having 5 years life) to Lessee X for 3 years for annual payment of ₹50,000 (at the end of every year) and residual value of ₹50,000, guaranteed by X up to loss of ₹30,000. Interest rate implicit is 10%. At the end of the lease the equipment is valued at ₹33,000. Show accounting in books of X and Y. Show accounting of lease classified as finance lease in books of Y. **The rate of interest income on the net investment in lease, however, is 19.274%.** **(ICMAI Study material)**

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

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

Statement showing computation of Lease Liability repayment and interest:

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

ROU asset depreciation during lease period by SLM Method:

Year	Depreciation	Balance
0		1,46,882
1	48,961	97,921
2	48,961	48,960
3	48,960	0

Journal entries in the book of lessee:

	Particulars		
At inception	ROU Asset A/c Dr. To, Lease Liability A/c	1,46,882	 1,46,882
At the end ofYear 1	Interest Expenses A/c Dr. To, Lease Liability A/c	14,688	 14,688
	Lease Liability A/c Dr. To, Bank A/c	50,000	 50,000
	Depreciation A/c Dr To, ROU Asset	48,961	 48,961

At the end of Year 2	Interest Expenses A/c To, Lease Liability A/c	11,157	 11,157
	Lease Liability A/c To, Bank A/c	50,000	 50,000
	Depreciation A/c To, ROU Asset	48,961	 48,961
At the end of Year 3	Interest Expenses A/c To, Lease Liability A/c	7,273	 7,273
	Lease Liability A/c To, Bank A/c	50,000	 50,000
	Depreciation A/c To, ROU Asset A/c	48,960	 48,960
	Lease Liability A/c Dr. To, Bank A/c (50,000 – 33,000 = 17,000, guaranteed up to 30,000) To, P&L (liability remission) ##	30,000	 17,000 13,000
## if during lease any increase or decrease in liability arises when there exists a balance in ROU, to that extentROU will be debited/credited instead of P&L.			

Accounting treatment in the book of Y (Lessor):

(a) present value of lease receivable = ₹1,46,882 (calculated as above)
(b) Deferred selling profits at inception:

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

***₹20,000 × 0.7513 = ₹15,026**

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

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

Net Investment in Lease	1,36,000
Add Interest Income @ 19.274% = ₹1,36,000 × 19.274%	26,213
Total	1,62,213
Less Payment	50,000
Balance at the end of year 1	1,12,213
Add Interest Income @ 19.274% = ₹1,12,213 × 19.274%	21,628
Total	**1,33,841**

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

JOURNAL ENTRIES IN THE BOOK OF LESSOR

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

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

1.6-- IND AS 21- The Effects of Changes in Foreign Exchange Rates'

Objective: The objective of the Standard is to address the accounting for foreign activities which include:

- transactions in foreign currencies; or
- foreign operations.

Considering that an entity may present its financial statements in a foreign currency, the Standard also seeks to prescribe how to translate financial statements into a presentation currency.

Some important definitions:

1. **Functional currency** is the currency of the primary economic environment in which the entity operates. In this regard, the primary economic environment will normally be the one in which it primarily generates and expends cash i.e. it operates.

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

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

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

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

3. Foreign operation has been defined as an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

4. Presentation currency is the currency in which the financial statements are presented, the presentation currency may be different from the entity's functional currency.

Scope: This Standard shall be applied:

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

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

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

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

Detail discussion on functional currency:

- An entity measures its assets, liabilities, equity, income and expenses in its functional currency.
- All transactions in currencies other than the functional currency are foreign currency transactions.
- Ind AS 21 requires each entity to determine its functional currency.
- In determining its functional currency, an entity emphasises the currency that determines the pricing of the transactions that it undertakes, rather than focusing on the currency in which those transactions are denominated.

The following are the factors that may be considered in determining an appropriate functional currency (**Primary indicators**):

(a) **The currency:**

i. that mainly influences sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and

ii. of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) the currency that mainly influences labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

- **Other factors** that may provide supporting evidence to determine an entity's functional currency are (**Secondary indicators**):

(a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and

(b) the currency in which receipts from operating activities are usually retained.

ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS:

Initial recognition: A foreign currency transaction is initially recorded by translation in the entity's functional currency at the exchange rate on the transaction date.

For practical reasons, a rate that approximates the actual exchange rate is often used. An average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period.

However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Question 1. During the year 2023-24, COC Ltd made following foreign transaction.

Date	**Transactions**	**Amount**
12th July 2023	Machinery purchased	US$ 40,000
18TH August 2023	Loan raised from American bank	US$ 2,00,000
17th September 2023	Loan given to foreign company	Rs 20,00,000
25th October	Sales made to a foreign customer	US$ 10,000
30th November	Rent paid	US$ 12,000
During the month of October	Purchases made at various dates	US$ 50,000

Exchange rates on various dates are given below:

Date	**Exchange rate per US $**
12th July 2023	₹82
18TH August 2023	₹ 85
17th September 2023	₹83
25th October	₹ 84
During the month of October	₹ 84.5

Calculate the price at which above transactions will be recorded in functional currency (₹) of COC Ltd.

Subsequent Recognition at the end of each Reporting Period:

- At the reporting date, assets and liabilities denominated in a foreign currency are translated as follows:

(a) **Monetary items** are translated at the exchange rate at the reporting date i.e., closing rate;

(b) **Non-monetary items measured at historical cost** are not translated / restated; instead they remain at the exchange rate at the date of the transaction; and

(c) **Non-monetary items measured at fair value in a foreign currency** are translated at the exchange rate on the date the fair value was determined.

Note1: **Meaning of Monetary items: -** Units of currency held and assets and liabilities to be received or paid are in a fixed or determinable number of units of currency.

Examples of monetary item: All liabilities (long term, short term), Debtors, Bills receivables, investments in securities, pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash, lease liabilities; cash dividends that are recognised as a liability;

Note 2: Meaning of Non-Monetary items: - There is no fixed or determinable number of units of currency. For example, items of PPE, stock, prepaid expenses, advance income etc.

Note 3. Examples of **Non-monetary items measured at fair value/net realizable value: -**

- Inventories - measured at lower of cost and net realisable value.
- When assets are shown at revalued amount in case of subsequent measurement.
- Asset subject to impairment loss - lower of an asset's carrying amount and its recoverable amount.

If **such an asset is non-monetary** and measured in a foreign currency, the carrying amount is determined by comparing:

(a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e., the rate at the date of the transaction); and

(b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g., the closing rate at the end of the reporting period).

Note- The above may result in an impairment loss being recognised in the functional currency but not in the foreign currency, or vice versa.

Question 2. Following are balances of assets and liabilities appearing in the balance sheet of COC Ltd related to foreign transactions as on 31st March 2024.

Particulars	Amount (US $)	Exchange rate
Bank loan	20,000	
Debtors	10,000	
Creditors	12,000	
Equipments	16,000	
Building	14,000	
Bonus payable	8,000	
Investment in foreign securities	15,000	
Lease liabilities	10,000	
Prepaid expenses	2,000	
Advance income	1,000	
Inventory		
Inventory – cost US$ NRV- US$	12,000 15,000	
Inventory – cost US$ NRV- US$	17,000 15,000	
Building- carrying amount Recoverable amount	US$ 7,000 US$ 10,000	
Equipment revalued at	US$ 15,000	

State the rate (i.e. transaction rate, closing rate) at which above items related to foreign transactions will be converted at the balance sheet data (subsequent recognition)

Question 3. COC Ltd 's functional currency is Rupee. It has a building located in US acquired at a cost of US$ 50,000 when the exchange rate was US$ 1= ₹80. At the balance sheet date, company decided to follow revaluation model. For the purpose of this question depreciation is ignored. At the balance sheet date, fair value of the building is determined to be US$ 52,000. The exchange rate as at the balance sheet date is US$ 1= ₹84. Calculate amount at which building will be recorded in the book of COC Ltd as on 31st March 2024.

Question 4. Entity A's functional currency is Rupee. It has a building located in US acquired at a cost of US$ 20,000 when the exchange rate was US$ 1= ₹60. The building is carried at cost in the financial statements of Entity A. For the purpose of this question depreciation is ignored. At the balance sheet date, there is an indication of impairment for this building. Consequently, an impairment test has been made in accordance with Ind AS36 as at the balance sheet date and the recoverable amount of the building is determined to be US$ 19,000. The exchange rate as at the balance sheet date is US$ 1= ₹64. Calculate amount of impairment loss, if any. **(ICMAI Study material)**

Solution: Cost translated at the exchange rate on the dateof acquisition US$ 20,000 @ ₹60 per US$ is ₹12,00,000. Recoverable amount translated at the exchange rate on the balance sheet date-US$19,000 @ ₹64 per US$ is ₹12,16,000. Though there is an impairment loss of US$ 1000 (US$20,000-US$19,000) in terms of foreign currency, there is no impairment loss in termsof functional currency. This is because, recoverable amount in terms of functional currency (₹12,16,000) exceeds carrying amount (i.e., cost) in terms of functional currency (₹12,00,000). Hence, no impairment loss is recognised for the building.

Recognition of foreign exchange loss or gain (Treatment of exchange differences):

(I) Exchange differences arising on monetary items: -

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

Question 5. On 1st June 2023, COC Ltd took a loan of US$ 20,000 from a foreign bank at interest rate of 10% p.a. On that date rate was US$ 1= ₹80. On 1st February 2024, COC Ltd made payment of its loan along with interest. Exchange rate on 1st February 2024 was US$ 1= ₹82. Make journal entries for the year ended on 31st march 2024.

Question 6. On 1st June 2023, COC Ltd took a loan of US$ 20,000 from a foreign bank at interest rate of 10% p.a. On that date rate was US$ 1= ₹80. Make journal entries for the year ended on 31st march 2024 assuming that loan and interest are outstanding at the end of the year. Exchange rate on 31st March 2024 was US$ 1= ₹82.

(II) Exchange differences arising on non- monetary items:

- Ind AS requires if the gain or loss on a non-monetary item is recognised in other comprehensive income (OCI)., any exchange component of that gain or loss is also recognized in other comprehensive income (OCI).

For example, revaluation gain on property, plant and equipment is recognised in other comprehensive income as per Ind AS 16. When such an asset is measured in a foreign currency and its revalued amount is translated as per this Standard using the rate at the date the fair value was determined, the resulting exchange gain or loss is also recognised in other comprehensive income.

- If the gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss is also recognized in profit or loss.

Question 7. COC Ltd 's functional currency is Rupee. It has a plant located in US acquired at a cost of US$ 1,00,000 on credit basis when the exchange rate was US$ 1= ₹80. At the balance sheet date, company decided to follow revaluation model. For the purpose of this question depreciation is ignored. At the balance sheet date, fair value of the building is determined to be US$ 1,05,000. The exchange rate as at the balance sheet date is US$ 1= ₹84. Calculate amount at which building will be recorded in the book of COC Ltd as on 31st March 2024 also make journal entry for revaluation.

Question 8. TATA Ltd 's functional currency is Rupee. It has a building located in US acquired at a cost of US$ 1,00,000 for cash when the exchange rate was US$ 1= ₹80. At the balance sheet date, company decided to follow revaluation model. For the purpose of this question depreciation is ignored. At the balance sheet date, fair value of the building is determined to be US$ 90,000. The exchange rate as at the balance sheet date is US$ 1= ₹82. Calculate amount at which building will be recorded in the book of COC Ltd as on 31st March 2024 also make journal entry for revaluation.

Note: - When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transactionis settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the changein exchange rates during each period.

Question 9. On 30th January, 2023, A Ltd. purchased a machinery for $ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1 $ = ₹60. The fair value of the machinery determined on 31st March, 2023 is $ 5,500. The exchange rate on 31st March, 2023 is 1$ = ₹65. The payment to overseas supplier done on 31st March 2024 and the exchange rate on 31st March 2024 is 1$ = ₹67. The fair value of the machinery remains unchanged for the year ended on 31st March 2024. Prepare the Journal entries for the year ended on 31st March 2023 and year 2024 according to Ind AS 21. Tax rate is 30%. A Ltd. follows Revaluation method in respect of Plant & Machinery. **(ICAI Study material)**

Solution: journal entries in the book of A Ltd:

Purchase of Machinery on credit basis on 30th January 2023:

	₹	₹
Machinery A/c ($ 5,000 x 60) Dr. To Creditors-Machinery A/c (Initial transaction will be recorded at exchange rate on thedate of transaction)	3,00,000	3,00,000

Exchange difference arising on translating monetary item on 31st March 2023:

	₹	₹
Profit & Loss A/c [($ 5,000 x 65) – ($ 5,000 x 60)] Dr. To Creditors-Machinery A/c	25,000	25,000

Machinery A/c Dr. To Revaluation Surplus (OCI) [Being Machinery revalued to USD 5,500; (60 x (USD 5,500 -USD 5,000)]	30,000	30,000
Machinery A/c Dr. To Revaluation Surplus (OCI) (Being Machinery measured at the exchange rate on31-03-2023 [USD 5,500 x (65 - 60)]	27,500	27,500
Revaluation Surplus (OCI) Dr. To Deferred Tax Liability (DTL created @ of 30% of the total OCI amount)	17,250	17,250

Exchange difference arising on translating monetary item and settlement of creditors on31st March 2024:

	₹	₹
Creditors-Machinery A/c ($ 5,000 x 65) Dr. Profit & loss A/c [($ 5,000 x (67 - 65)] Dr. To Bank A/c	3,25,000 10,000	3,35,000
Machinery A/c [($ 5,500 x (67 - 65)) Dr. To Revaluation Surplus (OCI)	11,000	11,000
Revaluation Surplus (OCI) Dr. To Deferred Tax Liability (DTL created @ of 30% of the total OCI amount)	3,300	3,300

Translations of foreign operation:

- The guidance provided on determining an entity's functional currency equally applies to determine the functional currency of a foreign operation of the entity.
- Effectively, the translation procedures those for translating foreign operations are the same as those followed when an entity present its financial statements:

(a) assets and liabilities are translated at the exchange rate at the reporting date;

(b) items of income and expense are translated at exchange rates at the dates of the relevant transactions, although appropriate average rates may be used;

(c) the resulting exchange differences are recognised in **other comprehensive income (OCI)** and are presented in a separate component of equity (generally referred to as **the foreign currency translation reserve** or **currency translation adjustment**) until disposal of the foreign operation; and

(d) cash flows are translated **at exchange rates at the dates of the relevant transactions**, although an appropriate average rate may be used.

Question 10. Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$). The following balances appear in the books of Infotech Global Ltd. at the year-end prior to translation:

Particular	USD	L$
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	**9,85,000**	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274
Profit & Loss A/c (Profit for the year)	20,000	
Accounts payable	8,40,000	
Accrued liabilities	47,000	
Total equity and liabilities	**9,85,000**	

Translate the above balances of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.) Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information: Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13

Solution: translation of balances for the purpose of consolidation:

	USD	Rate	L$
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	**9,85,000**		**8,71,682**
Issued capital	50,000	—	30,055
Opening retained earnings	28,000	—	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	**9,85,000**		**8,47,306**
Foreign Currency Translation Reserve (OCI)			**24,376**
Total equity and liabilities L$			**8,71,682**

When there is difference in reporting dates of reporting entity and foreign operation:

When there is difference in the year end of foreign operation and that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements.

When such financial statements are not prepared, Ind AS 110 allows the use of a different date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.

In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the end of the reporting period of the foreign operation. Adjustments are made for significant changes in exchange rates up to the end of the reporting period of the reporting entity in accordance with Ind AS 110.

A similar approach is used in applying the equity method to associates and joint ventures in accordance with Ind AS 28, Investment in Associates and Joint Ventures.

Intra group transactions:

- Although intra-group balances are eliminated on consolidation, any related foreign exchange gains or losses will not be eliminated. This is because the group has a real exposure to a foreign currency since one of the entities will need to obtain or sell foreign currency in order to settle the obligation or realise the proceeds received.
- Accordingly, in the consolidated financial statements of the reporting entity, the exchange difference arising on such intra group transactions is recognised in the statement of profit or loss account, **unless it arises from a monetary item that forms part of a reporting entity's net investment in a foreign operation in which case it is taken to other comprehensive income.**

CONCEPT BUILDING EXAMPLE: Parent P has USD as its functional currency and Subsidiary S has Euro as its functional currency. P, whose reporting date is 31st March, lends USD 100 to S on 30th September,2023. S converted the loan amount received into Euro on receipt.

	USD	EURO
Exchange rate at 30th September 2023	1	1.5
Exchange rate at 31st March 2024	1	2

Entries in the book of subsidiary 'S'

		Debit (EURO)	Credit(EURO)
30 sept 23	Bank account Dr To intra book payable (Being intra group loan received)	150	 150
31st March 24	Exchange loss account (P&L) Dr To intra group payable (being exchange loss recognised on intra group loan)	50	 50

Entry in the book of parent 'P'

		Debit (USD)	Credit (USD)
30 sept 23	Intra book receivable Dr to Bank account To (Being intra group Loan issued)	100	 100

On consolidation at 31st March, 2024, the receivable and payable will be eliminated. However, an exchange loss equivalent to EURO 50 for the year ended 31st March, 2024 will remain on consolidation. This is appropriate because S will need to obtain USD in order to repay the liability. Therefore, the group has a foreign currency exposure. The exchange loss will be taken to consolidated profit or loss, **unless the loan forms part of P's net investment in S in which case it will be transferred to other comprehensive income at the time of consolidation.**

Question 11. The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due, and the exchange rate is USD 1 = Euro 2.2. How should the exchange difference, if any, be accounted for in the consolidated financial statements?

Solution: At year-end, S should restate its accounts payable to EURO 220, recognising a loss of Euro 20 in its profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.
For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate.
At the time of consolidation, USD 100 which will get eliminated against the receivable in the books of P but the exchange loss of EURO 20 recorded in the subsidiary's statement of profit or loss has no equivalent gain in the parent's financial statements. Therefore, exchange loss of EURO 20 will remain in the consolidated statement of profit or loss.

NOTE: - A Group may have intra-group transactions like sale and purchase of various assets such as property, plant and equipment, intangible assets or inventory. These transactions could result in intra-group profits or losses. At the time of consolidation, these profits / losses are eliminated until the profit or loss is realized i.e., when the asset is sold outside the group, depreciated, amortised or written off as per the requirements of Ind AS 110. The elimination of intra-group profits / losses arising from such transactions, like sales between entities that are consolidated, should be based on the spot rate i.e., the exchange rate of the date of the sale.

Question 12. M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 2023. The cost of these bottles was ₹830 lacs in the books of M Ltd at the time of sale. At the year-end i.e., 31st March, 2023, all these bottles were lying as closing stock and payable with G Ltd.
Euro is the functional currency of G Ltd. while Indian Rupee is the functional currency of M Ltd. Following additional information is available:
Exchange rate on 1st February, 2023 1 Euro = ₹83
Exchange rate on 31st March, 2023 1 Euro = ₹85

Provide the accounting treatment for the above in books of M Ltd. and G Ltd. Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary, in the books of M Ltd.

Solution: **Accounting treatment in the books of M Ltd (Functional Currency INR)**

M Ltd will recognize sales of ₹ 996 lacs (12 lacs Euro x 83) Profit on sale of inventory = 996 lacs – 830 lacs = ₹166 lacs.

On balance sheet date receivable from G Ltd. will be translated at closing rate i.e., 1 Euro = ₹85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹24 lacs. (i.e. (85 - 83) x 12 Lacs)

Journal entries in the book of M Ltd

	₹ (in Lacs)	**₹ (in Lacs)**
G Ltd. A/c Dr. To Sales (Being revenue recorded on initial recognition)	996	996
G Ltd. A/c Dr. To Foreign exchange difference (unrealised) (Being foreign exchange difference recorded at year end)	24	24

Accounting treatment in the books of G Ltd (Functional currency EURO): - G Ltd will recognize inventory on 1st February, 2023 of Euro 12 lacs which will also be its closing stock at year end.

Journal Entry:

	(in Euros)	**(in Euros)**
Purchase Dr. To M Ltd.	12 lakhs	12 lakhs

Accounting treatment in the consolidated financial statements: - Receivable and payable in respect of above mentioned sale / purchase between M Ltd and G Ltd will get eliminated.

The closing stock of G Ltd will be recorded at lower of cost or NRV.

	Euro (in lacs)	**Rate**	**₹ (in lacs)**
Cost	12	83	**996**
NRV (Assumed Same)	12	85	1020

Therefore, no write off is required.

The amount of closing stock of Rs. 996 lacs include two components–

- Cost of inventory for ₹ 830 lacs; and
- Profit element of ₹ 166 lacs; and

At the time of consolidation, the second element amounting to ₹166 lacs will be eliminated from the closing stock.

Journal Entry:

	₹ (in Lacs)	₹ (in Lacs)
Consolidated P&L A/c Dr. To Inventory (Being profit element of intragroup transaction eliminated)	166	166

CONCEPT OF NET INVESTMENT IN FOREIGN OPERATION:

A monetary item receivable/payable from/to foreign operation may form part of net investment in foreign operation if settlement of such receivable/payable in neither planned nor likely to occur in foreseeable future. Such monetary items long term loans whose repayment plan is not defined, loan repayable on demand with no intention of repayment **but never include trade receivable or trade payable.**

Treatment of such items:

(i) In separate financial statement / individual financial statement: –

- Intra group transactions will appear in their financial statements.

- exchange differences on such transactions are recognised in P& L account. (As in case of treatment of monetary items.)

(ii) in Consolidated financial statement: --

- Intra group transactions will be eliminated in their financial statements.

- exchange differences on such transactions will not be eliminated.

- exchange difference is initially recognised in Other Comprehensive Income (OCI) because loss/profit due to exchange difference will never be realised due to non-settlement of such loan in foreseeable future.

- and if such loan is settled in coming future, then only it will be re-classified from equity (OCI) to profit & loss account on its disposable.

Question 13. Entity A, whose functional currency is ₹, has a foreign operation, Entity B, with a Euro functional currency. Entity B issues to A perpetual debt (i.e., it has no maturity) denominated in euros with an annual interest rate of 6%. The perpetual debt has no issuer calloption or holder put option. Thus, contractually it is just an infinite stream of interest payments in Euros.

In A's consolidated financial statements, can the perpetual debt be considered, in accordance with Ind AS 21 para 15, a monetary item "for which settlement is neither planned nor likely to occur in the foreseeable future" (i.e., part of A's net investment in B), with the exchange gains and losses on the perpetual debt therefore being recorded in equity?

Solution: Yes, as per Ind AS 21 net investments in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation.

As per para 15 of Ind AS 21, an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Analysis on the basis of above-mentioned guidance:

Through the origination of the perpetual debt, A has made a permanent investment in B. The interest payments are treated as interest receivable by A and interest payable by B, not as repayment of the principal debt. Hence, the fact that the interest payments are perpetual does not mean that settlement is planned or likely to occur. The perpetual debt can be considered part of A's net investment in B.

In accordance with para 15 of Ind AS 21, the foreign exchange gains and losses should be recorded in equity at the consolidated level because settlement of that perpetual debt is neither planned nor likely to occur.

FULL DISPOSAL OR PARTIAL DISPOSAL OF FOREIGN OPERATIONS:

(a) FULL DISPOSAL OF FOREIGN OPERATIONS:

- A disposal may arise, for example, through sale, liquidation or repayment of share capital. On disposal of the foreign operation, the cumulative exchange differences relating to that foreign operation recognised in other comprehensive income(OCI) and accumulated in equity are reclassified from equity to profit or loss (reclassification adjustment) when the gain or loss on disposal is recognised.
- On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences related to that foreign operation that have been attributed to the non- controlling interests is derecognised, but it is not reclassified to profit or loss.
- In addition to the disposal of an entity’s entire interest in a foreign operation, the following partial disposals are accounted for as (Full) disposals:

- ♦ when the partial disposal involves the loss of control of a subsidiary that includes a foreign operation, regardless of whether the entity retains a non-controlling interest (NCI) in its former subsidiary after the partial disposal; and
- ♦ when the retained interest after the partial disposal of an interest in a joint arrangement or a partial disposal of an interest in an associate that includes a foreign operation is a financial asset that includes a foreign operation.

Example: Parent P owns 100 percent of foreign subsidiary S. P sells 70 percent of its investment and loses control of S. The entire balance in the foreign currency translation reserve in respect of S is reclassified to profit or loss.

(b) Partial disposal of foreign operation:

A partial disposal of an entity’s interest in a foreign operation is any reduction in an entity’s ownership interest in a foreign operation, except for those reductions that are accounted for as (full) disposals.

In the case of the partial disposal of a subsidiary that includes a foreign operation, the entity re- attributes the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the NCI in that foreign operation.

In any other partial disposal of a foreign operation, the entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income (OCI).

EXAMPLE 2. Parent P owns 100 percent of foreign subsidiary S. P sells 10 percent of its investment and retains control over S. Therefore, 10 percent of the balance in the foreign currency translation reserve is reclassified to NCI.

EXAMPLE 3. Parent P owns 35 percent of foreign associate B. P sells a 5 percent stake and retains significant influence over B. Therefore, one-seventh (5/35) of the balance in the foreign currency translation reserve is reclassified to profit or loss.

NOTE: - A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

ACCOUNTING OF CHANGE IN FUNCTIONAL CURRENCY:

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

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

DISCLOSURES REQUIREMENTS:

Ind AS 21 requires following disclosures:

(a) amount of exchange differences recognised in profit or loss;

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

(c) when the presentation currency is different from the functional currency - that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency;

(d) in case of change in functional currency of either the reporting entity or a significant foreign operation:

- (i) fact of such change;
- (ii) reason for the change and;
- (iii) date of change in functional currency;

(e) if presentation currency is different from functional currency, the financial statements can be described as complying with Ind AS only if all Ind AS including the translation method of this Standard is complied with.

However, if an entity presents its financial statements or supplementary financial information in a currency other than its functional or presentation currency:

PRACTICE QUESTIONS:

Question 14. Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ₹ 1,500 lakhs. The net assets of S are ₹1,000 and the NCI in S is ₹100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of ₹ 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of ₹180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ₹20 lakhs. Calculate P's gain on disposal in its consolidated financial statements.

Solution: P's gain on disposal in its consolidated financial statements would be calculated in the following manner:

	(₹ in Lakhs)
Sale proceeds	1,500
Net assets of S	(1,000)
NCI derecognized	100
Foreign currency translation reserve	180
Gain on disposal	780

Question 15. On 1st January, 2023, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= ₹68. P Ltd. is not required to pay for this purchase until 30th June, 2023. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2023 the exchange rate was $1 = ₹65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees, which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same. Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2023 as per Ind AS.

Solution: As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date i.e., 1st January, 2023. Therefore, the amount initially recognised would be ₹1,36,00,000 ($ 2,00,000 x 68).

The liability is a monetary item so it is retranslated using the rate of exchange in force at 31st March, 2023. This makes the closing liability of ₹1,30,00,000 ($ 2,00,000 x 65).

The loss on re-translation of ₹6,00,000 (1,36,00,000 – 1,30,00,000) is recognised in the statement of profit or loss.

The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of ₹68 to $ 1.

Depreciation of ₹8,50,000 (1,36,00,000 x ¼ x 3/12) would be charged to profit or loss for the year ended 31st March, 2023.

Question 16. DELETED

Question 17. Global Limited, an Indian company acquired on 30th September, 2023 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 2024.

(i) The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 2023. The exchange rates as at 30th September, 2023 was ₹82/ EURO and at 31st March, 2024 was ₹84 / EURO. What is the value at which the goodwill has to be recognised in the financial statementsof Global Limited as on 31st March, 2024?

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 2024. The exchange rate on the date of purchase by Global Limited was ₹83 / EURO and on 31st March, 2024 was ₹84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 2024. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements.

Solution: **(i)** Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated atthe closing rate in accordance with paragraphs 39 and 42. In this case the amount of goodwill will be as follows:

Net identifiable asset	Dr	23 million	
Goodwill (bal. fig.)	Dr	1.4 million	
To Bank			17.5 million
To NCI (23 x 30%)			6.9 million

Thus, goodwill on reporting date would be 1.4 million EURO x ₹ 84 =₹117.6 million

(ii)

Particulars	**EURO in million**
Sale price of Inventory	4.20
Unrealised Profit [a]	1.80

Exchange rate as on date of purchase of Inventory [b] ₹83 / Euro Unrealized profit to be eliminated [a x b] ₹149.40 million. As per para 39 of Ind AS 21 "income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the datesof the transactions". In the given case, purchase of inventory is an expense item shown in the statementprofit and loss account. Hence, the exchange rate on the date of purchase of inventoryis taken for calculation of unrealized profit which is to be eliminated on the event of consolidation.

1.7--- IND AS -23 (BORROWING COSTS)

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

Scope: 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. For example, dividend on equity/ irredeemable preference shares, cost of raising share capital etc.

An entity is not required to apply the Standard to borrowing costs directly attributable to the acquisition,construction or production of:

(a) a qualifying asset **measured at fair value**, for example, a biological asset; or

(b) inventories that are **manufactured**, or otherwise produced, **in large quantities on a repetitive basis.**

Question 1. A company deals in production of dairy products. It prepares and sells various milk products like ghee, butter and cheese. The company borrowed funds from bank for manufacturing operation. The cheese takes substantial longer period to get ready for sale.

State whether borrowing costs incurred to finance the production of inventories (cheese) that have along production period, be capitalised?

Answer: Ind AS 23 does not require the capitalisation of borrowing costs for inventories that are manufactured in large quantities on a repetitive basis. Since cheese are produced in large quantities on a repetitive basis, interest capitalisation is not permitted.

Key definitions:

1. Meaning of borrowing costs: - Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs may include:

(a) Interest expense calculated using the effective interest method as described in Ind AS 39 Financial Instruments: Recognition and Measurement;

(b) Finance charges in respect of finance leases recognised in accordance with Leases; and

(c) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

2. Qualifying assets: A qualifying asset is an asset that necessarily **takes a substantial period of time to get ready for its intended use or sale.** Example of qualifying assets are manufacturing plants, real estate, infrastructure assets such as bridges and railways, intangible assets, investment properties, bearer plants, inventories etc.

- Assets that are ready for their intended use or sale when acquired are not qualifying assets.

Substantial period of time - Ind AS-23 does not provide any guidance on what constitutes a 'substantial period of time'. The specific facts and circumstances should be considered in each case. **It is likely that a period of 12 months or more might be considered 'substantial'.**

Treatment of 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.

Treatment of exchange differences to be included in borrowing costs:
The extent to which exchange differences can be considered as borrowing cost depends on the terms and conditions of the foreign currency borrowing.

The gains and losses that are an adjustment to interest costs include the interest rate differential between borrowing costs that would be incurred if the entity borrowed funds in its functional currency and borrowing costs actually incurred on foreign currency borrowings. An entity may borrow funds in a currency that is not its functional currency e.g. A Company with INR functional currency may take US dollar loan for financing asset development project in a company.

This may have been done on the basis that, over the period of the development of asset, the borrowing costs, even after allowing for exchange differences, were expected to be less than the interest cost of an equivalent INR loan.

Following approach is to be followed for determining the extent to which the exchange difference should be treated as borrowing costs:

(i) The adjustment should be of an amount which is equivalent to the extent to which the exchange loss does not exceed the difference between the cost of borrowing in functional currency when compared to the cost of borrowing in a foreign currency.

Question 2. An entity can borrow funds in its functional currency (₹) @ 12%p.a. It borrows $1,000 @ 4% p.a on 1st April, 2021 when $1 = ₹40 from a foreign bank for construction of its plant in India. The equivalent amount in functional currency is ₹40,000. Interest is payable on 31st March, 2022. On 31st March, 2022, exchange rate is $1 = ₹50. The loan is not due for repayment. Explain the treatment of foreign exchange loss/ gain as per Ind AS-23.

Solution: The borrowing cost i.e., interest on loan is ₹2,000 ($ 1,000 x 4% x ₹50). It will be capitalised and added to the cost of plant.

The exchange loss on 31st March 2022, in this case is ₹10,000 [$1,000x (₹50- ₹40)].

Had the entity borrowed funds in functional currency, the borrowing cost would have been ₹4,800 (₹40,000 x 12%).

The entity will treat exchange difference upto ₹2,800 (₹4,800 – ₹2,000) as a borrowing cost that will be eligible for capitalisation under this Standard and remaining exchange loss (i.e., 10,000 – 2,800) will be debited to profit and loss account.

Question 3. Assume in previous question number 2, the exchange rate on 31st March 2022 is $ 1= ₹41

Solution: If the exchange rate on 31st March, 2022, is $1 = ₹41.

The borrowing cost i.e., interest on loan is ₹2,000 ($ 1,000 x 4% x ₹50). It will be capitalised and added to the cost of plant.

The exchange loss on 31st March 2022, in this case is ₹1,000 [$ 1,000 – (₹41 – ₹40)].

Had the entity borrowed funds in functional currency the borrowing cost would have been ₹4,800 (₹40,000 x 12%).

The entity will treat exchange difference up to ₹2,800 (₹4,800 – ₹2,000) as a borrowing cost that will be eligible for capitalisation under this Standard.

Here loss due to increase in foreign exchange rate (i.e., ₹1,000) does not exceed ₹2,800. Hence whole ₹1,000 will be capitalised to the cost of plant.

Thus, the total eligible borrowing cost to be capitalised is ₹3,000 (₹2,000 + ₹1,000).

(ii) where there is an unrealised exchange loss which is treated as an adjustment to interest and subsequently there is a realised or unrealised gain in respect of the settlement or translation of the same borrowing, the gain to the extent of the loss previously recognised as an adjustment should also be recognised as an adjustment to interest."

Question 4. Assume in question 2, exchange rate on 31-3-2023 is $1=₹48; Explain the further treatment of foreign exchange loss as on 31st March 2023.

Solution: If the exchange rate on 31st March, 2023, is $1 = ₹48;
The exchange rate on 31st March, 2022, being $ 1= ₹50, the borrowings are still not due for payment. The entity will recognise a borrowing cost (Interest) of ₹1,920 ($ 1,000 x 4% x ₹48).
There is an exchange gain of ₹2,000 ($ 1,000 x (₹50 – ₹48). This will be adjusted (deducted) in the borrowing cost as there is unrealised exchange loss and the adjustment is less than the exchange loss of ₹2,800 recognised in earlier year.

Question 5. Assume in question 2, exchange rate on 31-3-2023 is $1=₹44; Explain the further treatment of foreign exchange loss as on 31st March 2023.

Solution: If the exchange rate on 31st March, 2023, is $ 1 = ₹44;

The exchange rate on31st March, 2022, being $1 = ₹50, the borrowings are still not due for payment. The entity will recognise a borrowing cost (interest) of ₹1,760 ($1,000 x 4% x ₹44).

There is an exchange gain of ₹6,000 [$ 1,000 x (₹50 – ₹44)]. This will be adjusted in the borrowing cost up to ₹2,800 as there is unrealised exchange loss and the adjustment of the exchange loss recognised in earlier years is of ₹2,800.

The remaining exchange gain of ₹ 3200 (6,000- 2,800) will be credited to profit and loss account.

Question 6. Assume in **question 2**, exchange rate on 31-3-2023 is $1=₹44 and $600 of the borrowings was paid on 31st March, 2022; Explain the further treatment of foreign exchange loss as on 31st March 2023.

Solution: If the exchange rate on 31st March, 2023, is $1 = ₹44 and part of loan is repaid; the exchange rate on 31st March, 2022, being $1 =₹50; $600 of the borrowings was paid on 31st March, 2022, $ 400 of the borrowings are still not due for payment. The entity will recognise a borrowing cost of ₹704 ($ 400 x 4% x ₹44). There is an exchange gain of ₹2400 [$ 400 x (₹50 – ₹44)]. The unrealised exchange loss of earlier year is ₹4,000 [$ 400 x (₹50 – ₹40)] out of which ₹1,120 (₹2,800 x $ 400 / $ 1000) was charged in 31st March, 2021, as borrowing cost. Thus, there will be an adjustment in the borrowing cost up to ₹1,120 as this is unrealised exchange loss.

Question 7. COC Ltd can borrow funds in its functional currency (₹) @ 15%p.a. It borrows $2,000 @ 10% p.a on 1st April, 2022 when $1 = ₹80 from a foreign bank for construction of its plant in India. Interest is payable on 31st March every year. On 31st March, 2023, exchange rate is $1 = ₹90. On 1st April 2023, entity repaid $1,500. On 31-3-2024 the exchange rate is $1=₹83. Explain the treatment of foreign exchange loss/ gain as per Ind AS-23 by making journal entries.

Question 8(H/W). ABC Ltd. has taken a loan of USD 20,000 on 1st April, 2023 for constructing a plant at an interest rate of 5% per annum payable on annual basis.

On 1st April, 2023, the exchange rate between the currencies i.e., USD vs Rupees was ₹45 per USD. The exchange rate on the reporting date i.e., 31st March, 2024 is (₹48 per USD).

The corresponding amount could have been borrowed by ABC Ltd from State bank of India in local currency at an interest rate of 11% per annum as on 1st April, 2023. Compute the borrowing cost to be capitalized for the construction of plant by ABC Ltd. for the period ending 31st March,2024.

Solution: In the above situation, the borrowing cost needs to determine for interest cost on such foreign currency loan and eligible exchange loss difference if any.

(a) Interest on foreign currency loan for the period:USD 20,000 x 5% = USD 1,000

Converted in ₹: USD 1,000 x ₹48/USD = ₹ 48,000

Increase in liability due to change in exchange difference: USD 20,000 x (48 - 45) = ₹60,000

(b) Interest that would have resulted if the loan was taken in Indian Currency:

USD 20,000 x ₹45/USD x 11% = ₹ 99,000

(c) Difference between interest on foreign currency borrowing and local currency borrowing:

₹99,000 - 48,000 = ₹51,000

Hence, out of exchange loss of ₹60,000 on principal amount of foreign currency loan, only exchange loss to the extent of ₹51,000 is considered as borrowing costs.

Total borrowing cost to be capitalized is as under:

(a)	Interest cost on borrowing	₹48,000
(b)	Exchange difference to the extent considered to be an adjustment to Interest cost	₹ 51,000
		₹ 99,000

The exchange difference of ₹51,000 has been capitalized as borrowing cost and the remaining ₹9,000 will be expensed off in the Statement of Profit and loss.

Recognition criteria: Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of the qualifying asset. Such borrowing cost are capitalised when below two conditions are satisfied:

- it is probable that it will result in future economic benefits to the entity; and
- the costs can be measured reliably.

Other borrowing costs are recognised as an expense in the period in which they are incurred.

Treatment and accounting of specific borrowing costs:

- If an entity borrows funds specifically to obtain a qualifying asset, the borrowing costs that are directly related to that qualifying asset can be readily identified.
- The borrowings cost eligible for capitalisation would be the **actual** borrowing costs incurred during the period less any investment income on the temporary investment of those borrowings.

Note 1: ***A 'notional' borrowing cost cannot be capitalised.*** Ind AS 23 limits the amount that can be capitalised to the **actual borrowing costs incurred**.

Note 2: The standard does not address actual or imputed cost of equity. Where an entity has no borrowings and uses its own cash resources to finance the construction of property, plant and equipment, the entity cannot assume that interest that could have been earned on that cash represents forgone benefit and could be capitalised.

Note 3: In determining the amount of borrowing costs eligible for capitalisation during a period, **any investment income earned on such funds is deducted from the borrowing costs incurred.**

Question 9: Alpha Ltd. on 1st April, 2023 borrowed 9% ₹30,00,000 to finance the construction of two qualifying assets. Construction started on 1st April, 2023. The loan facility was availed on 1st April, 2023 and was utilized as follows with remaining funds invested temporarily at 7%.

	Factory Building	Office Building
1st April, 2023	5,00,000	10,00,000
1st October, 2023	5,00,000	10,00,000

Calculate the cost of the asset and the borrowing cost to be capitalized.

Solution:

Particulars	**Factory Building**	**Office Building**
Borrowing Costs	(10,00,000 x 9%) 90,000	(20,00,000 x 9%) 1,80,000
Less: Investment Income	(5,00,000 x 7% x 6/12) (17,500)	(10,00,000x7% x 6/12) (35,000)
	72,500	1,45,000
Cost of the asset:		
Expenditure incurred	10,00,000	20,00,000
Borrowing Costs	72,500	1,45,000
Total cost	**10,72,500**	**21,45,000**

Treatment and accounting of general borrowing costs:

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

Question 10. Beta Ltd had the following loans in place at the end of 31st March, 2024: **(Amount in '000)**

Loan	**1st April, 2023**	**31st March, 2024**
18% Bank Loan	1,000	1,000
16% Term Loan	3,000	3,000
14% Debentures	-	2,000

14% debenture was issued to fund the construction of Office building on 1st July, 2023 but the development activities has yet to be started.

On 1st April, 2023, Beta ltd began the construction of a Plant being qualifying asset using the existing borrowings. Expenditure drawn down for the construction was: ₹500,000 on 1st April, 2023 and ₹25,00,000 on 1st January, 2024. Calculate the borrowing cost that can be capitalised for the plant.

Answer: Capitalisation rate 16.5%**;** borrowing cost ₹1,85,625

Period of capitalisation:

- An entity is required to begin the capitalisation of borrowing costs as part of the cost of aqualifying asset **on the commencement date.**
- The commencement date is the date when the entity first meets all of the following conditions cumulatively on a particular date:
  - **(a)** it incurs expenditures for the asset;
  - **(b)** it incurs borrowing costs; and
  - **(c)** it undertakes activities that are necessary to prepare the asset for its intended use or sale.

Question 11. X Ltd is commencing a new construction project, which is to be financed by borrowing. The keydates are as follows:

(i) 15th May,2023: Loan interest relating to the project starts to be incurred.

(ii) 2nd June,2023: Technical site planning commences.

(iii) 19th June,2023: Expenditure on the project started to be incurred.

(iv) 18th July,2023: Construction work commences

Identify commencement date.

Solution: In the above case, the three conditions to be tested for commencement date would be: Borrowing cost has been incurred on: **15th May, 2023**

Expenditure has been incurred for the asset on: 19th June, 2023

Activities necessary to prepare asset for its intended use or sale: 2nd June, 2023

Commencement date would be the date when the above three conditions would be satisfied in **all i.e., 19th June, 2023**

Suspension of capitalisation:

Capitalisation of borrowing costs shall be suspended **during the extended periods in which the active development of a qualifying asset is suspended**. Such costs are costs of holding partially completed assets and do not qualify for capitalisation.

Capitalisation of borrowing cost **is not suspended when temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale.**

For example, capitalisation continues during the extended period when high water levels delay construction of a bridge, if such high-water levels are common during the construction period in the geographical region involved.

Cessation of capitalisation:

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

An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that are outstanding, this indicates that substantially all the activities are complete.

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

Disclosure requirements: An entity shall disclose:

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

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

Practice questions:

Question 12. Marine Transport Limited ordered 3 ships for its fleet on 1st April, 2022. It pays a down payment of 25% of the contract value of each of the ship out of long term borrowings from a scheduled bank. The delivery has to commence from the financial year 2019. On 1st March, 2024, the ship builder informs that it has commenced production of one ship. There is no progress on other 2 ships. Marine Transport Limited prepares its financial statements on financial year basis. Is it permissible for Marine Transport Limited to capitalise any borrowing costs for the financial year ended 31st March, 2023 or 31st March, 2024?

Solution: As per Ind AS 23, a qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

Ind AS 23 also states that an entity shall begin capitalising borrowing costs as part of the cost of a qualifying asset on the commencement date. The commencement date for capitalisation is the date when the entity first meets all of the following conditions:

(a) It incurs expenditures for the asset.

(b) It incurs borrowing costs.

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

The ship is a qualifying asset as it takes substantial period of time for its construction. Thus, the related borrowing costs should be capitalised. Marine Transport Limited borrows funds and incurs expenditures in the form of down payment on 1st April, 2022. Thus condition (a) and (b) are met. However, condition (c) is met only on 1st March, 2024, and that too only with respect to one ship. Thus, there is no capitalisation of borrowing costs during the financial year ended 31st March, 2023. Even during the financial year ended 31st March, 2024, borrowing costs relating to the 'one' ship whose construction had commenced from 1st March, 2024 will be capitalised from 1st March, 2024 to 31st March, 2024. All other borrowing costs are expensed.

Question 13(H/W). X Limited has a treasury department that arranges funds for all the requirements of the Company including funds for working capital and expansion programs. During the year ended 31st March, 2024, the Company commenced the construction of a qualifying asset and incurred the following expenses:

Date	**Amount (₹)**
1st July, 2023	2,50,000
1st December, 2023	3,00,000

The details of borrowings and interest there on are as under:

Particulars	**Average Balance (₹)**	**Interest (₹)**
Long term loan @ 10%	10,00,000	1,00,000
Working capital loan @ 13%	5,00,000	65,000
	15,00,000	1,65,000

Compute the borrowing costs that need to be capitalised.

Solution: The capitalisation rate is calculated as below:

Total borrowing costs / Weighted average total borrowings: 1,65,000/15,00,000 = 11%.

Interest to be capitalised is calculated as under:

— On ₹2,50,000 @ 11% p.a. for 9 months = ₹20,625

— On ₹3,00,000 @ 11% p.a. for 4 months = ₹11,000

Total interest capitalised for year ended 31 March 2024 is ₹ 31,625

Question 14. COC Ltd. commences building an asset on 1-4-2021. For this purpose, it issues debentures on the same date for ₹10,00,000 bearing an interest of 10%. During the year ending the company also raised general loans from financial Institutions as per details below:

1.7.2021 Rs. 5,00,000 @12% per annum

1.10.2021 Rs. 3,00,000 @15% per annum

Expenditures on the asset were as per details given below:

Date	**Amount (Rupees)**
1.4.2021	4,00,000
1.7.2021	8,00,000
1.10.2021	6,00,000
1.2.2022	3,00,000

The company earned an interest of ₹15.000 on temporary investments made with funds borrowed specifically for the asset. You are required to compute the amount of borrowing cost to be capitalised in relation to this asset.

Question 15. K Ltd. began construction of a new building at an estimated cost of ₹7 lakh on 1st April, 2023.To finance construction of the building it obtained a specific loan of ₹2 lakh from a financial institution at an interest rate of 9% per annum.

The company's other outstanding loans were:

Amount	**Rate of Interest per annum**
₹7,00,000	12%
₹9,00,000	11%

The expenditure incurred on the construction was:

April, 2023	₹1,50,000
August, 2023	₹2,00,000
October, 2023	₹3,50,000
January, 2024	₹1,00,000

The construction of building was completed by 31st January, 2024. Following the provisions of Ind AS 23 'Borrowing Costs', calculate the amount of interest to be capitalized and pass necessary journal entry for capitalizing the cost and borrowing cost in respect of the building as on 31st January, 2024.

Solution:

(i) Calculation of capitalization rate on borrowings other than specific borrowings:

Amount of loan (₹)	**Rate of interest**		**Amount of interest (₹)**
7,00,000	12%	=	84,000
9,00,000	11%	=	99,000
16,00,000			1,83,000
Weighted average rate of interest (1,83,000/16,00,000) x 100		=	11.4375%

(ii) Computation of borrowing cost to be capitalized for specific borrowings and general borrowings based on weighted average accumulated expenses:

Date of incurrence of expenditure	**Amount spent**	**Financed through**	**Calculation**	**Interest**
1st April, 2023	1,50,000	Specific borrowing	1,50,000 x 9% x 10/12	11,250
1st August, 2023	2,00,000	Specific borrowing	50,000 x 9% x 10/12	3,750
		General borrowing	1,50,000x11.4375% x 6/12	8,578.125
1st October, 2023	3,50,000	General borrowing	3,50,000x11.4375% x 4/12	13,343.75
1st January, 2024	1,00,000	General borrowing	1,00,000x11.4375% x 1/12	953.125
				37,875

Note: Since construction of building started on 1st April, 2023, it is presumed that all the later expenditures on construction of building had been incurred at the beginning of the respective month.

(iii) Total expenses to be capitalized for building:

	₹
Cost of building ₹ (1,50,000 + 2,00,000 + 3,50,000 + 1,00,000)	8,00,000
Add: Amount of interest to be capitalized	37,875
	8,37,875

(iv) Journal entry:

Date	Particulars	₹	₹
31.1.2024	Building account Dr. To Bank account To Interest payable (borrowing cost) (Being expenditure incurred on construction of building and borrowing cost there on capitalized)	8,37,875	 8,00,0000 37,875

Note: In the above journal entry, it is assumed that interest amount will be paid at theyear end. Hence, entry for interest payable has been passed on 31.1.2024.

Alternatively, following journal entry may be passed if interest is paid on the dateof capitalization:

Date	*Particulars*	₹	₹
31.1.2024	Building account Dr. To Bank account (Being expenditure incurred onconstruction of building and borrowing cost thereon capitalized)	8,37,875	8,37,875

Question 16: Kirloskar Ltd. had following general borrowings and investments in qualifying assets.

Source	Date of raising	Amount (₹)
12% Debentures	0.1.04.2023	15,00,000
15% Term Loan	0.1.04.2023	6,00,000
18% Term Loan	0.1.04.2023	4,00,000

Qualifying Assets	Amount (Rs)	Data of Commencement	Data of Completion
A	6,00,000	0.1.04.2023	31.01.2024
B	5,00,000	0.1.05.2023	31.03.2024
C	4,00,000	0.1.07.2023	---

With the help of these details determine for the year ended 31.03.2024

(a) The amount of the borrowing cost incurred
(b) The amount of borrowing cost to be capitalized for qualifying assets
(c) The amount of borrowing cost to be charged to revenue

Answer: (a) 3,42,000; (b) 1,72,140; (c) 1,69,860

Question 17: On April 1, 2024, MGH constructions undertook construction of a factory building for expansion purpose. Total cost of project was ₹3,00,00,000. The building was completed by end of March 2025 and during the period following payments were made:

Payment made	Amount
1st April 2024	20,00,000
30th June 2024	60,00,000
31st December 2024	1,80,00,000
31st March 2025	40,00,000
Total	**3,00,00,000**

MGH construction borrowings as at March 31, 2025 were as follow:

- **i.** 9% term loan amounting to ₹80,00,000 taken on December 31, 2023. Simple interest is payable annually. Amount outstanding as March 31, 2024 and during 24-25 is ₹80,00,000. The loan was taken specifically for the project.
- **ii.** 11% debentures issued on March 31, 2023 with simple interest payable annually. Amount outstanding for the year 24-25 is ₹1,50,00,000.
- **iii.** 10% bonds issued on December 31, 2022 amounting to ₹1,70,00,000. Simple interest payable at annual rest. Amount outstanding for the year 24-25 is ₹1,60,00,000.

How much borrowing cost should be capitalized for construction of the building as per AS-16 "Borrowing Cost"?

(CMA FINAL 8 Marks)

Answer: Capitalization % = 10.484% p.a

Question 18. On 1st April, 2023, entity A contracted for the construction of a building for ₹22,00,000. The land under the building is regarded as a separate asset and is not part of the qualifying assets. The building was completed at the end of March, 2024, and during the period the following payments were made to the contractor:

Payment date	Amount (₹ ’000)
1st April, 2023	200
30th June, 2023	600
31st December, 2023	1,200
31st March, 2024	200
Total	2,200

Entity A’s borrowings at its year end of 31st March, 2024 were as follows:

a. 10%, 4-year note with simple interest payable annually, which relates specifically to the project; debt outstanding on 31st March, 2024 amounted to ₹7,00,000. Interest of ₹65,000 was incurred on these borrowings during the year, and interest income of ₹20,000 was earned on these funds while they were held in anticipation of payments.

b. 12.5% 10-year note with simple interest payable annually; debt outstanding at 1st April, 2023 amounted to ₹10,00,000 and remained unchanged during the year; and

c. 10% 10-year note with simple interest payable annually; debt outstanding at 1st April, 2023 amounted to ₹15,00,000 and remained unchanged during the year.

What amount of the borrowing costs can be capitalized at year end as per relevant Ind AS ?

Solution: As per Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity should determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

Capitalisation rate $= \frac{(10,00,000 \times 12.5\%) + (15,00,000 \times 10\%)}{10,00,000 + 15,00,000} = 11\%$

Computation of interest on general borrowings:

Date	Expenditure	Amount allocated in general borrowings	Weighted for period Outstanding
1st April 2023	200,000	0	0
30th June 2023	600,000	100,000	1,00,000 × 9/12x 11% = 8,250
31st Dec 2023	12,00,000	12,00,000	12,00,000 × 3/12 x 11%= 33,000
31st March 2024	2,00,000	200.000	2,00,000 × 0/12 x 11%= 0
Total	**22,00,000**		**41,250**

*Specific borrowings of ₹7,00,000 fully utilized on 1st April & on 30th June to the extent of ₹5,00,000 hence remaining expenditure of ₹1,00,000 allocated to general borrowings.

Borrowing cost to be capitalized:	**Amount (₹)**
On specific loan	65,000
On General borrowing	41,250
Total	**1,06,250**
Less: interest income on specific borrowings	(20,000)
Amount eligible for capitalization	86,250

Question 19 (concept of effective rate of interest). How will you capitalise the interest when qualifying assets are funded by borrowings in the nature of bonds that are issued at discount?

Y Ltd. issued at the start of year 1, 10% (interest paid annually and having maturity period of 4 years) bonds with a face value of ₹2,00,000 at a discount of 10% to finance a qualifying asset which is ready for intended use at the end of year 2.

Compute the amount of borrowing costs to be capitalized if the company amortizes discount using Effective Interest Rate method by applying 13.39% p.a. of EIR.

Solution: As per the Standard, borrowing costs may include interest expense calculated using the effective interest method. Further, capitalisation of borrowing cost should cease where substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.

Thus, only that portion of the amortized discount should be capitalised as part of the cost of a qualifying asset which relates to the period during which acquisition, construction or production of the asset takes place.

Hence based on the above explanation the amount of borrowing cost of year 1 & 2 are to be capitalised and the borrowing cost relating to year 3 & 4 should be expensed.

The value of the bond to Y Ltd. is the transaction price ie ₹1,80,000 (2,00,000 – 20,000) Therefore, Y Ltd will recognize the borrowing at ₹1,80,000.

Computation of the amount of Borrowing Cost to be Capitalised:

Y Ltd will capitalise the interest (borrowing cost) using the effective interest rate of 13.39% for two years as the qualifying asset is ready for intended use at the end of the year 2, the details of which are as follows:

Year	Opening Borrowing	Interest @13.39% to be capitalized	Total	Interest paid	Closing Borrowing
1	1,80,000	24,102	2,04,102	20,000	1,84,102
2	1,84,102	24,651	2,08,753	20,000	1,88,753
		48,753			

Accordingly, borrowing cost of ₹48,753 will be capitalized to the cost of qualifying asset.

Question 20. Happy Ltd. has taken a loan of US $10 lakhs on 1st April, 2023, for a specific project at an interest rate of 10% p.a., payable annually. On 1st April, 2023, the exchange rate between the currencies was ₹65 per US $. The exchange rate, as at 31st March, 2024, 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, 2023. Show the treatment of borrowing costs as per Ind AS-23. **(ICMAI Study material)**

Solution: The following computation would be made to determine the amount of borrowing costs for the purposes of Ind 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 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 Ind AS-23 and the remaining ₹50,000 would be considered as the exchange difference to be accounted for as per Ind AS-21 “The Effects of Changes in Foreign Exchange Rates”.

Question 21. On 30.4.2022 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 crores.

(iv) Advance for Purchase of truck ₹50 lakhs.

In March 2024, 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 Ind AS-23.

Solution: As per Ind AS-23, 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 Ind AS-23, 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.

1.8-- IND AS-36 - Impairment of assets

OBJECTIVE: - The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount.

SCOPE: - Impairment of assets is recognized as per Ind AS 36 for assets including PPE, Intangible assets and goodwill but excluding:

(a) Inventories

(b) Biological assets (Ind AS 41)

(c) Non-current assets classified as held for sale (Ind AS 105)

(d) Assets arising from construction contracts (Ind AS 11)

(e) Deferred tax assets

(f) Assets arising from employee benefits (Ind AS 19)

(g) Financial assets (Ind AS 109)

Important definitions:

1. **Carrying amount** is the amount at which an asset is recognised after deducting any accumulated depreciation (amortisation) and accumulated impairment losses thereon.
2. **Corporate assets** are assets other than goodwill that contribute to the future cash flows ofboth the cash-generating unit under review and other cash-generating units.
3. **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 (refer Ind AS 113 Fair Value Measurement).
4. **Value in use** is the present value of the future cash flows expected to be derived from an asset or cash-generating unit

When is impairment of asset recognized?

The 'Ind AS 36' prescribes the procedure to ensure that its **assets are carried at no more than their recoverable amount.**

If it carrying amount exceeds the amount to be recovered through use or sale of the asset, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss.

An asset is impaired **when the carrying amount of the asset exceeds its recoverable amount.**

Recoverable amount is the higher of the fair value less cost to sell and value in use.

Question 1. X Ltd. purchased a machinery on 1.1.2016 for ₹ 20 lakhs. WDV of the machine as on 31.3.23 ₹ 12 lakhs. The Recoverable amount of the machine is ₹ 11 lakhs. What is the impairment loss?

Question 2. Carrying amount ₹ 200 lakhs. Net Selling Price (Fair value less cost of sell) ₹ 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 NSP and value in use)

Since, recoverable amount is more than carrying amount of asset, there will arise no impairment loss.

Question 3. C Ltd. acquired a machine for ₹ 3.2 crores on 1.1.2023. It has a life of 5 years with a salvage value of ₹ 40 lakhs. Apply the test of impairment on 31.3.2026:

(a) Present value of future cash flow ₹ 1.3 crores

(b) Fair value less cost to sell ₹ 1.2 crores

Answer: Carrying amount 1.38 crores; Impairment loss 0.08 crores.

Question 4. Carrying amount of Machinery and provision for depreciation and revaluation reserve appeared in the balance sheet as on 31 march 2024 are ₹8,00,000, ₹1,50,000 and ₹40,000 respectively. On 31.3.2024, Fair value less cost of sell and value in use were estimated at ₹5,40,000 and 5,10,000 respectively. Show its treatment in the books of account as per Ind AS-36.

QUESTION 5. A Ltd. Has a machine whose original cost was ₹45,000. The accumulated depreciation on the machine is ₹15,000. Similar machine has recently been sold in the same locality at ₹25,000 with selling expenses ₹2,000. Management determined the entity specific present value of future cash flows of the machine as ₹28,000. Find

(a) Fair value less cost to sell

(b) Recoverable amount

(c) Impairment loss

(d) Carrying amount of the machine after impairment. **(ICMAI Study material)**

Solution:

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

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

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

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

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

Question 6. Mars Ltd. gives the following estimates of cash flows relating to property, plant and equipment on 31st March, 2024. The discount rate is 15%.

Year	*Cash Flow (₹ in lakh)*
2024-2025	*2,000*
2025-2026	*3,000*
2026-2027	*3,000*
2027-2028	*4,000*
2028-2029	*2,000*
Residual Value at 31st March, 2029	*500*

Property, plant & equipment was purchased on 1st April, 2021 for ₹20,000 lakh

Useful Life was 8 Years

Residual value estimated at the end of 8th year 500 lakhs

Fair value less cost of disposal ₹10,000 lakhs

Calculate impairment loss, if any on the PPE. Also calculate the revised carrying amount and revised depreciation on PPE.

Solution: **carrying amount on 31st March 2024 – ₹12,687: value in use ₹9,513; recoverable amount ₹10,000; impairment loss ₹2,687; revised carrying amount ₹10,000; revised depreciation/year ₹1,900.**

Special issues about impairment of assets:

1. Recoverable amount is determined for **an individual asset**. But If the asset does not generate cash inflows that are largely independent of those from other assets, **then recoverable amount is determined for cash generating unit to which the asset belongs.**

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

Example: A bus company provides services under contract with a municipality that requires minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Since the entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit for each route is the bus company as a whole.

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

Following are indications that an asset any be impaired: -

a) External Sources of Indications: -

- **i.** If market value has declined significantly.
- **ii.** Significant technological change (production **of Typewriter, mobile phone without touch button)** or change in
- **iii.** market **(company moving from an existing market),** economic or legal environment in which enterprise operates.
- **iv.** Market interest rate on investments have significantly increased**. (running factory of power generation project with foreign loan and increase in interest expense).**

b) Internal Sources of Indications: -

- **i.** Evidence is available of **physical damage or obsolescence** of an asset.
- **ii.** **Plan to discontinue or restructure** the operation to which an asset belongs.
- **iii.** Evidence is available that the economic performance of an asset is or will be worse than expected.

Note: -Above given examples are not exhaustive. An enterprise may identity other indications also.

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

4. Irrespective of whether there is any indication of impairment, an entity is required to test following items for impairment **at least annually:**

a) intangible asset with an indefinite useful life;

b) intangible asset not yet available for use; and

c) goodwill acquired in a business combination for impairment.

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

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

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

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

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

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

(i) Its net selling prices

(ii) Its value in use

(iii) zero

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

9. Reversal of impairment loss: If the recoverable amount subsequently increases, the previously recognizedimpairment loss shall be reversed not exceeding the carrying amount without any impairment.

- An impairment loss recognised for goodwill shall not be reversed in a subsequent period.

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

Question 7. An entity has the following assets with relevant data on the reporting data: (₹ in Lakhs)

Assets	Carrying amount	Fair value less cost to sell	Value in use
A	280	300	250
B	460	400	390
C	220	200	170
D	180	115	125
E	100	80	—

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

Determine impairment loss and revised carrying amount of all the assets stated above. Show the accounting treatment. **(ICMAI Study material)**

Question 8. An entity has a machinery on 01.04.2023 with carrying amount of ₹28,00,000 after annual depreciation of ₹3,00,000 with remaining useful life of 9 years and residual value of ₹1,00,000. Depreciation is charged on straight line method. In 31.03.2024 the machine is revalued at ₹29,00,000. On 31.03.2026 the machine has fair value less cost to sell ₹20,00,000 and value in use ₹21,00,000. Show how the transactions would be reflected in the financial statements of the entity as on 31.03.24, 31.03.25, 31.03.26 and 31.03.27. **(ICMAI Study material)**

Solution: **Working Note 1:**

Carrying Amount on 01.04.2023	28,00,000
Less: Depreciation during 2023-24	3,00,000
	25,00,000
Add: Revaluation Profit (₹29,00,000 – ₹25,00,000)	4,00,000
Carrying out on 31-03-2024	29,00,000
Less Depreciation during 2024-2025 = (₹29,00,000 – ₹1,00,000)/8	3,50,000
Carrying and on 31-03-25	25,50,000
Less Depreciation during 2025-2026	3,50,000
Carrying out on 31-03-2006	22,00,000
Less Impairment loss (Carrying amt less recoverable amount. # = 2200000 - 2100000)	1,00,000
Carrying amt on 31.03.2026	21,00,000
Less Depreciation during 2026-2027 = (₹21,00,000 – ₹1,00,000)/6	3,33,333
Carrying Amount on 31.3.27	**17,66,667**

Statement of profit and loss:	**31-3-24**	**31-3-25**	**31-3-26**	**31-3-27**
Depreciation	(–)3,00,000	(–) 3,50,000	(–) 3,50,000	(–) 3,33,333
Other comprehensive Income:				
Revaluation Profit	+ 4,00,000			
For Annual realization of revaluation Profit through depreciation transfer from Revaluation profit to retained earnings [Note 2]				
Revaluation Profit (OCI)		(–) 50,000	(–) 50,000	(–) 33,333
P & L		+ 50,000	+ 50,000	+ 33,333
Impairment loss charged against revaluation profits			(–) 1,00,000	
Balance Sheet:	**31.03.18**	**31.03.19**	**31.03.20**	**31.03.21**
PPE – Machinery	29,00,000	25,50,000	21,00,000	17,66,667
Revaluation Profit under Other equity [Note 3]	4,00,000	3,50,000	2,00,000	1,66,667

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

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

Question 7. Saturn India Ltd is reviewing one of its business segments for impairment. The carrying value of its net assets is 40 million. Management has produced two computations for the value-in-use of the business segment. The first value of ₹36 million excludes the benefit to be derived from a future reorganization, but the second value of ₹44 million includes the benefits to be derived from the future reorganization. There is not an active market for the sale of the business segments. Whether the business segment needs to be Impaired?

Solution: The benefit of the future reorganization should not be taken into account in calculating value-in-use. Therefore, the net assets of the business segment will be impaired by ₹4 million because the value- in-use of ₹36 million is lower than the carrying value of ₹40 million. The value-in-use can be used as the recoverable amount as there is no active market for the sale of the business segment.

Question 8. Mercury Ltd. has an identifiable asset with a carrying amount of ₹1,000. Its recoverable amount is ₹650. The tax rate is 30% and the tax base of the asset is ₹800. Impairment losses are not deductible for tax purposes. What would be the impact of impairment loss on related deferred tax asset / liability against the revised carrying amount of asset?

Solution: **the effect of impairment loss is as follows:**

	Identifiable assets before impairment loss	**Impairment loss**	**Identifiable assetsafter impairment loss**
Carrying amount	1,000	(350)	650
Tax Base	800	-	800
Taxable(deductible) temporary difference	200	(350)	(150)
Deferred tax liability (asset) at 30%	60	(105)	(45)

Question 9. Earth Infra Ltd has two cash-generating units, A and B. There is no goodwill within the units' carrying values. The carrying values of the CGUs are CGU A for ₹20 million and CGU B for ₹30 million. The company has an office building which it is using as an office headquarter and has not been included in the above values and can be allocated to the units on the basis of their carrying values. The office building has a carrying value of ₹10 million. The recoverable amounts are based on value-in-use of ₹18 million for CGU A and ₹38 million for CGU B. Determine whether the carrying values of CGU A and B are impaired. **(ICAI Study material)**

Solution: The office building is a corporate asset which needs to be allocated to CGU A and B on areasonable and consistent basis:

	A	B	Total
Carrying value of CGU Allocation of office building in the ratio of carrying value of CGU	20 4	30 6	50 10
Carrying value of CGU after allocation of corporate asset	24	36	60
Recoverable amount	18	38	56
Impairment loss	**6**	**nil**	

Impairment loss will be allocated on the basis of 4/24 against the building (₹1 million) and 20/24 against the other assets (₹5 milloin)

1.9--Ind AS-38 (Intangible assets)

Objective: This Standard requires an entity to recognise an intangible asset if, and only if, specified criteria are met. This standard specifies the requirement of recognition, measurement and disclosures of Intangible Assets.

Meaning: - An intangible asset is an **identifiable** non-monetary **asset** without **physical substance**.

Note 1. **Meaning of Identifiable--** separable and transferable individually or arises from a contract.

Note 2. **An asset** is a resource:

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

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

Note 3: **Controlled by an entity** means power to obtain those benefits **and** ability to restrict others to access those benefits.

Example of Intangible asset: trade mark, patents, copyrights, customer lists, franchises, computer software, technical know-how, licences, goodwill, masthead etc.

Following are not considered as intangible assets:

(i) Market share – because it is not identifiable.

(ii) Marketing and advertisement campaign (i.e., promotional activity)- future economic benefit are not certain.

(iii) Staff training programme – since entity has no control over the staff as they can resign anytime. **But if there is some restriction for period of working then it may be treated as intangible asset.**

Scope:- It excludes:

(i) Financial assets.

(ii) The recognition and measurement of exploration for and evaluation of Mineral resources (Ind AS 106),

(iii) Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources; **and**

(iv) intangible assets that are within scope of another standard — for example.

(a) Ind AS 2: Inventory

(b) Ind AS 12: Income Taxes

(c) Ind AS 116: Leases

(d) Ind AS 19: Employee Benefits

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

(f) Ind As 103: Business combination

(g) Ind AS 104: Insurance contracts

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

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

Intangible assets contained in or on a physical substance: Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent) or film. In determining whether an asset that incorporates both tangible and intangible elements should be treated under Ind AS 16, Property, Plant and Equipment, or as an intangible asset under this Standard, an entity uses judgement to assess which element is more significant.

For example, computer software for a computer-controlled machine tool that cannot operate without that specific software is an integral part of the related hardware and it is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

Recognition criteria:

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

(a) The asset is identifiable and controlled by the entity,
(b) Future economic benefits will flow to the entity,
(c) Cost can be measured reliably.

Cost includes any directly attributable cost necessary to bring intangible asset to the condition intended by the management.

Computation of cost of Intangible asset purchased or internally generated (called constructed in case of PPE):

Purchase price xxxx

Less: trade discount/rebate

Add: any import duty, purchase taxes (e.g. excise tax, GST only if non-refundable)

Add: legal charges

Add: professional/ consultant/advisor fees.

Add: customization cost/charges (generally in case of software)

Add: testing/trial run cost

Add: employment costs (e.g. salary /charges paid for software coding etc)

Add: **any other development phase expense. (in case of internally generated intangible asset)**

Add: any other directly attributable cost

Following costs are not included in the cost of intangible assets:

(i) Staff training cost,

(ii) cost of introducing or launching intangible assets,

(iii) advertisement/promotional cost,

(iv) preliminary expenses,

(v) administrative, general, selling and distribution expenses,

(vi) allocated overheads,

(vii) operating losses,

(viii) purchase of maintenance contract for intangible assets,

(ix) subsequent cost of intangible assets (e.g. annual fees, royalty as % of sales/production etc),

(x) cash discount,

(xi) interest on loan to purchase or internally generated asset (unless allowed by Ind AS 23)

(xii) Research phase expenses (in case of internally generated intangible asset).

Specific points to remember in case of internally generated intangible asset:

Intangible asset is internally generated in two phases:

(i) Research phase: - it includes planned investigation to gain new knowledge. Expenditures incurred during research phase is not recognized as cost of intangible asset. They are expensed.

(ii) Development phase: - This phase comes after the research phase. it means the stage of application of research findings to develop the intangible asset.

Development phase starts after establishment of technical feasibility and regulatory approval. **It is the date on which recognition criteria of internally generated intangible asset is met.**

The necessary conditions to be satisfied for capitalization of development expenditures are —

(i) Technical feasibility
(ii) Intention and ability to complete the intangible asset and to use or sell it.
(iii) Ability to measure the expenditure
(iv) Technical, financial and other resource to complete it and to use or sell it.
(v) Ability to generate future economic benefits.

Expenses incurred during development phase are capitalized and hence recognized as cost of intangible asset.

Note 1: **Internally generated** goodwill, brands, mastheads, publishing titles, customer lists and similar items are not recognized as intangible assets since their cost cannot be measured accurately. They all are expensed.

Note 2. Internally generated intangible assets may not be shown by the company in its book of account if recognition criteria are not met. **But in case of business combination, acquirer company may show** in his books such internally generated assets **at Fair value** if recognition criteria are met.

Note 3: If research project (expenses on research phase) is acquired in a business combination**, then it is recognized as intangible asset at fair value.**

Subsequent measurement – exactly same as we have already studied in Ind AS 16- PPE.

Cost model: - The intangible asset will be carried at cost less accumulated amortization and impairment losses.

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

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

Accounting of intangible assets (purchased or internally generated)

(i) when purchased/ internally generated

Intangible asset account Dr

To bank /payable account

(ii) At the year end:

- **For amortization of intangible assets:**

  Amortization expense account Dr

  To intangible asset

  OR

  Amortization expense account Dr

  To provision for amortization account

- **For transferring amortization to profit & loss account:**

  Profit & loss account Dr

  To amortization expenses account

(iii) if intangible asset is acquired on deferred settlement terms:

- **Same as discussed in Ind AS-16**

(iv) if intangible asset is acquired in exchange of other assets:

- **Same as discussed in Ind AS-16**

(v) If goodwill is acquired in a business combination- apply Ind AS 103.

Amortisation of Intangible assets: -

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

(ii) Amortization of intangible asset begins when it is available for use (i.e. ready for use)

(iii) Amortization of intangible asset ceases when it is – de-recognised (i.e sold) **OR** classified as held for sale.

(iv) Methods of charging impairment:

(A) straight line method

(B) diminishing value method

(C) unit of production method.

(v) Estimated useful life is considered for charging depreciation. **Legal life of** intangible asset **is not relevant.**

(v) Change in method of amortisation, useful life, residual value - it is change in accounting estimate **and applied with prospective effect from the year of change.**

Treatment of Gain or loss on sale of intangible assets: recorded in profit & loss account.

Question 1. After acquiring control of the subsidiary company, the draft of consolidated balance sheet of parent included thefollowing intangible assets which did not appear in the draft individual balance sheet of the subsidiary:

(i) Customers list

(ii) Publishing titles

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

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

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

Question 2. Venus India Private Ltd acquired a software for its internal use costing ₹10,00,000. The amount payable for the software was ₹600,000 immediately and ₹400,000 in one year time. The other expenditure incurred were: -

Purchase tax: ₹1,00,000

Entry Tax: 10% (recoverable later from tax department)

Legal fees: ₹87,000

Consultancy fees for implementation: ₹1,20,000

Cost of capital of the company is 10%. Calculate the cost of the software on initial recognition using the principles of Ind AS 38 Intangible Assets.

Solution:

Particulars	**Amount in ₹**
Cash paid	600,000
Deferred consideration (₹400,000/1.1)	3,63,636
Purchase Tax	1,00,000
Entry tax (not to be considered as it is a refundable tax)	-
Legal fees	87,000
Consultancy fees for implementation	1,20,000
Total cost to be capitalised	**12,70,636**

Question 3. On 31st March,2024, Earth India Ltd. paid ₹50,00,000 for a 100% interest in Sun India Ltd. At that date Sun Ltd.'s net assets had a fair value of ₹30,00,000. In addition, Sun Ltd. also held the following rights:

- Trade Mark named "GRAND" – valued at ₹180,000 using a discounted cash flow technique.
- Sole distribution rights to an electronic product; future cash flows from which are estimated to be ₹150,000 per annum for the next 6 years. 10% is considered an appropriate discount rate.The 6-year, 10% annuity factor is 4.36.

Calculate goodwill and other Intangible assets arising on acquisition.

Solution:

Particulars	**Amount**	**Amount**
Purchase Consideration		50,00,000
Net Asset acquired	30,00,000	
Trade Mark	1,80,000	
Distribution Rights (1,50,000 x 4.36)	6,54,000	
Total		(38,34,000)
Goodwill on Acquisition		11,66,000

Question 4. Expenditure on a new production process in 2023-2024: `

1st April to 31st December	2,700
1st January to 31st March	900
	3,600

The production process met the intangible asset recognition criteria for development on 1st January, 2024. The amount estimated to be recoverable from the process is ₹1,000 on 31st March 2024.

Expenditure incurred for development of the process in FY 2024-2025 is ₹6,000. Asset was brought into use on 31st March, 2025 and is expected to be useful for 6 years.

What is the carrying amount of the intangible asset at 31st March, 2024 and 31st March, 2025. Also determine the charge to profit or loss for 2023-2024?

At 31st March, 2026, the amount estimated to be recoverable from the process is ₹5,000.

What is the carrying amount of the intangible asset at 31st March, 2026 and the charge to profit orloss for 2025-2026 on account of impairment loss?

Question 5.

1. Saturn Ltd. acquired an intangible asset on 31st March , 2022 for ₹1,00,000. The asset was revalued at ₹1,20,000 on 31st March, 2023 and ₹85,000 on 31st March, 2024.
2. Jupiter Ltd. acquired an intangible asset on 31st March, 2022 for ₹1,00,000. The asset was revalued at ₹ 85,000 on 31st March, 2023 and at ₹1,05,000 on 31st March, 2024.

Assuming that the year-end for both companies is 31st March and that they both use the revaluation model, show how each of these transactions should be dealt with in the financial statements. Explain the treatment for revaluation of intangible asset. Ignore computation of amortization on them.

Solution:

Saturn Ltd.: -On 31st March, 2023, ₹20,000 revaluation increase should be credited to the revaluation reserve and recognised in other comprehensive income (OCI). On 31st March, 2024, ₹20,000 of the revaluation decrease should be debited to revaluation reserve and remaining ₹15,000 should be recognised as an expense.

Jupiter Ltd.: - On 31st March, 2023, ₹15,000 revaluation decrease should be recognised as an expense in the Statement of Profit and loss. On 31st March, 2024, ₹15,000 out of the ₹20,000 increase should be recognised as income. The remaining ₹5,000 should be credited to revaluation reserve and recognised in other comprehensive income (OCI).

Question 6. X Limited engaged in the business of manufacturing fertilisers entered into a technical collaboration agreement with a foreign company Y Limited. As a result, Y Limited would provide the technical know-how enabling X Limited to manufacture fertiliser in a more efficient way. X Limited paid ₹10,00,00,000 for the use of know-how for a period of 5 years. X Limited estimates the production of fertiliser as follows:

Year	(In metric tons)
1	50,000
2	70,000
3	1,00,000
4	1,20,000
5	1,10,000

At the end of the 1st year, it achieved its targeted production. At the end of 2nd year, 65,000 metric tons of fertiliser was being manufactured, and X Limited considered to revise the estimates for the next 3 years. The revised figures are 85,000, 1,05,000 and 1,15,000 metric tons for year 3, 4 & 5 respectively. How will X Limited amortise the technical know-how fees as per Ind AS 38?

Question 7. X Ltd. purchased a patent right on 1st April, 2022, for ₹3,00,000; which has a legal life of 15 years. However, due to the competitive nature of the product, the management estimates a useful life of only 5 years. Straight-line amortisation is determined by the management to be the best method. As at 1st April, 2023, management is uncertain that the process can actually be made economically feasible, and decides to write down the patent to an estimated market value of ₹1,50,000 and decides to amortise over 2 years. As at 1st April, 2024, having perfected the related production process, the asset is now appraised at a value of ₹3,00,000. Furthermore, the estimated useful life is now believed to be 4 more years. Determine the value of intangible asset at the end of each financial year?

Solution:

Value as on 31st March, 2023

Original cost	3,00,000
Less: amortisation	(60,000)
Net Value	2,40,000

Value as on 31st March, 2024

On 1st April, 2023, the impairment is recorded by writing down the asset to the estimated value of ₹1,50,000, which necessitates a ₹90,000 charge to profit & loss (carrying value, ₹2,40,000 less fair value ₹1,50,000).

Amortisation provided for the financial year 2023-2024 is ₹75,000 (₹1,50,000/2)

Net value is = ₹1,50,000 – 75,000 = ₹75,000.

Value as on 31st March, 2025

As of 1st April, 2024, the carrying value of the patent is ₹75,000.

Revalued amount of patent is ₹3,00,000.

Out of total revaluation gain of ₹2,25,000, ₹90,000 will be charged to profit & loss and balance amount of ₹1,35,000 (₹2,25,000 – ₹90,000) will be credited to revaluation reserve.

Amortisation provided for the financial year 2024-2025 is ₹75,000 (₹3,00,000 / 4)

Net value is = ₹3,00,000 – ₹75,000 = ₹2,25,000.

Similarly, Value as on March 31, 2026 = ₹2,25,000 – ₹75,000 = ₹1,50,000

Value as on March 31, 2027 = ₹1,50,000 – ₹75,000 = ₹75,000

Value as on March 31, 2028 = ₹75,000 – ₹75,000 = Nil

Question 8. X Pharmaceutical Ltd. seeks your opinion in respect of following accounting transactions:

1. Acquired a 4-year license to manufacture a specialised drug at a cost of ₹1,00,00,000 at the start of the year. Production commenced immediately.
2. Also purchased another company at the start of year. As part of that acquisition, X Pharmacy Ltd. acquired a brand with a fair value of ₹3,00,00,000 based on sales revenue. The life of the brand is estimated at 15 years.
3. Spent ₹1,00,00,000 on an advertising campaign during the first six months. Subsequent sales have shown a significant improvement and it is expected this will continue for 3 years.
4. It has commenced developing a new drug 'Drug-A'. The project cost would be ₹10,00,00,000. Clinical trial proved successful and such drug is expected to generate revenue over the next 5 years.
   Cost incurred (accumulated) till 31st March, 2023 is ₹5,00,00,000.
   Balance cost incurred during the financial year 2023-2024 is ₹5,00,00,000.
5. It has also commenced developing another drug 'Drug B'. It has incurred ₹50,00,000 towards research expenses till 31st March, 2024. The technological feasibility has not yet been established.

How the above transactions will be accounted for in the books of account of X Pharmaceutical Ltd?

Solution: X Pharmaceutical Ltd. is advised as under:

1. It should recognise the drug license as an intangible asset, because it is a separate external purchase, separately identifiable asset and considered successful in respect of feasibility and probable future cash inflows.
   The drug license should be recorded at ₹1,00,00,000.
2. It should recognise the brand as an intangible asset because it is purchased as part of acquisition and it is separately identifiable. The brand should be amortised over a period of 15 years.
   The brand will be recorded at ₹3,00,00,000.
3. The advertisement expenses of ₹1,00,00,000 should be expensed off.
4. The development cost incurred during the financial year 2023-2024 should be capitalised. Cost of intangible asset (Drug A) as on 31st March, 2024

Opening cost	₹5,00,00,000
Development cost	₹5,00,00,000
Total cost	₹10,00,00,000

5. Research expenses of ₹50,00,000 incurred for developing 'Drug B' should be expensed off since technological feasibility has not yet established.

Chapter 1.10- Ind AS- 102 (Share based payment)

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 modes 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.

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 of 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 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.

Note: This Ind AS 102 will not be applicable for payment made under Ind AS 103.

EMPLOYEE SHARE BASED PAYMENT PLANS: It is an agreement between an entity and 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, provided specified vesting conditions are met.**

TYPES OF SHARE BASED PAYMENT PLANS: -

(i) 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.

(ii) 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.

(iii) 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.

TYPES OF SHARE BASED PAYMENT TRANSACTIONS/ MEASUREMENT OF SHARE BASED PAYMENT:

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. The entity shall measure the goods or services received and the corresponding increase in equity at the fair value of goods and services received.
- If the entity cannot estimate reliably the fair value of goods or services received, the entity shall measure their value and the corresponding increase in equity by reference to the fair value of the equity instruments granted.
- In case of employees, it is required by the standard to use fair value of equity granted because it is practically not possible to identify the fair value of the services rendered by the employees.

• Cash-settled share-based payment transactions:

- Under this type of Share-based Payment transaction, the entity acquires goods or services by incurring liabilities for the amount.

- The entity shall measure the goods or services acquired and the liability incurred at 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 and loss for the period.

- There could be vesting conditions attached to the share-based payment plans e.g. to remain in service for 3 years etc. The recognition of such share-based payment plan should be done by recognising fair value of the liability at the time of goods/services received and not at the date of grant. The liability so recognised will be fair value at each reporting date and difference in fair value will be charged to profit & loss for the period.

- There could be cases where no vesting period/condition is required to be fulfilled. In those cases, cash settled share-based payment can be recognised in full at initial recognition itself.

Share-based payment transactions with cash alternatives:

- Here an entity has a choice of issuing shares or paying cash.
- For share based payment transactions in which the terms of the arrangements 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 as a cash settled 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.

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.

Further, 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.

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.

<u>ACCOUNTING For equity settled transaction:</u>

Important terms:

- The day a share-based payment plan is announced and accepted by employees is called the **grant date**
- 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 fulfil 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.
- **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:

Based on different types of vesting conditions, share based payment transactions with employees are divided into four categories:

<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
Non-market performance condition (D)</td></tr>
</table>

<u>LET'S START PRACTICAL QUESTIONS:</u>

QUESTION 1: On 1^{st} April 2023, Tata Ltd announced 30,000 ESOPS to its employees at an exercise price of ₹4 per share. Vesting period 3 years.
Market price/Fair value per share on 1^{st} April 2023 ₹30 (Face value ₹10).
Market price/Fair value per share on 31^{st} March 2024 ₹35
Market price/Fair value per share on 31^{st} March 2025 ₹38
Market price/Fair value per share on 31^{st} March 2026 ₹27

Make entries for three years if all employees exercised the options.

QUESTION 2. A company has its share capital divided into shares of Rs 10 each. On 1^{st} April 2019, it granted 10,000 employees' stock options at ₹40, when the market price was ₹130. The options were to be exercised between 15^{th} March 2020 and 31^{st} March 2020. The employees exercised their options for 9500 shares only. The remaining options lapsed. The company closes its books on 31^{st} March every year. Show journal entries.

Solution: Fair value of option = 90; Total loss due to ESOP to company = 9,500 X 90 = ₹8,55,000

QUESTION 3. On 1^{st} April 2023, A Ltd offered to its employees 5000 options at ₹15 each to be vested after 24 months. Fair value (market value) on that date was ₹60 per share. 1000 options were withdrawn on 30 November 2023. Again, on 31^{st} December 2024, 500 options were withdrawn.
Remaining options were exercised on 31^{st} march 2025.

QUESTION 4. X Ltd offered 15,000 ESOPs to its employees on 1^{st} April ,2023 exercisable on 31^{st} march 2026. On 1^{st} Jan 2024, 1000 options were withdrawn from employees. On 31^{st} march 2025, 8000 options were cancelled due to resignation of employees. Rest of the options were availed by employees on due date. Market price on 1-4-2023 for equity shares of the company is ₹40(face value). However, market price on 31^{st} march 2026 is ₹80 per share. Journalize entries and prepare employees compensation expense account.

Question 5. X Ltd. grants 100 stock option to each of its 2000 employees on 1.4.23 at exercise price of ₹30.
Exercise period 1 year
Market price on 1.4.23=₹50 (Face value ₹10)
These options will be vested at the end of 1^{st} year, if the earning is 16%, or it will be vested at the end of 2^{nd} year, if average earning of 2 years is 13% or lastly it will be vested at the end of 3^{rd} year, if the average rate of earning will be 10%. 10,000 options lapsed on 31.3.2024. 8,000 options lapsed on 31.3.2025 and 7,000 option lapsed 31.3.2026, Earning of company are given below:

31.3.2024 =14%
31.3.2025 =10%
31.3.2026 =7%

1500 employees exercised their option during exercise period and remaining option lapsed at the end of exercise period. Make Journal entries.

QUESTION 6. Z Ltd. grants 100 share options to each of its 400 employee's conditionals on their continuing in service for 3 years. Fair value of share option on the grant date is ₹30. 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.

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%. During year 3, a further 14 employees leave. Calculate amount of remuneration expense for each year.

Answer: Computation of amount to be written of to profit & loss account each year:

$$\left(\frac{\text{Total expected existing options to be exercised X fair value of option}}{\textit{Total vesting period}} \text{X total lapsed vesting period}\right) - \text{total expenses already recognised in SPL till the end of previous year}$$

Year end	Calculation	Amount
1	$\left(\frac{(400 \text{ X } 84\%) \text{ X}100\text{X } 30}{3} \text{X } 1\right)$ - nil	3,36,000
2	$\left(\frac{(400 \text{ X } 87\%) \text{ X}100\text{X } 30}{3} \text{X } 2\right) - 3,36,000$	3,60,000
3	$\left(\frac{348 \text{ X}100\text{X } 30}{3} \text{X } 3\right) - 6,96,000$	3,48,000

QUESTION 7. (Concept of 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%; at the end of year 2 if the entity's earnings increase by more than an average of 12% 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 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%, 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% 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%, resulting in an average increase over 10% per year. Make journal entries for three years.

Answer:

Fair value of share on the date of announcement of ESOP =	**40**
Less: exercise price of share =	**0**
Fair value of option =	**40**

Computation of amount to be written of to profit & loss account each year:

$$\left(\frac{\text{Total expected existing options to be exercised X fair value of option}}{\textit{Total vesting period}} \text{X total lapsed vesting period}\right) - \text{total expenses already recognised in SPL till the end of previous year}$$

Year end	Calculation	Amount
1	$\left(\frac{(400-32-30)\text{X } 200\text{X } 40}{2} \text{X } 1\right)$ - nil	13,52,000
2	$\left(\frac{(400-32-27-25) \text{ X}100\text{X } 30}{3} \text{X } 2\right) - 13,52000$	3,33,333
3	$\left(\frac{400-32-27-22}{3} \text{X } 3\right) - 16,85,333$	8,66,667

QUESTION 8. (Concept of Grant with a performance condition, in which the number of equity instruments varies). 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 increase by at least at an average of 8% per year. If the per cent of increase is 8% and above but below 10% per year, each employee will receive 120 share options, if 10% and above but below 15% each year, each employee will receive 240 share options and if on or above 15%, 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% 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% 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%, resulting in an average of 15% 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 year in the three-year period.
Calculate amount of expenses to be shown in SPL each year.

Answer: Computation of amount to be written of to profit & loss account each year:

$$\left(\frac{\text{Total expected existing options to be exercised X fair value of option}}{\textit{Total vesting period}}\text{X total lapsed vesting period}\right) - \text{total expenses already recognised in SPL till the end of previous year}$$

Year end	Calculation	Amount
1	$\left(\frac{(200-12-20)\text{X }240\text{X }40}{3}\text{X } 1\right)$ - nil	5,37,600
2	$\left(\frac{(200-12-10-5)\text{X}360\text{ X }40}{3}\text{X } 2\right) - 5{,}37{,}600$	11,23,200
3	$\left(\frac{200-12-10-8}{3}\text{X } 3\right) - 16{,}60{,}800$	7,87,200

QUESTION 9. (Concept of Grant with a performance condition, in which the exercise price varies).

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 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. Calculate amount of expenses to be recognised each year.

Answer: Computation of amount to be written of to profit & loss account each year:

$\left(\frac{\text{Total expected existing options to be exercised X fair value of option}}{\textit{Total vesting period}}\right.$X total lapsed vesting period) – total expenses already recognised in SPL till the end of previous year

Year end	Calculation	Amount
1	$(\frac{10,000 \text{X} 16}{3}$X 1) - nil	53,333
2	$(\frac{10,000 \text{X} 16}{3}$X 2) – 53,333	106,666
3	$(\frac{10,000 \text{X} 12}{3}$X 3) – 1,06,666	13,333

QUESTION 10. 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. 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: Computation of amount to be written off to profit & loss account each year:

$\left(\frac{\text{Total expected existing options to be exercised X fair value of option}}{\textit{Total vesting period}}\right.$X total lapsed vesting period) – total expenses already recognised in SPL till the end of previous year

Year end	Calculation	Amount
1	$(\frac{10,000 \text{X} 24}{3}$X 1) - nil	80,000
2	$(\frac{10,000 \text{X} 24}{3}$X 2) – 80,000	80,000
3	$(\frac{10,000 \text{X} 24}{3}$X 3) – 1,60,000	80,000

QUESTION 10 A. Assume the probability is 80% of increasing price by above Rs 65 in question number 10.

CASH SETTLED SHARE BASED PAYMENT

(i) **Fair value of each reporting date is being used instead of fair value on grant date.**

(ii) **SBP-Liability is used instead of SBP-Reserve account.**

(iii) **If vesting period is not given, then recognise SBP-Liability on the date of grant and it should be revalued at each reporting date.**

(iv) **Formula for calculating expenses to be shown each year in profit and loss account:**

$$\frac{\textit{number of SAR expected to be settled X FV of SAR on reporting date}}{\textit{total vesting period}} X\ Expired\ period = XXXX$$

Less: opening cumulative balances of already recognised **XXXX**

Employees benefit expense for the current year **XXXX**

(v) **If vesting period is given, then allocate employees benefit expense over the vesting period (same as discussed in equity settled)**

QUESTION 11. XYZ Ltd issued 10,000 shares appreciation rights (SAR) that vest immediately to its employees on 1st April 2023. The SAR is to be settled in cash. At that time, it is estimated, using an option pricing model, that the fair value of a SAR is ₹95. SAR can be exercised any time up to 31st March 2026. At the end of the period on 31st March 2024, it is expected that 95% of the total employees will exercise the option, 92% of total employees will exercise the option at the end of next year and finally 89% will be vested only at the end of 3rd year. Fair value at the end of each period have been given as bellows:

31.3.2024 ₹112
31-3-2025 ₹109
31-3-2026 ₹114
Pass journal entries.

Solution: Computation of amount to be written off to profit & loss account each year:

Year end	**Total expenses recognised till date**	**Opening balance of amount recognised**	**Expenses to be recognised during the current year**
1-4-2023	10,000 X 95 = 9,50,000	NIL	9,50,000
31-3-24	(10,000 X 95%) X 112 = 10,64,000	9,50,000	1,14,000
31-3-25	(10,000 X 92%) X 109 = 10,02,800	10,64,000	(61,200)
31-3-26	(10,000 X 89%) X 114 = 10,14,600	10,02,800	11,800

Journal entries:

Date	**Particulars**	**Debit**	**Credit**
1-4-23	Employees compensation expense account Dr To share based payment liability account	9,50,000	 9,50,000
31-3-24	Employees compensation expense account Dr To share based payment liability account	1,14,000	 1,14,000
31-3-25	Share based payment liability account Dr To Employees compensation expense account	61,200	 61,200
31-3-26	Employees compensation expense account Dr To share based payment liability account	11,800	 11,800
31-3-26	Share based payment liability account Dr To bank account	10,14,600	 10,14,600

QUESTION 12. What will be the amount of expenses P.A. in question 11, if SAR can be exercised only as at 31-3-2026 after a vesting period of 3 years.

Answer: Computation of amount to be written off to profit & loss account each year:

$\left(\frac{\text{Total expected existing options to be exercised X fair value of option}}{Total\ vesting\ period} \text{X total lapsed vesting period}\right)$ – total expenses already recognised in SPL till the end of previous year

Year end	Calculation	Amount
1	$\left(\frac{10{,}000 \text{X } 95\% \text{ X } 112}{3} \text{X } 1\right) - \text{nil}$	3,54,667
2	$\left(\frac{10{,}000 \text{X } 92\% \text{ X } 109}{3} \text{X } 2\right) - 3{,}54{,}667$	3,13,866
3	$\left(\frac{10{,}000 \text{X } 89\% \text{ X } 114}{3} \text{X } 3\right) - 6{,}68{,}533$	3,46,067

Journal entries:

Date	Particulars	Debit	Credit
1st April 23	No entry		
31st March 24	Employees compensation expense account Dr To share based payment liability account	3,54,667	 3,54,667
31st March 24	Profit & loss account Dr To Employees compensation expense account	3,54,667	 3,54,667
31st March 25	Employees compensation expense account Dr To share based payment liability account	3,13,866	 3,13,866
31st March 25	Profit & loss account Dr To Employees compensation expense account	3,13,866	 3,13,866
31st March 26	Employees compensation expense account Dr To share based payment liability account	3,46,067	 3,46,067
31st March 26	Profit & loss account Dr To Employees compensation expense account	3,46,067	 3,46,067
31st March 26	Share based payment liability account Dr To bank account	10,14,600	 10,14,600

Note: expenses are recognised on the basis of FV of SAR on reporting date. IN CASE of equity settled payment, we take FV on grant date only.

Question 13. COC Ltd. grants 150 cash Share Appreciation Rights (SARs) to each of its 500 employees, on condition that the employees remain in its employment for the next three years. During year 1, 35 employees leave. The entity estimates that a further 60 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3. During year 3, 22 employees leave. At the end of year 3, 150 employees exercise their SARs, another 140 employees exercise their SARs at the end of year 4 and the remaining employees (113) 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 employee's 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	12.40	
2	13.50	
3	16.20	14
4	19.40	19
5		24

Pass journal entries and working notes.

QUESTION 14. COC Ltd. grants 150 cash Share Appreciation Rights (SARs) to each of its 500 employees, on condition that the employees remain in its employment for the next three years. During year 1, 35 employees leave. The entity estimates that a further 60 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3. During year 3, 22 employees leave. At the end of year 3, 150 employees exercise their SARs, another 140 employees exercise their SARs at the end of year 4 and the remaining employees (113) 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 employee's 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	12.40	
2	13.50	
3	16.20	14
4	19.40	19
5		24

Pass journal entries and show working notes.

Important Terminology:

- **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.

Solution:

End of	1st year	2nd year	3rd year	4th year	5th year
Total expenses expected to be settled	$\frac{(500-35-65)X150X12.4}{3}X\,1$ = 2,48,000	$\frac{400X150X13.5}{3}X\,2$ = 5,40,000	$\frac{253X150X16.2}{3}X\,3$ = 6,14,790	(253-140) X150 X 19.4 = 3,28,830	NIL
Total settled expenses	Nil	Nil	3,15,000 (150X 150 X 14)	3,99,000 (140X150X19)	4,06,000 (113X150X24)
Total amt of expenses to be recognised till end of current year	2,48,000	5,40,000	9,29,790	7,27,830	4,06,000
total amount of expense already recognised till end of previous year	NIL	2,48,000	5,40,000	6,14,790	3,28,830
Expenses to be recognised during current year	2,48,000	2,92,000	3,89,790	1,13,040	77,970

Journal entries:

Date	Particulars	Debit	Credit
End of 1st year	Employees compensation expense account Dr To share based payment liability account	2,48,000	 2,48,000
End of 2nd year	Employees compensation expense account Dr To share based payment liability account	2,92,000	 2,92,000
End of 3rd year	Employees compensation expense account Dr To share based payment liability account	3,89,790	 3,89,790
End of 3rd year	Share based payment liability account Dr To bank account (being 150 SAR Settled)	3,15,000	 3,15,000
End of 4th year	Employees compensation expense account Dr To share based payment liability account	1,13,040	 1,13,040
	Share based payment liability account Dr To bank account (being 140 SAR Settled)	3,99,000	 3,99,000
End of 5th year	Employees compensation expense account Dr To share based payment liability account	77,970	 77,970

	Share based payment liability account Dr To bank account (being 113 SAR Settled)	4,06,000	 4,06,000

ACCOUNTING OF Share-based payment transactions with cash alternatives:

An entity issues stock options to its employees which can be claimed either in cash or equity instrument of an entity. Employees need to be in service for next 2 years. Entity needs to find fair value component of equity to be settled and fair value of cash amount to be settled. Each balance sheet date, these values need to be updated. Upon the exercising of the option, if it is in equity then fair value liability will be transferred to the equity in full.

QUESTION 15. On 1st January, 2023, ABC limited gives options to its key management personnel (employees) to take either cash equivalent to 1,000 shares or 1,500 shares. The minimum service requirement is 2 years and shares being taken up must be kept for 3 years.

Fair value of shares are as follows:

Share alternative fair value (with restrictions) = ₹102

Grant date fair value on 1st January 2023 = ₹113

Fair value on 31st December 2023 = ₹120

Fair value on 31st December 2024 = ₹132

Employees exercise their cash option at the end of 2024. Pass journal entries.

Solution: 1.

Computation of Value of Equity component in compound instrument as on 1st January 2023:

Fair value of equity alternative (1,500 X 102) = 1,53,000

Fair value of cash alternative (1000 X 113) = 1,13,000

Value of Equity component in compound instrument 40,000

2. Computation of cash-based payment- liability to be recognised at the end of each year:

Year end	Calculation	Amount
31st December 23	$(\frac{1000 \text{ X } 120}{2} \text{X } 1) - \text{nil}$	60,000
31st December 24	$(\frac{1000 \text{ X } 132}{2} \text{X } 2) - 60{,}000$	72,000

3. Computation of share-based payment-reserve to be recognised at the end of each year:

Year end	Calculation	Amount
31st December 23	$(\frac{40{,}000}{2} \text{X } 1) - \text{nil}$	20,000
31st December 24	$(\frac{40{,}000}{2} \text{X } 2) - 20{,}000$	20,000

QUESTION 16. Tata industries issued share-based option to one of its key management personals which can be exercised either in cash or equity and it has following features:

Option 1: No of cash settled shares Service condition	 **74,000** **3 years**
Option 2: Number of equities settled shares of face value of Rs 100 each	 **90,000**
Condition:	
Service	**3 years**
Restriction to sell	**2 years**
Fair values:	
Equity price with a restriction of sale for 2 years	**115**
Fair value at the grant date (in case of cash settled)	**135**
Fair value at the end of 2023:	**138**
2024:	**140**
2025:	**147**

Make journal entries.

Solution: 1. Computation of Value of Equity component in compound instrument as on 1st January 2023:

Fair value of equity alternative (90,000 X 115) = 1,03,50,000

Fair value of cash alternative (74,000 X 135) = 99,90,000

Value of Equity component in compound instrument 3,60,000

2. Computation of share-based payment- liability to be recognised at the end of each year:

Year end	**Calculation**	**Amount**
31st December 23	$(\frac{74,000 \text{ X } 138}{3}$X 1) - nil	34,04,000
31st December 24	$(\frac{74,000 \text{ X } 140}{3}$X 2) – 34,04,000	35,02,667
31st December 25	$(\frac{74,000 \text{ X } 147}{3}$X 3) – 69,06,667	39,71,333

3. Computation of share-based payment- reserve to be recognised at the end of each year:

Year end	**Calculation**	**Amount**
31st December 23	$(\frac{3,60,000}{3}$X 1) - nil	1,20,000
31st December 24	$(\frac{3,60,000}{3}$X 2) – 1,20,000	1,20,000
31st December 25	$(\frac{3,60,000}{3}$X 3) – 2,40,000	1,20,000

QUESTION 17. An entity grants to an employee the right to choose either 2,000 shares, i.e., a right to a cash payment equal to the value of 2,000 shares, or 2,400 shares. The grant is conditional upon the completion of three years' service. If the employee chooses the share alternative, the shares must be held for three years after vesting date.

At grant date, the entity's share price is ₹50 per share. At the end of years 1, 2 and 3, the share price is ₹52, ₹55 and ₹60 respectively. The entity does not expect to pay dividends in the next three years. After taking into account the effects of the post-vesting transfer restrictions, the entity estimates that the grant date fair value of the share alternative is ₹48 per share. Make journal entries if at the end of year 3, the employee chooses:

Case 1: The cash alternative

Case 2: The equity alternative

Solution:

1. Computation of Value of Equity component in compound instrument as on 1st January 2023:

Fair value of equity alternative (2,400 X 48) = 1,15,200
Fair value of cash alternative (2,000 X 50) = 1,00,000
Value of Equity component in compound instrument 15,200

2. Computation of share-based payment- liability to be recognised at the end of each year:

Year end	Calculation	Amount
1st year	$(\frac{2,000 \text{ X } 52}{3} \text{X } 1)$ - nil	34,667
2nd Year	$(\frac{2,000 \text{ X } 55}{3} \text{X } 2)$ – 34,667	38,667
3rd year	$(\frac{2,000 \text{ X } 60}{3} \text{X } 3)$ – 73,334	46,667

3. Computation of share-based payment- reserve to be recognised at the end of each year:

Year end	Calculation	Amount
31st December 23	$(\frac{15,200}{3} \text{X } 1)$ **- nil**	**5,067**
31st December 24	$(\frac{15,200}{3} \text{X } 2)$ **– 5,066**	**5,067**
31st December 25	$(\frac{15,200}{3} \text{X } 3)$ **– 10,132**	**5,066**

Question 18. 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.

Question 19. 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 statement 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.

Question 20. Mr. X is an employee of P Ltd. and also holder of equity shares of P Ltd. 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.

Question 21. 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.

Question 22. (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. Whether Ind AS 102 will apply?

solution: 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.

Question 23. Z Ltd. grants 100 share options to each of its 400 employee's conditionals on their continuing in service for 3 years. Fair value of share option on the grant date is ₹ 30. 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.
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%. During year 3, a further 14 employees leave.

Solve the following questions on the basis of given information:
i. Is there any share-based payment transaction as per Ind AS 102?
Answer: Yes.

ii. Is the transaction equity settled or cash settled?
Answer: Equity settled.

iii. At what value the transaction will be recognized?
Answer: At fair value on the Grant date, ie at ₹ 30.

iv. When will the transaction be recognized?
Answer: In future at the time of financial reporting in every relevant year proportionately to services received.

v. calculates amount of remuneration expense for each year.

Question 24. 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, i.e. 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

Question 25. D Ltd. offers the employees shares at a discount in recognition of their past services. In total 60,000 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:

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)			

Question 26. 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 employee's 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: **Journal:**

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

1.11--- Ind AS-108 (operating segments)

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

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

- **(a)** better understand the performance of the enterprise;
- **(b)** better assess the risks and returns of the enterprise; and
- **(c)** make more informed judgements about the enterprise as a whole

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

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

Meaning of Operating Segments: An operating segment is a component of an entity:

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

(b) whose operating results are regularly reviewed by the entity's CODM (Chief Operating Decision Maker) to make decisions about resources to be allocated to the segment and assess its performance; and

(c) for which discrete financial information is available.

Note 1: An operating segment may engage in business activities for which it has yet to earn revenues.

For example,start-up operations may be operating segments before earning revenues.

Note 2: Not every part of an entity is necessarily an operating segment or part of an operating segment. For example,a corporate headquarters or some functional departments may not earn revenues or may earn revenues that are only incidental to the activities of the entity and would not be operating segments.

Note 3. Research and development department may be called operating segment if it satisfies conditions of being operating segment.

Note 4. Discontinued operations – whether an operating segment??....... Yes it can also be classified as operating segment.

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

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

(b) exceeds the quantitative thresholds.

Aggregation Criteria: Two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this Ind AS, the segments have similar economic characteristics, and the segments are similar in each of the following respects:

(a) The nature of the products and services;

(b) The nature of the production processes;

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

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

(e) If applicable, the nature of the regulatory environment, for example, banking, insurance or publicutilities.

Question 1: X Ltd. is engaged in the business of manufacturing and selling papers. Varieties of paper like adhesive paper, anti-rust paper, antique paper, art paper etc., are manufactured and sold by X Ltd. Should X Ltd classify these papers into different segments? (ICAI Study material)

Answer: Two or more operating segments may be aggregated into a single operating segment if the segments have similar economic characteristics, and the segments are similar with respect to various factors like nature of the product and production process, type of customers, method of distribution and regulatory requirement.

In case of X Ltd., so far as varieties of paper concerned, if all factors such as nature of the product and production process, type of customers, method of distribution and regulatory requirement are common, there is no need to create different segments for each type of paper.

Question 2: T Ltd is engaged in transport sector, running a fleet of buses at different routes. T Ltd has identified 3 operating segments:

- **Segment 1: Local Route**
- **Segment 2: Inter-city Route**
- **Segment 3: Contract Hiring**

The characteristics of each segment are as under:

Segment 1: The local transport authority awards the contract to ply the buses at different routes for passengers. These contracts are awarded following a competitive tender process; the ticket price paid by passengers are controlled by the local transport authority. T Ltd would charge the local transport authority on a per kilometer basis.

Segment 2: T Ltd operates buses from one city to another, prices are set by T Ltd on the basis of services provided (Deluxe, Luxury or Superior).

Segment 3: T Ltd also leases buses to schools under a long-term arrangement**.**

While Segment 1 has been showing significant decline in profitability, Segment 2 is performing well in respect of higher revenues and improved margins. The management of the company is not sure why is the segment information relevant for users when they should only be concerned about the returns from overall business. They would like to aggregate the Segment 1 and Segment 2 for reporting under 'Operating Segment'.

Required: Whether it is appropriate to aggregate Segments 1 and 2 with reference to Ind AS 108'Operating Segments'?

(ICAI Study material)

Answer: Ind AS 108 'Operating Segments' requires operating segments to be aggregated to present a reportable segment if the segments have similar economic characteristics, and the segments are similar in each of the following aggregation criteria:

(a) The nature of the products and services
(a) The nature of the production process
(b) The type or class of customer for their products and services
(c) The methods used to distribute their products or provide their services
(d) If applicable, the nature of the regulatory environment

While the products and services are similar, the customers for those products and services are different.

In Segment 1, the decision to award the contract is in the hands of the local authority, which also sets prices and pays for the services. The company is not exposed to passenger revenue risk, since a contract is awarded by competitive tender.

On the other hand, in the inter-city segment, the customer determines whether a bus route is economically viable by choosing whether or not to buy tickets. T Ltd sets the ticket prices but will be affected by customer behavior or feedback. T Ltd is exposed to passenger revenue-risk, as it sets prices which customers may or may not choose to pay.

Operating Segment provides information that makes the financial statements more useful to investors. In making the investment decisions, investors and creditors consider the returns they are likely to make on their investment.

Inappropriately aggregating segments reduces the usefulness of segment disclosures to investors. Ind AS 108 requires information to be disclosed that is not readily available elsewhere in the financial statements.

In T Ltd.'s case, if the segments are aggregated, then the increased profits in segment 2 will hide the decreased profits in segment 1. However, the fact that profits have sharply declined in segment 1 would be of interest to investors as it may suggest that future cash flows from this segment are at risk.

Question 3. XY Ltd. has operations in France, Italy, Germany, UK and India. It wishes to apply aggregation criteria on geographical basis. How will the aggregation criteria apply for reporting segments in the given scenario?

Answer: XY Ltd. needs to assess and prove that each country possesses the same economic characteristics. Factors including exchange control regulations, currency risks and economic conditions are required to be considered.
Considering above factors, it may be possible to aggregate the results of France, Italy and Germany (falling within EU region) and results of UK and India may be separately reported (no aggregation is permitted).

QUESTION 4: ABC Ltd. manufactures and sells healthcare products, and food and grocery products. Three products namely A, B & C are manufactured. Product A is classified as healthcare product and product B & C are classified as food and grocery products. Products B & C are similar products. Discrete financial information is available for each manufacturing locations and for the selling activity of each product. There are two-line managers responsible for manufacturing activities of products A, B & C. Manager X manages product A and Manager B manages productsB & C. The operating results of health care products (product A) and food and grocery products (products B & C) are regularly reviewed by the CODM. Identify reportable segments of ABC Ltd.

Answer: In this situation both the healthcare, and food and grocery product line meet the criteria for operating segments set out above. Therefore, it is likely that ABC Ltd.'s operating segments would be classified as being (i) healthcare and (ii) food and grocery segments.

QUESTION 5: The CEO along with other Board members do a review of financial information about various business segments and take decisions on the basis of discrete information available for these segments and are correctly identified as Chief Operating Decision Maker (CODM). Review of only revenue information is done for decision making about those segments by the CODM. As per CODM, many segments require minimal costs due to centralization of costs.

Whether review of only the revenue related information is sufficient for these segments to be considered as operating segments for the purposes of Ind AS 108 'Operating Segments'?

Answer: Many entities would be considering the decision making for segments on the basis of revenue growth especially the ones aggressively trying to build a market share. Common examples would be businesses into technology sector or those creating or launching new products from time to time. For them, the decision making for different regional segments would need revenue growth and related information for further investment decision.

The logic given by the CODM is that since many segments require minimal costs (due to centralization of costs), therefore, revenue-only data is a fair representation of the operating results.

In the above case, review of the information that is based only on revenue data may be appropriate to consider that the segment meets the definition of an operating segment.

QUESTION 6: X Ltd. is engaged in the manufacture and sale of two distinct type of products A & B. X Ltd. supplies the product in the domestic market in India as well as in Singapore. There are two regional managers responsible for manufacturing activities of product A & B worldwide and also two other managers responsible for different geographical areas. For internal reporting purposes, X Ltd. provides information product-wise and as per the geographical location of the company. The CODM regularly reviews the operating results of both sets of components. How should X Ltd. identify its operating segments?

Answer: In this situation, both the geographical sales areas and product areas may meet the criteria for operating segment. However, in such situation, it is more difficult to determine clearly which set of components should be identified as the entity's operating segments. In such situation the entity should determine which set of components constitutes the operating segments by reference to the core principle. The core principle is that the entity should disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. The entity should also assess whether the identified operating segments could realistically represent the level at which the CODM is assessing performance and allocating resources.

Therefore, X Ltd. should consider all the above factors and apply judgement to determine which component should be disclosed as operating segment.

Question 7. **CODM of XY Ltd. receives and reviews multiple sets of information when assessing the businesses' overall performance to take a decision on resources allocation. It receives the information as under:**

- **Level 1 Report: Summary report for all 4 regions**
- **Level 2 Report: Summary report for 20 Sub-regions within those regions**
- **Level 3 Report: Detailed report for 50 Branches within the sub-regions**

What factors and level should be considered for determining an operating segment?

Answer: We need to consider multiple factors (including but not limited to below):

- The process that CODM may use to assess the performance (Key Financial Matrix, KPIs,Ratio etc.);
- Identify the segment managers and their responsibility areas;
- The process of budgeting for resource allocations.

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

(a) Its reported revenue (including both sales to external customers and inter segment sales or transfers) is 10% or more of the combined revenue (internal and external) of all operating segments.

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

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

- Operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements.
- An entity may combine information about operating segments that do not meet the quantitative thresholds with information about other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria.
- If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, information about that segment shall continue to be reported separately in the current period even if it no longer meets the criteria for reportability.
- Under the quantitative threshold, external revenue of reportable segments must be $\geq$ 75% of total external revenue of the entity.
- If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for a prior period presented for comparative purposes shall be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the criteria for reportability in the prior period, unless the necessary information is not available and the cost to developit would be excessive.
- However, there may be a practical limit to the number of reportable segments that an entity separately discloses beyond which segment information may become too detailed. Hence, as the number of segments that are reportable increases above ten, the entity should consider whether a practical limit has been reached.

Question 8. X Ltd. has identified 4 operating segments for which revenue data is given below:

	External Revenue	Internal Revenue	Total
Segment A	30,00,000	Nil	30,00,000
Segment B	6,50,000	Nil	6,50,000
Segment C	8,50,000	1,00,000	9,50,000
Segment D	5,00,000	49,00,000	54,00,000
Total Revenue	**50,00,000**	**50,00,000**	**1,00,00,000**

Additional information:

Segment C is a new business unit and management expect this segment to make asignificant contribution to external revenue in coming years.

Which of the segments would be reportable under the criteria identified in Ind AS 108?

Question 9: ABC Limited has 5 operating segments namely A, B, C, D and E. The profit/ loss of respective segments for the year ended March 31, 2024 are as follows:

Segment	Profit/(Loss) (₹ in crore)
A	780
B	1,500
C	(2,300)
D	(4,500)
E	6,000
Total	**1,480**

Based on the quantitative thresholds, which of the above segments A to E would be considered as reportable segments for the year ending March 31, 2024?

Question 10. X Ltd. has identified the following business components.

Segment	Revenue (₹`)		Profit (`₹)	Assets (₹`)
	External	Internal		
Pharma	97,00,000	Nil	20,00,000	55,00,000
FMCG	Nil	4,00,000	2,50,000	25,00,000
Ayurveda	3,00,000	Nil	2,00,000	4,00,000
Others	8,00,000	41,00,000	5,50,000	6,00,000
Total for the entity	1,08,00,000	45,00,000	30,00,000	90,00,000

Which of the segments would be reportable as per the criteria prescribed in Ind AS108?

Question 11. An entity has branches in different parts of the country – catering to different customers and selling local made products (a product of one region is not sold in any other region). No regionor product contributes more than 5% to total revenue of the entity. Discuss how many segments are reportable?

Answer: Under the quantitative threshold, external revenue of reportable segments must be ≥ 75% of total external revenue of the entity. Considering above case, minimum 15 operating segments need to be reportable (75% [threshold] / 5% {revenue})

Question 12. An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table

(Amounts in`₹'000)

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

Identify the reportable segments as per Ind AS 108.

Disclosure:

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

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

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

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

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

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

- **(a)** Revenues from external customers;
- **(b)** Revenues from transactions with other operating segments of the same entity;
- **(c)** Interest revenue (separately from interest expense);
- **(d)** Interest expense;
- **(e)** Depreciation and amortisation and other material non-cash items;
- **(f)** Material items of income and expense
- **(g)** The entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;
- **(h)** Income tax expense or income.

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

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

- **(a)** Revenue.
- **(b)** Profit or loss before tax and discontinued operations.
- **(c)** Assets
- **(d)** Liabilities
- **(e)** Amount for every other material item of information.

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

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

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

(a) Revenues from external customers:

- **(i)** attributed to the entity's country of domicile and
- **(ii)** attributed to all foreign countries in total (separately if material).

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

- **(i)** located in the entity's country of domicile and
- **(ii)** located in all foreign countries in total in which the entity holds assets. If assets in an individual foreign country are material, those assets shall be disclosed separately.

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

SOME MORE IMPORTANT POINTS FOR EXAM FROM Ind AS 108:

(i) Entity preparing Separate financial statements (SFS) and Consolidated financial statement (CFS) both required to give segment information under this Ind AS for CFS.

(ii) Ind AS 108 not applicable to cash flow statements.

(iii) Employee benefit plans, investment divisions are not operating segments because they represent incidental activities of the business and are not in itself an operating line of business.

(iv) Ind AS 108 requires reconciliation of segment information with information given in financial statements. For example, matching of external sales of reportable segments with sales shown in profit and loss account of entity as a whole. Reconciliation is primarily required due to:

(a) Certain segments may be unreportable.

(b) Inter segment sale or purchase.

PRACTICE QUESTIONS:

Question 13: The Chief Accountant of Sports Ltd. gives the following Data regarding its six segments: (Rs in Lakh

Particulars	M	N	O	P	Q	R	Total
Segment Assets	40	80	30	20	20	10	200
Segment Results	50	-190	10	10	-10	30	-100
Segment Revenue	300	620	80	60	80	60	1,200

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

Question 14: Fellicy Limited has investment (equity and debit) in the book of HO. The investment constitutes 10% of total assets. There is some income of interest and dividend. Is it necessary to show this activity of the HO as a separate segment or can it be shown as unallocated corporate assets? (CMA FINAL 2004 JUNE 2 Marks)

Solution: As far as 10% limit is concerned it is material. If HO is actively engaged in trading in investments and earning income out of it then it can be treated as a separate segment. But if only surplus cash in invested and incidental income is earned then it can be taken to unallocated column.

Question 15: A Company has an inter-segment transfer pricing policy of charging of at cost less 10%. The market prices are generally 25% above cost. Is the policy adopted by the company, correct?

Solution: Ind AS-108 ' operating Segment ' requires that inter-segment transfers should be measured on the basis that the enterprise actually used to price these transfers. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements. Hence, the enterprise can have its own policy for pricing inter-segment transfers and hence, inter-segment transfers may be based on cost, below cost or market price.

However, whichever policy is followed, the same should be disclosed and applied consistently. Therefore, in the given case inter-segment transfer pricing policy adopted by the company is correct if, followed consistently.

Question 16. Identify the reportable segment by profitability test is demonstrated as follows for XYZ Ltd.

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

ICMAI Study material)

Solution: First, the operating segments are grouped according 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 incurring 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)**

Question 17. 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	1140	60	30	360

Prepare a Segmental Report for publication in M Ltd. Group. **(ICMAI STUDY MATERIAL)**

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

Chapter 1.12- 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 (e.g. Ind AS 103, Ind AS 105, Ind AS 109, Ind AS 16, Ind AS 38, Ind AS 40, Ind AS 41) **except cases under Ind AS 17, Ind AS 19, and Ind AS 102, Ind AS 2 or Ind AS 36.**

Definition of Fair value: 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** (as per respective Ind AS, not as per Ind AS 113)

-- under **current market conditions**.

Note 1. Fair value is a market-based measurement, not an entity-specific measurement.

Note 2. **Meaning of price**:- It is the exit price to the holder of asset or bearer of liability. The entry value (entry price) to the entity is not relevant.

Note 3. **Meaning of The orderly 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.

Important note:

Principal market means market with highest volume and high level of activities. In case there are many markets with such high volume and high level of activities, we take into consideration **most advantageous market**.

Most advantageous market means the market that maximise the amount that would be recovered on sale of an asset or minimise the amount that would be paid for transfer a liability.

While calculating most advantageous market, we calculate most advantageous price and for this we deduct both, transportation cost and transaction cost from selling price.

(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, even if the price in a different market is potentially more advantageous at the measurement date.

The fair value of the asset or liability shall not be adjusted for transaction costs but shall be adjusted for transport costs.

Question 1. State the name of principal market under following circumstances:

a. A share can be traded in BSE and NSE. But such share is generally traded in BSE with high volume.

b. There are many computers market in Delhi. But Nehru place is known as main market for computer.

c. A diamond dealer is selling diamond in domestic market as well as also export to outside India. In export market, he can sell only 20% of his output due to government restriction. In export market, he sells his product at price 25% more than domestic market.

Question 2. An asset is sold in two different active market. A market in which transaction for the asset and liability take place with sufficient frequency and volume to provide pricing information on an ongoing base at different prices. Entity can enter into both the market and can access the prices in both market for the asset on measurement date.

	Market A	**Market B**
Price	26,000	25,000
Transaction cost	3,000	1,000
Transportation cost	2,000	2,000
Net amount	21,000	22,000

Find out fair value of the asset as per Ind AS 113.

Note 4. Meaning of market participants: -- market participants are buyer or seller in principal or most advantageous market for asset or liability having following characteristics:

a. They should be independent (means should not be related party)

b. They should have proper knowledge about the product.

c. They should be able and willing to enter the transaction.

d. They should not be under any stress.

Note 5. Meaning of market conditions: - we consider market restrictions/conditions while determining fair value. It means entity specific condition/restriction is not considered.

Question 3. State whether the following statements will be called market/product-based restriction or entity-based restriction.

Case 1. A vehicle cannot be used for commercial purpose.

Case 2. Entity is using vehicle for transportation of employees.

Case 3. Securities (shares) given as security to bank for 10 years. It cannot be sold during 10 years.

Case 4. Securities cannot be physically transferred. It can be sold only through D-mat account.

Fair value Measurement:

When to measure? – As per respective Ind AS. Ind AS 113 does not deal with measurement date.

How to measure 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 (ex. a cash-generating unit).

Application to non-financial assets (e.g., PPE, Intangible assets etc).

(**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:

-- The transfer of a liability or an entity's own equity instrument assumes that 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.

Determination of fair value of liability or own equity instruments:

- If quoted price of such liability/instruments exist on measurement date, then use quoted price for measurement of fair value.
- If quoted price of such liability/instruments does not exist, then take fair value of identical asset held by another party.
- If identical asset does not exist, then apply other valuation techniques.

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(Means developed using market data) and minimising the use of unobservable inputs(means unreliable market data).

(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).

(iii) The income approach converts future amounts (eg cash flows or income and expenses) to a single current (ie discounted) amount.

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

(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.

Chapter 1.13- Ind AS 115 – REVENUE FROM CONTRACTS WITH CUSTOMERS

1. Introduction:

- This standard states **how to recognize revenue and to measure the amount at which revenue is recognized** from contracts with customers.
- **Revenue** is the consideration for satisfying performance obligation undertaken in the contract.
- **Revenue is recognized as and when performance obligation is satisfied** and it is **measured at the amount of transaction price** attributable to the satisfied performance obligation.

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

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

I. **Identifying the contract.**

II. **Identifying performance obligation.**

III. **Satisfaction of performance obligation.**

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

Note:- While stages I to III are for recognition of revenue, **stage IV is for its measurement.**

2. Scope:

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

(a) lease contracts (Ind AS 116);

(b) insurance contracts (Ind AS 104);

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

(d) Non-monetary exchanges between entities in the same line of business to facilitate sales to customers orpotential customers.

For example, this Standard would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations ona timely basis.

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

3. Four stages in revenue recognition and measurement:

Stage I. Identifying the contract –

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

(a) **the parties to the contract have approved the contract** (in writing, orally or industry practices) and are committed to perform their respective obligations;

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

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

(d) **the contract has commercial substance**. It means, the contract must have economic consequences. (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) **it is probable that the entity will collect the consideration** to which it will be entitled in exchange forthe goods or services that will be transferred to the customer. **In evaluating whether collectabilityof an amount of consideration is probable, an entity shall consider only the customer's ability andintention to pay that amount of consideration when it is due.**

POINTS TO THINK WHILE APPLYING ABOVE RECOGNITION CRITERIA:

i. The standard shall continue to be applied till the contract is in force and the parties to the contract have present enforceable rights and obligations.

ii. Termination provision:

(1) There does not exist a contract if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other parties**. A contract is wholly unperformed if—**

(a) the entity has not yet transferred any promised goods or services to the customer: **and**

(b) the entity has not received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

(2) In some situations, only the customer has the ability to terminate the contract without penalty. In those situations, the contract term for accounting purposes may be shorter than that stated in the contract.

Concept question 1: A gymnasium enters into a contract with a new member to provide access to its gym for a 12-month period at 4,500 per month. The member can cancel his or her membership without penalty after three months. Specify the contract term.

Solution: The enforceable rights and obligations of this contract are for three months, and therefore the contract term is three months.

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

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

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

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

- **The consideration received shall be recognized as liability** until any of the above criteria (of identifying the contract) is met at the time of the consideration received.

Concept question 2(related to point iv). On 2nd January 2024, an entity sold goods to a customer (Known as big don in the area) for Rs 1,20,000. The Entity received Rs 10,000 in cash and balance amount was payable after 1 months. But as per the track record of the customer, entity expects that there is very less or no chance of recovery of balance amount. Make journal entries, if:

(a) customer paid the amount on 2nd February 2024.

(b) Customer refused to pay the amount on 2nd February 2024 and we forfeited the amount received previously.

(c) Still no confirmation received at the end of the year.

Solution:

Date	**Particulars**	**Debit**	**Credit**
2-1-2024 **(in all 3 cases)**	Bank account Dr To deposit liability (being consideration received recognised as deposit liability)	10,000	10,000
Case (a) 2-2-24	Bank account Dr To sales account	1,10,000	1,10,000
2-2-24	Deposit liability Dr To sales account	10,000	10,000
Case (b) 2-2-24	Deposit liability Dr To sales account	10,000	10,000
Case (c)	No further entry will be passed. It will be shown as liability in the balance sheet.		

Stage 2: Identifying performance obligation:

a. Performance obligation means a promise to customer of transferring:

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

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

A good or service (or a bundle of goods and services) t is distinct	**A series of distinct goods and services substantially with sa pattern of transfer**
Each distinct good or service in a contract is treated as separate performance obligation	It is treated as single performance obligation.
For example, sale of TV, Music system, computer, laptop, mobile etc	For example, cable service, doctor service, accounting service, hotel management service, maintenance service, newspaper supply service, construction of dam/ bridge etc.
In this case, revenue from each distinct good or service is recognized by the entity when its control is transferred to the customer.	In this case, revenue is recognized on SLM basis over a period of time.

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

i. the customer can benefit from the good or service **either on its own or together with other resources**that are readily available to the customer; and

ii. the entity's promise to transfer the goods or services to the customer is **separately identifiable** from other promises in the contract.

For example:

i. Sale of AC/ TV and its installation are two distinct products only if installation can also be done from any third party.

ii. Sale of car with compulsorily three free services (Assurance warranty) are not distinct products because free car services are not readily available to the customer from any third party.

c. In the following cases goods or services will be treated as single performance obligation even they satisfy the above criteria:

(i) The entity has done significant integration. It means entity has used multiple goods and services to provide the customer a final product he has asked for. For example, construction of farm house.

(ii) if the entity has **significantly modified or customized the good or service**. For example, contract to provide customized software and its installation.

(iii) if good or service are highly interdependent or inter-related. For example designing and construction of building.

Concept question 3. An entity enters into contract to provide water purifier and 3 years maintenance service to the customer. Customer can also purchase water purifier and maintenance service separately from any other vendor. State whether there is one performance obligation or more than one.

Solution: Here, there are two separate performance obligation in the contract i.e. sale of water purifier and sale of maintenance services.

Stage III Satisfaction of performance obligations (when to Recognise Revenue):-

1. **At point of time;**
   OR
2. **Over the period of time**

1. At point of time:- An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by **transferring the control of promised goods or services** (i.e an asset) at a point of time.

Note 1: Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from the asset.

Note 2: The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly.

2. Over the period of time: If an entity transfers control of a goods or services over time and, therefore, recognises revenue

over the period of time, **if one of the following criteria is met:**

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

For example, Entity engage in business of security services, Maintenance services, hospitals.

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

For example, Entity engages in business of construction of buildings, bridges, metro etc.

or

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

For example, Entity engages in business of tailor-made products like CRM software, Site developments, satellite development etc,

- If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time.
- For each performance obligation satisfied over time, an entity shall recognise revenue over time by measuring the progress towards complete satisfaction of that performance obligation.

Appropriate methods of measuring % of progress to recognise revenue include:

(a) Output method and

(b) Input method.

(a) Output method:- Output method recognises revenue on the basis of direct measurements of % ofthe goods or services transferred to date in relation to total goods/services to be transferred under thecontract.

- This method is more appropriate in case an entity has a right to consideration from a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date.
- **Forexample,** a service contract in which an entity bills a fixed amount for each hour of service provided,the entity may recognise revenue in the amount to which the entity has a right to invoice.

Concept question 4. X Ltd entered into a contract with a customer to construct a building for Rs 50,00,000. As per surveyor report, company has completed 30% of the work by the end of first year and 70% by the end of 2nd year. Calculate revenue to be recognized till the end of first year and second year.

Solution: **Statement showing revenue to be recognized each year:**

	1st year	**2nd Year**
Revenue recognized till the end of current year **Less:** revenue already recognized till the end of previous year	15,00,000 (50 lakhs x 30%) Nil	35,00,000 (50 lakhs X 70%) -15,00,000
Revenue to be recognized during the current year	**15,00,000**	**20,00,000**

Concept question 5. On 1st July 2024, Y Ltd entered into a contract with A Ltd to provide security services for Rs 60,00,000 over a period of 5 Years. Calculate revenue to be recognized till the end of first year (i.e 31st March 2025) and 2nd year.

Solution: Revenue to be recognized till the end of first year = 60,00,000 X $\frac{9}{60}$ = Rs 9,00,000.

Statement showing revenue to be recognized each year:

	1st year	**2nd Year**
Revenue recognized till the end of current year **Less:** revenue already recognized till the end of previous year	9,00,000 Nil	21,00,000 (60,00,000 X $\frac{21}{60}$) -9,00,000
Revenue to be recognized during the current year	**9,00,000**	**12,00,000**

(b) Input method: - Input method recognises revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, costs incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation.

% of progress = $\frac{\textbf{cost incurred till date}}{\textbf{total estimated cost}}$ **x 100**

Note 1: Abnormal cost incurred are not considered for calculating % of progress.
Note 2. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for the entity to recognise revenue on a straight-line basis.

Important Note (Important for MCQ): In case of sales based royalty, Revenue is recognised when subsequent sale occurs or performance obligation (transfer of license) to which sales based royalty has been allocated is satisfied, whichever is later.

1. Accounting of revenue:

(i) when control is transferred but consideration is not received:

Debtors account (contract asset) Dr
To sales account

(ii) when payment is received but control of good or service is not transferred:

Bank account Dr
To unearned income account (contract liability)

(iii) when control is transferred and consideration is also received:

Bank account Dr
To sales account

(iv) When WIP asset is created as a contract cost:

WIP asset (prepaid expenses) account Dr
To bank account

2. Accounting in case of sale with right of return (Entity like Amazon, flipcart etc):

To account for the transfer of products/services with a right of return, an entity shall recognise all of the following: **(Based on their past experience and estimates)**

- **(i)** **revenue for the transferred products** is the amount of consideration to which the entity expects to be entitled (therefore, revenue would not be recognised for the products expected to be returned);
- **(ii)** **a refund liability;** and
- **(iii)** **an asset** (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.

Journal entries:

Transactions		Debit	Credit
When sales are made	Bank account Dr (total amount received) To sales account (Products expected to be sold) To refund liability (products expected to be returned)		 Sale price Sale price
	Inventory (stock with customer) Dr To profit and loss account	Cost price	 Cost price
If confirmation of sale received	Refund liability account Dr To sales account		
If sale is rejected	Refund liability account Dr To bank account		

Note: Amount of restocking fees (i.e. amount charged on returned products as a compensation for packing and shipping) is recognised as revenue.

Concept question 6. On 12.01.2024 COC Ltd. entered into a contract with Ram to sell 10 TV sets at a price of Rs 40,000 per unit (profit margin 20% on sale price). Determine revenue to be recognised by COC Ltd in 2023-24 It is a contract of sale or return. The TV sets can be returned by Ram unconditionally within 3 months and the entity expects 30% return.

Make journal entries if on 12th April 2024, Ram returned 2 sets and sent approval for remaining sets.

3. Accounting of warranties:

Assurance warranty	**Service warranty**
It is inbuilt in the product due to requirement of law/ industry practices.	It can be purchased separately by the customer (e.g extended warranty)
Treatment is done as per Ind AS 37. We make provision for expected warranty obligations.	Treat it as separates performance obligation
Journal entry: Warranty expense account (P/L account) Dr To provision for warranty	Make entry with transaction price of the warranty. (assume sale of car with extended warranty) Bank account Dr (amount received) To sales account (sale of car) To contract liability (extended warranty)
	In the year when extended warranty ends: Contract liability account Dr To sales account

Concept question 7: On 1st July 2024, Tata Ltd sold its car to a customer for Rs 9,00,000 with 1 year assurance warranty and 2 years of extended warranty. Standalone selling price of car with one year assurance warranty and two years extended warranty are Rs 8,00,000 and Rs 2,00,000 respectively. Make journal entries in the year 1, 2 and 3 assuming that during first year (assurance warranty period) Tata Ltd has incurred Rs 24,000 on its warranty **and** further estimated to incur Rs 10,000 as on 31st March 2025. During the period of second year and third year, no expenses were incurred.

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

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

Determining the transaction price:

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

The consideration promised in a contract with a customer may include **fixed amounts, variable amounts, or both.**

When determining the transaction price, an entity shall consider the effects of all the following:

(a) variable consideration (E.g. rate differences, quantity discount, incentive, additional compensation, penalties);
(b) constraining estimates of variable consideration;

(c) the existence of a significant financing component in the contract;
(d) non-cash consideration; and
(e) consideration payable to a customer (cash back, coupon, vouchers to customers).

Detail discussion of above points [i.e (a) to (e)]:

Explanation of point (a):- If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

- **An entity shall estimate an amount of variable consideration by using either of the following methods:**

(i) The expected value—This method is generally used when there are more than 2 possible outcomes. In this method, the expected value (i.e. Sum of probability-weighted amounts in a range of possible consideration amounts) is taken as Variable consideration. It will be calculated as follow:

Estimated variable consideration	**Probability**	**Probability X Estimated consideration (Z)**
C1	P1	C1 X P1
C2	P2	C2 X P2
C3	P3	C3 X P3
Cn	Pn	Cn X Pn
Total variable consideration		**Sum of (Z)**
Computation of variable consideration per unit (weighted average price per unit)		$\frac{\textbf{Total of (ProbabilityX Estimated consideration)}}{\textit{weighted average No of units}}$

Concept question 8: On 1st May 2024, X Ltd (a construction company) enter into a contract to deliver an office building to Ram at a contract price of Rs 80,00,000 on 31st March 2025 with a clause of variable consideration based on timing of completion of the contract, mentioned as below:

If completed on or before	**Additional consideration**	**Probability of completion**
30th November 2024	10,00,000	.30
31st December 2024	8,00,000	.45
31st January 2025	6,00,000	.15

Calculate amount of variable consideration to be accounted in the books of account.

Concept question 9: X Ltd entered into a contract with customer to charge different price/unit based on volume of units sold during the period of one year (i.e. 1st April 2024 to 31st March 2025) given as below:

Sales volume per year	**Price/unit**	**Probability**
Upto 10,000 units	Rs 100	20%
Upto 15,000 Units	Rs 85	70%
Upto 20,000 units	Rs 60	10%

Calculate variable consideration per unit and make entry for sale of 4,000 units of commodity on 16th July 2024 at the rate of Rs 100.

Concept Question 10. On 01.12.2024 A Ltd. entered into a contract with customer to install a system at Rs 20 lakhs and implement a software by June 2025 at Rs 80 lakhs plus Rs 15 lakhs bonus for completing software implementation by April 2025. Initially A Ltd. estimated the contract price at 1 crore for two performance obligations – system installation and software implementation by June 2025.

In March 2025 the company found system installation complete and software implementation 80% complete with confidence to earn bonus of Rs 15 lakhs by completing implementation by April 2025. Compute revenue to be recognised in 2024-25. **(ICMAI Study material)**

Solution: Bonus of Rs 15 Lakhs is the variable consideration considered as change in contract price to be allocated to performance obligation of software implementation and recognised to the extent of performance obligation satisfied over time.

Thus, revenue recognition in 2024-2025:

System installation completed Rs 20 Lakhs; and

Software implementation 80% completed = (Rs 80 lakhs + Rs 15 lakhs) × 80% = Rs 76 lakhs.

Note:- Had the software implementation be satisfied at a point in time when completed and control is transferred in April 2025, no revenue would be recognised proportionately in 2024-2025 for software implementation.

(ii) The most likely amount— the most likely amount is the single most likely amount in a range of possible consideration amounts. The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes.

Concept question 11: Y Ltd entered into a contract with customer to charge different price/unit based on volume of units sold during the period of one year (i.e. 1st April 2024 to 31st March 2025) given as below:

Sales volume per year	Price/unit	Probability
Upto 10,000 units	Rs 100	30%
Upto 15,000 Units	Rs 85	70%

Calculate variable consideration per unit and make entry for sale of 4,000 units of commodity on 16th July 2024 at the rate of Rs 100.

Note 1: In examination, if method of calculation is not mentioned in question, we should apply the most likely amount method if only two outcomes are given in question and the expected value method if more than two outcomes are given in questions.

Note 2: If more than two outcomes are given and it is clearly mentioned in question to apply the most likely amount method, then we should solve accordingly.

Concept question 12: Z Ltd entered into a contract with customer to charge different price/unit based on volume of units sold during the period of one year (i.e. 1st April 2024 to 31st March 2025) given as below:

Sales volume per year	Price/unit	Probability
Upto 10,000 units	Rs 100	20%
Upto 15,000 Units	Rs 85	70%
Upto 20,000 units	Rs 60	10%

Calculate variable consideration per unit by The most likely amount method.

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

<u>Explanation of Point (c):</u> If significant financing component exists in the contract whether explicitly or implicitly, that would be separately recognised as interest income.

Explanation 1:- if an entity makes sales and payment to be received after a certain period (which is more than normal trading period), then entity shall recognise sales at normal selling price and excess amount will be treated as interest income (finance income) over the credit period in the profit and loss account.

Note: if normal selling price is given in question **--- thank God**

If normal selling price is not given in the question, it can be calculated as follows:
(a) Normal selling price = cost of good or service + normal % of profit margin.
(b) Normal selling price = PV of future cash inflows at discounting rate.

Journal entries:

(a) At the time of sale:

Debtors account (contract asset) Dr (Normal selling price)

Accrued interest account Dr (total financing component)
To sales account (Normal selling price)
To liability for unearned interest (total financing component)

(b) At the end of each year:

(i) entry for interest accrued:
Liability for unearned interest account Dr
To interest income

(ii) for transferring interest income(finance income) to profit and loss account:
Interest income account Dr
To profit and loss account

(iii) when payment is received from debtors:
Bank account Dr
To debtors account
To Accrued interest account

Concept question 13. On 1st April 2024, COC Ltd sold its CFR Classes to a student for Rs 2,42,000. The student agreed to pay this amount after 2 years. Discount rate is 10%. Use PV Factor for 2 years at 10% discounting rate as .82645. Pass journal entries in the book of COC Ltd.

Explanation 2: DELETED
Explanation 3: In the following case, financing component will be assumed to be insignificant, hence it will not be adjusted from transaction price:

- **If rate of interest is insignificant (i.e less than 5%).**
- DELETED
- If consideration is based on some future events (i,e, sales based on royalty)
- **If time gap is 1year or less,** then entity may choose not to adjust financing component from transaction price.

Concept Question 15. On 31.03.2023 X Ltd. Sold goods at a price of Rs 1,33,100 payable on 31.03.2026. The implicit interest rate is 10% p.a. What would be the revenue to be recognized for the year 2022-23, 2023-24, 2024-25 and 2025-26? **(ICMAI Study material)**

Concept Question 16. On 01.04.2024 X Ltd. Sold goods at a price of Rs 1,30,000 payable on 31.07.2024. The implicit interest rateis 12% p.a. What would be the revenue to be recognized for the year 2024-25? **(ICMAI Study material)**

Solution: Since financing component is not considered significant as the period is normal credit period.Hence, the entire sale value of Rs 1,30,000 is recognised as revenue from contract with customer.

Concept Question 17. On 01.04.2024 X Ltd. sold goods at a price of Rs 1,25,000 plus interest at the rate of 30% p.a. payable on 31.07. 2024 at the end of normal credit period of 4 months. What would be the revenue to be recognized for the year 2024-25? **(ICMAI Study material)**

Solution: Any interest charged for normal credit period is not considered as a financing component of the contract price, rather included as part of revenue from contract with customer. As the credit period is normal Rs 1,25,000 plus interest Rs 10,000 = Rs 1,35,000 is recognised as revenue from contract with customer.

Concept Question 18. On 31.07.2024 X Ltd. sold goods at a price of Rs 1,25,000 plus interest at the rate of 30% p.a. payable on 31.07.2025. Normal interest rate is 10% p.a. What would be the revenue to be recognized for the year 2024-25? **(ICMAI Study material)**
Solution: As the credit period is longer than normal credit period and the rate of interest charged is significantly different from normal, selling price of Rs 1,25,000 plus interest in excess of normal (20% × 1,25,000), a total of Rs 1,50,000 is recognised as revenue from contract with customer in 2024-25 as the performance obligation is satisfied by sale of goods. The normal interest for 1 year is recognized as interest income to be distributed for 8 months in the year 24-25 and for 4 months in 25-26.

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

Note: If fair value of non-cash consideration cannot be estimated reliably, then assume complete transaction price as equals to standalone selling price of goods or services promised to customer.

Explanation of Point (e): - An entity shall account for consideration payable to a customer, if any, as a reduction of the transaction price. For example, cash back, coupon, vouchers to customers.

Concept Question 19. On 31.03.2024 A Ltd. enter into a contract with a customer for sale of goods of Rs 4,000 granting 50% discount voucher to be availed in future purchase up to Rs 3,000 within 30 days. Ordinarily 10% discount is allowed on sales. Ordinary discount will not be available to avail the 50% discount voucher. There is 60% probability that the customer will redeem the discount voucher and the estimated amount of purchase is Rs 2,000. In April 2024 the discount vouchers are redeemed for purchase of additional goods of Rs 2,800. Find revenue recognition in 2023-24 andin 2024-25. **(ICMAI Study material)**

Allocating the transaction price to performance obligations:

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

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

(B) Except for

(B1) allocating discounts, and

(B2) allocating variable consideration

Detail explanation of point A, B1 and B2:

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

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

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

- An entity shall allocate to the performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception.
- **In Bill-and-hold transaction,** the entity holds the goods as custodian and revenue is recognised. However,for establishing transfer of control, all the following criteria must be met:

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

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

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

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

Note: any consideration received for bill and hold transaction will be treated as revenue for the period it relates.

Concept Question 20 (bill-and-hold arrangement): A Ltd. entered into a contract with a customer for construction of a machine at the site of the customer at Rs 8 lakhs and for supply of spare parts at Rs 1.6 lakhs in the next financial year but to hold the spare parts in A Ltd's warehouse separately to be delivered to the customer's factory as and when required in following 3 financial years for additional consideration of Rs 20,000 p.a. Recognise revenue in the financial years if the contract is duly performed. **(ICMAI Study material)**

Solution: In the year of contract, no revenue is recognised as no performance obligation satisfied. In the next year Rs 8 lakhs is recognised for completing the construction and transfer of control at the point in time.

Further Rs 1.6 lakhs is recognised for supply of spare parts although it is held in warehouse of A Ltd. as custodian as control is transferred.

Rs 20,000 in each of the 3 years next shall be recognised as revenue from custodial services.

Concept question 21. COC Ltd is selling 4 different subjects to a student for Rs 20,000. Individual price of each subject is given below:

CFR	10,000
Cost Audit	6,000
Business valuation	4,000
IDT	5,000

Allocate the transaction price among all four subjects (products).

Solution: Allocation of the transaction price among all four subjects (products).

CFR	$\frac{10,000}{25,000}$ x 20,000 = Rs 8,000
Cost Audit	$\frac{6,000}{25,000}$ x 20,000 = Rs 4,800
Business valuation	$\frac{4,000}{25,000}$ x 20,000 = Rs 3,200
IDT	$\frac{5,000}{25,000}$ x 20,000 = Rs 4,000
Total	Rs 20,000

Concept question 22. COC Ltd is selling 4 different subjects to a student for Rs 20,000. Individual price of each subject is given below:

CFR	10,000
Cost Audit	6,000
Business valuation	4,000
IDT	5,000

Allocate the transaction price among all four subjects (products) if discount is to be wholly borne by CFR.

Solution: Allocation of the transaction price among all four subjects (products).

CFR	10,000 -5,000 = 5,000
Cost Audit	6,000
Business valuation	4,000
IDT	5,000
Total	**20,000**

Note: If there is clear differences between standalone price and billed amount of the product (for the purpose of tax evasion or any other reason).

Concept question 23 (If raised separate bills of the products are exceptionally different from their standalone price). COC Ltd is selling its CFR classes in google drive with hard book for Rs 9,000 (2 products- classes and book) raising two separate bill at Rs 5,000 for classes and Rs 4,000 for hard book. The standalone selling price of the two products are:

Classes – Rs 8,500

Book – Rs 1,500

Allocate transaction price between the two products as per Ind AS 115.

Solution: Allocation of the transaction price among two products:

Classes	$\frac{8,500}{10,000}$ x 9,000 = Rs 7,650
Book	$\frac{1,500}{10,000}$ x 9,000 = Rs 1,350
Total	**Rs 9,000**

Concept question 24: X Ltd is selling License A and B to the customer. Price stated in the contract is fixed at Rs 5,50,000 for license 'A' and price for License 'B' is % based on sales-based royalty (variable consideration) i.e expected to be Rs 30,00,000. The standalone selling price of the two products are:

Product	**Standalone selling price**
License A	16,00,000
License B	20,00,000

Allocate transaction price between the two products as per Ind AS 115. **(ICAI Study material)**

Solution: Allocation of the transaction price among two products:

License A	$\frac{16,00,000}{36,00,000}$ x 35,50,000 = Rs 15,77,778
License B	$\frac{20,00,000}{36,00,000}$ x 35,50,000 = Rs 19,72,000
Total	**Rs 35,50,000**

<u>Some important provisions (special cases):</u>

<u>Special case 1. Contract modifications</u>: -

Contract modification is a change in scope or price (or both) of a contract that is approved by the parties to the contract. An entity shall account for a contract modification either as:

Modification A: -

- **The conditions to be satisfied for contract modification 'A':**
    - (i) additional performances are distinct.
    - (ii) additional consideration is stand-alone selling price.
- Accounting should be done assuming it is a completely separate contract.

Modification B:-

Situation 1: Modification results in change in the price of existing goods or services.

OR

Situation 2: Modification results in addition of goods or services in the contract but price in the contract does not increase by stand-alone selling price of additional goods or services.

- It should be treated as termination of the existing contract and creation of a new contract for the remaining performance.
- Consideration for remaining goods or services is recognized as revenue over the remaining period.

Modification C:- If modification results in Continuation of existing contract with modifications (for example, increase in labour hour)

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

Concept Question 25 (based on Modification 'A'): Z Ltd. agrees to sell 200 units of product 'A' to a customer for Rs 3,20,000 (Rs 1,600 per unit). The product 'A' units are transferred over to the customers from 01.01.2024 to 30.06.2024. On 31.03.2024 after transfer of control of 100 units of A, the contract is modified to deliver additional 50 units at the then market price of Rs 1,400 per unit to be delivered in following 3 months. Show how the transaction will be accounted in books of Z ltd. **(ICMAI Study material)**

Concept Question 26 (based on Modification 'B'): assume in previous question, on 1.4.2024 the contract is modified to deliver 150 units of A instead of remaining 100 units by 30.6.2024 at Rs 1,500 per unit. **(ICMAI Study material)**

Concept Question 27 (based on Modification 'C'): On 1st November 2024, COC Ltd entered into a contract to teach students in USA at Original contract price of Rs 50,000 based on estimated 200 production hours at a rate of Rs 250 per hour. After revenue recognition for 100 hours for the year ended on 31st March 2025, the contract is modified to increase the required hours by 50

(i) at hourly rate by Rs 200;

(ii) at hourly rate of Rs 200 for the remaining hours;

(iii)) at hourly rate of Rs 200 for the total hours required **(ICMAI Study material- Modified)**

Make journal entries for the year 24-25 and 25-26.

Concept Question 28:

On 1st April, 2024, KLC Ltd. enters into a contract with Mr. K to provide a machine for Rs 2.5 million and one year of maintenance services for Rs 55,000 per month.

On 1st October, 2024, KLC Ltd. and Mr. K agree to modify the contract to reduce the amount of services from Rs 55,000 per month to Rs 45,000 per month. Determine the effect of change in the contract? **(ICAI Study material)**

Solution:

The next six months of services are distinct from the services provided in the first six months before modification in contract,

Therefore, KLC Ltd. will account for the contract modification as if it were a termination of the existing contract and the creation of a new contract.

The consideration allocated to remaining performance obligation is Rs 2,70,000, which is calculated as follows:

Unrecognised revenue of the original contract (as if terminated)	Nil
Contract modification 6 months ×Rs 45,000	2,70,000
Total	**2,70,000**

Special case 2. Combination of contracts:

- An entity should combine two or more contracts and account for them as a single contract in certain circumstances because **the substance of the individual contracts cannot be understood without considering the entire arrangement. This evaluation takes place at contract inception.**

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

(i) Contracts are negotiated as a package with single commercial objective. (development and installation of specific software, designing and construction of bridge/dam)
(ii) The consideration of one contract depends on the price or performance of the other, or
(iii) There is single performance obligation.

Note: Entities will need to apply judgement to determine whether contracts are entered into at or near the same time because the standard does not provide a bright line for making this assessment.

Concept question 29: Manufacturer of airplanes for the air force negotiates a contract to design and manufacture new fighter planes for a Kashmir air base. At the same meeting, the manufacturer enters into a separate contract to supply parts for existing planes at other bases. Would these contracts be combined? **(ICAI Study material)**

Solution: Contracts were negotiated at the same time, but they appear to have separate commercial objectives. Manufacturing and supply contracts are not dependent on one another, and the planes and the parts are not a single performance obligation. Therefore, contracts for supply of fighter planes and supply of parts shall not be combined and instead, they shall be accounted separately.

Concept question 30: Software Company S enters into a contract to license its customer relationship management software to Customer B. Three days later, in a separate contract, S agrees to provide consulting services to significantly customise the licensed software to function in B's IT environment. B is unable to use the software until the customisation services are complete. Would these contracts be combined?

Solution: S determines that the two contracts should be combined because they were entered into at nearly the same time with the same customer, and the goods or services in the contracts are a single performance obligation.

Special case 3. Contract cost:

(a) Incremental costs of obtaining a contract

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

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

- **Recognise it as WIP asset and amortise over the contract terms.**
- **Journal entry:**
  WIP asset (Prepaid expenses) account Dr
  To bank account

(b) Cost to fulfil a contract:

(i) If the costs incurred in fulfilling a contract with a customer are within the scope of another Standard(for example, Ind AS 2, Inventories, Ind AS 16, Property, Plant and Equipment or Ind AS 38, IntangibleAssets) – Apply respective Ind AS in accounting of such costs.

(ii) If not covered by any other Ind AS - an entity shall recognise a WIP asset and amortise over the contract term.

Special case 4. Service concession arrangement:

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

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

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

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

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

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

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

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

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

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

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

Accounting of revenue in case of Service concession arrangement:

Case 1: If entity has right to receive fixed amount of cash from government as financial assets(Ind AS 109):

Transactions	**Journal entry**	**Amount**
Journal entry in construction phase	Financial assets (debtors) account Dr To sales account	At fair value of construction service
Journal entry in operation phase	Financial assets (debtors) account Dr To finance income	Finance income included in financial asset.
	Financial assets (debtors) account Dr To sales account	Income related to operation at fair value
When payment received	Bank account Dr To financial assets(debtors) account	Amount received

Case 2: if entity has right to collect toll as intangible assets (as per Ind AS 38):

Particulars	**Journal entry**	**Amount**
Journal entry in construction phase	Intangible asset account Dr To sales account	At fair value of construction service
Journal entry in operation phase	Amortisation account (P/L) Dr To Intangible asset	Amortisation of intangible assets over contract period.
When Toll income received during the year	Bank account Dr To sales account	Toll income received during the year

Presentation and disclosures requirements of Ind AS 115:

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

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

(a) its contracts with customers;

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

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

Practice questions:

Concept Question 31: Determine whether there arise single or multiple performance obligations for the following contracts with customers?

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

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

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

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

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

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

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

(ii) Installation is customised to modify the software with additional functionalities. **(ICMAI Study material)**

Solution:

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

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

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

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

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

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

Concept Question 32: On 01.08.2024 A Ltd. enter into a contract with a hotel for daily sanitisation of the building for 3 years at Rs 12,000 per month. The customer receives and consume benefits each day. Determine the revenue to be recognised in 2024-25. **(ICMAI Study material)**

Solution: It is a series of distinct goods and services constituting a single performance obligation to be satisfied over time and transaction price has to be allocated proportionately to the performance obligation satisfied. Accordingly, for 8 months @ Rs 12,000 per month, Rs 96,000 will be the revenue to be recognised in 2024-25.

Concept Question 33: On 01.01.2024 A Ltd. entered into a contract with B to sell 20 TV sets at a price of Rs 50,000 per set and the goods were delivered in February, 2024. Determine revenue to be recognised by A Ltd in 2023-24 in the following circumstances:

(i) 2 sets found damaged at the time of receiving and returned by B.
(ii) 4 sets found not properly functioning in March, 2024 and they were replaced by A Ltd as per terms of warranty.
(iii) It is not a sale but goods sent on consignment and B will sell the TV sets at Rs 50,000 per set. 12 sets were sold by B.
(iv) It is a contract of sale or return. The TV sets can be returned by B unconditionally within 3 months. The entity expects (a) full return; (b) 50% return **(ICMAI Study material)**

Solution:

(i) Revenue is recognised for 18 sets at Rs 9,00,000. 2 sets returned to inventory of defective items.
(ii) Revenue is recognised for 20 sets at Rs 10,00,000 at delivery (assumed warranty is required by law and subsequent replacement is not considered as performance obligation to be satisfied over time and to attract any allocation of contract price).
(iii) Revenue is recognised for 12 sets at Rs 6,00,000. The other 8 sets are recognised as asset (inventory) at cost.
(iv) (a) No revenue is recognised on delivery as right of the customer to unconditionally return the goods has not expired and full return is expected. The amount received or receivable on delivery of the sets is recognised as a liability and asset (inventory) is recognised for all 20 sets at cost. The performance obligation will be satisfied at the point of time when that right to return will expire and then only revenue will be recognised cancelling the liability.
(b) Revenue will be recognised at Rs 5,00,000 (50% of delivery) and for balance Rs 5,00,000, liability will be recognised. Further, asset (inventory) should be recognised for 10 sets at cost.

Concept question 34: A construction services company enters into a contract with a customer to build a water purification plant. The company is responsible for all aspects of the plant including overall project management, engineering and design services, site preparation, physical construction of the plant, procurement of pumps and equipment for measuring and testing flow volumes and water quality, and the integration of all components.
Determine whether the company has a single or multiple performance obligations under the contract? **(ICAI Study material)**

Solution: Determining whether a goods or service represents a performance obligation on its own or is required to be aggregated with other goods or services can have a significant impact on the timing of revenue recognition.
In order to determine how many performance obligations are present in the contract, the company applies the guidance given in Ind AS 115.
While the customer may be able to benefit from each promised goods or service on its own (or together with other readily available resources), they do not appear to be separately identifiable within the context of the contract. That is, the promised goods and services are subject to significant integration, and as a result will be treated as a single performance obligation.
This is consistent with a view that the customer is primarily interested in acquiring a single asset (a water purification plant) rather than a collection of related components and services.

Concept question 35: An entity provides broadband services to its customers along with voice call service. Customer buys modem from the entity. However, customer can also get the connection from the entity and modem from any other vendor. The installation activity requires limited effort and the cost involved is almost insignificant. It has various plans where it provides either broadband services or voice call services or both.
Are the performance obligations under the contract distinct? **(ICAI Study material)**

Solution: Entity promises to customer to provide Broadband Service, Voice Call services and Modem. As per Ind AS 115, Entity's promise to provide goods and services is distinct if:
(a) customer can benefit from the goods or service either on its own or together with other resources that are readily available to the customer, and
(b) entity's promise to transfer the goods or service to the customer is separately identifiable from other promises in the contract

For broadband and voice call services: -
Broadband and voice services are separately identifiable from other promises as company has various plans to provide the two services separately. These two services are not dependant or interrelated. Also, the customer can benefit on its own from the services received.

For sale of modem: -
Customer can either buy product from entity or third party. No significant customisation or modification is required for selling product.
Based on the evaluation we can say that there are three separate performance obligation i.e Broadband Service, Voice Call services and Modem

Concept question 36: Entity sells gym memberships for Rs 7,500 per year to 100 customers, with an option to renew at a discount in 2nd and 3rd years at Rs 6,000 per year. Entity estimates an annual attrition rate of 50% each year.
Determine the amount of revenue to be recognized in the first year and the amount of contract liability against the option given to the customer for renewing the membership at discount.

Solution: Allocated price per unit (year) is calculated as follows:
Total estimated memberships in 3 years period is 175 members (Year 1 = 100; Year 2 = 50; Year 3 = 25) = 175
Total estimated consideration in 3 years period is Rs 12,00,000 {(100X7,500) + (50 X 6,000) + (25 X 6,000)
Allocated price per membership is Rs 6.857 (approx.) i.e. $\frac{12,00,000}{175}$
Based on above, it is to be noted that although entity has collected Rs 7,500 but revenue can be recognized at Rs 6,857 per membership and remaining Rs 643 should be recorded at contract liability against option given to customer for renewing their membership at discount.

Concept question 37: An entity enters into a contract for the sale of Product A for Rs 1,000. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to Rs 1,000 in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.
The entity believes there is 80% likelihood that a customer will redeem the voucher and, on an average, a customer will purchase Rs 500 of additional products.
Determine how many performance obligations does the entity have and their stand-alone selling price and allocated transaction price? **(ICAI Study material)**

Solution: Since all customers will receive a 10% discount on purchases during the next 30 days, the only additional discount that provides the customer with a material right is the incremental discount of 30% on the products purchased. The entity accounts for the promise to provide the incremental discount as a separate performance obligation in the contract for the sale of Product A.
The entity believes there is 80% likelihood that a customer will redeem the voucher and, on an average, a customer will purchase Rs 500 worth of additional products. Consequently, the entity's estimated stand-alone selling price of the discount voucher is Rs 120 (Rs 500 average purchase price of additional products X 30% incremental discount X 80% likelihood of exercising the option). The standalone selling price of product A and the discount voucher and the resulting allocation of the Rs 1,000 transaction price are as follows:

Performance obligations	**Stand-alone selling price**
Product A	1000
Discount voucher	120
Total	**1120**

Performance obligations		**Allocated transaction price (to nearest 10)**
Product A	$\frac{1000}{1,120} X\ 1000$	890
Discount voucher	$\frac{120}{1,120} X\ 1000$	110
Total		**1000**

The entity allocates Rs 890 to product A and recognises revenue for product A when control transfers. The entity allocates RS 110 to the discount voucher and recognises revenue for the voucher when the customer redeems it for the goods or services or when it expires.

Concept question 38: Manufacturer M enters into a 60-day consignment contract to ship 1,000 dresses to Retailer A's stores. Retailer A is obligated to pay Manufacturer M Rs 20 per dress when the dress is sold to an end customer.
During the consignment period, Manufacturer M has the contractual right to require Retailer A to either return the dresses or transfer them to another retailer. Manufacturer M is also required to accept the return of the inventory. State when the control is transferred.

Solution: Manufacturer M determines that control has not been transferred to Retailer 'A' on delivery, for the following reasons:

(a) Retailer 'A' does not have an unconditional obligation to pay for the dresses until they have been sold to an end customer;
(b) Manufacturer M is able to require that the dresses be transferred to another retailer at any time before Retailer A sells them to an end customer; and
(c) Manufacturer M is able to require the return of the dresses or transfer them to another retailer.

Manufacturer M determines that control of the dresses transfers when they are sold to an end customer i.e. when Retailer A has an unconditional obligation to pay Manufacturer M and can no longer return or otherwise transfer the dresses.

Manufacturer M recognizes revenue as the dresses are sold to the end customer.

Concept question 39: AST Limited enters into a contract with a customer to build a manufacturing facility. The entity determines that the contract contains one performance obligation satisfied over time.
Construction is scheduled to be completed by the end of the 36th month for an agreed-upon price of Rs 25 crore.
The entity has the opportunity to earn a performance bonus for early completion as follows:

- 15 percent bonus of the contract price if completed by the 30th month (25% likelihood)
- 10 percent bonus if completed by the 32nd month (40% likelihood)
- 5 percent bonus if completed by the 34th month (15% likelihood)

In addition to the potential performance bonus for early completion, AST Limited is entitled to a quality bonus of Rs 2 crore if a health and safety inspector assigns the facility a gold star rating as defined by the agency in the terms of the contract. AST Limited concludes that it is 60% likely that it will receive the quality bonus.
Determine the transaction price. **(ICAI Study material)**

Solution: In determining the transaction price, AST Limited separately estimates variable consideration for each element of variability i.e. the early completion bonus and the quality bonus.

AST Limited should use the expected value method to estimate the variable consideration associated with the early completion bonus because there is a range of possible outcomes. AST's best estimate of the early completion bonus is Rs 2.13 crores calculated as shown in the following table:

Bonus %	Amount of bonus (in crore)	Probability	Probability-weighted amount (in crore)
15%	3.75	25%	0.9375
10%	2.50	40%	1.00
5%	1.25	15%	0.1875
0%	-	20%	-
			2.125

AST Limited should use the most likely amount to estimate the variable consideration associated with the potential quality bonus because there are only two possible outcomes (Rs 2 crores or nil). AST Limited believes the most likely amount of the quality bonus is Rs 2 crore.

Hence, total transaction price = 29.125 crores i.e. (25 + 2.125 + 2)

Question 40. HT Limited enters into a contract with a customer on 1st April, 2024 to sell Product X for Rs 1,000 per unit. If the customer purchases more than 100 units of Product A in a financial year, the contract specifies that the price per unit is retrospectively reduced to 900 per unit.
For the first quarter ended 30th June, 2024, the entity sells 10 units of Product A to the customer. The entity estimates that the customer's purchases will not exceed the 100 unit threshold required for the volume discount in the financial year. HT Limited determines that it has significant experience with this product and with the purchasing pattern of the customer. Thus, HT Limited concludes that it is highly probable that a significant reversal in the cumulative amount of revenue recognized (i.e. Rs 1,000 per unit) will not occur when the uncertainty is resolved (i.e. when the total amount of purchases is known).
Further, in May, 2024, the customer acquires another company and in the second quarter ended 30th September, 2024 the entity sells an additional 50 units of Product A to the customer. In the light of the new fact, the entity estimates that the customer's purchases will exceed the 100-unit threshold for the financial year and therefore it will be required to retrospectively reduce the price per unit to Rs 900.

Determine the amount of revenue to be recognize by HT Ltd. for the quarter ended 30th June, 2024 and 30th September, 2024.

Solution: The entity recognizes revenue of Rs 10,000 (10 units × 1,000 per unit) for the quarter ended 30th June 2024.
HT Limited recognizes revenue of Rs 44,000 for the quarter ended 30th September, 2024. That amount is calculated as follows:

Revenue to be recognised till the end of 30th September 2024 (60 X 900) Less: revenue already recognised till the end of 30th June 2024 (10X 1000)	54,000 - 10,000
Revenue to be recognised for the quarter ended on 30th September 2024	44,000

Question 41. An entity enters into contracts with 1,000 customers. Each contract includes the sale of one product for Rs 50 (1,000 total products ×50 = Rs 50,000 total consideration). Cash is received when control of a product transfers. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity's cost of each product is Rs 30.
Since the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates that 970 products will not be returned.
The entity estimates that the costs of recovering the products will be immaterial and expects that the returned products can be resold at a profit.
Determine the amount of revenue, refund liability and the asset to be recognized by the entity for the said contracts.

(ICAI Study material)

Solution: Upon transfer of control of the 1,000 products, the entity does not recognize revenue for the 30 products that it expects to be returned. Consequently, in accordance with Ind AS 115, the entity recognizes the following:
(a) revenue of Rs 48,500 (50 × 970 products not expected to be returned).

(b) a refund liability of Rs 1,500 (50 refund × 30 products expected to be returned), and

(c) an asset of Rs 900 (30×30 products for its right to recover products from customers on settling the refund liability).

Question 42 (Concept of warranty) An entity manufactures and sells computers that include an assurance-type warranty for the first 90 days. The entity offers an optional 'extended coverage' plan under which it will repair or replace any defective part for three years from the expiration of the assurance-type warranty. Since the optional 'extended coverage' plan is sold separately, the entity determines that the three years of extended coverage represent a separate performance obligation (i.e. a service- type warranty). The total transaction price for the sale of a computer and the extended warranty is 36,000. The entity determines that the stand-alone selling prices of the computer and the extended warranty are Rs 32,000 and Rs 4,000, respectively. The inventory value of the computer is Rs 14,400. Furthermore, the entity estimates that, based on its experience, it will incur Rs 2,000 in costs to repair defects that arise within the 90-day coverage period for the assurance-type warranty. Pass required journal entries.

(ICAI Study material)

Solution:

Bank/Trade receivables		36,(	
Warranty expense		2,(	
To Accrued warranty costs (assurance-type warranty)			2,000
To Contract liability (service-type warranty)			4,000
To Revenue (sales)			32,000
(To record revenue and contract liabilities related to warranties)			

Cost of goods sold To Inventory (To derecognize inventory and recognize cost of goods sold)		14,4	14,400

Question 43 (Concept of warranty) Entity sells 100 ultra-life batteries for Rs 2,000 each and provides the customer with a five-year guarantee that the batteries will withstand the elements and continue to perform to specifications. The entity, which normally provides a one-year guarantee to customer purchasing ultra-life batteries, determines that from the years 2 to 5 represent a separate performance obligation. The entity determines that Rs 1,70,000 of the Rs 2,00,000 transaction price should be allocated to the batteries and 30,000 to the service warranty (based on estimated stand-alone selling prices and a relative selling price allocation). The entity's normal one-year warranty cost is Rs 100 per battery. Pass required journal entries.

Solution: Upon delivery of the batteries, the entity records the following entry:

Bank /Receivables/ debtor account To Revenue To Contract liability (service warranty)	Dr	2,00,000	 1,70,000 30,000
Warranty expense To Accrued warranty costs (assurance warranty)	Dr	10,000	 10,000

Question 44 (based on financing component): A commercial airplane component supplier enters into a contract with a customer for a promised consideration of Rs 70,00,000. Based on an evaluation of the facts and circumstances, the supplier concluded that Rs 1,40,000 represented an insignificant financing component because of an advance payment received in excess of a year before the transfer of control of the product.

State whether company needs to make any adjustment in determining the transaction price.

What if the advance payment was larger and received further in advance, such that the entity concluded that Rs 14,00,000 represented the financing component based on an analysis of the facts and circumstances.

Solution: The entity may conclude that Rs1,40,000, or 2 percent of the contract price, is not significant, and the entity may not need to adjust the consideration promised in determining the transaction price.

However, when the advance payment was larger and received further in advance, such that the entity may conclude that Rs14,00,000 represents the financing component based on an analysis of the facts and circumstances. In such a case, the entity may conclude that Rs 14,00,000, or 20% of the contract price, is significant, and the entity should adjust the consideration promised in determining the transaction price.

Question 45(based on allocation of transaction price) An entity enters into a contract with a customer to sell Products A, B and C in exchange for Rs 10,000. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs.

The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price	Method
Product A	5,000	Directly observable
Product B	2,500	Adjusted market assessment approach
Product C	7,500	Expected cost plus a margin approach
Total	15,000	

Determine the transaction price allocated to each product.

Solution: The customer receives a discount for purchasing the bundle of goods because the sum of the stand-alone selling prices (Rs 15,000) exceeds the promised consideration (Rs 10,000). The entity considers that there is no observable evidence about the performance obligation to which the entire discount belongs. The discount is allocated proportionately across Products A, B and C. The discount, and therefore the transaction price, is allocated as follows:

Product	Allocated transaction price (to nearest Rs 100)
Product A	3,300 (5,000 ÷15,000 × 10,000)
Product B	1,700 (2,500 ÷ 15,000 × 10,000)
Product C	5,000 (7,500 ÷ 15,000 × 10,000)
Total	**10,000**

Question 46: ABC enters into a contract with a customer to build an item of equipment. The customer pays 10% advance and then 80% in instalments of 10% each over the period of construction with balance 10% payable at the end of construction period. The payments are non-refundable unless the company fails to perform as per the contract. Further, if the customer terminates the contract, then entity is entitled to retain payments made. The company will have no further right to compensation from the customer.

Evaluate if contract will qualify for satisfaction of performance obligation over a period of time.

Solution: The Company shall evaluate conditions laid in Ind AS 115 as follows:

Criterion (a) – whether the customer simultaneously receives and consumes the benefits: - Customer can benefit only when the asset is fully constructed and no benefits are consumed as its constructed. Hence, this criterion is not met.

Criterion (b) – An asset created that customer controls: - As per provided facts, the customer does not acquire control of the asset as it is created.

Criterion (c) – no alternate use to entity and right to seek payment: - The customer has specific right over the asset and company does not have right to divert it for any alternate use. In other words, there is contractual restriction to use the asset for any alternate purpose.

In the event of early termination, Company has a right to retain any payments made by the customer. However, such payments need not necessarily compensate the selling price of the partially constructed asset, if the customer was to stop making payments. Therefore, Company does not have a legally enforceable right to payment for work completed to date and the criterion of Ind AS 115 not satisfied. Thus, revenue cannot be recognized over a period of time

Question 47: On 1st January, 2024, an entity contracts to renovate a building including the installation of new elevators. The entity estimates the following with respect to the contract:

Particulars	Amount
Transaction price	50,00,000
Expected costs:	
(a) Elevators	15,00,000
(b) Other costs	25,00,000
Total	**4,000,000**

The entity purchases the elevators, and they are delivered to the site six months before they will be installed. The entity uses an input method based on cost to measure progress towards completion. The entity has incurred actual other costs of Rs 5,00,000 by 31st March, 2024.

How will the Company recognize revenue, if performance obligation is met over a period of time.

Solution: Costs to be incurred comprise two major components – elevators and cost of construction service.

(a) The elevators are part of the overall construction project and are not a distinct performance obligation
(b) The cost of elevators is substantial (abnormal cost) to the overall project and are incurred well in advance.
(c) Upon delivery at site, the customer acquires control of such elevators.
(d) And there is no modification made to the elevators, which the company only procures and delivers at site. Nevertheless, as part of materials used in overall construction project, the company is a principal in the transaction with the customer for such elevators also.

Therefore, applying the guidance on Input method –

- The measure of progress should be made based on the % of costs incurred relative to the total budgeted costs.
- The cost of elevators (abnormal cost) should be excluded when measuring such progress and revenue for such elevators should be recognized to the extent of costs incurred.

The revenue to be recognized is measured as follows:

Particulars	**Amount**
Transaction price	50,00,000
Costs incurred:	
(a) Cost of elevators	15,00,000
(b) Other costs	5,00,000
Measure of progress:	5,00,000 / 25,00,000 = 20%
Revenue to be recognized:	
(a) For costs incurred (other than elevators)	Total attributable revenue = 35,00,000 % of work completed = 20% Revenue to be recognized = 7,00,000
(b) Revenue for elevators	1,500,000 (equal to costs incurred)
Total revenue to be recognized	1,500,000 + 700,000 = 2,200,000

Question 49: Construction Company C enters into a contract with Customer E to build an asset. Depending on when the asset is completed, C will receive either Rs 1,10,000 or Rs 1,30,000.

Outcome	Consideration	Probability
Project completes on time	1,30,000	90%
Project is delayed	1,10,000	10%

Determine the transaction price.

Solution: Because there are only two possible outcomes under the contract, C determines that using the most likely amount provides the best prediction of the amount of consideration to which it will be entitled. C estimates the transaction price to be Rs 1,30,000, which is the single most likely amount.

Question 50: Electronics Manufacturer M sells 1,000 televisions to Retailer R for Rs 50,00,000 (Rs 5,000 per television). M provides price protection to R by agreeing to reimburse R for the difference between this price and the lowest price that it offers for that television during the following six months. Based on M's extensive experience with similar arrangements, it estimates the following outcomes.

Price reduction in next six months	Probability
0	70%
500	20%
1,000	10%

Determine the transaction price.

Solution: After considering all relevant facts and circumstances, M determines that the expected value method provides the best prediction of the amount of consideration to which it will be entitled. As a result, it estimates the transaction price to be Rs 4,800 per television – i.e. (5,000 x 70%) + (4,500 x 20%) + (4,000 x 10%).

SECTION-B

Topics covered: -

Module 2. Valuation of shares, goodwill and intangible assets, post valuation of tangible and intangible assets.

2A. Valuation of intangible assets including goodwill.

2B. Valuation of shares.

Module 3. Accounting of financial instruments,

Module 4. NBFC

CHAPTER 2A- VALUATION OF INTANGIBLE ASSETS INCLUDING GOODWILL

Meaning of Goodwill: - Goodwill is the present value of a firm's anticipated super normal earnings. In other words, it is the value of reputation of business house in respect of profits expected in future over and above the normal level of profits earned by the undertakings belonging to the same class of business.

METHODS OF VALUATION OF GOODWILL: -- There are following methods for valuing goodwill:

1. **Simple/Average profit method;**
2. **Super profit method;**
3. **Annuity method;**
4. **Capitalization method**.

1. Simple Profit Method: - In this method, goodwill is valued on the basis of a certain number of years' purchase of the average profits of the past few years.

Question 1. Profits earned during last three years by X Ltd are as follows:

2024 --- 5,00,000
2025 --- 6,00,000
2026 --- 4,00,000

Calculate goodwill on the basis of three year's purchase price by

(a) average profit method

(b) weighted average profit method (if weights are not given)

(c) weighted average profit method if weights given are 1,3,6 respectively.

- **SUNO MERI BAAT DHYAN SE**

While calculating average profits (Average future maintainable profit) for the purpose of valuation of goodwill certain adjustments are made, which are as follows:

(a) All non-recurring and abnormal expenses and losses not likely to occur in the future are added back to profits.

(b) Non-recurring or casual income not likely to recur in future are deducted from such profits.

(c) Expenses and losses expected to occur in future are deducted from such profits, (e.g., increase in rent, managerial remuneration etc.)

(d) All profits likely to accrue in the future are added.

After above adjustments, average of the past years profits is calculated. Then such average profit is multiplied by certain number of years, say 4 years. The resultant amount will be value of goodwill.

Question 2 (Calculation of Future Maintainable Profits) TATA Ltd. desirous of selling its business to COC Ltd. has earned the following profits (after tax) in the past three years: ₹4,00,000, ₹5,50,000 and ₹6,40,000. Following facts need to be taken into consideration:

(i) Directors' fees ₹50,000 per year will not be payable by COC Ltd. whose existing board can easily manage the additional work.

(ii) Rent of ₹10,000 per month paid by TATA Ltd. will not be a charge against the profits of COC Ltd. as the latter company has its own premises.

(iii) TATA Ltd. has not transferred its trade investments to COC Ltd. Hence, interest of ₹9,000 would not be earned by the purchasing company.

(iv) TATA Ltd. had outsourced some of its business work for an annual contract of ₹1,24,000. However, COC Ltd. has enough surplus staff to manage the same. Hence savings of this cost. Calculate the Future Maintainable Profits.

Question:3 (Purchase of Weighted Average Profit Method) A Ltd. proposed to purchase the business carried on by M/s X and Co. Goodwill for this purpose is agreed to be valued at three years' purchase of the weighted average profits of the past four years. The appropriate weights to be used are:

Year	Weight	Profits (Rs.)
2023-24	1	1.01,000
2024-25	2	1,24.000
2025-26	3	1,00,000
2026-27	4	1,40,000

On a scrutiny of the accounts, the following matters are revealed:

(a) On 1 December 2025 a major repair was made in respect of the plant incurring ₹30,000 which was charged to revenue. The said sum is agreed to be capitalized for goodwill; calculation subject to adjustment of depreciation of 10% p.a. on reducing balance method.

(b) The closing stock for the year 2024-25 was overvalued by ₹12,000.

(c) To cover management cost, an annual charge of ₹24,000 should be made for the purpose of valuation of goodwill. Compute the value of goodwill of the firm. **[CMA Final 2001(Modified)**

Super Profit Method: -- Under this method annual super profit is calculated. This represents excess of future maintainable profits over normal profit. Goodwill is calculated by multiplying average super profit by certain number of year's purchase price.

Question 4. Average profit = 2,50,000

Capital employed = 20,00,000

Normal rate of return = 10%

Calculate goodwill on the basis of three year's purchase of super profit.

(A) Normal Profit: - This requires following information:

(a) Capital Employed in the business.
(b) Normal rate of return expected from the business.

NORMAL RATE OF RETURN-- The normal rate of return is that rate of earning which investors in general expect on their investments in the particular type of industry. Normal rate of earning depends upon the bank rate, market need, period of investment and risk attached to the investment.

(B) Capital Employed: - This represents net assets employed in the business.

- **(AAO KASAM KHATE HAI):** While calculating capital employed following points will be considered:

1. All assets except Goodwill, Non-trade investments and miscellaneous expenses should be taken.
2. Assets will be taken at current market prices.
3. All Liabilities (payable to outsiders) should be deducted.
4. Dividend payable (appearing in balance sheet) should not be deducted as it is part of current year's profit.
5. Funds/Reserves in the nature of liability should be deducted e.g. provident fund, Worker's profit-sharing fund, Gratuity fund.

Question 5. The balance sheet of X Ltd. as at 31.03.2024 is as follows:

Liabilities	₹	Assets	₹
8% 5,000 Preference Shares		Goodwill	10,000
of Rs. 10 each	50,000	Fixed Assets	1,80,000
10,000 Equity Shares of		Investments	20,000
Rs. 10 each	1,00,000	(tax free 5% Government Loan)	
Reserves (including provision		Current Assets	1.00,000
for taxation Rs. 10,000)	1,00,000	Preliminary Expenses	10,000
8% Debentures	50,000	Discount on Debentures	5,000
Creditors	25,000		
	3,25,000		**3,25,000**

The average profit of the company (before deducting interest on debentures and taxes) is ₹35,000. The market value of the machinery included in the assets is ₹5,000 more. Expected rate of return is 10%. Calculate the value of goodwill at three times of the super profits.

Note : Now concept of preliminary expenses and discount on debentures appearing in balance sheet does not exist. But as per ICMAI Study material, questions may come in exam along with these items appearing in balance sheet.

Question: 6. The following is the balance sheet of Shaifali Ltd. as on 31 December 2023:

	₹		₹
Equity Share Capital	9,00,000	Goodwill	1,50,000
10% Preference Share		Machinery	5,00,000
Capital	4,00,000	Buildings	7,50,000
General Reserve	4,00,000	Investments	2,00,000
Profit and Loss Account	3,00,000	Current Assets	12,00,00
Bank Loan	2,00,000		
Sundry Creditors	6,00,000		
	28,00,00		**28,00,00**

Additional information is as under

(i) Fixed assets are worth 20% above their book value. Depreciation on appreciation in value of fixed assets not to be considered for valuation of goodwill.

(ii) Of the investments, 60% are non-trading and the balance is trading. All trade investments are to be valued at 25% above cost. A uniform rate of dividend at 15% is earned on all investments after tax.

(iii) Goodwill is to be valued on the basis of 4 years' purchase of the super profits based on average profit (after tax) of the last 3 years. Profits (after tax at 50%) are as follows:

2021 - ₹4,00,000; **2022** - ₹4,30,000; **2023 -** ₹4,50,000

(iv) In 2021, new machinery costing Rs. 20,000 was purchased but wrongly charged to revenue. No effect has yet been given for rectifying the same. Depreciation charged on machinery is at 10% p.a. on reducing balance method. Compute the Value of Goodwill. **(ICMAI FINAL EXAM)**

Question: 7. From the following information, calculate goodwill on the basis of 4 years' purchase of super profits:

Balance Sheet of XYZ Ltd. As On 31 March 2023

Liabilities	Rs.	Assets	Rs.
Share capital (Rs. 10 share)	10,00,000	Goodwill	1,00,000
Reserves and surplus	4,00,000	Land and building	3,00,000
Creditors	3,00,000	Plant and machinery	8,00,000
		Investments	1,00,000
		Stock	2,00,000
		Debtors	1,50,000
		Cash at bank	50,000
	17,00,000		**17,00,000**

Profits before tax for 2022-23 amounted to ₹6,00,000 including ₹10,000 as interest on investments. However, an additional amount of ₹50,000 would be required to be spent for smooth running of the business.

Market values of land and building and plant and machinery are estimated at ₹9,00,000 and ₹10,00,000 respectively. Further, depreciation to the extent of ₹40,000 shall be taken into consideration. Income tax rate may be taken at 50%.

It may be noted that additional depreciation is not allowed for income tax purposes. Rate of return at 20% before tax may be considered normal. For the purpose of determining the actual rate of return, profit for this year, after aforesaid adjustments, may be taken as expected average profit. Similarly average trading capital employed is also to be considered on the basis of position during the current Year.

Capitalisation method: -

Question 8: Capital employed (net assets) at end = 6,00,000

Average profit = 1,00,000, Normal expected return= 10%

Calculate goodwill by capitalization method

Question:9 (Purchase of Super Profits, Capitalization of Super Profits and Annuity Methods)

The following particulars are available in respect of the business carried on by a trader:

1. Profits earned for the years:
2022-23 = ₹50,000

2023-24 = ₹60,000

2024-25 = ₹55,000

2. Normal rate of return = 10%

3. Capital employed = ₹3,00,000

4. Present value of an annuity of one rupee for 5 years at 10% = ₹3.78.

5. The profit included non-recurring profits on an average basis of ₹3,000.

You are required to calculate the value of goodwill:

(i) As per five years purchase of Super-profits;

(ii) As per capitalization of Super Profits Method; and

(iii) As per Annuity Method. **[CMA FINAL 2006 Adapted]**

Question:10 (Capitalization Method) Ascertain the value of goodwill of Sancheta Ltd. from the following:

Balance sheet as on 31st March 2025

Liabilities	**₹**	**Assets**	**₹**
Share Capital (Rs. 100	25,00,000	Goodwill at cost	2,50,000
Bank overdraft	4,80,000	Land and Building	11,00,000
Creditors	8,05,000	Plant and Machinery	
Provision for taxation	4,25,000	*Less:* Depreciation	10,00,000
Profit and Loss		Stock-in-trade	15,00,000
Account	6,00,000	Book Debts net of provision	9,60,000
	48,10,000		**48,10,000**

The company started operations in 2020 with the above stated paid up capital. Profits earned before providing for taxation have been as follows: Year ended 31 March: 2021 - ₹6,00,000; 2022 - ₹7,50,000; 2023 - ₹8,50,000 :2024 - ₹ 9,50,000; 2025 - ₹8,50,000. Income tax @ 50% has been payable on these profits. Dividends have been distributed from the profits of the first three years @ 10% and from those of the next two years @ 15% of the paid-up capital. **[CMA (Final)]**

Question 11. Balance Sheet of EXE Ltd as at 31st March, 2024

Liabilities	**₹**	**Assets**	**₹**	**₹**
11% Preference Share Capital	5,00,000	**Fixed Assets:**		
Equity Share Capital	20,00,000	Cost	50,00,000	
Reserve and Surplus	25,00,000	Less : Depreciation	30,00,000	20,00,000
10% Loans	27,00,000	Capital Work in-Progress		40,00,000
Current Liabilities and Provision	15,00,000	6% Government Securities		5,00,000
		Current Assets		25,00,000
		Underwriting Commission		2,00,000
	92,00,000			**92,00,000**

The company earned a profit of ₹9,00,000 after tax @50% in 2023-24. The capital work in progress represents additional plant equal to half the capacity of the present plant; It will be immediately operational, there being no difficulty in sales. With effect from 1st April, 2024, two additional part-time directors are being appointed at ₹75,000 p.a. Ascertain the future maintainable profit and the capital employed, assuming the present replacement cost of fixed assets is ₹1,00,00,000 and the annual rate of depreciation is 10% on original cost. **(CMA FINAL EXAM- 8 Marks)**

Question 12. From the following information ascertain the value to goodwill of X Ltd. under super profit method at 3 years purchase price. **Balance Sheet as on 31st March, 2024**

Liabilities	₹	Assets	₹
Paid-up capital		Goodwill at cost	50,000
(5,000, shares of ₨ 100 each) fully		Land and buildings at cost	2,20,000
paid	5,00,000	Plant and machinery at cost	2,00,000
Bank overdraft	1,16,700	Stock in trade	3,00,000
Sunday creditors	1,81,000	Book debts less provision for bad	1,80,000
Provision for taxation	39,000	debts	
Profit and loss appro. Account	1,13,300		
	9,50,000		**9,50,000**

The company commenced operation in 2018 with a paid-up capital of ₹5,00,000. Profit for recent years (after taxation) have been as follows:

Year ended 31st March	
2020(19-20)	40,000 (loss)
2021(20-21)	88,000
2022(21-22)	1,03,000
2023(22-23)	1,16,000
2024(23-24)	1,30,000

The loss in 2020 occurred due to a prolonged strike. The income-tax paid so far has been at the average rate of 40%, but it is likely to be 50% from April 2024 onwards. Dividends were distributed at the rate of 10% on the paid-up capital in 2021 and 2022 and at the rate of 15% in 2023 and 2024. The market price of shares is ruling at ₨ 125 at the end of the year ended 31st March, 2024. Profit till 2024 have been ascertained after debiting ₹40,000 as remuneration to the director. The company has approved a remuneration of ₨ 60,000 with effect from 1st April, 2024. The company has been able to secure a contract at an advantageous price thereby it can save materials worth ₹40,000 per annum for the next five years.

(CMA FINAL EXAM- 10 Marks)

Question 13: Following is the Balance Sheet of Z Ltd. as on 31st March, 2024:

Equity and liability	Amount	Assets	Amount
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	10,00,000
Profit and Loss Account	4,00,000	Investment in 10% Stock	4,80,000
15% Debentures	10,00,000	Plant	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

(c) 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%.

(d) Normal dividend expected on equity shares is 8% while fair return on closing capital employed is 10%. Goodwill may be valued at three year's purchase of super profits. **(ICMAI Study material)**

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

4. Normal Profit:

10% of closing Capital Employed

= 10% of 31,10,000 = 3,11,000

5. Super Profit = Actual Profit – Normal Profit

= 4,55,000 – 3,11,000 = 1,44,000

6. **Goodwill** = 1,44,000 × 3 = 4,32,000

Question 14. XY Ltd, a partnership firm, earned profits during the past 5 years as follows:

Year	2021	2022	2023	2024	2025
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 Goodwill on the basis of 2 years' purchase of average profit of last 5 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 2023;

(ii) Profit of 2024 included a non-recurring receipt of ₹ 2,500.

(iii) closing stock of 2025 was over-valued by ₹ 2,400. **(ICMAI Study material)**

Solution: Case (a): 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): 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): Weighted average profit = $\frac{(₹27,000 \times 1) + (₹36,000 \times 2) + (₹37,200 \times 3) + (₹42,000 \times 4) + (₹46,800 \times 5)}{1 + 2 + 3 + 4 + 5}$

∴ 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 years 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 2023 = Profit (as given) + Abnormal loss sustained in 2013 (which cannot be expected to occur in future) = ₹ 37,200 + ₹ 1,800 = ₹ 39,000

Profit of 2024 = Profit (as given) – non-recurring receipt of 2014 (which cannot be expected to occur in future)
= ₹ 42,000 – ₹ 2,500 = ₹ 39,500

Profit of 2025 = Profit (as given) – Overvaluation of closing stock (rectification of profit)
= ₹ 46,800 – ₹ 2,400 = ₹ 44,400

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

Question 15: XY Ltd, a partnership firm, earned profits during the past 4 years as follows:

Year	2022	2023	2024	2025
Profit (₹)	42,000	46,000	5,000	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. **(ICMAI Study material)**

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

Average capital employed = 69,200 – ½ of 46,500 = Rs 45,950

Normal profit = Average Capital employed × Normal rate of return

= ₹ 45,950 × 10% = ₹4,595

∴ Super profit = Average Future Maintainable Profit – Normal profit = ₹ 46,625 –₹ 4,595 = ₹ 42,030

∴ Value of Goodwill = ₹ 42,030 × 2½ years' purchase = ₹ 1,05,075

Question 16: 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

(CMA FINAL EXAM 2 Marks, ICMAI study material)

Solution:

Value of goodwill = Super profit × P.V of Annuity of ₹ 1for 4 years @ 12%

= ₹ 4,50,000 × 3.0374 = ₹ 13,66,830

Question 17. 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. (**ICMAI study material)**

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

Question 18: 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. **(ICMAI study material)**

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

Question 19: (June 2023 attempt) Given below are the extract from the Balance sheet of GINGER TULSI Ltd as at 31st March,2023:

Particulars	Rs
1,00,000 equity shares of Rs 10 each	10,00,000
6,00,000 Equity Shares of Rs 5 each fully paid up	30,00,000
Less: Calls in arrear on 2,00,000 shares	(4,00,000)
12% preference shares of Rs 100 each	10,00,000
Reserves and surplus	20,00,000
10% Debentures (60% Debentures are to be redeemed prior to valuation of goodwill)	20,00,000
Current liabilities	10,00,000
Goodwill	4,00,000
10% trade investments (Face value Rs 8,00,000)	10,00,000

Additional information: Profit before tax %@40: 2020-21- Rs 12,00,000; 2021-22- Rs 18,00,000, 2022-23- Rs 15,00,000. With effect from the next year, rate of income tax will be 25% and an increase in manager remuneration Rs 4,44,000 P.a. Normal rate of return on net assets for equity shareholders is 8%. Trade investments are to be valued at 275% of face value. Goodwill is to be valued at 3 year's purchase of super profit.

Solution:

Capital + liability	**Amount**	**Assets**	**Amount**
Equity share capital (1,00,000 of Rs 10 each)	10,00,000	Goodwill	4,00,000
Equity share capital		10% trade investment	10,00,000
6,00,000 shares of Rs 5 each 30,00,000		(Face value 8,00,000)	
Calls in arrear -4,00,000	26,00,000	Other assets (bal fig)	82,00,000
12% preference share capital	10,00,000		
Reserve and surplus	20,00,000		
10% debentures	20,00,000		
Current liabilities	10,00,000		
	96,00,000		**96,00,000**

(1) Computation of value of goodwill:

Goodwill = Super profit X Year's purchase price

= 10,00,000 X 3

= 30,00,000

Super profit = Average profit – Normal profit

= 15,12,000 – 5,12,000

= 10,00,000

(a) Computation of average maintainable profit:

	19-20	**20-21**	**21-22**
Profit after tax (given)	12,00,000	18,00,000	15,00,000
Profit before tax	20,00,000 ($\frac{12,00,000}{60} x100$)	30,00,000	25,00,000
Add: Interest on debenture	+1,20,000	+1,20,000	+1,20,000
Less: Managerial remuneration	-4,44,000	-4,44,000	-4,44,000
Maintainable profit before tax	16,76,000	26,76,000	21,76,000
Less: Tax @ 25%	-4,19,000	-6,69,000	-5,44,000
Maintainable profit after tax	12,57,000	20,07,000	16,32,000
Less: dividend on preference shares	-1,20,000	-1,20,000	-1,20,000
Maintainable profit for equity	11,37,000	18,87,000	15,12,000
Average maintainable profit	$\frac{17,37,000+18,87,000+15,12,000}{3}$ = 15,12,000		

(2) Computation of normal profit:

(i) Computation of net assets for equity shareholders:

10% trade investment Other assets (82,00,000- 12,00,000)	22,00,000 70,00,000
Less: Current liabilities 10% debentures (20,00,000- 12,00,000) 12% preference share capital	92,00,000 (10,00,000) (8,00,000) (10,00,000)
Net assets for equity shareholders	64,00,000
Normal profit (64,00,000 X 8%)	5,12,000

Question 20:(December 2023) The following figures have been extracted from the balance sheet of R Ltd as on 31-03-2023:

Particulars	**Rs**
1,12,000 equity shares of Rs 10 each	11,20,000
2,800, 13% preference shares of Rs 100 each	2,80,000
Other equity (Retained earnings and reserves)	7,00,000
12% debentures (Rs 100)	2,80,000
Trade payable	1,40,000
Total equity and liabilities	**25,20,000**
Property, plant and equipment	16,80,000
Goodwill	1,40,000
Non-current investments (Non-trading)	1,40,000
Current assets	5,60,000
Total assets	**25,20,000**

Additional information:

(i) Profit before tax for the year 2022-23 amounted to Rs 8,40,000 including Rs 14,000 as interest on investment.

(ii) An additional amount of Rs 70,000 p.a. shall be required to be spent for smooth running of the business.

(iii) Market value of property, plant and equipment are estimated at Rs 26,60,000. In order to match the above figures, a further depreciation to the extent of Rs 56,000 should be taken into consideration (additional depreciation is not tax deductible).

(iv) income tax rate is 50%.

(v) Return on capital @ 20% before tax may be considered normal for this business at the present stage.

(vi) For the purpose of determining the rate of return, the profit for this year after the aforesaid adjustments may be taken as the expected average profit. Consider average trading capital employed for determining the normal profit.

Based on the above details, you are required to compute the value of goodwill based on the 4 year's purchase of super profit. Working should form part of your answer. **(7 marks)**

Solution: Computation of future maintainable profit:

Particulars	**Amount**
Profit before tax Less: Interest on non-trade Investment Less: Additional expense	8,40,000 -14,000 -70,000
 Tax expense @ 50%	7,56,000 -3,78,000
 Less: Additional depreciation	3,78,000 -56,000
 Less: Dividend on preference shares (2,80,000 x 13%)	3,22,000 -36,400
Future maintainable profit for equity	**2,85,600**

Computation of average capital employed:

PPE Current assets	26,60,000 5,60,000
Total assets Less: Trade payable Less: 12% debentures Less: 13% Preference share capital	**32,20,000** -1,40,000 -2,80,000 -2,80,000
Capital employed at the end **Less : $\frac{1}{2}$ X current year profit for equity** **($\frac{1}{2}$ X (8,40,000 – 14,000) – (8,26,000 x 50%) – 36,400**	**25,20,000** -1,88,300
Average capital employed	**23,31,700**
Normal profit = 23,31,700 X 10%	2,33,170

Computation of super profit= Average profit – Normal profit

= 2,85,600 – 2,33,170

= 52,430

Goodwill = 52,430 X 4

= Rs 2,09,720

Question 21:(December 2023) The following is the summarised balance sheet of J Ltd as on 31-03-2023:

Particulars	Amount
1. Assets	
(1) Non-current assets:	
(a) Property, plant and equipment	5,40,000
(b) Non-current investment (Face value Rs 2,00,000)	3,00,000
(2) Current Assets:	
(a) Inventories	1,60,000
(b) Trade receivables: debtors	1,80,000
(c) Cash and cash equivalents: Bank	2,60,000
Total	**14,40,000**
II. Equity and liabilities	
(1) Equity	
(a) Share capital	8,00,000
(b) other Equity	2,60,000
(2) Non-current liabilities:	Nil
(3) current liabilities	
(a) trade payable: sundry creditors	2,40,000
(b) short term provisions	1,40,000
Total	**14,40,000**

Additional information:

(i) The net profits of the company after tax were-

2020-21 – Rs 5,04,000; 2021-22- Rs 4,53,600; 2022-23: Rs 4,62,000

(ii) Of the investment, 80% is non-trading and the balance is trading investment by nature. All trade investments are to be valued at 20% below cost. A uniform rate of dividend of 10% is earned on all investments.

(iii) Having regard to the type of business, a 10% return on capital employed is considered as reasonable.

(iv) assume tax rate at 30%. Ascertain the value of goodwill on the basis of three year's purchase of annual super profits. For this purpose, average operating capital employed is to be considered for goodwill valuation.

Solution:

(i) Computation of average maintainable profits:

	2020-21	2021-22	2022-23
Profit after tax	5,04,000	4,53,600	4,62,000
Less: interest on non-trade investment (16,000 x 70%)	-11,200	-11,200	-11,200
	4,92,800	**4,42,400**	**4,50,800**
Average maintainable profit	**4,62,000**		

(ii) computation of average capital employed:

Property, plant and equipment	5,40,000
Trade investment	48,000
Inventories	1,60,000
Debtors	1,80,000
Cash	2,60,000
Total	**11,88,000**
Less: creditors	2,40,000
Less: short term provisions	1,40,000
Capital employed at the end	**8,08,000**
Less ½ of 4,50,800	-2,25,400
Average capital employed	**5,82,600**
Normal profit (10% of 5,82,600)	58,260

(iii) Super profit = 4,62,000 – 58,260

= Rs 4,03,740

(iv) Goodwill = 4,03,740 X 3

= Rs 12,11,220

2B. VALUATION OF SHARES

INTRODUCTION: A share is the smallest unit of ownership of a company. It happens to be one of the sources by which a company raises funds from the market. The value of a share does not remain static over its life-time. Rather it changes over the period due to various circumstances. Thus, knowing the value of share at a particular point of time is of great importance.

PURPOSE OF SHARE VALUATION: The shares of a company are required to be valued for various purposes. Some of the most important purposes include the following:

1. For selling shares of a shareholder to a purchaser (which are not quoted in the stock exchange)

2. For acquiring a block of shares which may or may not give the holder thereof a controlling interest in the company.

3. To shares by employees of the company where the retention of such shares is limited to the period of their employment.

4. To formulate schemes of merger and acquisition.

5. To acquire interest of dissenting shareholders under a scheme of reconstruction.

6. For granting loans on the basis of security of shares

7. To compensate shareholders on the acquisition of their shares by the government under a scheme of nationalization.

8. For conversion of securities, say preference shares into equity shares.

9. To resolve a deadlock in the management of a company on the basis of the controlling block of shares given to either of the parties.

FACTORS AFFECTING VALUATION OF SHARES:

The different factors that affect the valuation of shares are:

1. Nature of the industry to which the company belongs

2. The companies past performance

3. Economic conditions of the country

4. Other political and economic factors (e.g., possibility of nationalization)

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.

The major three approaches to valuation of shares are:

A. Income Approach
B. Net Assets Approach
C. Market Approach

A. Income Approach:

The Income Approach indicates the value of a business or equity based on the value of the future income (represented by cash flows, operating profits, net profits or dividends as the case may be) that a business is expected to generate in future. This approach is appropriate in most going concern situations as the worth of a business or equity is generally a function of its ability to earn income/cash flow in future. **The Income approach includes a number of models/Techniques:**

(1) **Discounted Cash Flow**
(2) **Dividend Discount Model**
(3) **Maintainable Profits Basis and**
(4) **Other bases.**

(1) Discounted Cash Flow (DCF) model: It indicates the fair market value of a business (or Equity) based on the value of cash flows that the business(or Equity) is expected to earn in future. This method involves the estimation of Net Operating Profits Adjusted Tax (NOPAT) for the projected period, the business's requirement of reinvestment in terms of capital expenditure and incremental working capital and appropriate cost of capital that reflects the risks of the corresponding return.

Merits of DCF model:

(i) Cash flows are unaffected by any differences of accounting policies, principles, conventions, and methods.
(ii) It provides the intrinsic or economic value unaffected by market forces.

De-merits of DCF model: **It is hard**

(i) to estimate future cash flows, and
(ii) to apply appropriate rate of discounting.

Computation of value per share = Value of Equity/ No. of equity shares:

Value of Equity = Value of the business less value of Debt Capital.

Value of business = Aggregate of future cash flows (or Free Cash flows) discounted at its present worth.

Let us see how cash flows (FC, FCFF and FCFE) are computed so that future cash flows can be projected:

(a) Cash Flows (CF) = NOPAT + Depreciation, amortisation, impairment etc. (non-cash expenses charged against profits) + (-) Decrease (Increase) in non-cash working capital.

(b) Net Operating Profits Adjusted Tax (NOPAT) = EBIT×(1 -t)

Note 1. EBIT (Earnings Before Interest and Tax) is Net Operating Profits.

Note 2. Tax Rate(t) = Tax expenses/Earning Before Tax (EBT)

Question 1. (Concept building question)

Particulars	Amount	Particulars	Amount
To purchases	1,20,000	By sales	8,00,000
To rent	40,000		
To salary	35,000		
To depreciation	45,000		
To interest on debentures	30,000		
To provision for tax (30%)	1,59,000		
To net profit after tax	3,71,000		
	8,00,000		**8,00,000**

Net increase in working capital ₹70,000.

Calculate (a) Net Operating Profit After Tax (NOPAT) (b) Cash Flows (CF) (c) Tax Rate

Free Cash Flows (CF): Free Cash Flows are of two types:

(a) Free Cash Flows to the Firm **(FCFF)** and

(b) Free Cash Flows to the Equity **(FCFE).**

(a). FCFF- Free cash flow to firm is the amount by which a business's operating cash flow exceeds its working capital needs and expenditures on fixed assets.

FCFF = CF – Capex (Capex means capital expenditures made within the business for expansion, replacement etc.)

(b). FCFE (Free Cash Flow to the Equity)- FCFE is the amount of cash a business generates that is available to be potentially distributed to equity shareholders.

FCFE = FCFF – Interest net of tax + Net Debt Issued.

OR

FCFE = Net operating Income after interest and tax – Increase in non-cash WC – Net Capex + Net Debt Issue.

Question 2. NOPAT = ₹3,00,000.

Depreciation ₹1,20,000

Increase in working capital (net) ₹50,000.

Capital expenditure made during the year ₹40,000.

Debt issued during the year ₹12,000.

Debt repaid during the year ₹15,000.

Calculate CF, FCFF, FCFE.

Computation of value of business:

Value of business – it is aggregate of future cash flows (or Free Cash flows) discounted at its present worth.

Value of business = **∑DCF** (for the period future cash flows are projected) + **Terminal Value** (TV)/Continuing Value/Exit value discounted at its present worth.

Note 1. Meaning of Terminal Value or continuing value or exit value: As business is a going concern, at the end of the limited period for which future cash flows (CF, FCFFor FCFE) are projected, the terminal value has to be computed by aggregating the discounted cash flows from that moment till infinity.

Thus, Terminal Value = ∑DCF commencing from the end of projection period continued up to infinity.

(i) Two assumptions are made for finding terminal value for business valuation:

a. There is an infinite series of cash flows (CF, FCFF or FCFE)

b. Cash flows are either (a) constant or (b) growing at a constant rate

Computation of terminal value:

(i) Terminal Value (Continuing Value) at constant cash flows assumption =

$$TVn = \frac{CF(n+1)}{K}$$

where, k=WACC= is the discounting rate

(ii) Terminal Value (Continuing Value) at constant growth rate of cash flows assumption =

$$TVn = \frac{CF(n+1)}{K-g}$$

Note 2. Growth rate (g) in cash flows is determined by multiplying Re-investment rate (RR) with Return on invested capital (ROIC) or return on capital employed (ROCE in absence of ROIC).

g = RR× ROIC (or, ROCE)

Note 3. Re-investment rate = Re-investment/NOPAT.

Question 3.

Yr.	2018	2019	2020	2021	2022	....
CF (₹)	500	600	700	800	800	continued at 800

(a) Find value of the business on 01-01-2021, given that WACC = 10%.

(b) Find value of the business on 01-01-2020, given that WACC = 10%.

(c) Find value of the business on 01-01-2019, given that WACC = 10%. **(ICMAI Study material)**

Question 4.

D Data provided: Forthcoming year 1ata provided for forthcoming Year 1	` in₹ Lakh
EBIT	800
Depreciation	160
Capex	200
Interest	300
Increase in non-cash working capital	100
Debt Capital at year 0	3000
Debt repaid during year 1	500
Debt issued during year 1	600

Further information:

Tax rate = t	25%
WACC	10%
No of equity shares	6000000
Ke	12.5%

Find:

(a) (i) NOPAT, (ii) CF, (iii) FCFF,

(b) Value of business based on: (i) CF; (ii) FCFF,

(c) Value of business when growth rate is 5% based on: (i) CF; (ii) FCFF,

(d) Value per share based on FCFF when growth rate id 5% and

(e) Value per share based on FCFE when constant growth rate is 5%. **(ICMAI Study material)**

Question 5.

Data provided: Forthcoming year 1	₹
EBIT	700
Depreciation	120
Capex	180
Interest	80
Increase in non-cash working capital	100
Debt Capital	3,000
Debt issued during the year	140
Debt paid during the year	90

Further information:

Tax rate = t	25%
WACC	10%
No of equity shares	50,00,000
Ke	12.5%

Find:

(a)(i) NOPAT, (ii) CF, (iii) FCFF, (iv) FCFE

(b) Value of business based on: (i) CF; (ii) FCFF,

(c) Value of business when growth rate is 5% based on: (i) CF; (ii) FCFF,

(d) Value per share based on FCFF when growth rate id 5% and

(e) Value per share based on FCFE when constant growth rate is 5%. **(ICMAI Study material)**

Answer: (a) NOPAT- ₹525; CF- 545; FCFF- ₹365; FCFE ₹355
(b) Value of business based on CF ₹5,450 and based on FCFF ₹3,650;
(c) Value of business when growth rate is 5% based on CF ₹10,900 and based on FCFF ₹7,300
(d) Value per share based on FCFF when growth rate id 5% ₹86
(e) Value per share based on FCFE when constant growth rate is 5% - ₹94.67

(2) Dividend Discount Model:

Here, (a) when constant dividend is assumed for infinity

Value per share = Dividend per Share/ Ke

(b) when constant growth of dividend is assumed for infinity:

Value per share = Dividend per Share/ (Ke – g),

Ke is the cost of equity and **g** is the growth rate of dividend. This model is based on Gordon's model of share pricing.

Question 6. Earning for equity = ₹5,00,000.

Dividend payout ratio = 70%

Number of equity shares = 35,000.

Cost of equity = 15%

Growth rate 5%.

Calculate value of equity by dividend discount model.

Question 7. Calculate value of equity in the previous question by dividend discount model if Growth rate is 5%.

(3) Maintainable Profits Basis:

Value of equity under Maintainable Profits Basis = $\frac{\text{Maintainable Profits available to equity}}{\text{Equity capitalisation rate (Ke)}}$

Value per share = $\frac{\text{Value of Equity}}{\text{no.of equity shares}}$

Average Maintainable Profits are computed to find out expected future earnings of the Equity. Hence all non-recurring or abnormal items of income and expenses are eliminated. Simple or weighted average of past years (excluding any abnormal year) adjusted earnings are computed.

Question 8. Average maintainable profit before interest, tax = 6,0₹0,000.
12% Debentures = ₹10,00,000.

Equity share capital of Rs 100 each = ₹10,00,000.

Tax expense = 30%
Average profit given above includes non-recurring expenses of ₹1,50,000.
Equity capitalisation rate (Ke) = 10%.

Calculate value per equity share by maintainable profit basis.

(4) Other bases:

(i) Yield-Basis Method: Yield is the effective rate of return on investments which is invested by the investors. It is always expressed in terms of percentage. Since the valuation of shares is made on the basis of Yield, it is called Yield-Basis Method.

Under Yield-Basis method, valuation of shares is made on either of the following basis:

(a) Profit Basis; or (b) Dividend Basis.

(a) Under Profit Basis: Under this method, at first, profit should be ascertained on the basis of past average profit; thereafter, capitalized value of profit is to be determined on the basis of normal rate of return, and, the same (capitalized value of profit) is divided by the number of shares in order to find out the value of each share.

The following steps are followed for the purpose of valuation:

Capitalised value of profit = $\frac{\text{profit}}{\text{normal rate of return}} X\, 100$

Value of each equity share = $\frac{capitalised\ value\ of\ profit}{number\ of\ shares}$

(b) Under Dividend Basis: Valuation of shares may be made either :

(I) on the basis of total amount of dividend, or

(II) on the basis of percentage or rate of dividend:

(I) On the basis of Total Value of Dividend:

Capitalised value of dividend = $\frac{\text{Dividend Profit i.e.Total Amount of Dividend}}{normal\ rate\ of\ return\ i.e\ yield}\ x\, 100$

Value of each Equity Share = $\frac{Capitalised\ value\ of\ dividend}{number\ of\ equity\ shares}$

(ii) On the basis of percentage or Rate of Dividend:

Value of each Equity Share= $\frac{rate\ of\ dividend}{normal\ rate\ of\ return}\ x\ paid\ up\ value\ of\ each\ equity\ share$

NOTE: - Whether Profit Basis or Dividend Basis method is to be followed for ascertaining the value of shares depends on the shares that are held by the respective shareholders. In other words, the shareholders holding minimum number of shares (i.e., minority holding) may determine the value of shares on dividend basis. 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 divided among others. Under the circumstances, valuation of shares should be made on profit basis.

In short, Profit Basis should be followed in the case of Majority Holding, and Dividend Basis should be followed in the case of Non-controlling Holding.

(ii) Fair Value Method/ dual method: There are some valuers who do not accept either the Intrinsic Value or the Yield Value for ascertainingthe value of shares. They prescribe the Fair Value Method which happens to be the arithmetic mean of Intrinsic Value Method (net asset method) and Yield Value Method. The same provides a better indication about the value of shares than the earlier two methods.

Fair value = $\frac{\boldsymbol{intrinsic\ value+yield\ value}}{\mathbf{2}}$

B. Net assets approach: -

1. Asset-Backing Method/intrinsic value method/ real value basis method/asset break up 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.

Net assets value left is divided by number of equity shares to calculate intrinsic value per equity share.

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.

Question:9. On 31 March, 2024, the balance sheet of a limited company disclosed the following position:

Balance Sheet

Liabilities	₹	***Assets***	₹
Equity share Capital of ₹10 Preference share capital of ₹10	3,00,000 1,00,000	Fixed Assets	5,00,000
General Reserves	30,000	Current Assets	2,00,000
Profit and Loss Account	80,000	Goodwill	40,000
5% Debentures	1,00,000		
Current Liabilities	1,30,000		
	7,40,000		**7,40,000**

On 31 March 2024, the fixed assets were independently valued at ₹3,50,000 and the goodwill at ₹50,000. Compute the value of the company's shares by the net asset's method. **(Ans: ₹9 per share)**

C. Market Approach: Under market approach, value of equity is determined by applying relative or multiple to the base value of the company. Relative or multiple is the ratio of market price to some accounting variable of the company taken as the base value.

Most common multiples are price-earnings (P/E) ratio, price-sales (P/S) ratio, price-cash flow from operations (P/CFO) ratio etc. Important point is the relatives have to be computed for the peer group of companies to find the average relationship between the base value and market price. After obtaining the average relationship through relative or multiple, the company finds it calculated market price by applying the average relative to its base value.

The steps involved to find value per share based on market approach:

1. Market capitalisation of each of the peer group of companies is related to any fundamental element of that company (called base value such as Profits, Cash Flows, Net assets, Sales). The ratio obtained is called relative or multiple.
2. To decide what will be the base value on which multiple will be applied. More than one multiple is usually considered in practice.
3. To compute the average of the multiples of the peer group of companies (we call it as Comparator) for each base value.
4. To apply the average multiple (Comparator to a particular base value of the required company for valuation of its equity for that base. Then to find average of the different equity values based on differentbase values.
5. To divide average value of equity by the no. of shares in order to find value per share.

Market capitalisation is the product of market price of shares and the no. of shares outstanding. Thus, it represents market value of equity. In computation of relative we may find some popular ratios also such as Price Earnings ratio where base value is Earnings and Market to Book Value ratio where base value is Net Assets. But in all circumstances the base values are related to market value of equity.

Relative or multiple = Market Capitalisation/Base value.

[where, alternative base values are EAT, EBIT, NOPAT, CF, FCFF, FCFE, Net Assets, Enterprise Value, Sales, or any other fundamental variable]

Question 10. X Ltd. has EPS ₹12 and no. of shares 1000. Its CF ₹15,000 and Sales ₹80,000. Find value per share of X Ltd. based on the data of similar other companies as provided below:

Companies	PAT	CF	Sales	MC (Market capitalization)
A	20,000	25,000	1,20,000	1,50,000
B	16,000	20,000	1,40,000	1,75,000
C	25,000	32,000	1,60,000	2,00,000
D	18,000	24,000	1,44,000	1,92,000

(ICMAI Study material)

Solution:

PAT of X Ltd. = EPS × No. of shares = 12 × 1000 = 12,000

For the 4 companies in the peer group Relatives are computed as MC/ Base Value

For PAT as base value M1 is the multiple.For CF as base value M2 is the multiple. For Sales as base value M3 is the multiple.

Comparator is the average value of the multiples for the 4 companies.

Value of equity of X for each base = Base Value of X × Comparator

Companies	PAT	CF	Sales	MC	M1=$\frac{MC}{PAT}$	M2=$\frac{MC}{CF}$	M3=$\frac{MC}{Sales}$
A	20,000	25,000	1,20,000	1,50,000	7.5	6	1.25
B	16,000	20,000	1,40,000	1,75,000	10.9375	8.75	1.25
C	25,000	32,000	1,60,000	2,00,000	8	6.25	1.25
D	18,000	24,000	1,44,000	1,92,000	10.66667	8	1.333333
				Comparator	9.276042	7.25	1.270833
			Base of X		PAT	CF	Sales
			Base Value of X		12,000	15,000	80,000
			Value of equity of X		1,11,312.5	1,08,750	1,01,666.7
			No. of equity shares		1000	1000	1000
Value per share based on Base value					111.3125	108.75	101.6667
Average Value per share of X				107.243056			

Lets start practice of some more questions:

Question: 11 Following is the balance sheet of Sukh Ram Limited as on 31 March 2024

Liabilities	₹	***Assets***	₹
Share Capital		**Non-current assets:**	
30,000 Equity Shares of ₹20		Goodwill	25,000
each fully paid	6,00,000	Building	6,00,000
25,000 Equity Shares of		Machinery	3,75,000
₹20 each, ₹8 paid	2,00,000	Investments	50,000
15,000 Equity Shares of		**Current Assets:**	
₹10 each fully paid	1,50,000	Stock	3,00,000
10,000 Equity Shares of		Debtors	1,50,000
₹ 10 each, ₹5 paid	50,000	Bills Receivable	50,000
		Bank	1,30,000
General Reserves	4,50,000		
Profit and Loss Account	50,000		
		Preliminary expenses	
Creditors	2,00,000		20,000
	17,00,000		**17,00,000**

The Goodwill is valued at ₹15,000; Buildings at ₹12,00,000; Machinery at ₹3,00,000; Investments at ₹35,000; Stock at ₹2,50,000; Debtors at ₹1,40,000. There was a contingent liability of ₹20,000. Determine the value of different shares.

Answer:

Value per share of ₹20, fully paid	₹33.33
Value per share of ₹20, 8 paid	₹21.33
Value per share of ₹10, fully paid	₹16.70
Value per share of ₹10, 5 paid	₹11.70

Question: 12. The following figures were extracted from the books of M/S. Prosperous Limited:

Share Capital

9% Preference Shares of ₹100 each		3,00,000
(a) 1,000 Equity Shares of ₹100 each, ₹50 called up		50,000
(b) 1,000 Equity Shares of ₹100 each. ₹25 called up		25,000
(c) 1,000 Equity Shares of ₹100 each fully called up		1,00,000
Reserves and Surplus		**4,75,000**
General Reserve	2,00,000	
Profit and Loss Account	50,000	2,50,000
		7,25,000

On a fair valuation of all the assets of the company, it is found that they have an appreciation of ₹75,000. The articles of association provided that, in case of liquidation, the preference shareholders will have a further claim to the extent of 10% of the surplus assets. Ascertain the value of each preference and equity share, assuming liquidation. Ignore expenses of winding up. **[C.A. (Final) May 1979] [C.MA. (Final) June 1980]**

Answer:

Value per share of Rs 100, fully paid	₹197.50
Value per share of Rs 100, 50 paid	₹147.50
Value per share of Rs 100, 25 paid	₹122.50

Question: 13. The following particulars are available in relation to X Ltd.:

(a) Capital: 4,500, 8% Preference Shares of ₹100 each fully paid, and 50,000 Equity Shares of ₹10 each fully paid,

(b) External liabilities: ₹85,000.

(c) Reserves and Surplus: ₹50,000.

(d) The average expected profit (after taxation) earned by the company: ₹1,05,000.

(e) The normal profit earned on the market value of equity shares (fully paid) of the same type of companies is 10%.

(f) 10% of the profits after tax are transferred to reserves.

Calculate the intrinsic value per equity share and the value per equity share according to dividend yield basis. Assume that out of total assets, assets worth ₹4,000 are fictitious.

Solution:

(i) Intrinsic Value of Shares		₹
Equity Share Capital		5,00,000
Reserves and Surplus		50,000
Less: Fictitious assets		4,000
Assets available for Equity Shareholders		**5,46,000**
Intrinsic Value per Equity Share:	5,46,000 /50,000 = ₹10.92	

(ii) Dividend Yield basis

Average profit after tax	1,05,000
Less: Transfer to reserve @ 10%	10,500
Profits available for Equity shareholders	94,500

Rate of dividend = 94,500 /5,00,000x 100 = 18.9%

Value per Equity Share = 18.9/10 x 10 = ₹18.90

Question:14. From the following information of P Ltd. compute the value of its equity shares by capitalisation of earnings method:

Balance Sheet as at 31 December 2024

Liabilities	₹	*Assets*	₹
Share Capital		**Fixed Assets**	5,00,000
Equity Shares of Rs. 10		**Current Assets**	3,00,000
each fully paid	2,50,000	**Discount on debentures**	25,000
Reserves and Surplus	1,00,000		
Secured Loans			
12% Debentures	2,50,000		
(Since 2012)			
Other Liabilities	2,25,000		
	8,25,000		**8,25,000**

Year Ending 31 December

	2020	2021	2022	2023	2024
Sales	6,00,000	7,00,000	8,00,000	5,00,000	9,00,000
Operating Costs	3,45,000	3,95,000	4,45,000	2,95,000	4,95,000
Interest on Loan from Bank	**25,000**	**25,000**	**25,000**	**25,000**	**5,000**

Assume rate of taxation at 60% and rate of normal earnings at 12½ %. Show the working also.

Answer: **Capitalised value of earning ₹8,00,000; value per equity share ₹32.**

Question:15 (Yield basis) The profit of a company limited by shares, for the year ended 31 March 1995 were ₹60,00,000. After setting apart amounts for interest on borrowings, taxation and other provisions, the net surplus available to shareholders is estimated at ₹15,00,000. The company's capital base consisted of:

(i) 1,00,000 equity shares of ₹100 each (fully paid up); and

(ii) 25,000 12% cumulative preference shares of ₹100 each, fully paid up.

Enquiries in the stock market reveal that shares of compare engaged in similar business and declaring a dividend of 15% on equity shares are quoted at a premium of 10%. What do you expect the market value of the company shares to be, basing your working on the yield method.

Question:16. Assume in the previous question 15, paid up value of each equity share in company is ₹50 each and face value is ₹100.

Question 17: Following is the balance sheet of Ramesh Ltd. as on 31st March, 2024:

Liabilities	₹
Equity shares of ₹10 each	10,00,000
12% Preference shares of ₹*100* each	10,00,000
General reserve	6,00,000
Profit and loss account	4,00,000
15% Debentures	10,00,000
Creditors	8,00,000
	48,00,000
Assets	
Goodwill	5,00,000
Building	15,00,000
Plant	10,00,000
Investment in 10% stock (market value of ₹5,20,000, and nominal value ₹5,00,000)	4,80,000
Stock	6,00,000
Debtors	4,00,000
Cash	1,00,000
Preliminary expenses	2,20,000
	48,00,000

Additional information*:*

(i) Assets are revalued as follows: Building: ₹32,00,000; Plant: ₹18,00,000; Stock: ₹4,50,000; and Debtors: ₹3,60,000.

(ii) Average profit before tax of the company is ₹12, 00,000 and 12.5% of the profit is transferred to general reserve.

(iii) Rate of taxation 50%. Normal dividend expected on equity shares is 8% while fair return on closing capital employed is 10%.

Goodwill may be valued at 3 years' purchase of super profits. Ascertain the value of each equity share under fair value method.

Answer: Average profit ₹5,75,000; super profit ₹2,64,000; goodwill ₹7,92,000; value per equity share by intrinsic value method ₹44.22; value per equity share by dividend yield method ₹62.89.

Note- **Solution of this question given in study material is wrong. Follow solution given in class only.**

Question 18: On the basis of following information, compute the value of an equity share of both Chelsi Ltd. and Nensi Ltd.— (i) when only a few shares are sold; and (ii) when controlling shares are to be sold:

	Chelsi Ltd.	**Nensi Ltd.**
Profit after tax	10,00,000	10,00,000
Equity share capital		
(Shares of ₹10 each)	50,00,000	40,00,000

Assume that market expectation for both companies is 15%; and 80% of the profits are distributed.

(CMA FINAL- December 2009 - 6 MARKS)

Answer: **Valuation of Equity Share**

	Chelsi Ltd.	Nensi Ltd.
Profit after tax (₹)	10,00,000	10,00,000
(Profits available to equity shareholders)		
No of equity shares	5,00,000	4,00,000
Earnings per share	= ₹2	= ₹2.50
Profit to be distributed	80%	80%
Dividend per share	80% of 2	80% of 2.50
	= ₹1.60	= ₹ 2
(i) When few shares are sold:	**1.60/15x100**	**2/15x100**
	= ₹10.67	= ₹13.33
(ii) When controlling shares are sold:		
Value of share	2/15x100	2.50/15x100
	₹13.33	=₹16.67

Question 19. From the following figures, calculate the value of a fully paid equity share of ₹10 on **(i)** dividend basis; and (**ii**) return on capital employed basis, assuming in each case the market expectation to be 12%:

Year Ended	**Capital Employed**	**Profit Earned.**	**Dividend**
1999	50 crore	8 crore	12%
2000	80 crore	16 crore	15%
2001	100 crore	22 crore	18%
2002	120 crore	30 crore	20%

(CMA FINAL-June 2002- 6 MARKS)

Answer: value of equity shares by dividend yield method ₹13.54; value of equity shares by capitalisation of earning method ₹18.09.

Question 20: The balance sheet of Eskay Ltd. as on 30th June, 2024 is as follows:

Equity share capital:	
1,00,000 Equity shares of Rs. 10 each, fully paid-up	10,00,000
1,00,000 Equity shares of Rs. 6 each, fully paid-up	6,00,000
Reserves and surplus	4,00,000
Other liabilities	10,00,000
	30,00,000
Assets:	
Goodwill	5,00,000
Property, plant and equipment	15,00,000
Other tangible assets	5,00,000
Investments(market value)	3,00,000
Miscellaneous expenditure to the extent not written off	2,00,000
	30,00,000

The PPE are now worth ₹24,00,000 and other tangible assets are revalued at ₹3,00,000. The company is expected to settle the disputed bonus claim of ₹1,00,000 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 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 are tabled as follows:

Year	**PAT** (Rs.)	**Dividend** (%)
2021	3,00,000	11
2022	3,50,000	12
2023	4,00,000	13
2024	4,10,000	14

The normal expectation in the industry to which the company belongs is 10%. Calculate the break-up value and market value of shares based on dividend of both kinds of shares. **(ICMAI Study material)**

Answer: Normal profit Rs 1,44,500; average profit Rs 3,40,000; super profit 1,95,500; goodwill by super profit Rs 5,86,500; total value of goodwill Rs 10,43,250; value per equity share of Rs 10 fully paid by intrinsic value method Rs 18.40; value per equity share of Rs 10 fully paid by dividend yield method Rs 12.50.

Question 21. (Concept and application of PE Ratio)

Net profit before tax and dividends ₹5,00,000.

Tax rate 30%

Equity share capital is 1,00,000 shares of ₹10 each.

12% preference share capital ₹6,00,000.

Arrear of preference dividend for last 2 years.

Calculate EPS and PE Ratio if market price per share is ₹80.

Question 22: The capital structure of Hertz Ltd. is as follows:

14% Preference shares of ₹10 each	20,00,000
Equity shares of ₹10 each	32,00,000
Reserves and surplus	16,00,000
10% Debentures	24,00,000
11 % Loans from banks/financial institutions	28,00,000

The average annual profit before payment of tax and interest is ₹24,00,000. The income -tax rate is assumed to be @ 20%. Compute the value of equity shares of the company, if the applicable price earnings ratio is 10.

Question 23: The following is the balance sheet of Best Ltd. as at 30th June, 2024:

Liabilities	₹
Share capital:	
4, 00,000 Equity shares of ₹10 each, fully paid-up	40, 00,000
4, 00,000 Equity shares of ₹10 each, paid-up ₹7.50 per share	30, 00,000
4, 00,000 Equity shares of ₹10 each, paid-up ₹5 per share	20, 00,000
Reserves and surplus	56,00,000
Provision for bad debts	1,20,000
Sundry creditors	20,40,000
Dividend equalization fund	6,40,000
	1,74,00,000
Assets:	
Patent and copyrights	8,00,000
Land and buildings	48,00,000
Plant and machinery	48,00,000
Stock	24,00,000
Investments at cost	6,00,000
Debtors	32,00,000
Bank	6,40,000
Discount on shares	1,60,000
	1,74,00,000

Additional information are as follows:

(i) The normal average profit (after tax) for the company is estimated to be ₹21,60,000.

(ii) The applicable capitalization rate is 12%.

(iii) The revised values of —

— Patent and copyrights are estimated @ 50% of its value; and

— Land and buildings and plant and machinery are revalued at ₹60,00,000 and ₹52,00,000 respectively,

(iv) Investments have a market value of ₹7,20,000.

(v) Provision for bad and doubtful debts to be maintained @ 2%.

(vi) The balance sheet as at 30.6.24 does not contain provision for tax, which is estimated at 3,00,000.

You are required to calculate the value of fully and partly paid-up equity share (per share) by:

(i) The asset backing method (excluding goodwill) on the notional call method; and

(ii) The earning capacity method.

Answer: (i) **Calculation of value of Shares: Net Asset Method:**

		₹
(i) Patent and copyrights		4,00,000
(ii) Land and Buildings		60,00,000
(iii) Plant and Machinery		52,00,000
(iv) Investments		7,20,000
(v) Stock		24,00,000
(vi) Debtors less provisions for bad debts		31,36,000
(vii) Bank		6,40,000
Total Assets:		**1,84,96,000**
Less: Liabilities		
Sundry creditors	20,40,000	
Tax provisions	3,00,000	23,40,000
Net Assets		**1,61,56,000**
Add: Notional Calls (Calls-in-Arrears)		
4,00,000 x ₹2.50		10,00,000
4,00,000 x ₹5.00		20,00,000
Asset backing value for fully paid equity shares		1,91,56,000

$$\text{Value of each fully paid}-\text{up equity share}=\frac{\text{Asset Backing value}}{\text{Total No. of Share}}$$

$$=\frac{1,91,56,000}{12,00,000}=₹15.96$$

Value of Partly paid-up share capital:

Value of each ₹7.5 paid equity share = ₹15.96 -2.50 = ₹13.46

Value of each ₹5.0 paid equity share = ₹15.96 -5.00 = ₹10.96

(ii) Earning Capacity Method:

$$\text{The capitalised value of profit}=\frac{21,60,000}{0.12}=₹1,80,00,000$$

The present total paid-up capital = ₹ 90,00,000

Assuming this represents equivalent to 9,00,000 shares.

$$\therefore \text{value of each fully paid}-\text{up equity share}=\frac{₹1,80,00,000}{9,00,000}=₹20$$

Value of each ₹7.50 paid share = ¾ x 20 = ₹15.00

Value of each ₹5.00 paid share = ½ x20 = ₹10.00

Question 24: Following is the summarized balance sheet of Royal Ltd. as on 31st March, 2005:

Liabilities	₹
3,000,6% Preference shares of	
₹100 each, fully paid-up	3,00,000
1,30,000 Equity shares of ₹10 each,	
fully paid-up	13,00,000
Profit and loss account	9,00,000
8% Debentures	6,00,000
Sundry creditors	4,78,500
	35,78,500
Assets	
Goodwill	1,00,000
Freehold property	7,50,000
Plant and machinery less depreciation	7,00,000
Stock	7,40,000
Debtors (net)	7,98,500
Cash and bank balances	4,90,000
	35,78,500

The following are additional information:

(i) The profit after tax for the three financial years 2002-03,2003-04 and 2004-05 were ₹4,41,000, ₹6,45,000, and ₹4,80,000 respectively,

(ii) The normal rate of return is 10% on the net assets attributed,

(iii) The value of freehold property is to be ascertained on the basis of 8% return. The current rental value is ₹1,00,800.

(iv) The rate of tax applicable is 40%.

(v) 10% of profits for the financial year 2003-04 referred to above arose from a transaction of non-recurring nature,

(vi)A provision of ₹31,500 on sundry debtors was made in the financial year 2004-05 which is no longer required; profit for the year 2004-05 is to be adjusted for this item,

(vii) A claim of ₹16,500 against the company is to be provided and to be adjusted against profit for the financial year ended on 31st March, 2005.

(viii) Goodwill may be calculated at 3 times adjusted average super profits of the 3 years,

(ix) Capital employed may be taken as on 31st March, 2005.

You are required to ascertain the value of goodwill of the company.

Answer: Working Notes: Net Assets (Capital employed) of the company:

Freehold property		₹
(₹100,800 x 100/8)		12,60,000
Plant and machinery (less depreciation)		7,00,000
Stock		7,40,000
Debtors (net)	7,98,500	
Add: Provision Written back	31,500	8,30,000
Cash and bank balances		4,90,000
Total Assets:		**40,20,000**
Less: Liabilities:		
Sundry creditors	4,78,500	
Outstanding claim	16,500	
8% Debentures	6,00,000	
Preference share capital	**3,00,000**	13,95,000
Net Assets		**26,25,000**

2. **Calculation of Normal Rate of Return @ 10%**

$$Capital\ emloyed \times \frac{Normal\ Rate\ of\ Return}{100}$$

$$= Rs. 26{,}25{,}000 \times \frac{10}{100} = Rs. 2{,}62{,}500$$

3. **Calculation of Future Maintainable profit**

	2000-03	2003-04	2004-05
Profits after tax	4,41,000	6,45,000	4,80,000
Add: tax expense @ 40%	2,94,000	4,30,000	3,20,000
Profit before tax	**7,35,000**	**10,75,000**	**8,00,000**
Less: Non-recurring Profit @ 10% for 2003-04		(64,500)	…
Less: Omission of claim	-	-	(16,500)
Add: Provision for debtors no longer required	-	-	31,500
Adjusted Profit before tax	**7,35,000**	**10,10,500**	**8,15,000**
Less: 40% tax	**2,94,000**	**4,04,200**	**3,26,000**
Adjusted profit (after tax adjustment)	**4,41,000**	**6,06,300**	**4,89,000**

$$\text{Average profits } \frac{₹15{,}26{,}300}{3} = ₹5{,}12{,}100$$

4. **Calculation of super profits:**

= Future maintainable profits -Normal profits

= ₹ 5, 12,100 - ₹2,62,500

Super profits = ₹2,49,600

Value of Goodwill= (Super profits x 3 years purchase)

₹2,49,600 x 3= ₹7,48,800

Question 25: The following abridged Balance Sheet as on 31st March, 2024 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.

Normal rate of dividend in the concerned industry is 15%, whereas S 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, 2024 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. **(ICMAI Study material)**

Question 26. The following is the Balance Sheet as on 31st December, 2023 of N Ltd.:

Liabilities	₹ in Lakh	Assets	₹ in Lakh
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		
30,000 Equity shares of ₹5 each 4 paid-up	1,20,000	Land and Building	10,00,000
Other equity:		Furniture and Fixtures	1,00,000
General reserve	1,40,000		
Profit and Loss account	3,50,000	Vehicles	2,00,000
Non – current liabilities:		Investments	3,00,000
3,000 10% Preference shares of ₹100 each fully paid	3,00,000	**Current Assets:**	
		Stock	2,10,000
		Debtors	1,95,000
12% debentures	2,00,000	Prepaid Expenses	40,000
15% Term Loan	1,50,000	Advances	45,000
Deposits	1,00,000	Cash and Bank balance	2,00,000
Current Liabilities:			
Bank Loan	50,000		
Creditors	1,50,000		
Outstanding expenses	20,000		
Provision for tax	2,00,000		
Accrued Preference dividend	30,000		
	31,90,000		**31,90,000**

Additional Information:

(1) In 2021 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 2022. Debtors are to be reduced by ₹5,000 in 2023, some old furniture (Book value ₹10,000) was disposed of for ₹6,000.

(3) Fixed assets are worth 5% 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% 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, 2021. 50 per cent of the non-trade investments were acquired on 1st January, 2021 and the rest on January, 2022. A uniform rate of dividend of 10% 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 is 10%.

(8) Profit (after tax) are as follows: In 2021 — ₹2,10,000, in 2022 — ₹1,90,000 and in 2023 — ₹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. **(ICMAI Study material).**

Question 27: The following is the Balance Sheet of K Ltd. as on 31st March, 2024:

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
12.5% 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 1.4.2023. 50% of non-trade investments were purchased on 1.4.2022 and the rest on 1.4.2023. Non-trade investments yielded 15% return on cost.

(iii) In 2022 - 2023 Furniture with a book value of ₹1,00,000 was sold for ₹50,000. This loss should be treated as nonrecurring or extraordinary item for the purpose of calculating adjusted average profit.

(iv) In 2021 - 2022 new machinery costing ₹2,00,000 was purchased, but wrongly charged to revenue. This amount should be adjusted taking depreciation at 10% on reducing value method.

(v) Return on capital employed is 20% in similar business.

(vi) Goodwill is to be valued at 2 years purchase of super profits based on average profits of last four years.

Profits of last four years are as under:

Year	Amount (in ₹)
2020-2021	13,00,000
2021-2022	14,00,000
2022-2023	16,00,000
2023-2024	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. **(ICMAI Study material)**

Solution: (1) For Calculation of Goodwill

(i) Computation of 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 × 10% × 90%)	1,44,000	
Debtors (20,00,000 - 40,000)	19,60,000	
Stock (2,00,000 - 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**

(2) computation of average future maintainable profits:

Particulars	**20-21**	**21-22**	**22-23**	**23-24**
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**

Computation of adjusted average profits:

Particulars	**Amount**
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 is ₹8,23,792:

(iv) Super Profit = Average Adjusted profit – Normal profit
= 14,11,034 – 8,23,792 = ₹5,87,242

(**v) Goodwill**
= 2 years purchase of super profit
= 5,87,242 × 2 = ₹11,74,484

(2). Trade investments = ₹16,00,000 × 10% × 90% = ₹ 1,44,000
Non-trade investment = ₹ 16,00,000 - ₹ 1,60,000 = ₹ 14,40,000
Non-trade investment purchased on 1.4.2020 = 50% of ₹ 14,40,000 = ₹ 7,20,000
Non-trade investment purchased on 1.4.2021 = ₹ 14,40,000 - ₹7,20,000 = ₹7,20,000
Income from non-trade investment:
In the year 2020-2021 : 7,20,000 x 15% = ₹ 1,08,000
In the year 2021-2022 : 7,20,000 x 15% = ₹ 1,08,000
7,20,000 x 15% = ₹ 1,08,000
= ₹ 2,16,000

(3) Intrinsic Value of Equity Shares of K Ltd. ₹22.44

Question 28: The Balance Sheet of Mulyan Ltd., as on 31st December, 2023 is as follows:

Liabilities	**₹ in Lakh**	**Assets**	**₹ in Lakh**
Share Capital:		Goodwill:	50,000
Equity shares of ₹10 each. 5,00,000		**Fixed Assets:**	
less, calls in arrear 10,000	4,90,000	Machinery	2,30,000
(₹2 for final call)		Factory shed	3,00,000
8% Preference shares of ₹10 each fully paid	2,00,000	Vehicles	60,000
Reserves and Surplus:		Furniture	25,000
General Reserve	2,00,000	Investments	1,00,000
Profit & Loss A/c	1,40,000	**Current Assets:**	
Current Liabilities:		Stock in trade	2,10,000
Sundry Creditors	2,70,000	Sundry debtors	3,50,000
Bank Loan	1,00,000	Cash at bank	50,000
		Preliminary Expenses	25,000
	14,00,000		**14,00,000**

Additional Information

(i) Fixed assets are worth 20% above their actual book value, depreciation on appreciated portion of fixed assets is to be ignored for valuation of goodwill.

(ii) Of the investments, 80%, is non-trading and the Balance is trading. All trade investments are to be valued at 20% below cost. A uniform rate of dividend of 10% is earned on all investments.

(iii) For the purpose of valuation of shares, Goodwill is to be considered on the basis of 6 year's purchase of the super profits based on simple average profit of the last 3 years. Profits, after tax @ 50%, are as follows:

Year	**₹**
2021	1,90,000
2022	2,00,000
2023	2,50,000

In a similar business, return on capital employed is 20%. In 2021, a new furniture costing ₹10,000 was purchased but wrongly charged to revenue.

No effect has yet been given for rectifying the same. Depreciation is charged on furniture @ 10% p.a. (Diminishing Balance Method). Find out the value of each fully paid and partly paid equity shares. **(ICMAI STUDY MATERIAL)**

Question 29: The capital structure of VWX Ltd. is as follows as on 31st March, 2023:

Particulars	(₹)
45,000, Equity Shares of 100 each fully paid	45,00,000
12,500, 12% Preference Shares of 100 each fully paid	12,50,000
12% Secured Debentures	12,50,000
Reserves	12,50,000
Profit before Interest and tax during the year	18,00,000
Tax rate	40%

Normally the return on equity shares in this type of industry is 15%. Find out the value of the equity shares subject to the following:

(i) Profit after tax covers fixed interest and fixed dividend at least 4 times.

(ii) Debt equity ratio is at least 2.

(iii) Yield on shares is calculated at 60% of distributed profits and 10% on undistributed profits.

(iv) The company has been paying regularly an equity dividend of 15%.

(v) Risk premium for dividends is generally assumed at 1%.

Solution: 1. Computation of Profit after Tax (PAT) and Retained Earning:

Particulars		₹
Profit before interest and tax (PBIT) Less: Debentures interest (12,50,000 ×12/100) Profit before tax (PBT) Less: Tax @ 40% Profit after tax (PAT)		18,00,000 (1,50,000) 16,50,000 (6,60,000) 9,90,000
Less: Distributed profits		
Preference dividend $\left(12{,}50{,}000\text{x}\frac{12}{100}\right)$	1,50,000	
Equity dividend$\left(45{,}00{,}000\text{x}\frac{15}{100}\right)$	6,75,000	8,25,000
Retained earnings (undistributed profit)		**1,65,000**

2. Computation of Interest and Fixed Dividend Coverage

$=\frac{\text{PAT Debenture interest}}{\text{Debenture interest Preference dividend}}=\frac{₹9{,}90{,}000+₹1{,}50{,}000}{₹1{,}50{,}000+₹1{,}50{,}000}=3.8$

Note: This ratio is less than the prescribed ratio i.e., 4.

3. Computation of Debt Equity Ratio

$$\text{Debt Equity Ratio} = \frac{\text{Debt (long term loans)}}{\text{Equity (shareholders' funds)}}$$

$$= \frac{\text{Debentures}}{\text{Preference share capital Equity share c + + apital Reserves}}$$

$$= \frac{₹12{,}50{,}000}{₹12{,}50{,}5000+₹45{,}00{,}000+₹12{,}50{,}000}$$

Debt Equity Ratio $=₹\frac{12{,}50{,}000}{70{,}00{,}000}= 0.179$

The ratio is less than the prescribed ratio i.e., 2.

4. Computation of Actual Yield on Equity Shares

Yield on equity shares is calculated at 60% of distributed profits and 10% of undistributed profits as follows:

	Amt. (₹)
60% of distributed profits (60% of ₹6,75,000) 10% of undistributed profits (10% of ₹1,65,000)	4,05,000 16,500
	4,21,500

Yield on equity shares = $\frac{\text{Yield on shares}}{\text{Equity Share capital}}$ x100 = $\frac{4,21,500}{45,00,000}$ x 100 = 9.37%

5. Calculation of Expected Yield on Equity Shares

Normal return expected Add: Risk premium for low interest and fixed dividend coverage (3.8 < 4) Risk adjustment for debt equity ratio not required	15% 1% (Note - 1) Nil (Note - 2)
	16%

Note 1: When interest and fixed dividend coverage is lower than the prescribed norm, the riskiness of equity investors is high. Thus, they should claim additional risk premium over and above the normal rate of return.

Note 2: The debt equity ratio is lower than the prescribed ratio that means outside funds (Debts) are lower as compared to shareholders' funds. Thus, the risk is less for equity shareholders. Therefore, no risk premium is required to be added in such a case.

Value of an Equity Share

= Actual yield Expected yield × Paid up value of a share = $\frac{9.37\%}{16\%}$ × 100 = 58.5

Question 30. Earth Ltd. has a peer group consisting of Jupitar Ltd., Neptune Ltd. and Mars Ltd. Market capitalisation of the companies in peer group are ₹50 crores, ₹63 crores and ₹80 crores respectively. Other relevant data are: **(₹ in lakhs)**

Companies	Earth ltd	Jupiter ltd	Neptune ltd	Mars ltd
Earnings	1,250	500	700	1,000
Sales	2,800	4,000	5,400	7,000
Cash Flows	1,500	625	900	1,600

No. of shares	2,00,00,000	1,60,00,000	2,50,00,000	3,00,00,000

As value driver Earnings has the weight of 60%, Sales 10% and Cash 30%. Find value per share of Earth Ltd. under market approach.

Question 31. Multiple choice questions (ICMAI Study material)

1. **The major three approaches to valuation of shares are:**

a. Income Approach
b. Net Assets Approach
c. Market Approach
d. All of the above

2. **The major bases of asset valuation for a going concern:**

a. Book Value
b. Net Replacement Value
c. Net Realisable Value
d. All of the above

3. The Income approach for Valuation of Shares includes the models/Techniques:

a. Discounted Cash Flow
b. Dividend Discount Model
c. Maintainable Profits Basis
d. All of the above

4. Some of the methods of Goodwill Valuation are

a. Capitalisation method
b. Super profits method
c. Average Maintainable Profits method
d. All of the above

5. The ways of determining the value of goodwill using the capitalisation approach

a. Capitalisation of Average Profits
b. Capitalisation of Super Profits
c. Both a and b
d. Capitalisation of Average Future maintainable profit.

Answer:

1	2	3	4	5
D	d	d	d	C

Question 32. Fill in the blanks: (ICMAI Study material)

1. Every firm in an industry is expected to earn a normal rate of return. If a particular firm of the industry manages to earn a rate of return that happens to be more than the normal industry rate of return, then such a firm is said to be earning_.

2. ______________________ refers to a series of continuous cash flows (either cash inflows or cash outflows) of equal amount that occur in every period, over a specified period of time.

3. _________________________ refers to the excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over the external liabilities.

4. The phrase___________________________refers to the expected number of future years for which the firm is expected to earn the average profit from the year of purchase.

5. ………….represents the capacity of the business to earn excess profit for a period of time over normal profit.

Answer:

1.	**super profits**	**2.**	**Annuity**
3.	**Net Assets**	**4.**	**Number of Years of Purchase**
5.	**Goodwill**		

Module 3-- RECOGNITION & VALUATION OF FINANCIAL INSTRUMENTS

Topics to be covered:

Ind AS-32- Financial Instruments: Presentation
Ind AS- 109-Financial Instruments: Recognition, measurement and de-recognition
Ind AS -107: Financial Instruments disclosures

Ind AS 32: Financial Instruments: Presentation

Important note: Financial instruments to be classified as per substance rather than legal form.

Objective: The objective of this Standard is to establish Principles for classification and presentation of financial instruments into financial assets, financial liabilities and equity instruments, and for offsetting financial assets and financial liabilities.

Scope: This Standard shall be applied by all entities to all types of financial instruments except:

- Share based payments (Ind as 102)
- Insurance contracts
- Employee benefit plans (Ind AS 19)
- Interests in subsidiaries, associates and joint ventures.

Meaning of financial instruments: -- 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 of financial asset: 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 (e.g debtors, B/R, investment in bonds/ debenture);

OR

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity (e.g derivatives like call option, put option, future/forward contracts);

(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.

Examples of financial assets:

(a) Cash: Cash is by definition a financial asset. It also includes cash held in foreign currency.

(b) An equity instrument of another entity: Suppose X purchases 200 equity 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, investment in interest bearing securities or fixed dividend bearing securities 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 500 debentures in X Ltd for ₹ 100 per debenture at some future date while the current selling price of debenture is ₹ 120 per debenture.

Definition of financial liability: Any liability that is:

(a) Contractual obligation:

(i) To deliver cash or another financial asset to another entity; (For example, creditors, B/P, Outstanding expenses)

OR

(ii) To exchange financial assets or financial liabilities with another entity under conditions **that are potentially unfavourable to the entity;** Example of such an asset is a contract held by an entity to buy 500 debentures in X Ltd for ₹ 100 per debenture at some future date while the current selling price of debenture is ₹ 90 per debenture.

(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.

Example to understand point (b):

i. Non-derivative contract: - Contract to deliver equity instruments by COC Ltd to Mr Karan, a lender of Rs 5,00,000 after 3 years. Here number of equity instruments to be issued is not known at this time. It will depend on fair value of shares on the date of payment. Hence it is a financial liability.

ii. Derivative contract: - Contract to deliver as many numbers of entity's own equity instruments by the company as are equal to 1 kg of gold after 2 months. It is also a financial liability because number of shares to be issued will be known only on date of payment, which is also uncertain.

Question 1. On 1st February 2024, Entity 'X' enters into forward contract with entity 'Z' to purchase 10,000 equity shares @ ₹60 each after a period of 3 months. On 31st March 2024, Entity 'X' strongly believes that price will increase in future by ₹15 per share. Classify it.

Answer: For Entity X, it is financial asset and for Entity Y, it is financial liability.

Question 2. On 28 December 2024, Entity 'Y' enters into forward contract with entity 'Z' to purchase 1,000 equity shares @ ₹50 each after a period of 4 months. On 31st March 2025, Entity 'Y' strongly believes that price will decrease in future by ₹20 per share. Classify it in the book of Entity 'Y'.

Question 3. State whether followings are financial assets/liabilities or non-financial assets/liabilities.

	Items	Remark
1.	**Prepaid expenses**	Non- financial assets.
2.	**Deferred revenue/ advance income**	Non- financial liability.
3.	**Warranty obligations**	Non- financial liability.
4.	**Income tax payable**	Non- financial liability.(It's a legal obligation)
5.	**Constructive obligations (e.g provisions)**	Non- financial liability.
6.	**Gold**	Non- financial assets.
7.	**Gold bond**	Financial assets
8.	**Financial guarantee given**	Financial Liability
9.	**Advance received from customers**	Non- financial liability
10.	**Advance given for supply of goods or services**	Non- financial assets
11.	**Property, plant and equipment**	Non- financial assets
12.	**Intangible assets**	Non- financial assets
13.	**Inventory**	Non- financial assets
14.	**Perpetual debt instrument held**	Equity instrument
15.	**Promissory note payable in government bonds**	Financial liability
16.	**Promissory note receivable in government bonds**	Financial assets

Question 4. State whether followings are financial assets/liabilities or non-financial assets/liabilities.

Items	Remark
Trade payables (creditors/bills payables)-	Financial liability
Cash in foreign currency	Financial assets
Bank balance	Financial assets
Deposits received	Financial liability
Deposits given	Financial assets
Trade receivables(debtors/ bills receivable)	Financial assets
Bank loan	Financial liability
12% redeemable debentures	Financial liability

Lets compare definition of financial asset and financial liability:

FINANCIAL ASSETS	FINANCIAL LIABILITY
(a) cash; **(b) an equity instrument of another entity;**	
(c) a contractual right: **(i)** To receive cash or another financial asset from another entity. **Example:** Debtors, Bills receivable; **OR** **(ii)** To exchange financial assets or financial liabilities with another entity under conditions that are **potentially favourable to the entity** **Example 1:** On 12th February 2024, COC Ltd entered into a forward contract to buy 500 shares @ ₹ 100/share after 3 months. On 31st march 2024, market price of shares are Rs 120/share.	**(a) a Contractual obligation:** **(i)** To deliver cash or another financial asset to another entity'. **Example:** bills payable, creditors; **OR** **(ii)** To exchange financial assets or financial liabilities with another entity under conditions that are **potentially unfavourable to the entity;** **Example 1:** On 12th February 2024, COC Ltd entered into a forward contract to buy 500 debentures @ ₹ 100/share after 3 months. On 31st march 2024, market price of debentures are Rs 95/debenture.
(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.	**(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; **For example:-** COC Ltd issued 12% debentures of Rs 5 lakhs. These debentures are convertible into equity shares @ price prevailing after 3 years from the date of issue. **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**. **Example**: S Ltd purchases an option from A Ltd entitling the holder to subscribe to variable number of equity shares at a fixed exercise price of Rs 50 per share at any time during a period of 3 months. Holder paid an initial premium of Rs 2 per option. It is a financial liability.

Note for quick revision:

If fixed number of shares are to be received- it will reduce our equity and will be shown as financial liability.

If variable number of equity to be received- financial assets.

Question 5: On 12th February 2024, COC Ltd entered into a forward contract with Mr X to buy 500 shares @ ₹ 100/share after 3 months. On 31st March 2024, market price of shares are Rs 120/share. On 12th May 2024, market price/share was Rs 125/share. Make Journal entries in the book of COC Ltd and Mr X.

Solution: Journal entries in the book of COC Ltd:

Date	Particulars	Debit	Credit
12-2-24	No entry		
31-3-24	Derivative financial assets account Dr To profit and loss account 500 shares X (120-100)	10,000	 10,000
12-5-24	Derivative financial assets account Dr To profit and loss account [500 shares X (125-100)] – 10,000]	2,500	 2,500
12-5-24	Bank account Dr To Derivative financial assets account	12,500	 12,500

Journal entries in the book of Mr X:

Date	Particulars	Debit	Credit
12-2-24	No entry		
31-3-24	profit and loss account Dr To Derivative financial liability account 500 shares X (120-100)	10,000	 10,000
12-5-24	profit and loss account Dr To Derivative financial liability account [500 shares X (125-100)] – 10,000]	2,500	 2,500
12-5-24	Derivative financial Liability account Dr To bank account	12,500	 12,500

Question 6: On 12th February 2024, COC Ltd entered into a forward contract with Mr X to buy 500 shares @ ₹ 100/share after 3 months. On 31st march 2024, market price of shares are Rs 120/share. On 12th May 2024, market price/share was Rs 95/share. Make Journal entries in the book of COC Ltd and Mr X.

Solution: Journal entries in the book of COC Ltd:

Date	**Particulars**	**Debit**	**Credit**
12-2-23	No entry		
31-3-23	Derivative financial assets account Dr To profit and loss account 500 shares X (120-100)	10,000	 10,000
12-5-23	Profit and loss account Dr To Derivative financial assets account (entry for reversal of gain)	10,000	 10,000
12-5-23	Profit and loss account Dr To Derivative financial liability account 500 shares X (100-95)	2,500	 2,500
12-5-23	Derivative financial liability account To bank account	2,500	 2,500

Journal entries in the book of Mr X:

Date	**Particulars**	**Debit**	**Credit**
12-2-23	No entry		
31-3-23	profit and loss account Dr To Derivative financial liability account 500 shares X (120-100)	10,000	 10,000
12-5-23	Derivative financial liability account Dr To profit and loss account (liability reversed)	10,000	 10,000
12-5-23	Derivative financial asset account Dr To profit and loss account [500 shares X (100-95)	2,500	 2,500
12-5-23	Bank account Dr To Derivative financial asset account	2,500	 2,500

Definition of equity instruments:

Equity instruments

Equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

An instrument is an equity instrument, if and only if, following conditions are met:

(a) The instruments include **no contractual obligation**:

(i) to deliver cash or another financial asset to another entity (Example- equity share capital)

OR

to exchange financial assets or financial liabilities with another entity under conditions that **are potentially unfavourable to the issuer** (Our company). For example, Preference shares redeemable at the option of Issuer.

Some case study important for MCQs:

1. Preference shares redeemable at the option of Issuer – **Equity instrument.**
2. Non-redeemable preference shares – **Equity instrument.**
3. Redeemable preference shares at specified date – **Financial liability**
4. Preference shares redeemable at the option of Holder. – **Financial liability**

(b) If the instrument will or may be settled in the issuer' own equity instruments, it is:

(i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equit instruments:

Note: It means non-derivative **contract to deliver fixed number of own equity against our obligation** will be called equity instruments.

For example:- COC Ltd issued 12% debentures of Rs 5 lakhs. These debentures are convertible into equity shares of Rs 10 each at the rate of Rs 50 each after a certain period.

OR

(ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

For example: S Ltd purchases an option from A Ltd entitling the holder to subscribe to fixed number of equity shares at a fixed exercise price of Rs 50 per share at any time during a period of 3 months. Holder paid an initial premium of Rs 2 per option. It is an equity instrument.

Question 7: ST Ltd purchases an option from AT Ltd entitling the holder to subscribe to fixed number of equity shares at a fixed exercise price of Rs 50 per share at any time during a period of 3 months. Holder paid an initial premium of Rs 2 per option. Examine whether the financial instrument will be classified as equity or financial liability?

Solution: For the issuer AT Ltd, this option is an equity instrument as it will be settled by the exchange of a fixed amount of cash for a fixed number of its own equity instruments.

If, on the other hand, if the exercise period of the option was variable or the number of shares are to be issued was not fixed, then it will be classified as financial liability in the book of AT Ltd.

Question 8. In a future contract, COC Ltd issued 2,000 warrants to Mr X on condition that after period of 3 years, COC Ltd will issue one share against every warrant @ Rs 40 per share. State whether it will be treated as equity instrument or financial liability for COC Ltd.

Answer: Equity instruments. (Fixed number of shares and fixed amount of cash)

Question 9. In a future contract, COC Ltd issued 2,000 warrants to Mr X for Rs 2,40,000 on condition that after period of 3 years, COC Ltd will issue one share against every warrant at the rate of market price per share on the date of issue of shares. State whether it will be treated as equity instrument or financial liability for COC Ltd.

Answer: Financial liability (Fixed number of shares but no fixed cash)

Question 10. On 1st February 2024, Entity 'X' enters into forward contract with entity 'Z' to purchase 10,000 equity shares @ ₹60 each after a period of 3 months. On 31st March 2024, Entity 'X' strongly believes that price will increase in future by ₹15 per share. Classify it.

Answer: Financial assets.

Question 11. On 15 February 2024, Entity 'Y' enters into forward contract with entity 'Z' to purchase 1,000 equity shares @₹50 each after a period of 3 months. On 31st March 2024, Entity 'Y' strongly believes that price will decrease in future by ₹20 per share. Classify it in the book of Entity 'Y'.

Answer: Financial Liability.

Question 12. Entity 'A' enters into call option with entity 'B' to purchase 500 shares for ₹55 per share. Premium paid ₹2 per share after a period of 2 months. Classify it for A and B and show its treatment in their book, if

Case 1. Entity 'A' and 'B' strongly believe that price will increase in future by ₹15 per share.

In the book of A	**In the book of B**
Financial asset (Potentially favorable)	**Financial Liability (Potentially Unfavorable)**
Derivative financial asset account Dr 7,500 To profit and loss account 7,500 500 X (70-55)	profit and loss account Dr 7,500 To Derivative financial liability account 7,500

Case 2. Entity 'A' and 'B' strongly believe that price will decrease in future by ₹20 per share.

In the book of A	**In the book of B**
Since option will not be exercised, it will not be treated as financial instrument for anyone	
No entry will be passed	**No entry will be passed**

Question 13. COC Ltd issued 12% debentures of ₹20,00,000. As per the terms of issue, it has been agreed to issue equity shares of ₹10 each to redeem these debentures at the end of third year. Equity shares will be issued at the rate prevailing in market on the date of redemption. Are issued debentures financial liability?

Answer: Number of equity shares to be issued is not fixed. It would vary depending upon the market price of equity shares at the time of issue. So the equity settled debentures are treated as financial liabilities.

Question 14. If X Ltd writes (option writer/seller) an option under which the counter party can force the entity to sell equity shares at ₹15 per share at any time in next 70 days (called American call/put option). Is it a financial liability?

Answer: since X Ltd stands to lose if the option is exercised and the exchange is potentially unfavourable. Hence it is a financial liability.

Question 15. Y Ltd issued 1,00,000 zero coupon bond of ₹10 each amounting to ₹10,00,000. Bonds will be redeemed at the end of 4^{th} year by issuing 1,45,000 own equity shares of ₹10 each of the company. Should the equity settled bonds be classified as an equity instruments or financial liability?

Answer: in this case Y Ltd will issue fixed number of equity shares at the end of 4^{th} year. Hence it should be classified as equity instruments.

Question 16. State whether following items will be treated as financial liability instruments or equity instruments.

- **a.** Preference shares redeemable at stipulated date. - **Financial liability**
- **b.** Preference shares redeemable at the option of holder.- **Financial liability**
- **c.** Preference shares redeemable at the option of issuer- **Equity instrument**
- **d.** Non-redeemable preference shares:
  - Principal amount
  - Dividend amount:

Case 1. Contractual obligation exist to pay dividend.

Case 2. No contractual obligation exist to pay dividend

Question 17. A Ltd invests in compulsorily convertible preference shares(CCPS) issued by B Ltd (its subsidiary) at ₹1,000 each (₹10 face value and ₹990 premium). Under the terms of the instruments, each CCPS is compulsorily convertible into 1 equity shares of B Ltd at the end of 5 years. Such CCPS carry dividend @ 12% per annuam, payable only when declared at the discretion of B Ltd. Evaluate this under the definition of financial instrument for B ltd.

Solution: Since there is no contractual obligation to deliver cash or other financial asset by B ltd. Dividends are payable only when declared and hence, at the discretion of the issuer (B Ltd), thereby resulting in no contractual obligation over B ltd. CCPS are convertible into fixed number of equity shares. Hence it meets the definition of equity instruments and shall be classified as equity instrument in the book of B Ltd.

Question 18. COC Ltd issues convertible debentures to Krishnamurty for a subscription amount of ₹100 crores. Those debentures are convertible after 1 year into equity shares of COC Ltd using a pre-determined formula i.e.

$$\frac{100 \text{ crores X } (1+10\%)}{\text{Fair value on date of conversion}}$$

Examine the nature of financial instruments.

Solution: Such a contract is a financial liability of the entity even though the entity can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity to settle the contract.

Question 19. A Ltd issues warrants to all existing shareholders entitling them to purchase additional equity shares of A Ltd (with face value of ₹100 per share) at an issue price of ₹150 per share. Evaluate whether this constitutes an equity instrument or a financial liability?

Solution: in this case issue of warrant by A ltd constitutes a contractual arrangement for issuance of fixed number of shares against fixed amount of cash. Here it is also fixed the number of shares to be issued by A Ltd. Hence it constitutes equity instruments for A Ltd.

Concept of puttable instrument: 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.

Puttable equity instrument should be classified as financial liability unless it satisfies all of the following conditions(in such case it may be called equity**)**

i. It entitles the holder to a pro-rata share of the entity's net assets in the event of the entity's liquidation.

ii. It should be most subordinate to all other classes of instruments. It means they should not have priority over other claims.

iii. In case of puttable instruments, all financial instruments in the most subordinate class have identical features.

iv. Apart from contractual obligation for issuer to repurchase or redeem the instrument for cash or another financial asset, there are no other contractual obligation:

- ✓ To deliver cash or other financial assets, or
- ✓ To settle in variable number of entity's own equity instruments.

v. In case of puttable instruments, the total expected cash flows attributable to the instruments over the life of the instruments are based substantially on

- ✓ Profit or loss
- ✓ Change in the fair value of the recognised or unrecognised net assets of the entity over the life of the instrument.

vi. The issuer must have no other financial instrument or contract to provide some extra advantages to the holder of instrument.

Question 20. ABC Ltd has two classes of puttable shares- class A shares and class B shares. On liquidation, class B shareholders are entitled to a pro-rata share of the entity's residual assets upto a maximum of ₹10,00,000. There is no limit to the rights of the class A shareholders to share in the residual assets on liquidation. Examine the nature of the financial instrument.

Solution: the cap of ₹10,00,000 means that class B shares do not have entitlement to a pro rata share of the residual assets of the entity on liquidation. They cannot therefore be classified as equity.

But class A shareholders have entitlement to a pro-rata share of the residual assets on liquidation. Therefore they can be treated as equity instruments subject to satisfying all other conditions.

Compound/ hybrid financial instruments: instruments which have features of both, a financial liability and equity instrument. Such instrument are called 'compound financial instrument'.

Split accounting for compound financial instruments: Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount i.e. fair value of the instrument as a whole less the amount separately determined for the liability component.

Note: No gain or loss arises from initially recognising the component of the instrument separately.

Question 21. On 1st July 2024, D Ltd issues preference shares to G Ltd for a consideration of ₹10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime upto a period of 3 years. If the option is not exercised by the holder, the preference shares will be redeemed at the end of 3 years. The preference shares carry a fixed coupon of 6% p.a. the prevailing rate for the similar preference shares, without the conversion feature is 9% p.a. calculate the value of the liability and equity components.

Answer :1. Computation of fair value of amount payable on preference shares if not converted in equity shares:

Year end	Amount payable	Pv factor @ 9%	Discounted value
1	60,000	.917	55,020
2	60,000	.842	50,520
3	10,60,000	.772	8,18,320
Liability component			**9,23,860**
Equity component (10,00,000 – 9,23,860)			**76,140**

Question 22. On 1st March 2025, A Ltd issues preference shares to G Ltd for a consideration of ₹10 lakhs. The holder has an option to convert these preference shares to a fixed number of equity instruments of the issuer anytime upto a period of 3 years. If the option is not exercised by the holder, the preference shares will be redeemed at the end of 3 years. The preference shares carry a coupon of RBI base rate plus 1% p.a.

The prevailing market rate for the similar preference shares, without the conversion feature is RBI base rate plus 4% p.a. On the date of contract RBI base rate is 9%. Calculate the value of the liability and equity components.

Answer: liability component ₹9,29,165 and equity component ₹70,835.

Conversion: Classification of the liability and equity instruments of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders.

Holder may not always act in the way that might be expected. Furthermore, the likelihood of conversion will change from time to time.

On conversion of a convertible instrument at maturity, the entity:

- ✓ Derecognises the liability component and
- ✓ Recognises it as equity
- ✓ Original equity component remains as equity. Although it may be transferred from one line item within equity to another.
- ✓ There is no gain or loss on conversion at maturity.

Recognition of Interest, dividend, losses and gains on financial liability and equity instruments:

- ➢ Interest, dividend, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit and loss account (SPL)
- ➢ Distribution to holders of an equity instrument shall be recognised by the entity directly in equity.

Offsetting a financial asset and a financial liability:

A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when and only when, an entity

a. Currently has a **legally enforceable** right to set off the recognised amounts; and

b. Intends either to settle on a net basis, or to realise the assets and settle the liability **simultaneously.**

IND AS -109 (FINANCIAL INSTRUMENTS: RECOGNITION, MEASUREMENT AND DE-RECOGNITION)

Objective: To establish principles for the financial reporting of financial assets and financial liability.

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.
- Financial assets and financial liabilities **are recognised at their fair value upon initial recognition.**

(b) Methods of Subsequent measurement of Financial assets:

(a) Amortised cost

(b) Fair value through other comprehensive income (FVTOCI)

(c) Fair value through profit and loss (FVTPL)

Financial assets measured at		
Amortised cost	**FVTOCI**	**FVTPL**
INSTRUMENT TESTS: If contractual terms of the instrument give rise on specified dates to cash flows that are **solely payments of principal and interest** on the principal amount outstanding. **AND** **BUSINESS MODEL TEST:** FA is held with business model (BM) whose objective is **to hold financial assets in order to collect contractual cash flows.**	**INSTRUMENT TESTS:** If contractual terms of the instrument give rise on specified dates to cash flows that are **solely payments of principal and interest** on the principal amount outstanding. **AND** **BUSINESS MODEL TEST:** FA is held with business model (BM) whose objective is achieved **both by collecting contractual cash flows and by selling financial asset.**	**Any asset which is not measured at amortised cost or FVTOCI.** **(e.g Investment in equity instruments)**

1. Those Financial assets which have been covered under amortised cost method or FVTOCI, can opt for FVTPL method. But this **option will be irrevocable.**
2. Equity instruments do not have any contractual terms that give rise to cash flows that are solely payment of principal and interest. Therefore, investment in equity (FA) can never be classified at amortised cost/ FVTOCI. Hence equity financial assets are always classified at FVTPL.

   HOWEVER, those financial assets which have been covered under FVTPL, can opt for FVTOCI. But this option will be **irrevocable.**

Question 1. Entity 'X' sells goods to customers on credit. Entity 'X' typically offers customers upto 60 days following the delivery of goods to make payment in full. Entity 'X' collects cash in accordance with the contractual cash flows of trade receivables and has no intention to dispose of the receivables. Evaluate the business model.

Answer: Entity X 's objective is to solely collect contractual cash flows from trade receivables and therefore , trade receivables meet the business model test for the purpose of **classifying the financial assets at amortised cost.**

Question 2. An entity anticipates capital expenditure in a few years. The entity invests its excess cash in short and long terms financial **assets so that it can fund the expenditure when the need arises.** Many of the financial assets have contractual lives that exceed the entity's anticipated investment period.

The entity will hold financial assets to collect the contractual cash flows and, when an opportunity arises, it will sell financial assets to re-invest the cash in financial assets with a higher return. The managers responsible for the portfolio are remunerated based on the overall return generated by the portfolio. Evaluate the business model.

Answer: The objective of the business model is achieved by both collecting contractual cash flows and selling financial assets. The entity will make decisions on an ongoing basis about whether collecting contractual cash flows or selling financial assets will maximise the return on the portfolio until the need arises for the invested cash. Hence the business model test for the purpose of **classifying the financial assets is FVTOCI.**

Question 3. Silver Ltd has made an investment in optionally convertible preference shares (OCPS) of a company- Bronze Ltd at Rs 100 per share (face value Rs 100 per share). Silver ltd has an option to convert these OCPS into equity shares in the ratio of 1:1 and if such option not exercised till the end of 9 years, then the shares shall be redeemable at the end of 10 years at premium of 20%. Analyse the measurement of this investment in the book of Silver Ltd.

Answer: The classification assessment for a financial asset is done based on two characteristics:

- **i.** Whether the contractual cash flows comprise cash flows that are solely payments of principal and interest on the principal outstanding.
- **ii.** Entity's business model for managing financial assets – whether the company's BM is to collect cash flows; or a BM that involves realisation of both contractual cash flows and sale of financial assets;
- **iii.** In all other cases, the financial assets are measured at fair value through profit and loss (FVTPL).

In the above case, the holder can realise return either through conversion or redemption at the end of 10 years, hence it does not indicate contractual cash flows that are solely payment of principal and interest. Therefore such investment shall be carried at fair value through profit and loss (FVTPL).

ACCOUNTING OF FINANCIAL ASSETS:

i. Amortised cost Method :-

- Financial assets carrying value is subsequently adjusted for principal/Interest repayments and interest accrued using effective interest rates.
- Interest/dividend income earned is recorded and transferred to profit or loss account (SPL)

Question 4. COC Ltd provides a loan to its customers amounting to Rs 5,00,000. Interest is payable @ 10% p.a. every year and principal will be paid on maturity. Maturity period is 3 years. Principal amount will be redeemed at maturity. Make entries at initial recognition and subsequent recognition till its redemption by Amortised cost method.

IMPORTANT NOTE FOR REVISION OF Amortised cost method :

1. Interest/dividend accrued will be used for increasing the value of FA (in the asset side) and will be credited in profit and loss account (in liability side).

2. Instalment received on Financial assets(FA) will reduce the cost of investment and will increase the bank balance in the balance sheet.

3. Loss/ gain on sale of FA will also be transferred to SPL.

4. In examination, if fair value is given in question, then it should be completely ignored.

ii. **FVTOCI method**: Financial assets are subsequently measured at **Fair value and gain or loss on revaluation is transferred to OCI.**

Question 5. COC Ltd made investment in bonds of X Ltd amounting to Rs 5,00,000. Interest is receivable @ 10% p.a. every year and principal will be received on maturity. Maturity period is 3 years. Transaction cost incurred by COC Ltd is Rs 10,000. Principal amount will be redeemed at maturity. Make entries at initial recognition and subsequent recognition till its redemption by FVTOCI method. Effective rate of interest is 9.2%.

Fair value of financial assets at different dates are as follows:
Year end 1 - 5,10,000
Year end 2 - 5,25,000
Year end 3 - NA

Important Note for revision:-

1. Interest/dividend accrued will be used for increasing the value of FA (in the asset side) and will be credited in profit and loss account (in liability side).

2. Installment received on Financial assets(FA) will reduce the cost of investment and will increase the bank balance in the balance sheet.

3. At the end of every year, FA will are valued at fair value.

4. Loss or gain on revaluation of FA (Unrealised gain/loss) will be transferred to OCI (Through fair value gain reserve a/c)

5. Amount available in OCI will be transferred to SPL on disposal of FA.

6. Loss/ gain on sale of FA will also be transferred to SPL.

7. Concept of effective interest rate is applicable only when transaction cost will be given under Amortised cost method and FVTOCI method.

8. Accrued interest is always calculated by effective interest rate.

In case entity opted to FVTPL method for debt instruments: (Exception)

Question 6. COC Ltd made investment in bonds of X Ltd amounting to Rs 5,00,000. Interest is receivable @ 10% p.a. every year and principal will be received on maturity. Maturity period is 3 years. Transaction cost incurred by COC Ltd is Rs 10,000. Principal amount will be redeemed at maturity. Make entries at initial recognition and subsequent recognition till its redemption by FVTPL method.

Effective rate of interest is 9.2% approx. and Fair value of financial assets at different dates are as follows:

Year end 1 - 5,10,000

Year end 2 - 5,25,000

Year end 3 - NA

Important Note for revision of FVTOCI method:-

1. No entry is made for Interest/dividend accrued on Financial assets (FA).

2. When interest/ dividend will be received, it will be used to reduce the cost of FA.

3. At the end of every year, FA will be valued at fair value.

4. Loss or gain on revaluation of FA will be transferred to SPL.

5. Loss/ gain on sale of FA will also be transferred to SPL.

iii. FVTPL method: Financial assets are subsequently measured at Fair value and gain or loss is transferred to Profit and loss.

Question 7. Entity 'X' invest in 10,000 equity shares of Tata Ltd @ Rs 250 per share. Transaction cost incurred is Rs 30,000. Make entries by FVTPL method for two years. Fair value of investment at following dates are given below:

End of 1st year Rs 25,70,000

End of 2nd year Rs 26,10,000

Dividend received during 1st year and 2nd year were Rs 40,000 and Rs 25,000 respectively.

Solution: . Journal entries in the book of COC Ltd:

Date		Debit	Credit
0 year	Investment in equity of TATA account Dr	25,00,000	
	Profit and loss account Dr	30,000	
	To Bank account		25,30,000

During 1 Year	Bank account Dr To Investment in equity of TATA account (being dividend received)	40,000	40,000
Year end 1	Investment in equity of TATA account Dr To Profit and loss account (being investment revalued at its fair value)	1,10,000	1,10,000
During Year 2	Bank account Dr To Investment in equity of TATA account (being dividend received)	25,000	25,000
	Investment in X Ltd account Dr To Profit and loss account (being investment revalued at its fair value)	65,000	65,000

Important Note for revision of FVTPL Method:-

1. No entry is made for Interest/dividend accrued on Financial assets (FA).

2. When interest/ dividend will be received, it will be used to reduce the cost of FA.

3. At the end of every year, FA will be valued at fair value.

4. Loss or gain on revaluation of FA will be transferred to SPL.

5. Loss/ gain on sale of FA will also be transferred to SPL.

Accounting of investment in equity by FVTOCI (Exception to FVTPL method)

Question 8. (exception to FVTPL in case of investment in equity instruments) Entity X invest in 10,000 shares of Tata Ltd @ Rs 250 per share. Transaction cost incurred is Rs 30,000. Make entries by FVTOCI method for two years. Fair value of investment at following dates are given below:

End of 1st year Rs 25,70,000

End of 2nd year Rs 26,50,000

Dividend received during 1st year and 2nd year were Rs 40,000 and Rs 25,000 respectively. Assume at the end of 2nd year, investment in equity instruments was sold for Rs 27,00,000**.**

Important note for revision: All realised and unrealised gain on valuation/ sale of investment in equity instruments will be transferred to OCI and from there it will be directly transferred to EQUITY (it means gain on revaluation/sale will not be transferred to Profit and Loss account under any circumstances).

Question 9 (Accounting of investment in debt instrument) As part of staff welfare measures, Y Co Ltd has contracted to lend to its employees sums of money at 5% p.a. rate of interest. The amount lent are to be repaid in five equal instalments for principal along with the interest. The market rate of interest is 10% p.a. for comparable loans. Y Co. lent Rs 16,00,000 to its employees on 1st April 2024.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for the year ended 31st March 2025, for the transactions and also compute the value of loan initially to be recognised and amortised cost for all subsequent years. For the purpose of calculation, following discount factors at interest rate of 10% p.a. may be adopted-

At the year end	P.V Factor
1	.909
2	.827
3	.751
4	.683
5	.620

Question 10. A ltd has made a security deposit for obtaining right to use asset whose details are described below. Make necessary journal entries for accounting of the deposits in the first year and last year. Assume market interest rate for a deposit for similar period to be 12% per annum.

Particulars	Details
Date of security deposit (starting date)	1 April 2024
Date of security deposit (finishing date)	31 march 2029
Description	Lease
Total lease period	5 years
Discount rate	12%
Security deposit	10,00,000
Present value factor at the end of 5^{th} year	0.567427

Solution: 1. computation of value of financial asset at the beginning :

Security deposits	10,00,000
Present value factor of 5^{th} year end	0.567427
Present value of deposits at the beginning	Rs 5,67,427
Prepaid lease payment at the beginning (10,00,000 – 5,67,427)	Rs 4,32,573

2. computation of interest accrued on financial asset:

Year	Amount outstanding at the beginning	Interest accrued @ 12%	Amount received	Outstanding at the end of year
1	5,67,427	68,091	Nil	6,35,518
2	6,35,518	76,262	Nil	7,11,780
3	7,11,780	85,414	Nil	7,97,194
4	7,97,194	95,663	Nil	8,92,857
5	8,92,857	1,07,143	10,00,000	Nil

Journal entries in the book of A Ltd (Amotised cost method)

Date	Particulars	Debit	Credit
At start	Security deposits account Dr Prepaid expenses account Dr To bank account	5,67,427 4,32,573	 10,00,000
End of first year	Security deposit account Dr To interest earned account	68,091	 68,091
	interest earned account Dr to profit and loss account	68,091	 68,091
	Profit and loss account Dr To prepaid expenses account (4,32,573/5)	86,515	 86,515
End of last year	Security deposit account Dr To interest earned account	1,07,143	 1,07,143
	interest earned account Dr to profit and loss account	1,07,143	 1,07,143
	Bank account Dr To security deposits	10,00,000	 10,00,000

FINANCIAL LIABILITIES: CLASSIFICATION AND MEASUREMENT:

- **Upon initial recognition,** all financial liabilities are measured at fair value.
- **Subsequently**, the classification of financial liabilities shall be as follows:

i. **Measured at amortised cost.**

OR

ii. **Measured at FVTPL** :- **This method should be followed only if-**

(a) Financial liabilities are held for trading.

(b) Contingent consideration recognised by an acquirer in a business combination.

Question 11. Entity X issues 5,000 debentures of Rs 100 each. Interest payable every year @ 10% p.a.

Maturity period is 3 years

Transaction cost incurred by entity X is Rs 20,000.

After three years, debentures will be redeemed at 5% premium.

Effective interest rate is 13.16% (approx.)

Make journal entries for the three years in the book of entity X.

Fair value of debentures at the end of 1^{st} year and 2^{nd} year were Rs 5,10,000 and Rs 5,05,000 respectively.

EQUITY INSTRUMENTS ACCOUNTING:

Equity instruments will be measured at cost at its initial recognition.

Subsequent measurement is not applicable for equity instruments, because there is no obligation to refund.

Question 12. Entity X issues 5,000 equity shares for Rs 90 each. Transaction cost incurred Rs 10,000. Make journal entries in the book of Entity X.

Answer: Rs 4,40,000.

ACCOUNTING OF HYBRID INSTRUMENTS:

Question 13. G Ltd. issued 6% Debenture of total Rs 10,00,000 on 01.04.2024 repayable on 31. 03.2029. The debenture holders have right to receive equity shares of face value of Rs 4,00,000 at maturity as alternative to repayment in cash. The required rate of return is 10%. How the transaction will be recognised, measured and presented in 2024-2025? Make journal entries for the first year and last year assuming that debenture holders opted for conversion into equity shares.

At maturity, if conversion into shares are opted:

Debenture (Equity component) A/c	Dr.	1,51,631	
Debenture (Liability component) A/c	Dr	10,00,000	
To, Equity Share Capital A/c			4,00,000
To, Security Premium A/c			7,51,631

Question 14. Dew Ltd. issues 2,000 convertible bonds on 1st April 2024. The bonds have a three-year term, and are issued at par with a face value of Rs 1,000 per bond, giving total proceeds of Rs 20,00,000. Interest is payable annually at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 25,000 ordinary shares of Rs 10. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9%. The holders of the Debentures elected to convert the Debentures into Equity at maturity. Pass journal entries in the books of Dew Ltd.

Solution: The liability component is measured first, and the difference between the proceeds of the debenture issue andthe fair value of the liability is assigned to the equity component.

The present value of the liability component is calculated using a discount rate of 9%, the market interest rate for similar bonds having no conversion rights, as shown below.

year	Interest and principal	DCF @ 9%
1	1,20,000	1,10,092
2	1,20,000	1,01,002
3	1,20,000	92,662
3	20,00,000	15,44,367
Total (Liability component)		**18,48,122**
Proceeds from the Debenture issued		20,00,000
Equity component		**1,51,878**

For the year ended	Opening balance of debenture (liability)	Interest @ 9%	Payment 6% coupon	Total debenture liability
31-03-2025	18,48,122	1,66,331	1,20,000	18,94,453
31-04-2026	18,94,453	1,70,501	1,20,000	19,44,954
31-03-2027	19,44,954	1,75,046	1,20,000	20,00,000

Journal entries:

01-04- 2024	Bank account To, Convertible Debenture (liability) To, Convertible Debenture (Equity component)	Dr.	20,00,000	 18,48,122 1,51,878
31-03- 2025	Interest Expense accountTo, Bank account To, Convertible Debenture (liability)	Dr.	1,66,331	 1,20,000 46,331
31-04-2026	Interest ExpenseaccountTo, Bank account To, Convertible Debenture (liability)	Dr.	1,70,501	 1,20,000 50501
31-03-2027	Interest ExpenseaccountTo, Bank account To, Convertible Debenture (liability)	Dr.	1,75,046	 1,20,000 55,046
31-03-2027	Convertible Debenture (liability) Convertible Debenture (Equity component) To, Equity Share CapitalTo, Securities Premium	Dr. Dr.	20,00,000 1,51,878	 2,50,000 19,01,878

Question 15. ABC Ltd issued 10,000 compulsory cumulative convertible preference shares (CCCPS) as on 1st April 2024 @ ₹150 each. The rate of dividend is 10% payable every year. The preference shares are convertible into 5,000 equity shares of the company at the end of 5th year from the date of allotment. When the CCCPS are issued, the prevailing market interest rate for similar debt without conversion options is 15% p.a. Transaction cost on the date of issuance is 2% of the value of the proceeds. Key terms are as follows:

Date of allotment	1 April 2024
Date of conversion	1 April 2029
Number of preference shares	10,000
Face value of preference shares	150
Total proceeds	15,00,000

Rate of dividend	10%
Market rate of similar instruments	15%
Transaction cost	30,000
Face value of equity after conversion	10
Number of equity shares to be issued	5,000
Effective interest rate	15.86%

You are required to compute the liability and equity component and make entries for the first year of issue.

Question 16. A Ltd issued redeemable preference shares to a holding company – Z Ltd. the terms of the instruments have been summarized below. Account for this in the books of Z Ltd are:

Nature	**Non-cumulative redeemable preference shares**
Repayment	After 5 years
Date of allotment	1 April 2021
Date of repayment	31 March 2026
Total period	5 years
Value of preference shares issued	10 crores
Dividend rate	0.0001% (negligible)
Market rate of interest	12% p.a.
Present value factor	0.56743

Calculate amount of interest accrued each year and make journal entries in the year of issue only in the book of Z Ltd.

Solution: 1. Statement showing cash flow in financial instrument (preference shares)

0	**1**	**2**	**3**	**4**	**5**
10 crores	Nil	Nil	Nil	Nil	10 crores

2. Computation of liability component and equity component in preference shares:

Liability component in face value of preference shares (10 crores X 0.56743)	5,67,43,000
Equity component in face value of preference shares (10 Crores – 5,67,43,000)	4,32,57,000

3. Computation of interest accured on liability component of preference shares:

Year	Outstanding principal amount (opening)	Interest accrued @ 12%	Amount paid	Outstanding principal amount (end)
1	5,67,43,000	68,09,160	NIL	6,35,52,160
2	6,35,52,160	76,26,259	NIL	7,11,78,419
3	7,11,78,419	85,41,410	NIL	7,97,19,829
4	7,97,19,829	95,66,380	NIL	8,92,86,209
5	8,92,86,209	1,07,13,791	10,00,00,000	NIL

4. Journal entries in the book of Z Ltd:

Year	Particulars	Debit	Credit
0	Investment in equity instrument Dr Loan receivable account Dr To bank account	4,32,57,000 5,67,43,000	 10,00,00,000
End of 1st year	Loan receivable account Dr To interest income	68,09,160	 68,09,160
End of 1st year	Interest income Dr to profit and loss account	68,09,160	 68,09,160

Question 17. A Ltd issue ₹1,00,00,000 convertible bonds on 1st January 2021. The bonds have a life of 8 years and a face value of ₹10 each, and they offer interest, payable at the end of each financial year, at the rate of 6% p.a. The bonds are issued at their face value and each bond can be converted into one ordinary share in A Ltd at any time in next 8 years. Companies of a similar risk profile have recently issued debt with similar terms, without the option for conversion, at a rate of 8% p.a. required:

- **i.** Provide the appropriate accounting entries for initial recognition.
- **ii.** Calculate the stream of interest expenses across the 8 years of the life of bonds.
- **iii.** Provide the accounting entries if the holders of the bonds elected to convert the bonds to ordinary shares at the end of 3rd year.

Answer: i. initial recognition: liability component ₹88,50,671 and equity component ₹11,49,329.

at the end of third year:

Equity (component) Dr 11,49,329

Bond (liability) Dr 92,01,455

To ordinary equity share capital 1,03,50,784

Question 18. X ltd. Granted a loan to Y ltd amounting to Rs 40 lakhs repayable in 2 years at Rs 46 lakhs. However, due to economic recession after 1 year the repayable amount has been revised at Rs 44 lakhs.

Effective annual interest rate for such a loan is determined at 6% pa. The loan processing cost was Rs 2 lakhs.

X Ltd's accountant suggested to:

(i) Charge processing cost to the first year profit and loss A/c.

(ii) To credit Rs 4 Lakhs as interest income in the second year profit and loss a/c.

(iii) To carry loan a/c in the first year balance sheet at Rs 40 lakhs. Your advice is solicited.

(iv) He is not able to understand the accounting in second year.

Question 19: Wheel Co. Limited has a policy of providing subsidized loans to its employees for the purpose of buying or building houses. Mr. X, who's executive assistant to the CEO of Wheel Co. Limited, took a loan from the Company on the following terms:

- Interest rate: 4% for the first 400,000 and 7% for the next 600,000
- Start date: 1 April 2024
- Tenure: 5 years
- Pre-payment: Full or partial pre-payment at the option of the employee
- The principal amount of loan shall be recovered in 5 equal annual instalments and will be first applied to 7% interest bearing principal.
- The accrued interest shall be paid on an annual basis
- Mr. X must remain in service till the term of the loan ends

The market rate of a comparable loan available to Mr. X, is 12% per annum.

Make journal entries for the first year and 2nd year. Take PV factor upto four decimal.

Solution:

1. Statement showing cash flow from loan to employee:

	0	**1**	**2**	**3**	**4**	**5**
Principal	-10,00,000	+ 2,00,000	+ 2,00,000	+ 2,00,000	+ 2,00,000	+ 2,00,000
Interest @ 4% **Interest @ 7%**		16,000 42,000	16,000 28,000	16,000 14,000	16,000 Nil	8,000 Nil
Total	-10,00,000	2,58,000	2,44,000	2,30,000	2,16,000	2,08,000

2. computation of fair value of loan (financial liability)

Year	Cash inflow flow	PV @ 12%	Discounted value
1	2,58,000	0.8929	2,30,357
2	2,44,000	0.7972	1,94,515
3	2,30,000	0.7118	1,63,709
4	2,16,000	0.6355	1,37,272
5	2,08,000	0.5674	1,18,025
			8,43,878
Amount of Prepaid expenses (10,00,000 – 8,43,878)			**1,56,122**

3. computation of interest expenses on loan to employees:

year	Outstanding principal (opening)	Accured interest @ 12%	Amount received	Outstanding principal (end)
1	8,43,878	1,01,265	2,58,000	6,87,143
2	6,87,143	82,457	2,44,000	5,25,600
3	5,25,600	63,072	2,30,000	3,58,672
4	3,58,672	43,041	2,16,000	1,85,713
5	1,85,713	22,287 (bal fig)	2,08,000	Nil

Journal entries:

Date	Particulars	Debit	Credit
1-4-24	Loan to employees account Dr Prepaid expenses account Dr To bank account	8,43,878 1,56,122	 10,00,000
31-3-25	Loan to employees account Dr To interest earned account	1,01,265	 1,01,265
31-3-25	Interest earned account Dr to profit and loss account	1,01,265	 1,01,265
31-3-25	Bank account Dr To Loan to employees account	2,58,000	 2,58,000
31-3-25	Profit and loss account Dr To prepaid expenses account (1,56,122/5)	31,224	 31,224
31-3-26	Loan to employees account Dr To interest earned account	82,457	 82,457

31-3-26	Interest earned account Dr to profit and loss account	82,457	 82,457
31-3-26	Bank account Dr To Loan to employees account	2,44,000	 2,44,000
31-3-26	Profit and loss account Dr To prepaid expenses account (1,56,122/5)	31,224	 31,224
Carrying amount of loan to employees at the end of second year i.e 31-3-2026 (8,43,878 + 1,01,265 – 2,58,000 +82,457 – 2,44,000			**5,25,600**

Question 20: Assume in previous question Mr X prepays Rs 2,00,000 on 31st December on 31-3-2026, reducing the outstanding principal as at that date to Rs 4,00,000. Make adjustment entry on 31-3-2026.

Solution:

1. **Statement showing cash flows on 31-3-2016**

	3	**4**
Principal	+ 2,00,000	+ 2,00,000
Interest @ 4% **Interest @ 7%**	16,000 NIL	8,000 Nil
Total	2,16,000	2,08,000

2. **Computation of new carrying value of loan to employee on 31-3-2026:**

Year ended	**Cash inflow flow**	**PV @ 12%**	**Discounted value**
31-3-27	2,16,000	0.8929	1,92,857
31-3-28	2,08,000	0.7972	1,65,816
new carrying value of loan to employee on 31-3-2026			**3,58,673**

3. **Computation of adjustment required in carrying amount of financial asset:**

Existing carrying amount as per original agreement Less: new carrying amount	5,25,600 3,58,673
Adjustment required	**1,66,927**

4. **Journal entry for adjustment:**

	Debit	Credit
Bank account Dr To loan to employee account To prepaid expenses account	2,00,000	 1,66,927 33,073

Question 21: K Ltd issued 5,00,000, 6% convertible debentures @ Rs 10 each on 1 April 2024. The debentures are due for redemption on 31st March 2028 at a premium of 10%, convertible into 2,50,000 equity shares of Rs 10 each i.e to the extent of 50% and balance to be settled in cash to the debenture holders. The interest rate on equivalent debentures without conversion rights was 10%.

You are required to separate the debt and equity components at the time of issue and show the accounting entries in the company's books at initial recognition. The following present value of Re 1 at 6% and at 10% are provided:

Interest rate	Year 1	Year 2	Year 3	Year 4
6%	0.94	0.89	0.84	0.79
10%	0.91	0.83	0.75	0.68

The accountant of K Ltd has already recognised interest expense of Rs 3,00,000 in the statement of profit and loss account for the year ended on 31st march 2025. Advise.

Solution: 1. Statement showing cash flow on financial instrument (6% debentures)

0	1	2	3	4
+50,00,000	-3,00,000	-3,00,000	-3,00,000	-3,00,000 -27,50,000

2. computation of fair value of 6% debentures (financial liability)

Year	Cash outflow flow	PV @ 12%	Discounted value
1	3,00,000	0.91	2,73,000
2	3,00,000	0.83	2,49,000
3	3,00,000	0.75	2,25,000
4	30,50,000	0.68	20,74,000
Fair value of liability component			**28,21,000**
Amount of equity component (50,00,000 – 28,21,000)			**21,79,000**

3. Journal entry:-

Particulars	Debit	Credit
bank account Dr	50,00,000	
To 6% debentures (liability)		28,21,000
To 6% debentures (equity)		21,79,000

4. For the year ended on 31st march 2025, interest expense to be recognised in profit and loss account should be Rs 2,82,100 (10% of 28,21,000). Excess amount recognised should be reversed in profit and loss account (i.e. 3,00,000 – 2,82,100) = Rs 17,900.

Journal entry:

6% debentures (liability) account Dr 17,900

To profit and loss account 17,900

Question 22: On 1st January 2024, Sam Co. Ltd. agreed to purchase USD ($) 20,000 from JT Bank in future on 31st December 2024 for a rate equal to 68 per USD. Sam Co. Ltd. did not pay any amount upon entering into the contract. Sam Co Ltd. is a listed company in India and prepares its financial statements on a quarterly basis.

Following the principles of recognition and measurement as laid down in Ind AS 109, you are required to record the entries for each quarter ended till the date of actual purchase of USD.

For the purposes of accounting, please use the following information representing marked to market fair value of forward contracts at each reporting date:

As at 31st March 2024 = (Rs 25,000)

As at 30th June 2024 = (Rs 15,000)

As at 30th September 2024 = Rs 12,000

Spot rate of USD on 31st December 2024 = Rs 66 per USD

Question 23: BEAS Ltd borrows a sum of Rs 20 crores from SINDHU Ltd on 1.04.2023 repayable as a single bullet payment at the end of 5 years. The interest thereon @ 5% p.a. is payable at yearly rests. Since the market rate of interest is 8%. BEAS Ltd paid an origination fee of Rs 2.3954 crore to SINDHU Ltd to compensate SINDHU Ltd for the lower rate of interest. Apart from the above, there are no other transactions between the two parties.

You are required to calculate the amount at which BEAS Ltd would recognise the loan and SINDHU Ltd would recognise the annual interest income thereon in the first year.

The present values of Rs 1 at 5% and 8% are supplied to you.

Interest rate	Year 1	Year 2	Year 3	Year 4	Year 5
5%	0.9524	0.9070	0.8638	0.8227	0.7835
8%	0.9259	0.8573	0.7938	0.7350	0.6806

(ICMAI June 2024- 7 marks)

Solution:

1. computation of cash flows on loan from SINDHU Ltd (Financial liability): (figures in crores)

0	1	2	3	4	5
+ 20 crores - 2.3954	-1	-1	-1	-1	-21

2. Computation of fair value of Loan from Sindhu: (figures in crores)

Year	Outflow	PV @ 8%	Discounted value
1	1	0.9259	0.9259
2	1	0.8573	0.8573
3	1	0.7938	0.7938
4	1	0.7350	0.7350
5	21	0.6806	14.2926
Present value of liability component **Less: Origination fee**			**17.6046** **- 2.3954**
Fair value of loan from Sindhu			**15.2092**

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.

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.

(b) financial assets and liabilities measured at amortised cost.

(c) financial assets measured at fair value through other comprehensive income.

CHAPTER- 4. NON-BANKING FINANCIAL COMPANY (NBFC)

Topics to be covered:

(1) **Meaning of NBFC**
(2) **Types of NBFC**
(3) **Income recognition**
(4) **Classification of assets and creation of Provision**
(5) **Accounting of investment**
(6) **CAR (Capital Adequacy ratio)/ CRAR (Capital to risk weighted assets ratio)**
(7) **Theory**

NON-BANKING FINANCIAL COMPANY (NBFC) – CONCEPT

- IND AS is applicable to NBFCs on and from **1.4.2018**

Meaning of NBFC:-

- 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.

- 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, leasing, hire-purchase, insurance business, chit business etc.

- **However**, such a company 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.

Concept of Residuary Non-banking company:- It is also a type of NBFC. A non-banking institution which is a company and has its principal business of receiving deposits under any scheme or arrangement in one lumpsum or in instalments by way of contributions or any other manner (other than demand deposits) or lending in any manner is called a residuary non- banking company.

CLASSIFICATION OF NON- BANKING FINANCIAL COMPANIES (NBFCs):-

[A] On the basis of Liability Structure:

1. **Deposit taking NBFCs (referred to as NBFC-D): The NBFCs which are allowed to accept public deposits(other than deposits repayable on demand) are called Deposit taking NBFCs. For example, Bajaj Finance, Mahindra Finance etc.** 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): The NBFCs which are not allowed to accept public deposits.** They can further be divided into two parts:-
   - **(a) The NBFCs-ND (those with assets of less than Rs 500 crore):-** will be those NBFCs-ND which have asset size of less than ₹500 crore as per the last audited balance sheet.
   - **(b) Systematically important NBFCs (referred to as NBFC-ND-SI): The NBFCs which are not allowed to accept public deposits**. The NBFCs-ND will be those NBFCs-ND which have asset size of ₹500 crore or more as per the last audited balance sheet.

[B] On the basis of nature of primary activities performed (as per RBI): On this basis, the NBFCs can be classified into the following categories:

1. **Asset Finance company(AFC)** is a company which carries on as its principal business the financing of physical assets supporting productive/economic and general purpose assets, such as automobiles, tractors, lathe machine, generator set, earth moving and material handling equipment and general purpose industrial machine etc.
2. **Investment company** means any company which carries on as its principle business of the acquisition of securities.
3. **Loan company(LC)** 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(AFC).
4. **Leasing company** is a company which carries on as its principal business, the business of leasing of equipments or the financing of such activity.
5. **Infrastructure finance company** is a company which carries on as its principle business, the financingof 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-OperativeFinancial 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.

Prudential Norms: In order to ensure that NBFCs work on sound and healthy lines and make adequate disclosure in financial reports, the RBI has issued following norms applicable for NBFCs.

(a) **Income recognition**

(b) **Principles for accounting of Investments**

(c) **Assets classification and Provisioning norms**

(d) **CRAR (only theory)**

(e) **Credit concentration norms (remember name only)**

Let's discuss in details:

(a) Income recognition:

(i) Interest income recognition on loans and advances:

Loans and advances (assets)	
Performing assets (PA)	**Non-performing assets (NPA)**
Those loans and advances on which bank receives regular instalments without any default, **OR** Default in payment has been made but period of default does not exceed normal risk.	If period of default exceeds normal risk.
Income recognition – Accrual basis	**Income recognition-** actual receipt basis

Note 1:- Normal risk period:

(i) For NBFC-ND with asset size of less than Rs 500 crores (i.e. Non-systematically important, Non-deposit NBFC), **normal risk period is 180 days.**

(ii) For Deposit taking NBFCs (NBFC-D) and Systematically important NBFCs (NBFC-ND-SI), **normal risk period is 90 days.**

Note 2. Any such income recognised before the asset (loan and advances) became NPA and remain unrealised income shall be reversed.

Question 1 Given below is the detail of interest on advances of an NBFC (Rs. in lakhs).

Advances	**On performing Assets**		**On Non-performing Assets**	
	Interest Earned	**Interest Received**	**Interest Earned**	**Interest Received**
Term Loan	100	80	50	20
Cash Credit	200	120	100	60
Bill Purchased	300	180	150	90

Calculate the interest income to be recognized for the year ending 31st march 2024.

(ii) Income recognition from hire purchase asset financing business/ lease assets financing business:

Hire purchase Instalments/ lease rent	
Performing assets (PA)	**Non-performing assets (NPA)**
If regular instalments/lease rent are receive **OR** Instalments/ lease rent are overdue for 3 months or le	Instalments/ lease rent are overdue for more than mo
Income recognition – Accrual basis	**Income recognition**- actual receipt basis,

Note 1. Any such income recognised before the asset (loan and advances) became NPA and remain unrealised income shall be reversed.

(iii) Income from investment in securities:

Income from investment in securities (E.g equity shares, debentures, bonds etc	
Dividend income	**Interest income**
Actual receipt basis	**Accrual basis**
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.	

(b) Principles for accounting of Investments:

- 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.

- 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:

(a) **Long term investments- are valued as per ICAI Accounting Standards**

(b) **Current investments** can further be classified into:

(i) **Quoted investments**

(ii) **Unquoted investments**

(i) Valuation of Quoted investments:

- 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.

(ii) Valuation of unquoted current investments:

Unquoted current investments	Valued at
Investment in preference shares	at cost or face value, whichever is lower.
Investments in Government securities or Government guaranteed bonds	cost or face value, whichever is lower.
Investments in the units of mutual funds	net asset value declared by the mutual fund
Investments in Commercial papers	carrying cost.
Investments in Debentures, bonds, government securities	Cost price

- **Unquoted equity shares in the nature of current investments** shall be valued at cost or break-up value, whichever is lower. However, the NBFC may substitute fair value in place of break-up value of the shares, if considered necessary.

"Breakup value" =

$$\frac{\textbf{equity capital + all reserves} - \textbf{intangible assets – non cash reserve (revaluation reserves)}}{\textbf{number of equity shares of the investee company}}$$

Note: - Where the balance sheet of the investee company is not available for two years, such **shares shall be valued at one rupee only.**

Question 2: Anischit Finance Ltd. is a non-banking finance company. It makes available to you the costs and market price of various investment held by it as on 31.3.2025.

Scrip's	Cost	Market Price
A. Equity Shares		
A	60.00	61.20
B	31.50	24.00
C	60.00	36.00
D	60.00	120.00
E	90.00	105.00
F	75.00	90.00
G	30.00	6.00
B. Mutual fund-		
MF-1	39.00	24.00
MF-2	30.00	21.00
MF-3	6.00	9.00
C. Government securities		
GV-1	60.00	66.00
GV-2	75.00	72.00

i. Can the company adjust depreciation of a particular item of investment within a category?
ii. What should be value of investment as on 31st March 2025.
iii. Is it possible to offset depreciation in investment in mutual fund against appreciation of the value of investment in equity shares and government securities? **(CMA Final- 5 marks)**

Note: - Transaction in government securities: - Every non-banking financial company shall undertake transactions in Government securities through its CSGL account or its demat account.

(c) Assets classification and provisioning required in case of loans, advances:

The NBFCs have to classify their loans and advances(assets) into 4 categories:--

(i) Standard Assets

(ii) Sub-Standard Assets

(iii) Doubtful Assets

(iv) Loss assets.

Category	**Standard Assets**	**Sub-Standard Assets**	**Doubtful Assets**	**Loss assets.**
Definition	Assets which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset is not an NPA	Asset which has been classified as NPA for a period not exceeding 12 months.	Assets which has remained NPA for a period exceeding 12 months, it is called doubtful assets.	Assets which is considered uncollectible; ➢ by NBFC; or ➢ internal auditors; or ➢ external auditors; or ➢ the RBI inspection
Provision Requirement	0.4% of the total amount outstanding	10 % of the total amount outstanding	● Unsecured Portion-100% ● Secured Portion: Debt doubtful: up to 1 year : 20 % 1 To 3 Years: 30 %	100% of the total outstanding

Note 1: Percentage of provision for Standard Asset is 0.25% as per Non-Banking Financial Company - Non Systemically Important Non-Deposit taking Company.

Question 3. Classify the following customers of NBFC into different category for the purpose of provision to be made:

Customer	**Period of default**	**Remark**
A	No default	
B	5 months	
C	8 months	
D	15 months	
E	2 years	
F	3 years	
G	5 years	

Question 4. Advances have been classified as under:

	Cash-Credit	Term Loans	Bills Purchased
Standard Assets	1,000	975	225
Sub-Standard Asset	125	100	25
Doubtful-up to one year	100	20	—
One to three years	120	50	—
More than three years	50	80	—
Loss Assets	30	50	—
	1,425	**l,275**	**250**

No Provision has been made so far against these assets. Sub-standard assets are secured upto 35% and doubtful assets are secured to the extent of 60% of the dues. Make the required provisions assume it is NBFC-ND-SI.

Question 5: While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

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. **(ICMAI Study material)**

Solution: computation of amount of provision which must be made against the advances:

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.

Provisioning requirements in respect of hire purchase and lease asset business shall be calculated as follows:

(i) Provision for doubtful debt =

Total dues (overdue and future instalments taken together)	XXXX
Less: finance charges not credited to P/L and carried forward as unmatured finance charges	XXXX
Less: depreciated value of the underlying assets (notionally computed on the original cost of the asset reduced by depreciation @ 20 p.a. by SLM method)	XXXX
Provision for doubtful debt	**XXXX**

Note 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/lease finance may be deducted against the provisions stipulated above.

(ii) Additional provision for hire purchase/lease asset finance: -

(a) where hire charges/lease rentals are overdue upto 12 months	**Nil**
(b) where hire charges/lease rentals are overdue for more than 12 months but upto 24 months	**10% of net book value**
(c) where hire charges/lease rentals are overdue for more than 24 months but upto 36 months	**40% of net book value**
(d) where hire charges/lease rentals are overdue for more than 36 months but upto 48 months	**70% of net book value**
(e) overdue for more than 48 months	**100% of net book value**

Question 6: Samvedan Limited is a non-banking finance company. It accepts public deposit and also deals in hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31-03-2024. Few machines were sold on hire purchase basis. The hire purchase price was set as ₹ 100 lakhs as against the cash price of ₹ 80 lakhs. The Amount was payable as ₹ 20 lakhs down payment and balance in 5 equal instalments. The hire vendor collected first instalment as on 31-03-2025. The company was finalising accounts for the year ending 31-03-2026.Till 15-05-2026, the date on which the Board of Directors signed the accounts, the second instalment was not collected. Presume IRR to be 10.42%. Required:

(i) What should be the principal outstanding on 1-4-2025? Should the company recognize finance charge for the year 2025-26 as income?

(ii) What should be the net book value of assets as on 31-03-26 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? **(ICMAI Study material)**

Answer: principal outstanding on 1-4-2025 Rs 50,25,200; Net Book Value of assets for Samvedan Ltd-Rs 48,00,000;

Amount of Provision- Rs 7,49,000;

Since, the installment of Rs 16 lakhs not paid, was due on 31.03.2026 only, the asset is classified as standard asset. therefore, no additional provision has been made for it.

Question 7: Peoples Financiers Ltd. is an NBFC providing Hire Purchase Solution for acquiring Consumer Durable. The following information is extracted from its books for the year ended 31st March, 2025:

Assets Funded	**Interest Overdue but recognized in Profit & Loss**		**Net Book Value of Assets outstanding**
	Period Overdue	**Interest Amount**	
		(₹in crore)	**(₹ in crore)**
LCD Television	Upto 12 months	480.00	20,123.00
Washing Machines	For 24 months	102.00	2,410.00
Refrigerators	For 30 months	50.50	1,280.00
Air Conditioner	For 45 months	26.75	647.00

You are required to calculate the amount of provision to be made.

Other important theory:

- **REGULATORY APPROACH FOR NBFCs:**

(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.

- **Prudential regulation norms applicable to NBFCs:**

  - The Reserve Bank of India has issued detailed directions on prudential norms.
  - **Prudential regulation norms** include guidelines on income recognition, asset classification and provisioning requirements applicable to NBFCs 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.

- 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.
- **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.

- 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%.**

- **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 (Capital to risk weighted asset);

(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.

- **<u>MANDATORY REQUIREMENTS OF MINIUM NET OWNED FUND(NOF) BY NBFC</u>:**

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 ₹ 2 crores or more.**

- **<u>GETTING RATING TO ACCEPT OR RENEW PUBLIC DEPOSITS FOR NBFC</u>:**

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 net owned funds (NOF).**

<u>Preparation of Balance Sheet and Profit and Loss Account</u>:

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 nonbanking 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 Annex I.

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 Annex I.
- The following disclosure requirements are applicable only to systemically important (Asset Size more than Rs. 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.

8. Multiple choice questions:

1. IND AS is applicable to NBFCs on and from

a. 1.4.2016 b. 1.4.2017 c. 1.4.2015 d.1.4.2018

2. As per Sec. 45I(f)of RBI Act, 1934, a non-banking financial company means:

a. a financial institution which is a company

b. a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner

c. such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify

d. All of the above

3. The term ‘Public Funds’ includes

a. Debentures

b. Funds raised directly or indirectly through public deposits

c. Bank finance

d. All of the above

4. As per Prudential Regulations for NBFCs-ND, the NBFCs-ND with asset size of less than Rs 500 crores shall be

a. Exempted from the requirement of maintaining CRAR

b. Exempted from complying with Credit Concentration Norms

c. Maintain a leverage ratio (Total Outside Liabilities Owned Funds) of 7 to link Asset Growth with the Capital

d. all of the above

5. Non-Performing Asset (NPA) in case of Lease Rental and Hire-Purchase Assets if:

a. Overdue for 9 Months as on 31st March 2016
b. Overdue for 6 Months as on 31st March 2017
c. Overdue for 3 Months as on 31st March 2018 and Onwards
d. All of the above

Answer:

1.	2.	3.	4.	5.
d.	d.	d.	d.	d.

9. Fill in the blanks:

1. Commercial papers shall be valued at________________________.

2. The provision towards standard assets need not be netted from gross advances but shall be shown separately as____________________________________in the balance sheet.

3. In addition to disclosure of all material items in financial statements, a note for every item of Other Income or Other Expenditure should be given if it exceeds___% of the total income.

4. Balance sheet items are to be classified as Financial and Non-financial and are allowed to be arranged in order of___.

5. All NBFCs-ND which have an asset size of `500 crore and above and all NBFCs-D shall maintainminimum Tier 1 Capital of ____.

Answer:

1.	carrying cost	2.	Contingent Provisions against Standard Assets
3.	1%	4.	liquidity
5.	10%		

Section C

CHAPTER 5A and 5C-Accounting of Business Combinations & Restructuring

Topics covered:

(i) Business acquisition (Ins AS 103)
(ii) Business Combination under common control (Appendix C of Ind AS 103)
(iii) External reconstruction (Appendix C of Ind AS 103)
(iv) Internal reconstruction
(v) De-merger
(vi) Reverse acquisition/Merger

INTRODUCTION: --

Two new terms are used in Ind AS 103, Business Combinationand Business Combination under Common Control. All the events and arrangements such as mergers, acquisitions, absorptions, amalgamations, external reconstruction, de-merger and reverse merger are now accommodated within these two new terms. Only events and arrangements meant like internal reconstruction, financial restructuring or capital reduction are continuing with the same terminology as Ind AS has not intervened on such events.

In fact, the economic events or transactions that were accounted under accounting of absorption, amalgamationand external reconstruction continue to exist and continue to be accounted under Business Combination as per Ind AS 103, Further, Ind As 103 on Business combination expands the scope of accounting to transaction orother event in which an acquirer obtains control of one or more businesses, when the legal entity of the acquiree continues to exist.

CONCEPT OF BUSINESS COMBINATION: - Business Combination is a transaction or an event in which an acquirer obtains control of one or more businesses.

Business means an integrated set of activities having three elements i.e. **INPUT- PROCESS-OUTPUTS**, that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower cost or other economic benefit directly to the investors.

Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in this Ind AS.

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.

- When after business combination, acquiree continues to exist, it is to be recorded in the books of the acquirer in two sets, one for consolidated accounts and the other for its separate financial statements i.e., for its stand-alone accounts.
- When after business combination, acquiree ceases to exist, it is to be recorded in the books of the acquirer in one set only, in its stand-alone accounts (it is also called individual set).

Note 1. Acquiree is the business or businesses that the acquirer obtains control of in a business combination.

Note 2. Acquirer is the entity that obtains control of the acquiree.

CONTROL OVER BUSINESS of other company can be obtained:

(a) By acquiring net assets of other company: -

- In this case, acquiree company ceases to exist.
- Acquiree company will close its books of account by liquidation method of accounting.
- Acquirer company will account for business combination in its SFS (also called individual set) only as per Ind AS 103.

(b) By acquiring more than 50% equity shares of acquiree company.

- In this case, acquiree company will exist and will continue its operation in normal way.
- No accounting is required in the book of acquiree company for closing its books of account.
- Acquirer company will prepare 2 types of financial statement i.e. Separate Financial Statement (SFS) and Consolidated Financial Statement (CFS).

(I) In SFS (stand-alone set) as stated below:

Investment in shares in the Acquiree	Dr.	xxxx	
To, Consideration			Xxxx

Note: There is no application of Ind AS 103, rather, Ind AS 109 is applicable.

(II) In consolidated set, Acquisition Method of Ind AS 103 is applied.

Identified Assets of Acquiree	Dr.	xxxx	
Goodwill (if any) To,	Dr.		
Consideration			
To, Identified Liabilities			xx
To, Non-controlling Interest			xx
To, Previously-held equity interest in AcquireeTo,			xx
Gain from a bargain purchase (if any)			xx
			xx

Accounting and reporting in the book of acquirer is made under:

(i) Acquisition method

(ii) Pooling of interest method (also called business combination under common control)

(i) **Acquisition method: - 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:

(1) 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).

(2) 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.

Question 1A. Balance Sheet of King Fisher Ltd. as on 31.03.2024

Particular	₹	Particular	₹
Equity share capital	9,00,000	Assets	12,00,000
Liabilities	3,00,000		
	12,00,000		**12,00,000**

COC Ltd. acquires King Fisher Ltd. for ₹ 10,70,000 payable in equity shares of ₹ 10 each. Fair value of assets of King Fisher Ltd. on 31.03.2024 were ₹ 12,50,000. Made journal entries in the book of COC ltd. assuming King Fisher Ltd does not exist after the absorption.

Answer. Goodwill = ₹ 1,20,000

Question 1B. Assume in previous question King Fisher Ltd exist after its absorption.

Question 2. A Ltd. acquires B Ltd. for ₹9,60,000 payable by issue of 24,000 equity shares of ₹10 each at a premium of ₹30. Fair Value of B's net assets at time of acquisition amounts ₹ 10,00,000. Required:

1. Calculate Goodwill.
2. Journal Entry in the books of A.

Question 3. Balance Sheet of Gaya Ram Ltd. as on 31.03.2024

Particular	₹	Particular	₹
Equity (of ₹ 10 each)	8,00,000	PPE	7,00,000
Other equity (reserves)	5,00,000	Investment	3,00,000
		Current Assets	5,00,000
Liabilities	2,00,000		
	15,00,000		**15,00,000**

Aao Ram ltd. acquired 90% shares of Gaya Ram ltd. for ₹ 12,90,000. Fair value of PPE on date of acquisition amounts to ₹ 7,50,000 and fair value of liabilities were ₹ 1,80,000.
Non- controlling interest (NCI) is to be calculated at proportionate to fair value of net assets. Gaya Ram ltd will be paid ₹ 1,02,000 in cash and balance by issue of equity share of ₹ 10 each at premium of ₹ 1 per share.
Make journal entries in the book of both companies.

Answer. Goodwill ₹ 57,000, NCI 1,37,000; In the book of Gaya Ram -- No entry.

Question 4. A Ltd. acquires 80% of B Ltd. for ₹9,60,000 paid by equity share 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) by fair value method and Goodwill.
2. Journal Entries in the books of A.

Question 5. Z Ltd. acquired a 60% interest in P Ltd. on January 1, 2024. 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.

Lets summarize above concepts

1. In above questions, we defined and solved many questions on 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).
(b) by acquisition of shares, or
(c) by other legal process.

2. An entity shall account for each business combination by applying the acquisition method, similar to 'Purchase method as per AS 14'. (It does not include 'business combination under common control', which is accounted under 'Pooling of Interest' method and discussed later.)

3. Applying the acquisition method requires:

A. Identifying the acquirer;

B. Determining the acquisition date;

C. Determining purchase consideration

D. Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

E. Recognising and measuring goodwill or a gain from a bargain purchase.

Lets discuss in details:

(A). 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:

a. In a business combination effected primarily the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

b. 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.

(f) 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.

(g) 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.

(h) 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 given above paragraphs. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

(B) 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. **In case, it requires government approval, acquisition date is assumed to be on date of receiving approval from government.**

Question 6. COC Education ltd acquired 80% equity interest in Microsoft Ltd for cash consideration. The relevant dates are as under:

Date of shareholder agreement -- 1st June 2024

Appointed date as per shareholder agreement – 1st April 2024

Date of obtaining control over the board representation – 1st July 2024

Date of payment of consideration -- 15th July 2024

Date of transfer of share to COC Education ltd-- 1st August 2024

Solution: in above question as the control over financial and operating policies are acquired through obtaining board representation on 1st July 2024, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, because COC Education Ltd did not have control over Microsoft Ltd as at that date.

(C) Determining purchase consideration: It is calculated as follows:

Cash paid	
Add: Fair value of equity shares issued	
Add: Fair value of debentures issued	
Add: Fair value of assets transferred	
Add: Present value of deferred consideration	
Add: Fair value of contingent consideration	

IMPORTANT NOTE ON CONSIDERATION: -Consideration transferred should also be measured as per the requirement of Ind AS 103.

- 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. If so, the acquirer shall re-measure 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.

Question 7. D Ltd. has acquired 100% of the equity of F Ltd. on March 31, 2024. The purchase consideration comprises of an immediate payment of ₹ 10 lakhs and two further payments of ₹1.21 lakhs if the Return on Equity exceeds 20% in each of the subsequent two financial years. A discount rate of 10% is used. Compute the value of total consideration at the acquisition date.

Solution:

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

Question 8. Z Ltd. acquired C Ltd. on April 1, 2023. For a lawsuit contingency C Ltd. has a present obligation as on April 1, 2023 and the fair value of the obligation can be reliably measured as ₹ 50,000. Asof the acquisition date it is not believed that an out flow of cash or other assets will be required to settlethis matter. What amount should be recorded by Z Ltd. under Ind AS for this contingent liability of C Ltd.? **(ICMAI Study material).**

Solution: Contingent liabilities of the Acquiree are recognized as of the acquisition date if there is a present obligation (even if it is not probable that an outflow of resources embodying economic benefitswill be required to settle the obligation, contrary to Ind AS 37) and the fair value of the obligation can bemeasured reliably. Hence, a liability of ₹50,000 would be recorded by Z.

Question 9. (concept of contingent liability) Balance Sheet of Raga Ltd. as on 31.03.2024

	₹		₹
Equity shares capital (₹10 each)	6,00,000	PPE	8,00,000
Other equity (Reserves)	3,50,000	Intangible assets	3,00,000
12% Debentures	2,50,000	(patents & trademark)	
Current Liabilities	4,00,000	Investment	1,20,000
		Cash & cash equivalent	1,80,000
		Debtors	2,00,000
	16,00,000		**16,00,000**

Saga ltd. acquires 70% shares in Raga ltd for ₹21,00,000 payable by issue of equity shares of ₹ 10 each at premium of ₹ 2 per share. Fair value of PPE was 10% more than book value. Investments were found overvalued by 20%. Debtors of ₹ 10,000 were found doubtful and provision to be made. There was contingent liability of claim disputed in court of ₹ 50,000, which become payable and need to be provided for. Make journal entries in the book of both companies. Assuming that NCI is to be calculated by fair value approach.

Answer: NCI 9,00,000; Goodwill 20,50,000.

Important note on 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.

CONCEPT OF 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 2024, Entity A holds a 35% non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40% 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 re-measure 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.

Question 10. A Ltd acquired 30% of Entity B on 4.9.2022 for ₹3,50,000. At the end of year, fair value of investment in shares of entity B was ₹4,50,000. On 1-7-2023, A Ltd further acquired 40% stake in entity B. Consideration paid ₹5,80,000. A Ltd identifies the net assets of B at ₹12,50,000. Value of 30% shares previously held at ₹4,80,000. NCI is valued at proportionate net assets. Give journal entries.

Question 11. Entity A acquired 35 % of Entity B on 01-04-2023 for ₹35,000. On 31-03-2024, fair value of shares of Entity B is ₹42,000, thus ₹ 7,000 reported under OCI in 2023-24. On 01-07-2024 Entity A further acquired 40% stake in Entity B. Consideration paid is ₹60,000. Entity A identifies the net assets of Entity B at fair value of ₹120,000 at the acquisition date, value 35% shares at ₹45,000. NCI is valued at proportionate net assets. Show Journal entries on various dates.

Solution:

01-04-2023	Investment in Entity B account DrTo bank account	35,000	 35,000
31-03-2024	Investment in Entity B account DrTo OCI	7,000	 7,000
01-07-2024	Investment A/c Dr OCI A/c Dr To, Profit and Loss A/c	3,000 7,000	 10,000
01-07-2024	Net Assets A/c Dr Goodwill A/c Dr To, Consideration A/c To, Investment A/c To, NCI A/c	1,20,000 15,000	 60,000 45,000 30,000

Question 12. Balance Sheet of Naya Ltd. & Old Ltd. as on 31.03.2024

Particular	Naya	Old	Particular	Naya	Old
Equity share capital (of ₹ 10 each)	15,00,000	12,00,000	PPE	17,00,000	11,00,000
Other equity	8,00,000	4,00,000	Investment in 30% Shares of Old ltd.	3,00,000	
Liabilities	2,00,000	3,00,000	Other Assets	5,00,000	8,00,000
	25,00,000	**19,00,000**		**25,00,000**	**19,00,000**

On 1 April 2024, Naya ltd. further acquired 40% stake in Old ltd. for ₹ 6,00,000. On that date PPE of Old ltd. was showing fair value of ₹ 12,50,000. NCI is valued at proportionate net assets. Fair value of 30% previously held investment is 3,20,000. Show workings and journal entries in the book of Naya ltd.

Answer: NCI 5,25,000; Gain on bargain purchase 3,05,000.

Question13. The Balance Sheet of COC Education Ltd. and Reliance Ltd. are as follows:

Balance Sheet as on 31.03.2024

	COC Education	**Reliance Ltd.**		**COC Education**	**Reliance Ltd.**
Equity share capital (of ₹ 100 each)	12,00,000	10,00,000	Building	4,10,000	6,80,000
			Machinery	1,80,000	5,20,000
			Furniture	1,20,000	1,30,000
Other equity (General Reserves)	6,00,000	3,00,000			
			Investment in 2,000 shares of Reliance ltd.	4,80,000	-
Liabilities	1,00,000	2,30,000			
			Stock	2,00,000	40,000
			Debtors	1,10,000	60,000
			Bank	4,00,000	1,00,000
	19,00,000	**15,30,000**		**19,00,000**	**15,30,000**

On 1 April 2024, COC Education Ltd. acquired further ₹ 7000 equity shares of Reliance Ltd. On that date fair value of building and machinery of Reliance ltd. were found at ₹ 6,70,000 and ₹ 5,00,000 respectively.

Total consideration was fixed at ₹8,00,000. 40% of consideration was payable in cash and balance by issue of equity shares of ₹100 each at premium of ₹20 per share. Make journal entries in the book of both companies. Investment in 2,000 shares of Reliance ltd previously held valued at ₹5,30,000.

Disclosure requirement as per Ind AS 103 (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 dates.
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.

Difference between Ind AS 103 and AS 14:

1. Scope: Ind AS 103 has a wider scope than AS 14.

2. Method of accounting: Ind AS 103 prescribes only acquisition method for every business combination whereas AS 14 states two method of accounting: Pooling of interest method and Purchase method.

3. 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.

4. Goodwill: Under Ind AS 103, Goodwill is not amortised but tested for annual impairment whereas AS 14 require goodwill to be amortised over a period not exceeding 5 years.

5. Non-Controlling Interest: Ind AS 103 provide for accounting of NCI, AS 14 do not.

6. Recording for consolidated financial statements: It is provided in Ind AS 103, not in AS 14.

7. Common control transactions: Appendix C deals with accounting for common control transactions, which prescribes Pooling of interest method of accounting. AS-14 do not prescribe any different accounting for such transactions.

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

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

Question 14. Balance sheet of Atlas Ltd as on 31.3. 2024 is given below:

B/S of Atlas Ltd.

Equity share capital of Rs. 10 each	**3,50,000**	**Assets**	**21,00,000**
Preference share capital of Rs. 10 each	**5,50,000**		
General reserve	**2,00,000**		
Liability	**10,00,000**		
	21,00,000		**21,00,000**

Business of Atlas Ltd was absorbed by COC Ltd. on the above date.

(i) COC Ltd. will issue 3 equity shares of ₹10 each at ₹15 per share for every 2 equity shares held in Atlas Ltd.

(ii) COC Ltd. will also pay cash @ ₹12 for every equity share in Atlas Ltd.

Calculate purchase consideration.

Question 15. **Balance Sheet of Ram Ltd. as on 31st March 2024**

Liabilities	**₹**	**Assets**	**₹**
Equity Share Capital of Rs. 10 each	8,00,000	PPE	18,00,000
Preference share capital of Rs 100 each	6,00,000	Investments	5,00,000
Other equity	4,00,000	Current assets	2,00,000
12% debentures	5,00,000		
Other liabilities	2,00,000		
	25,00,000		**25,00,000**

Ram Ltd. was taken over by A Ltd. on above date.

(1) That PPE should be taken over at ₹90,000.

(2) That 3 Equity shares of A Ltd. would be issued for every two equity shares held in Ram Ltd. at ₹12 each.

(3) Equity shareholders of Ram Ltd were paid cash @ ₹5 on every 2 equity shares.

(4) Equity shareholders of Ram Ltd were also issued 2,000 10% debentures of ₹50 each at premium of ₹10 per debenture.

(5) Preference shares were issued 5 equity shares of ₹10 each at ₹12 for every 3 preference shares in Ram Ltd. and cash of Rs 8 for every preference share in Ram Ltd.

(6) 12% debentures of Ram Ltd were also issued 12,000 equity shares in A Ltd.

Calculate Purchase Consideration.

Question 16. Balance sheet of Hutch Ltd as on 31-3-2024 is given below:

B/s of Hutch Ltd.

Equity share capital	**3,50,000**	**Land & building**	**5,00,000**
Preference share capital	**5,50,000**	**Machine**	**2,00,000**
		Furniture	**3,00,000**
General reserve	**2,00,000**	**Debtors**	**4,00,000**
10% debentures	**7,00,000**	**Cash**	**2,00,000**
Creditors	**3,00,000**	**Goodwill**	**5,00,000**
	21,00,000		**21,00,000**

Business of Hutch Ltd. was absorbed by Vodafone Ltd.

(i) Fair value of assets were valued as under

Land & building = ₹7,00,000

Machine = ₹1,50,000

Goodwill = ₹8,50,000

(ii) Fair value of liabilities were taken at their book value.

(iii) There was a contingent liability of ₹40,000 for bill discounted by Hutch Ltd.

Purchase consideration was payable by issue of 10,000 equity shares of ₹10 each at premium of ₹20 per share and balance was payable in cash.

Calculate purchase consideration and amount of cash paid.

Question 17. The following are the balance sheets of Pratiksha Ltd. and Nidhi Ltd. as on 31 March 2024

Balance Sheet of Pratiksha Ltd.

Liabilities	**₹**	**Assets**	**₹**
Share Capital :		PPE	7,00,000
40,000 equity Shares of Rs. 10 each	4,00,000	Investment property	2,00,000
12% preference share capital	3,00,000		
General Reserve	1,00,000	Stock	1,80,000
		Debtors	3,30,000
15% Debentures	2,00,000		
Current liabilities	4,10,000		
	14,10,000		**14,10,000**

Balance Sheet of Nidhi Ltd.

Liabilities	₹	Assets	₹
Share Capital :		PPE	8,00,000
50,000 equity Shares of Rs. 10 each	5,00,000	Stock	50,000
		Investment property	2,00,000
15% debentures	3,00,000		
		Debtors	1,50,000
Current liabilities	4,00,000		
	12,00,000		**12,00,000**

Pratiksha Ltd. agrees to take over Nidhi Ltd. Find out intrinsic value of shares on the basis of the following information and Calculate purchase consideration if it was payable by issue of equity shares in Pratiksha Ltd.

(i) Fair value of assets and liabilities of Pratiksha Ltd were as follows:

(a) PPE were valued at ₹8,50,000.

(b) Stocks were found undervalued by 10%.

(c) Debtors were found overvalued by 10%.

(d) There are arrears of dividend on equity shares for one year.

COMPREHENSIVE QUESTIONS:

Question 18. A Ltd. agreed to take over B Ltd. as on 1st October, 2024. No Balance Sheet of B was prepared on that date:

Balance Sheet of A and B as at 31st March, 2024 were as follows

Particular	A	B	Particular	A	B
Share capital in equity shares of	15,00,000	10,00,000	PPE	12,50,000	8,75,000
₹ 10 each fully paid up			**Current Assets:**		
Other equity:			Stock	2,37,500	1,87,500
Reserve	4,15,000	2,56,000	Debtors	3,90,000	2,56,000
P & L A/c	1,62,500	1,37,500	Bank	2,93,750	1,50,000
Creditors	93,750	75,000			
	21,71,250	**14,68,500**		**21,71,250**	**14,68,500**

Additional Information available:

(1) For the six months period from 1st April, 2024, A made a profit of ₹ 4,20,000 after writing off depreciation at 10% per annum on its PPE.

(2) For the same period, B Ltd made a net profit of ₹ 2,04,000 after writing off depreciation at 10% p.a. on its fixed assets

(3) Both the companies paid on 1st August, 2024, equity dividends of 16.5%.

(4) Goodwill of B was valued at ₹ 1,20,000 on the date of takeover; stock of B, subject to an abnormal item of ₹7,500 to be fully written off, would be appreciated by 25% for purposes of take-over.

(5) A Ltd to issue B's shareholders fully paid equity shares of ₹ 10 each, on the basis of the comparative intrinsic values of the shares on the take-over date. Draft the Balance Sheet of A after absorption of B. All workings are to form part of your answer. **(CA May 2002- 16 marks modified)**

Answer: - Updated balance sheet total- A Ltd ₹23,43,750; B Ltd ₹15,07,500;

Intrinsic value per share- A Ltd ₹15; PC = ₹15,90,000.

Consolidated Balance sheet total ₹40,08,750.

Question 19. Balance Sheets of Strong Ltd. and Weak Ltd. as on 31st March, 2024 are as below:

Balance Sheet as on 31.03.2024

Liabilities	Strong Ltd.	Weak Ltd.	Assets	Strong Ltd.	Weak Ltd.
Equity shares capital (10 each)	50,00,000	30,00,000			
Reserve	4,00,000	2,00,000	PPE	30,00,000	20,00,000
P & L A/c	4,00,000	3,00,000	Stock	8,00,000	6,00,000
Creditors	5,00,000	3,00,000	Debtors	14,00,000	9,00,000
			Cash & Bank	11,00,000	3,00,000
	63,00,000	**38,00,000**		**63,00,000**	**38,00,000**

Strong Ltd. takes over Weak Ltd. on 01.07.24. No Balance Sheet of Weak Ltd. is available as on that date. It is however estimated that Weak Ltd. earns estimated profit of ₹2,00,000 after charging proportionate depreciation @ 10% p.a. on fixed assets, during April-June, 2024. Estimated profit of Strong Ltd. during these 3 months is ₹4,00,000 after charging proportionate depreciation @ 10% p.a. on fixed assets.

Value of current assets on 01.07.2024 were as follows:

	Strong Ltd	Weak Ltd
Stock	7,40,000	6,30,000
Debtors	15,50,000	8,00,000
Creditors	4,50,000	3,50,000

Both the companies have declared and paid 10% dividend within this 3 months' period. Goodwill of weak Ltd. is valued at ₹ 2,00,000 and Fixed Assets are valued at ₹1,00,000 above the estimated book value. Stocks were found overvalued by 5% for the purpose of take over. Purchase consideration is to be satisfied by Strong Ltd. by issue of shares of ₹10 each at premium of 20% and fraction, if any, in cash. Ignore Income-tax. You are required to make entries and to prepare consolidated Balance sheet as per Ind AS 103.

Question 20. The summarised Balance Sheets of A Ltd. and B Ltd. as on 31st March, 2017 are given below. B Ltd. was absorbed by 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	2,30,000	1,10,000
Taxes payable	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. Pass journal entries in the book of A Ltd on the date of acquisition.

Answer: Value of goodwill- A Ltd ₹16,70,000; B Ltd ₹4,40,000;

Average profit for valuation of goodwill – A Ltd ₹5,70,000 ; B Ltd ₹1,94,000;

Net assets- A Ltd ₹30,00,000; B Ltd ₹10,20,000;

Intrinsic value per equity share- A Ltd ₹37.50; B Ltd ₹34;

Question 21. 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 lacs)

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

Answer: Purchase consideration- X Ltd ₹1200; Y Ltd ₹900; Goodwill- X Ltd ₹110; Y Ltd ₹ (90)

Total of consolidated Balance sheet ₹5,520.

Accounting in the event of Inter-Company Investment:

Case 1: New company already hold some shares in old company:

Question 22. The following are the Balance Sheets of Good Ltd. and Bad Ltd. as on 31.03.2024:

	Good Ltd. (₹in crores)		Bad Ltd. (₹ in crores)	
Equity and Liabilities:				
Equity Share Capital:				
Authorised share capital:		**25**		**5**
Issued and Subscribed Equity Shares of ₹ 10 each fully paid		12		5
Other Equity		87		10
Total Equity		99		15
Unsecured loan from Good Ltd.		-		10
		99		25
PPE at cost		80		40
Less: Depreciation		60		34
Written down value		20		6
Investments at Cost:				
20 lakhs equity shares of ₹10 each of Bad Ltd.		2		-
Long term loan to Bad Ltd.		10		-
Current Asset:	200		134	
(Less Current Liabilities)	-133	67	-115	19
		99		**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 shares held by them in Bad Ltd. The necessary approvals are obtained; You are asked to pass Journal entries in the books of Good Ltd to give effect to the above.

Answer: Value of investment already held on DOA ₹48 lakhs; loss on revaluation of investment ₹152 lakhs; Gain on bargain purchase ₹13.8 crores, PC payable to outsiders ₹72 lakhs.

Question 23. The Balance Sheet of Big Ltd. and Small Ltd as on 31 3.2024 were as follows:

Liabilities	Big Ltd.	Small Ltd.	Assets	Big Ltd.	Small Ltd.
Equity shares capital (₹ 10 each)	8,00,000	3,00,000	Building	2,00,000	1,00,000
10% Preference Share Capital ₹ 100)	-	2,00,000	Machinery	5,00,000	3,00,000
General Reserve	3,00,000	1,00,000	Furniture	1,00,000	60,000
P & L A/c	1,50,000	70,000	Investment		
Creditors	2,00,000	3,00,000	(6000 shares of Small Ltd.)	60,000	-
			Stock	1,50,000	1,90,000
			Debtors	3,50,000	2,50,000
			Cash & Bank	90,000	70,000
	14,50,000	**9,70,000**		**14,50,000**	**9,70,000**

Big Ltd. has taken over the entire undertaking of Small Ltd. on 30.9.2024 on which date the position of current assets except Cash and Bank balances and Current Liabilities were as under:

Year	Big Ltd.	Small Ltd.
Stock	1,20,000	1,50,000
Debtors	3,80,000	2,50,000
Creditors	1,80,000	2,10,000

Profits earned for the half year ended on 30.09.2024 after charging depreciation at 10% p.a on building. 15% p.a. on machinery and 10% p.a. on furniture are:

Big Ltd. ₹1,02,500

Small Ltd. ₹54,000

On 30.08.2024 both Companies have paid 15% dividend on equity shares for 2023 - 2024.

Goodwill of Small Ltd. has been valued at ₹50,000 and other Fixed Assets at 10% above their book values on 30.9.2024.

Preference shareholders of Small Ltd. are to be allotted 10% preference shares of Big Ltd. and equity shareholders of Small Ltd. are to receive requisite number of equity shares of Big Ltd. valued at ₹15 per share in satisfaction of their claims. Show the Balance Sheet of Big Ltd. as of 30.09.2024 assuming absorption is through by that date.

(CMA Final 16 marks, CA Final-15 marks)

Answer: Net assets of Small Ltd ₹5,71,950; Value of investment on DOA ₹1,14,390; No of equity shares issued as PC = 30,504 Shares. Total of CFS ₹23,34,450

Question 24. Balance Sheet of Joy Ltd. and Roy Ltd. as on 31.12.2024 are as below:

Liabilities	Joy Ltd.	Roy Ltd.	Assets	Joy Ltd.	Roy Ltd.
Equity share capital (₹ 10)	5,00,000	4,00,000	Fixed Assets	8,20,000	6,00,000
6% Pref. shares capital (₹ 100)	5,00,000	1,00,000	Investment in 5,000 equity		
Other equity	1,40,000	1,00,000	shares of Roy Ltd.	40,000	
7% Debentures (₹ 100)	-	1,00,000			
Loan from Joy Ltd.	-	30,000	Current Assets	5,00,000	2,00,000
Other Liabilities	2,50,000	70,000	Loan to Roy Ltd.	30,000	-
	13,90,000	**8,00,000**		**13,90,000**	**8,00,000**

Joy Ltd. decides to take over Roy Ltd. on the following terms:

(1) Joy Ltd. will issue 7 equity shares of ₹10 and ₹5 cash for every 5 equity shares of Roy Ltd. surrendered.

(2) Preference shareholders of Roy Ltd. are to be given one 6% preference share of ₹100 in Joy Ltd. for every share held. These shares are to be issued at a premium of 5%.

(3) 7% Debentures of Roy Ltd. are to be redeemed at 8% premium by issue of 7% debentures of Joy Ltd.

(4) Joy Ltd. revalued the fixed assets of Roy Ltd. at ₹8,00,000 on takeover.

Close the books of Roy Ltd., pass journal entries in the books of Joy Ltd. and prepare Balance sheet after takeover.

Question 25A. The following Balance Sheet are given as on 31st March, 2024**:**

Liabilities	**Best Ltd.**	**Better Ltd.**	**Assets**	**Best Ltd.**	**Better Ltd.**
Share Capital:			PPE	25,00,000	15,00,000
Equity Shares of ₹100 each	18,00,000	9,00,000	Investment	5,00,000	-
Preference shares of ₹10 each	2,00,000	1,00,000	Current Assets	20,00,000	5,00,000
Other equity	10,00,000	8,00,000			
Other Liabilities	20,00,000	2,00,000			
	50,00,000	**20,00,000**		**50,00,000**	**20,00,000**

The following further information is given —

(a) Investments of Best Ltd. include ₹ 3,00,000 representing shares in Better Ltd. having a face value of ₹2,25,000.

(b) Better Limited issued bonus shares on 1st April, 2024, in the ratio of one share for every two held.

(c) It was agreed that Best Ltd. will take over the business of Better Ltd., on the basis of the latter's Balance Sheet, the consideration taking the form of allotment of equity shares in Best Ltd.

(d) The value of shares in Best Ltd. was considered to be ₹150 and the shares in Better Ltd. were valued of ₹100 after the issue of the bonus shares. The allotment of shares is to be made on the basis of these values.

(e) 1 equity share will be issued to every 5 preference shares in Better Ltd.

(f) Liabilities of better Ltd., included ₹ 1,00,000 due to Best Ltd. for purchases from it, on which Best Ltd., made profit of 25% of the cost. The goods of ₹ 50,000 out of the said purchases, remained in stock on the date of the above Balance Sheet.

Make the closing ledger in the books of Better Ltd. and the opening journal entries in the Books of Best Ltd., and prepare the Balance Sheet as at 1st April, 2024 after the takeover.

Question 25B. Assume in previous question, preference share is treated as part of equity.

Solution: **Accounting treatment in the book of Better Ltd**

Realisation account

Particulars	Amount	Particulars	Amount
Non-current assets Current assets	15,00,000 5,00,000	Liabilities By Best Ltd (PC) By equity share holder (loss on realization)	2,00,000 13,80,000 4,20,000
	20,00,000		**20,00,000**

Equity shareholders account

Particulars	Amount	Particulars	Amount
To realization To Best Ltd To equity shares in Best Ltd	4,20,000 3,37,500 10,12,500	By equity share capital By other equity By preference share holder	9,00,000 8,00,000 70,000
	17,70,000		**17,70,000**

Preference shareholders account

Particulars	Amount	Particulars	Amount
To equity share in Best Ltd To equity share holder(bal fig)	30,000 70,000	By preference share capital	1,00,000
	1,00,000		**1,00,000**

Best Ltd

Particulars	Amount	Particulars	Amount
To realization account	13,80,000	By Equity share holder account By equity share in Best Ltd	3,37,500 10,42,500
	13,80,000		**13,80,000**

Equity shares in Best Ltd

Particulars	Amount	Particulars	Amount
To Best Ltd	10,42,500	By preference share holders By equity share holders	30,000 10,12,500
	10,42,500		**10,42,500**

Question 26. Balance Sheet of COC Ltd. and Roy Ltd. as on 31.3.2024 are as below:

Liabilities	**COC Ltd.**	**Roy Ltd.**	**Assets**	**COC Ltd.**	**Roy Ltd.**
Equity shares capital (₹ 10)	5,00,000	4,00,000	Machinery	6,00,000	3,50,000
6% Pref. shares capital (₹ 100)	5,00,000	1,00,000	Furniture	2,00,000	2,50,000
Profit and loss A/c	1,40,000	1,00,000	**Investment:**		
7% Debentures (₹ 100)	-	1,00,000	5,000 equity shares of Roy Ltd.	40,000	
Bills payable	-	30,000			
Creditors	1,00,000	20,000	Debtors	30,000	40,000
Other current Liabilities	1,50,000	50,000	Bank	20,000	35,000
			Other current assets	5,00,000	1,25,000
	13,90,000	**8,00,000**		**13,90,000**	**8,00,000**

COC Ltd. decides to take over Roy Ltd. on the following terms:

(1) COC Ltd. will issue 7 equity shares of ₹10 at premium of 20% and ₹4 cash for 5 equity shares of Roy Ltd. surrendered.

(2) Preference shareholders of Roy Ltd. are to be given 5 equity shares of ₹10 in COC Ltd. for every share held. These shares are to be issued at a premium of 5%.

(3) 7% Debentures of Roy Ltd. are to be redeemed at 8% premium by issue of 10% debentures of COC Ltd. at par.

(4) Liquidation expenses amounting to ₹15,000 are to be paid by Roy Ltd.

(5) COC Ltd. revalue the Machinery of Roy Ltd. at ₹3,00,000 and furniture at ₹4,00,000 on take over.

(6) During the year COC Ltd had sold goods for ₹25,000 to Roy ltd at profit of 20% on sale. Out of this 40% of goods are still in stock of Roy Ltd at the end of year. 30% of the amount still payable at the end and included in creditors of Roy Ltd.

Close the books of Roy Ltd., pass journal entries in the books of COC Ltd. and prepare the Balance sheet after the takeover..

Case 2: Old company already hold shares in new company:

Question 27. The Balance Sheet of COC Education Ltd. and TATA Ltd. are as follows:

Balance Sheet As on 31.03.2024

	COC Education Ltd.	TATA Ltd.		COC Education Ltd.	TATA Ltd.
Share capital (Equity share of ₹ 10 each)	10,00,000	3,00,000	PPE	12,00,000	2,00,000
General Reserves	2,00,000	1,50,000	Investment in 2000 shares of COC ltd.	-	2,00,000
Profit & loss A/c	1,40,000	50,000	Inventories	2,00,000	1,00,000
Creditors	1,70,000	40,000	Debtors	1,00,000	50,000
Loan from COC	-	10,000	Loan to TATA	10,000	-
	15,10,000	**5,50,000**		**15,10,000**	**5,50,000**

COC Ltd. was to absorb TATA ltd on the basis of intrinsic value of the shares, the purchase consideration was to be discharged in the form of fully paid shares of COC Ltd. Fair value of PPE of COC and TATA were ₹13,60,000 and ₹2,30,000 respectively.

Also included in stock of TATA Ltd. ₹30,000 worth goods supplied by COC Ltd. at profit of 25% on sales. Debtors of COC Ltd. included ₹12,000 receivable from TATA Ltd. Make journal entries in the book of both companies.

Question 28. Following are the summarized Balance Sheet of companies as at 31. 12. 2024

Liabilities	D Ltd.	V Ltd.	Assets	D Ltd.	V Ltd.
Equity share capital (₹ 100)	8,00,000	6,00,000	Goodwill	6,00,000	-
General Reserve	4,00,000	3,00,000	Fixed Assets	5,00,000	8,00,000
Investment Allowance Reserve	-	4,00,000	Investment	2,00,000	4,00,000
Sundry Creditors	5,00,000	2,00,000	Current Assets	4,00,000	3,00,000
	17,00,000	**15,00,000**		**17,00,000**	**15,00,000**

D Ltd. took over V Ltd on the basis of the respective shares value, adjusting wherever necessary, the book values of assets and liabilities on the basis of the following information: -

(i) Investment of V Ltd. included 1,000 shares in D Ltd. acquired at cost of ₹ 150 per share. The other investment of V Ltd have a market value of ₹1,92,500.

(ii) The market value of investments of D Ltd. are to be taken at ₹1,00,000.

(iii) Goodwill of D Ltd. and V Ltd. are to be taken at ₹5,00,000 and ₹1,00,000 respectively.

(iv) Fixed assets of D Ltd. and V Ltd. are valued at ₹6,00,000 and ₹8,50,000 respectively.

The above scheme has been duly adopted. Pass necessary Journal Entries in the books of D Ltd. and prepare Balance Sheet of D Ltd. after taking over the business of V Ltd. Fractional share to be settled in cash, rest in shares of D Ltd. Calculation shall be made to the nearest multiple of a rupee.

Special case 3: If old company already holds shares in other old company:

Question 29. The summarized Balance Sheet of A Ltd. and B Ltd. as at 31st March, 2024 were as under:

	A ltd.	**B. Ltd**
Fully paid up equity shares of Rs 10 each	20,00,000	12,00,000
Security 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) There was a contingent liability of A Ltd. of ₹1,20,000.

(c) Fair value of assets of both the companies were found as follow:

Assets	A Ltd	B Ltd
Land and building	19,50,000	10,00,000
Plant and machinery	9,00,000	8,00,000
Stock	10,90,000	6,50,000

(d) The shareholders of A Ltd. and B Ltd. are to be paid by issuing sufficient number of shares of Z Ltd. at par.
(e) The shares of Z Ltd. are issued at ₹10 each.

Required:

(i) Show the computation of 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.

Accounting treatment of Chain Holding:

Chain-holding refers to the transaction of business combination where a parent is acquiring control of its subsidiary(intermediate parent) which in turn is acquiring control of another company (sub-subsidiary). In separate set of accounts of the Acquirer (parent), there will be no additional treatment for chain holding. But in the consolidated set of accounts of the Acquirer net assets of the subsidiary (which is intermediate parent also) and the net assetsof the sub-subsidiary are recognised at fair value. Also, the non-controlling interest of the subsidiary and the sub-subsidiary are recognised.

Question 30: Prepare the consolidated Balance Sheet as on 31st March, 2024 of a group of companies comprising P Limited, S Limited and SS Limited. Their balance sheets on that date are given below:

Assets	P Ltd	S Ltd	SS Ltd
Non- current assets:			
Property, plant and equipment	320	360	300
Current assets:			
Inventories	220	70	50
Financial assets:			
Debtors	260	100	220
Bills receivables	72	---	30
Cash and bank	568	320	40
	1,440	**850**	**640**
Equity and liabilities:			
Equity share capital	600	400	320
Other equity:			
Reserves	180	100	80
Retained earning	160	50	60
Current liabilities:			
Creditors	470	230	180
Bills payable	30	70	….
	1,440	**850**	**640**

P Ltd acquired 80% equity shares in S Ltd for ₹340 lacs and S Ltd acquired 75% equity interest in SS Ltd for ₹280 lacs on 31st March 2024. Prepare CFS as per Ind AS 103 on date of acquisition. NCI is to be calculated by proportionate to net asset value.

Question 31: Pass journal entries for business combination in the books of P Ltd. from the following particulars:

Summarised balance sheet as on 31st March 2024

Assets	P Ltd	Q Ltd	R Ltd
PPE	400	200	320
Current Assets:			
Inventory	250	80	60
Trade Receivables	280	120	200
Bills Receivables		70	50
Cash and Bank	180	350	60
Total Assets	**1,110**	**820**	**690**
Equity and Liabilities			
Equity Share Capital (Rs 10)	450	500	300
Other Equity	260	160	120
Current Liabilities:			
Trade Payables	300	300	200
Bills Payables	100	90	70
Total	**1110**	**1050**	**690**

P Ltd. acquired 80% shares of Q Ltd. at a consideration of ₹480 lakhs and Q Ltd. acquired 75% shares of R Ltd. at a consideration of ₹300 lakhs on 01-04-2024. NCI is measured at fair value.

Fair value as at acquisition:

	P	Q	R
PPE	700	600	400
Current Assets:			
Inventory	240	80	60
Trade Receivables	250	120	180
Bills Receivables		70	50
Current Liabilities:			
Trade Payables	300	300	170
Bills Payables	100	90	70

(ICMAI Study material).

Answer: Total NCI- 220; Gain on bargain purchase- 640;

Accounting treatment in the book of Acquiree company:

Question 32. Balance sheet of X ltd is given below:

Equity share capital @ ₹10	5,00,000	Fixed assets	12,00,000
General reserve	7,00,000	Investment	8,00,000
8% debenture	9,00,000	Bank	2,00,000
Creditors	4,00,000	Other current assets	3,00,000
	25,00,000		**25,00,000**

X Ltd. was absorbed by Y Ltd on following terms and conditions.

(i) 3 equity shares in new company will be issued for every 2 equities in old company @ ₹16 each.

(ii) Investments were sold by Y Ltd. For ₹8,60,000.

(iii) 8% debentures were paid in cash by Y ltd.

You are required to close the books of X Ltd.

Question 33A. Balance sheet of TATA ltd is given below:-

B/S of TATA Ltd

equity share capital @ Rs. 10	4,00,000		
		Building	7,00,000
Preference share capital @ Rs. 10	3,00,000	Furniture	2,00,000
		Machinery	4,00,000
General reserve	2,00,000	Debtors	3,00,000
		Bank	2,50,000
12% debentures	7,00,000	Goodwill	2,50,000
Bank loan	3,50,000		
Provision for doubtful debt	1,50,000		
	21,00,000		**21,00,000**

TATA Ltd. was absorbed by COC ltd. on following terms and conditions.

(i) COC Ltd will issue 3 equity shares @ ₹12 for every 2 shares in TATA Limited.

(ii) COC Ltd will pay ₹5 in cash for each equity share in TATA ltd.

(iii) COC Ltd will issue 25,000 12% preference shares @ ₹14 each to preference shareholders of TATA limited.

(iv) While calculating purchase consideration assets of TATA ltd. were valued as under

Building = ₹9,00,000

Furniture = ₹1,50,000

Machinery = ₹4,50,000

Goodwill = ₹2,00,000

(v) COC Ltd will issue 15% debentures of ₹7,50,000 for 12% debentures in TATA limited.

(vi) Expenses on liquidation amounted to ₹12,000 paid by COC Ltd. Close the books of TATA ltd.

Question 33B: assume in the previous question, preference shares are to be treated as part of equity.

Question 34. Balance sheet of Rat ltd is given below: -

Equity share capital @ ₹10	6,00,000	Fixed assets	8,00,000
		Investment	3,00,000
General reserve	1,00,000	Bank	2,00,000
Security premium	2,00,000	Bills receivable	1,00,000
8% debentures	4,00,000	Debtors	4,00,000
Creditors	2,00,000	Stock	5,00,000
Bank loan	10,00,000	Profit and loss A/c	2,00,000
	25,00,000		**25,00,000**

Cat Ltd. took over the business of Rat Ltd. on following terms and conditions.

(i) All assets and liabilities of Rat Ltd. was taken over by Cat Ltd. except investment and creditors.

(ii) Business of Rat Ltd. was valued at ₹13,00,000 payable in equity shares of ₹13 each.

(iii) Investments were sold at 80% of its book value.

(iv) Creditors were paid at a discount of 10%

(v) Expenses on liquidation of Rat Ltd. ₹30,000 paid by Rat Ltd.

(vi) Cat Ltd. Issued 12% debentures to 8% debentures of Rat Ltd. of ₹4,00,000.

Close the books of Rat Ltd.

Question 35. (If old company already holds some shares in new company) Following are the extractBalance sheets of two companies, B Ltd. and D Ltd. as at March 31, 2024.

Liabilities	B Ltd.	D Ltd. (₹)	Assets	B Ltd.	D Ltd. (₹)
Equity Share Capital: (Shares of ₹ 10 each)	5,00,000	3,00,000	PPE	5,60,000	2,20,000
Reserve	1,00,000	55,000	10,000 Shares in B Ltd.	-	1,00,000
Creditors	1,50,000	95,000	Stock	1,20,000	80,000
			Debtors	70,000	50,000
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 entries in the books of both theCompanies and prepared a Balance Sheet after absorption.

Solution: Computation of intrinsic value per equity share of both companies:

	B Ltd	D Ltd
Assets at fair value:		
PPE	5,60,000	2,20,000
Investments	Nil	1,20,000 (10,000 x 12)
Stock	1,20,000	80,000
Debtors	70,000	50,000
Less: liabilities at payable value		
Creditors	(1,50,000)	(95,000)
	6,00,000	**3,75,000**
Number of equity shares	**50,000**	**30,000**
Intrinsic value/equity share	$\frac{6,00,000}{50,000}$ = **₹12**	$\frac{3,75,000}{30,000}$ = **₹12.5**

Computation of purchase consideration:

Total number of shares to be issued = $\frac{3,75,000}{12}$ = 31,250 shares

Less: shares already held by old company = 10,000 shares

Number of shares to be issued for PC = 21,250 shares

Amount of PC for making accounting in the book of new company = 21,250 X 12 = ₹2,55,000.

Journal entries in the book of new company (B Ltd)

PPE account Dr	2,20,000	
Stock account Dr	80,000	
Debtors account Dr	50,000	
To creditors		95,000
To consideration		2,55,000
Consideration Dr	2,55,000	
To equity share capital		2,12,500
To security premium		42,500
Creditors account Dr	20,000	
To debtors account		20,000
Goodwill account Dr	5,000	
To stock account		5,000

Note: new company does not bring investment made by old company in new company.

Accounting in the book of old company (D Ltd)

Realisation account

Particulars	Amount	Particulars	Amount
PPE Stock Debtors	2,20,000 80,000 50,000	Creditors By B Ltd (PC)	95,000 2,55,000
	3,50,000		**3,50,000**

Equity shareholders account

Particulars	Amount	Particulars	Amount
To equity shares in B Ltd	3,55,000	By equity share capital By reserves	3,00,000 55,000
	3,55,000		**3,55,000**

B Ltd

Particulars	Amount	Particulars	Amount
To realization account	2,55,000	By equity share in B Ltd	2,55,000
	2,55,000		**2,55,000**

Equity shares in B Ltd

Particulars	Amount	Particulars	Amount
To balance b/d To B Ltd	1,00,000 2,55,000	 By equity share holders	 3,55,000
	3,55,000		**3,55,000**

Important Note:

- ✓ **In case of absorption –** Generally we apply Ind AS 103
- ✓ **In case of amalgamation -** Generally we apply Appendix C of Ind AS 103
- ✓ **In case of external reconstruction -** Generally we apply Appendix C of Ind AS 103
- ✓ **The Acquirer company will account for the transactions following Ind AS 103 and Ind AS 103Appendix C for preparing consolidated financial statements (CFS).**

Appendix C of Ind AS-103--BUSINESS COMBINATION UNDER COMMON CONTROL

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.

Question 36. DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31-03-24 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 31-03-24:

(₹ Lakhs)

Particular	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.

Answer: Journal in the books of transferor company TA Ltd.:

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

Journal entries in the book of DATA Ltd

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

Balance sheet abstract of DATA Ltd. as at 31.03.2024

PPE	15,500
Financial Assets	1,300
Current Assets	11,200
Total	28,000
Equity Share Capital	14,000
Other Equity	6,000
Borrowings	5,000
Current Liabilities	3,000
Total	**28,000**

Question 37. The Balance Sheet of COC Education Ltd. and Wipro Ltd. are as follows:

Balance Sheet as on 31.03.2024

	COC Education Ltd.	**Wipro Ltd.**		**COC Education Ltd.**	**Wipro Ltd.**
Equity share capital (of ₹ 10 each)	17,00,000	8,00,000	Machinery Less: prov. for dep.	8,00,000 2,00,000 6,00,000	7,00,000 1,80,000 5,20,000
12% preference share capital of ₹ 10 each	-	4,00,000	Building	7,00,000	8,00,000
General Reserves	2,80,000	60,000	Patents	8,00,000	-
Profit & loss A/c	1,10,000	80,000	Financial Assets	5,00,000	4,00,000
Security Premium	70,000	-	Inventories	1,20,000	80,000
Export profit reserve	80,000	2,30,000	Debtors	70,000	50,000
15% Debentures	6,00,000	3,00,000	Cash & Bank	3,00,000	2,00,000
Creditors	2,50,000	1,80,000			
	30,90,000	**20,50,000**		**30,90,000**	**20,50,000**

Both companies amalgamated to form COPRO Ltd. on 01.04.2024. Both companies were issued new equity of ₹10 each in COPRO Ltd. in such a way that their equity interest in the new company should be in the ratio of 3:2. Preference shares of Wipro Ltd. were issued 10% Preference shares of ₹10 each in COPRO Ltd. Fair value of assets and liabilities were as follow:

	COC Ltd.	WIPRO Ltd.
Machinery	6,50,000	4,80,000
Building	7,90,000	7,80,000
Inventories	1,50,000	1,00,000
Creditors	2,30,000	1,60,000

Pass journal entries in the book of COC Ltd. Wipro Ltd and COPRO Ltd. under Business combination under common control.

Question 38. Balance Sheet of X Ltd. and Y Ltd.

Particular	X	Y	Particular	X	Y
Equity share capital (of ₹ 10 each)	9,000	4,500	PPE	8,000	5,000
			Financial assets	3,000	2,000
General Reserves	2,000	3,500			
			Current assets	7,000	6,000
Borrowings	5,000	2,500			
Creditors	2,000	2,500			
	18,000	**13,000**		**18,000**	**13,000**

Both Companies decided to amalgamate and form XY Ltd. They were to be issued equity shares of ₹10 each in XY Ltd. based on their combined net assets in new company at fair value. They decided to keep their holdings in the same ratio as when they were operating separately. The fair value of their PPE were ₹9,200 and ₹5,800 respectively. Prepare necessary accounts in the book of X Ltd. and Y Ltd. and Prepare Balance Sheet (Opening) in the book of XY Ltd assuming common control.

Question 39. AX Ltd and BX Ltd amalgamated on and from 1 January 2024. A new company ABX Ltd with shares of ₹10 each was formed to take over the businesses of the existing companies.

Summarized balance sheet as on 31-3-2024

Assets	**Note no.**	**AX Ltd ('000)**	**BX Ltd ('000)**
Non- current assets			
Property, plant and equipment		8,500	7,500
Investments		1,050	550
Current assets:			
Inventory		1,250	2,750
Trade receivables		1,800	4,000
Cash and cash equivalent		450	400
		13,050	**15,200**
Equity and liabilities			
Equity			
Equity share capital(Rs 10 each)		6,000	7,000
Other equity	1	3,050	2,700
Non-current liabilities			
Borrowings (12% debentures)		3,000	4,000
Current liabilities			
Trade payables		1,000	1,500
		13,050	**15,200**

1. Other equity	AX Ltd	BX Ltd
General reserve	1,500	2,000
Profit and loss	1,000	500
Investment allowance reserve	500	100
Export profit reserve	50	100
	3,050	**2,700**

ABX Ltd issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance sheet of ABX Ltd assuming that both the entities are under common control.

Question 40. SUN Ltd and MOON Ltd were amalgamated on and from 1st April 2023. A new company Star Ltd was formed to take over the business of existing companies. The Balance sheet of SUN Ltd and MOON Ltd as on 31st March 2023 are given below: (₹in lakh)

Particulars	SUN Ltd	MOON Ltd
Equity shares of ₹100 each	400	375
12% preference shares of ₹100 each	150	100
Revaluation reserve	75	50
General reserve	85	75
Investment allowance reserve	25	25
Profit and loss account	25	15
10% debentures (₹100 each)	30	15
Trade payables	210	95
Property, plant and equipment	450	325
Investments	75	25
Inventories	175	125
Trade receivables	150	175
Cash and bank balances	150	100

Additional information:

(a) Star Ltd will issue 5 equity shares for each equity share of SUN Ltd and 4 equity shares for each equity shares of Moon Ltd. (The shares are to be issued @ ₹30 each), having a face value of ₹10 per share.

(b) Preference shareholders of the two companies are issued the equivalent number of 15% preference shares of Star Ltd. (Face value ₹100)

(c) 10% Debenture holders of Sun Ltd and Moon Ltd are discharged by Star Ltd, issuing new 15% Debentures of ₹100 each.

(d) investment allowance reserve is to be maintained for 4 more years.

(e) liquidation expenses are: Sun Ltd ₹2,00,000 and Moon Ltd ₹1,00,000. It was decided that these expenses would be borne by Star Ltd.

(f) All the assets and liabilities of Sun Ltd and Moon Ltd are taken over at book value.

(g) Authorised equity share capital of Star Ltd is ₹5,00,00,000 divided into equity shares of ₹10 each. After issuing required number of shares to the liquidators of Sun Ltd and Moon Ltd, Star Ltd issued balance shares to public. The issue was fully subscribed.

Prepare balance sheet of Star Ltd as on 1st April 2023 after amalgamation has been carried out. **(CMA Final 2023 – June attempt – 10 Marks)**

Question 41: On March 31, 2024, A Ltd and B Ltd. were amalgamated into C Ltd., control of the businesses lying with the same parties as before. C Ltd. issued 80,000 equity shares to A Ltd. and 75,000 equity shares to B Ltd. at the nominal value of ₹10 per share. The book value of A Ltd.'s net assets was ₹12,00,000, Equity Share Capital ₹5,00,000 and Other Equity ₹7,00,000 on March 31. The fair value of net assets of A Ltd. was assessed at ₹16,00,000. The book value of B Ltd.'s net assets was ₹10,00,000, Equity share capital ₹4,00,000 and Other Equity ₹6,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at ₹15,00,000.Show journal entries complying Ind AS.

Question 42: On March 31, 2024, A Ltd externally reconstructed into B Ltd. B Ltd. issued 80,000 equity shares at the nominal value of ₹10 per share. The book value of A Ltd.'s net assets was ₹12,00,000 and other equity ₹6,00,000 onMarch 31. The fair value of net assets was assessed at ₹15,00,000. Show journal entries complying Ind AS.

Solution: It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C, where control lies with the same parties before and after the transaction.

Net Assets A/c Goodwill A/c To, Consideration A/c To, Other Equity A/c	Dr. Dr.	12,00,000 2,00,000	 8,00000 6,00,000
Consideration A/c To, Equity Share Capital A/c	Dr.	8,00,000	 8,00,000

SUMMARY FOR REVISION:

The pooling of interest method is considered to involve the following:

(i) The assets and liabilities of the combining entities are reflected at their carrying amounts.

(ii) No adjustments are made to reflect fair values, or recognize any new assets or liabilities.

(iii) The equity share capital will be recorded at nominal value only. Consideration in excess of equity share capital will be recorded as goodwill (Capital reserve in case of deficiency).

(iv) The other equity of the transferor shall be carried by the transferee in the same form in which they appeared in the financial statements of the transferor.

Accounting entries in the book of Acquirer (new company)

Assets account Dr Goodwill account Dr To liability account To all reserves To consideration To capital reserve	Carrying amount balancing figure	 Carrying amount Carrying amount P.C Balancing figure
Consideration account Dr To equity share capital To cash account To other assets	P.C	 Face value actual Fair value

Note 1. Equity shares issued as consideration will always be recorded at face value of shares. Premium on issue of equity shares shall be ignored.

Note 2. In examination, fair value of assets and liabilities of acquiree company given in question shall be completely ignored.

Note 3.

(a) In case of amalgamation of two companies, if purchase consideration of both companies is given.—Solve the question accordingly.

(b) In case of amalgamation of two companies, if purchase consideration of both companies is not given.—It should be assumed to be equal to total share capital of both acquiree company when they operated separately.

For making accounting in the book of both acquiree company separately. We should know the PC of both companies separately. For this PC should be divided between two companies in the following ratio:-

(i) In the ratio given in question

(ii) If ratio is not given in question, then it should be distributed in the ratio of their net asset at carrying amount.

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.

Let’s enter into concept of 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 accountingpurposes for the transaction to be considered a reverse acquisition.**
- ✓ **For example, reverse acquisitions sometimes occur when a private operating entity wants to become apublic 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 inexchange for the equity interests of the public entity.**

Question 43. Entity A acquires 80% shares of Entity B and satisfies the consideration by issue of three shares of Entity A for every share of Entity B. Market price of ₹10 share of Entity A is ₹25.

The summarized Balance Sheets:

	Entity A	**Entity B**
Net Assets	30,000	20,000
Equity	30,000	20,000
No. of Equity Shares	1000	750

Is it a reverse acquisition?

Solution: 80% of 750 = 600 shares of Entity B are acquired and Entity A issues 600 × 3 = 1800 shares to Entity B. Now, shareholders of Entity A hold 1,000 shares and shares holders of Entity B hold 1,800 shares effectively,the group is controlled by Entity B. This is a case of reverse acquisition.

In such case accounting will be done in books of Entity A, the legal acquirer, but it would be assumed that Entity B is the accounting acquirer and accordingly assets and liabilities of Entity A would be identified and effective consideration would be calculated.

Question 44. Reverse Acquisition takes place as H Ltd. acquires 100% equity shares of S Ltd on 31-03-2024. From the following data pass journal entries and prepare balance sheet in the books of Accounting Acquirer.

	H Ltd	**S Ltd**
Non-current Assets	2,000	3,000
Current Assets	1,000	1,000
Total	**3,000**	**4,000**
Equity Share Capital H: 100 shares; S: 80 shares	1,000	800
Other Equity	500	1,600
Non-current Liabilities	700	1,200
Current Liabilities	800	400
Total	**3,000**	**4,000**

H Ltd. and S Ltd. shares are quoted at ₹20 and ₹50 respectively on 31-03-2024. H Ltd. issues shares in exchange ratio based on quoted price. Fair value of non-current assets of H Ltd and S Ltd are ₹2,400 and ₹3,500 respectively.

Solution: deemed consideration 2,000 (40 shares x Rs 50); goodwill Rs 100

Question 45. **Balance sheet as on 31-3 2024**

Equity and liabilities	**X Ltd**	**Y Ltd**	**Assets**	**X Ltd**	**Y Ltd**
Equity share capital	10,00,000	5,00,000	Assets	20,00,000	8,00,000
General reserve	4,00,000	1,00,000			
Liability	6,00,000	2,00,000			
	20,00,000	**8,00,000**		**20,00,000**	**8,00,000**

X Ltd absorbed Y Ltd on the above date. X Ltd issued 4 equity shares of ₹10 each for every share in Y Ltd.Fair value of assets of X Ltd and Y Ltd were 24,00,000 and 10,00,000 respectively. Prepare consolidated balance sheet in the book of X Ltd.

Solution: computation of number of shares issued assuming no reverse acquisition:

To (Y Ltd)	**In (X Ltd)**	**Calculation**
Equity share	Equity share	$(\frac{50,000}{1}$ x 4 $)$ = 2,00,000 Shares

After acquisition:

Holding of shareholders of Y Ltd in X Ltd	**2,00,000**	**66.67%**
Holding of shareholders of X Ltd in X Ltd	**1,00,000**	**33.33%**
Total	**3,00,000**	**100%**

Since holding of shareholders of Y Ltd is more than shareholders of X Ltd after acquisition, therefore it is the case of reverse acquisition.

Total number of shares after acquisition = $\frac{50,000}{2}$ X 3 = 75,000 shares

For $\frac{1}{3}$ holding, number of shares to be issued= $\frac{50,000}{2}$ X 1 = 25,000 shares.
Hence, total deemed consideration payable to X ltd = 25,000 X 16 = ₹4,00,000

Question 46. DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31-03-24 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 31-03-24:

₹ Lakhs

	DA Ltd	TA Ltd
PPE	7,500	8,000
Financial Assets	800	500
Current Assets	4,700	6,500
Equity Share Capital	6,000	10,000
Other Equity	3,000	1,000
Borrowings	2,000	3,000
Current Liabilities	2,000	1,000

Fair value of the following items is given:

	DA Ltd	TA Ltd
PPE	8,000	6,000
Current Assets	5,000	7,000
Fair Value of Business	7,500	15,000

However, the control of DATA Ltd. is taken by the management of TA Ltd. Show the merged balance sheet.

Answer: total deemed consideration = 500 lakh shares of ₹10 each at ₹5 premium = ₹7,500; capital reserve Rs 2,300.

Question 47. AX Ltd. and BX Ltd. amalgamated on and from 1st January, 2024. A new Company ABX Ltd. with shares of Rs 10 each was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-2024 (in '000)

ASSETS	Note No.	AX Ltd.	BX Ltd
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investment		1,050	550
Current assets			
Inventory		1,250	2,750
Trade receivables		1,800	4,000
Cash and Cash equivalent		450	400
		13,050	**15,200**

EQUITY AND LIABILITIES			
Equity:			
Equity share capital (of face value of Rs 10 each)		6,000	7,000
Other equity	**1**	3,050	2,700
Liabilities			
Non-current liabilities			
Financial liabilities:			
Borrowings (12% Debentures)		3,000	4,000
Current liabilities			
Trade payables		1,000	1,500
		13,050	**15,200**

Note:

1. Other equity	AX Ltd	BX Ltd
General Reserve	1,500	2,000
Profit & Loss	1,000	500
Investment Allowance Reserve	500	100
Export Profit Reserve	50	100
	3,050	**2,700**

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies. Also the new debentures were issued in exchange of the old series of both the companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

a. **Assuming that both the entities are under common control**
b. **Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.**

The fair value of net assets of AX and BX limited are as follows:

Assets	AX Ltd (‘000)	BX Ltd (‘000)
Property, Plant and Equipment	9,500	1,000
Inventory	1,300	2,900
Fair value of the business	11,000	14,000

DE-MERGER

"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 undertaking, 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 undertaking or undertakings 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 shareholders 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 undertaking 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.

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 demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders 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.

Let's enter into practical problems:

(a) Demerger means transferring of one or more undertakings/ divisions by demerged company to resultant company.

(b) All assets and liabilities of such undertaking/division are transferred at book value of demerged company.

(c)Accounting treatment in the book of demerged company:

Without consideration OR consideration is received by shareholders of demerged company	**With consideration (treated as sale of division) And consideration is received by demerged company**
Liabilities account Dr (book value) Loss on demerger Dr (bal fig) To assets account (book value)	Liabilities account Dr (book value) Investment in New company Dr To assets account (book value) To revenue reserve (bal fig)
Capital reserve account Dr Security premium account Dr Free reserve account Dr Loss on demerger account **Note:** if details of other equity is not given in question, then 'other equity' can be used for making entry.	No entry is made for receiving consideration (taught in class)
In case of profit on demerger, it will be credited to capital reserve account(other equity).	

(d)Accounting treatment in the book of resulting company:

Under common control of same management	**Not under common control of same management**
Generally new company is formed	New company is not formed
Apply appendix 'C' of Ind AS 103	Apply provisions of Ind AS 103

Question 48. 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, 2024 are as follows:

	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.

Hints:

In the book of demerged company (AB Ltd) – since shares are issued to the shareholders (members) of AB Ltd. It will be recorded as demerger without consideration.

In the book of resulting company (X Ltd) – Appendix C of Ind AS 103 will be applied.

Question 49. 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 Capital	100		100
Other Equity	--	--	600
Borrowing	--	200	200
Total	**500**	**400**	

Y Division is sold to Z Ltd. and consideration of ₹250 lakhs was settled by issue of equity shares of Z Ltd of ₹10 at premium of ₹15 per share. Pass journal entries in the books of XY Ltd. and Z Ltd.

Hints: In the book of demerged company (XY Ltd) – since division is sold to the Z Ltd (other entity). it will be recorded as demerger with consideration.

In the book of resulting company (X Ltd) – Ind AS 103 will be applied.

Question 50. Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses. On 31st March, 2024, the division-wise draft extract of the Balance Sheet was: **(in crores)**

	Laptops	**Mobiles**	**Total**
Property, Plant and Equipment cost	250	500	750
Depreciation	(225)	(400)	(625)
Net Property, Plant and Equipment **(A)**	25	100	125
Current assets:	200	500	700
Less: Current liabilities	(25)	(400)	(425)
(B)	175	100	274
Total (A+B)	200	200	400
Financed by:			
Loan funds -	-	300	300
Capital : Equity 10 each	25	-	25
Surplus	175	(100)	75
Total	200	200	400

Division Mobiles along with its assets and liabilities was sold for ₹25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹10 each at a premium of ₹15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. Mx A, a shareholder holding 56% shares in Enterprise Ltd. Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.
(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).
(iii) Prepare the Balance Sheet of Turnaround Ltd.

Question 51. Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 2024 was as under:

	Maxi division	**Mini division**	**Total (in crores)**
Property, Plant and Equipment			
Cost	600	300	900
Depreciation	(500)	(100)	(600)
W.D.V. **(A)**	100	200	300
Current assets	400	300	700
Less: Current liabilities	(100)	(100)	(200)
(B)	300	200	500
Total (A+B)	**400**	**400**	**800**

Financed by :			
Loan funds **(A)**	-	100	100
(secured by a charge on property, plant and equipment)			
Own funds:	-	-	50
Equity capital (fully paid up ` 10 per share)			650
Other Equity	?	?	700
(B)	**400**	**400**	**800**
Total (A+B)			

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures, the assets and liabilities of that division. Mini Ltd. is to allot 5 crore equity shares of ₹10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 2024, showing corresponding previous year's figures.

(b) The directors of the 2 companies ask you to find out the net asset value of equity shares pre and post demerger.

(c) Comment on the impact of demerger on "shareholders wealth".

Disclosure requirements: An acquirer should disclose information that enables users to evaluate the nature and financial effect ofbusiness combinations that were affected. This information includes:

(a) The name and a description of the acquiree.

(b) The acquisition dates.

(c) The percentage of voting equity interests acquired.

(d) The primary reasons for the business combination and a description of how the acquirer obtainedcontrol 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 fairvalue 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 orloss for the period, unless impracticable. If impracticable, fact must be disclosed.

Multiple Choice Questions:

1. As per Ind AS 103, accounting and reporting for business combination is done under
(a) Acquisition Method
(b) Purchase method
(c) Pooling of interest method
(d) None of the above

2. As per Ind AS 103, while accounting and reporting for business combination goodwill is calculated as
(a) Consideration + Non-controlling Interest – Net assets
(b) Consideration - Non controlling Interest + Net assets
(c) Consideration - Non controlling Interest – Net assets
(d) Consideration + Non-controlling Interest + Net assets

3. How is non-controlling interest shown in the financial statements of the acquirer at the time of a business combination under Ind AS 103.
(a) It is shown as a liability
(b) It is shown as an item under equity
(c) It is not shown in balance sheet
(d) Non-controlling interest is not recognised.

4. At what value is non-controlling interest recorded in the books of the Acquiree at the time of a business combination transaction under Ind AS 103?
(a) It is recognised at fair value only
(b) It is recognised at proportionate fair value of identified net assets only
(c) It is not recognised at all
(d) It is recognised either at fair value or at proportionate fair value of identified net assets.

5. As per Ind AS 103, while accounting and reporting for business combination goodwill is calculated as
(a) Consideration + Non-controlling Interest + Fair value of previously held interest in the Acquiree –Net assets
(b) Consideration + Non-controlling Interest - Fair value of previously held interest in the Acquiree –Net assets
(c) Consideration - Non controlling Interest + Fair value of previously held interest in the Acquiree –Net assets
(d) Consideration - Non controlling Interest - Fair value of previously held interest in the Acquiree –Net assets

6. Transactions sometimes referred to as__or__are also business combinations as that term is used in this Ind AS.
(a) True Mergers, Mergers of Equals
(b) Business Combination, Business Combination under Common Control
(c) Internal reconstruction, financial restructuring
(d) None of the above

7. Ind AS 103 has a wider scope than ______
(a) AS 15
(b) AS 14
(c) AS 16
(d) AS 13

8. If a parent loses control of a subsidiary, it shall derecognise: -
(a) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost

(b) the carrying amount of any non-controlling interests in the former subsidiary at the date whencontrol is lost (including any components of other comprehensive income attributable to them)
(c) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control
(d) Both A and B

9. In business combination, control of business can be obtained by
(a) acquiring assets and assuming liabilities (such assets and liabilities must constitute a business,otherwise it is not a business combination)
(b) by acquisition of shares
(c) by other legal process
(d) All of the above

10. When after business combination, acquiree ceases to exist, it is to be recorded in the books of the_____in one set only, in its stand-alone accounts
(a) acquirer
(b) acquiree
(c) both A. and B.
(d) either A. or B.

11. As per Ind AS 103, accounting and reporting for business combination is done under
(a) Acquisition Method
(b) Purchase method
(c) Pooling of interest method
(d) None of the above

12. As per Ind AS 103 Appendix C, accounting and reporting for business combination under common control is done under
(a) Acquisition Method
(b) Purchase method
(c) Pooling of interest method
(d) None of the above

13. As per Ind AS 103, while accounting and reporting for business combination, goodwill is calculated as
(a) Consideration + Non-controlling Interest – Net assets
(b) Consideration - Non controlling Interest + Net assets
(c) Consideration - Non controlling Interest – Net assets
(d) Consideration + Non-controlling Interest + Net assets

14. At what value is non-controlling interest recorded in the books of the Acquirer at the time of a business combination transaction under Ind AS 103?
(a) It is recognised at fair value only
(b) It is recognised at proportionate fair value of identified net assets only
(c) It is not recognised at all
(d) It is recognised either at fair value or at proportionate fair value of identified net assets.

15. ________________is the business or businesses that the acquirer obtains control of in a business combination.
(a) Acquiree
(b) old company

(c) seller
(d) all of the above.

16. A ______________occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes.
(a) business acquisition
(b) business combination under common control
(c) de-merger
(d) reverse acquisition

17. Business combinations involving entities or businesses under common control shall be accounted for using the __________________method.

(a) acquisition method
(b) purchase method
(c) pooling of interest method
(d) any of the above

18. _______________refers to the transaction of business combination where a parent is acquiring control of its subsidiary (intermediate parent) which in turn is acquiring control of another company (sub- subsidiary).
(a) cross holding
(b) chain holding
(c) any of the above
(d) none of the above

19. As per Ind AS-103,___________________is the equity in a subsidiary (acquiree) not attributable, directly or indirectly, to a parent (acquirer).
(a) Controlling interest
(b) Minority interest
(c) Non-controlling interest
(d) Either (B) or (C)

20. A Ltd. acquires 80% of B Ltd. for ₹12,80,000 paid by equity at par. Fair Value (FV) of B's net assets at time of acquisition amounts ₹9,00,000. Carrying amount of net assets at the time of acquisition ₹10,00,000. NCI is measured at proportionate net asset. The value of goodwill will be:

(a) ₹6,60,000

(b) ₹3,80,000

(c) ₹4,50,000

(d) ₹5,60,000

21. Q Ltd. acquired a 60% interest in R Ltd. on January 1st, 2024. Q Ltd. paid ₹900 Lakhs in cash for theirinterest in R Ltd. The fair value of R Ltd.'s assets is ₹2,000 Lakhs, and the fair value of its liabilities is ₹1,000 Lakhs.
(i) If NCI is valued at proportionate net asset, value of Goodwill:
(a) ₹300 lakhs
(b) ₹250 lakhs
(c) ₹400 lakhs

(d) ₹350 lakhs

(ii) If NCI is valued at fair value, goodwill amounts to:
(a) ₹300 lakhs
(b) ₹250 lakhs
(c) ₹500 lakhs
(d) ₹350 lakhs

22. A Ltd. acquires 80% of B Ltd. for ₹10,00,000 paid by equity at par. Fair Value (FV) of B's net assets at time of acquisition amounts ₹9,00,000. The value of goodwill based on NCI valued at proportionate fairvalue of identified net asset will be:
(a) ₹3,00,000

(b) ₹2,80,000

(c) ₹4,50,000

(d) ₹5,00,000

23. On 1st January 2024 A Ltd. acquires 80 per cent of the equity interests of B Ltd in exchange of cash of ₹600 lakhs. The identifiable assets are measured at ₹925 lakh and the liabilities assumed are measured at ₹150 lakh. The fair value of the 20 per cent non-controlling interest in P is ₹90 lakhs. The gain on bargain purchase will be -
(a) ₹90 lakhs
(b) ₹85 lakhs
(c) ₹105 lakhs
(d) ₹75 lakhs

24. X has acquired 100% of the equity of Y on March 31st, 2024. The purchase consideration comprises of an immediate payment of ₹50 lakhs and three further payments of ₹2.5 lakhs if the Return on Equity exceeds 20% in each of the subsequent three financial years. A risk adjusted discount rate of 20% is used. Compute the value of total consideration at the acquisition date.
(a) ₹50 lakhs
(b) ₹55.266 lakhs
(c) ₹55 lakhs
(d) ₹57.5 lakhs

25. Q Ltd. acquired a 75% interest in R Ltd. on January 1st, 2024. Q Ltd. paid ₹900 Lakhs in cash and for theirinterest in R Ltd. The fair value of R Ltd.'s assets is ₹2,000 Lakhs, and the fair value of its liabilities is ₹920 Lakhs. NCI valued at Fair Value and at Proportionate Value are:
(a) ₹300 lakhs and ₹360 lakhs
(b) ₹225 lakhs and ₹270 lakhs.
(c) ₹300 lakhs and ₹270 lakhs.
(d) ₹225 lakhs and ₹360 lakhs.

26. On 1st January 2024 A Ltd. acquires 80% of the equity interests of B Ltd for ₹560 lakh. The identifiable assets are measured at ₹960 lakh and the liabilities assumed are measured at ₹160 lakh. The non-controlling interest in B Ltd. is measured at fair value. The gain on bargain purchase will be: -
(a) ₹90 lakhs
(b) ₹100 lakhs
(c) ₹55 lakhs
(d) ₹75 lakhs

27. P Ltd. acquires 3/4th equity shares of Q Ltd. by issue of 80,000 equityshares of ₹10 (market price ₹30) and exchanges of Debentures of Q by P's own Debenture ₹2,00,000.Net assets of Q amounts to ₹27,00,000 at fair value. NCI is measured at fair value. Transaction cost borne by P is ₹25,000. Ind AS 103 is applicable.

(i) In separate set of accounting
(a) Investment is debit by ₹24,00,000.
(b) Investment is debit by ₹26,00,000.
(c) Investment is debit by ₹8,00,000.
(d) Investment is debit by ₹10,00,000

(ii) In consolidated set of accounting
(a) Investment is debit by ₹24,00,000.
(b) Investment is debit by ₹26,00,000.
(c) Net asset is debited by ₹27,00,000.
(d) Goodwill is recognised at ₹8,00,000.

(iii) In consolidated set of accounting
(a) Equity is credit by ₹26,00,000.
(b) Purchase consideration is ₹26,25,000.
(c) Goodwill is debit by ₹7,00,000.
(d) Non-controlling interest is recognised at ₹8,00,000.

(iv) In consolidated set of accounting
(a) Other Equity is credit by ₹24,00,000.
(b) Investment is debit by ₹26,00,000.
(c) Goodwill is debit by ₹5,00,000.
(d) Non-controlling interest is recognised at ₹7,00,000.

(v) In consolidated set of accounting
(a) Equity share capital is credit by ₹8,00,000.
(b) Purchase consideration is ₹26,00,000.
(c) Goodwill is debit by ₹3,75,000.
(d) Non-controlling interest is recognised at ₹6,75,000.

(vi) In consolidated set of accounting
(a) Other Equity is credit by ₹15,75,000.
(b) Purchase consideration is ₹24,25,000.
(c) Goodwill is debit by ₹3,75,000.
(d) Non-controlling interest is recognised at ₹6,75,000.

(vii) In consolidated set of accounting
(a) Equity is credit by ₹16,00,000.
(b) Purchase consideration is ₹24,00,000.
(c) Goodwill is debit by ₹3,75,000.
(d) Non-controlling interest is recognised at ₹6,75,000.

28. Definition of demerged company is given under section ……………….
(a) Section 19AAA

(b) Section 2(41A)
(c) section 72 A
(d) None of the above

29. Definition of resulting company is given under section ……………….
(a) Section 19AAA
(b) Section 2(41A)
(c) section 72 A
(d) None of the above

30. Demerger means transferring of one or more divisions by …………. to ………. company.
(a) resultant company; demerged company
(b) demerged company; resultant company
(c) acquirer company; acquiree company
(d) acquiree company; acquirer company.

31. In case of demerger, accounting in the book of resultant company is done as per…..
(a) acquisition method
(b) pooling of interest method
(c) either acquisition or pooling of interest method.
(c) Not any prescribed method

32. In case of demerger, all assets and liabilities are transferred at …….. of demerged company.
(a) Fair value
(b) Book value
(c) either fair value or book value
(d) none of the above

Answer:

1.	**2.**	**3.**	**4.**	**5.**	**6.**	**7.**	**8.**	**9.**	**10.**	**11.**	**12.**	**13.**	**14**
A	**A**	**B**	**D**	**A**	**A**	**B**	**D**	**D**	**A**	**A**	**C**	**A**	**D**
15.	**16.**	**17**	**18**	**19**	**20**	**21(i)**	**21(ii)**	**22**	**23**	**24**	**25**	**26**	
A	**D**	**C**	**B**	**C**	**D**	**A**	**C**	**B**	**B**	**B**	**C**	**B**	
27.i	**27.ii**	**27.iii**	**27.iv**	**27.v**	**27.vi**	**27.vii**	**28**	**29**	**30**	**31**	**32**		
B	**C**	**D**	**C**	**A**	**A**	**B**	**A**	**B**	**B**	**B**	**B**		

CHAPTER 5C -- INTERNAL RECONSTRUCTION

The need for reconstruction arises when a company has accumulated losses or when a company finds itself overcapitalized 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, 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 requested 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.

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 of internal reconstruction:

(1) First of all the total amounts to be written off should be ascertained. This would mean totalling up the debit balance of the Profit and Loss account, all fictitious assets like goodwill, discount on debentures, any fall in value of assets ,any increase in liabilities and arrears of dividends on cumulative preference shares. 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, the preference share holder will have to accept a sacrifice, although their sacrifice will be smaller than that of the equity shareholders. (Equity shareholders should not be completely wiped off). If the future earning power of the company permits, the dividend rate should be increased so that, in terms of rupees, the dividend on preference shares 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 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. In such circumstances, 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. 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? External 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 Rama Ltd., to take over the business of the Ram Ltd(outgoing company). There are advantages in both, but generally internal reconstruction is preferred. The advantages in its favour are: -

(a) Creditors, specially bank overdraft and debenture holders, may continue whereas they may not if the company is formally liquidated(external reconstruction) which will involve payment of claims to outsiders, 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 which is quite difficult in case 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.

PRACTICAL PROBLEMS:

Question: 1 Balance sheet of X Ltd is given below on 31 march 2024.

B/S of X Ltd.			
Equity share capital @ ₹10	5,00,000		
		Machine	3,00,000
12% Preference share Capital	3,00,000	Building	5,00,000
@ Rs. 10		Furniture	2,00,000
General reserve	1,50,000	Debtors	3,50,000
16% Debentures	4,00,000	Cash	1,50,000
		Goodwill	2,00,000
18% Bank Loan	3,50,000	Discount on debenture	1,00,000
Creditors	3,00,000	Profit and Loss (Dr)	3,00,000
Bills Payable	1,00,000		
	21,00,000		**21,00,000**

The following scheme of reconstruction is sanctioned.

(i) Value of machine is to be depreciated by 10%

(ii) Value of building has to be increased by 20%

(iii) Market value of furniture is estimated at ₹1,40,000.

(iv) Debtors of ₹20,000 are to be written off.

(v) Cost of reconstruction amounting to ₹10,000 paid to be written off.

(vi) Interest rate on debentures reduced to 10%

(vii) 18% Bank loan converted into 12% bank loan and their claim was also reduced to ₹2,40,000.

(viii) All existing equity shares are reduced to ₹6 per share.

(ix) All preference shares are reduced by ₹3 per share.

(x) Creditors agreed to reduce their claim by ₹80,000. Pass journal entries.

Question: 2 Balance sheet of Bakwas Ltd is given below on 31 march 2024.

B/S of Bakwas Ltd

Equity shares capital @ ₹20	5,00,000	Fixed assets	9,00,000
Preference share capital @ ₹10	3,00,000	Investment (market value ₹2,50,000)	4,00,000
Profit & Loss A/c	1,00,000		
Security premium	1,50,000	Current assets	5,00,000
Capital reserve	2,50,000		
8% debentures	2,00,000		
Provision for tax	1,00,000		
Creditors	2,00,000		
	18,00,000		**18,00,000**

The following scheme of reconstruction is sanctioned and approved by court:

(i) Fixed assets reduced to ₹4,00,000

(ii) Investment to reflect their market value.

(iii) Current assets revalued at ₹5,50,000.

(iv) 8% debentures were converted into 10,000 equity share of ₹20 each.

(v) Creditors were agreed to continue business on existing terms.

(vi) Taxation liability settled at ₹1,50,000.

(vii) 10,000 new preference shares were issued @ ₹10 each to the public. Shares were fully subscribed by the public.

(viii) Each equity share reduced by ₹2 per share.

Pass entries and prepare reconstruction A/c and new balance sheet.

Question: 3 Balance sheet of Satyam Ltd is given below on 31 march 2024.

Equity share capital @₹10	4,00,000		
10% preference share capital	3,00,000	Bank	2,00,000
12% Debentures @ ₹100	5,00,000	Other assets	18,00,000
Creditors	3,00,000	Preliminary expenses	3,00,000
Bill Payable	5,00,000		
Other liability	3,00,000		
	23,00,000		**23,00,000**

NOTE: - Preference dividends are in arrear for 2 years.

(i) Preference shareholders agreed to forgo their rights of arrears of dividend.

(ii) Creditors agreed to continue business on existing terms if they are paid 20% of their dues immediately.

(iii) 12% debentures were converted into 9% debentures. Face value of each debentures also reduced by ₹25 per debenture.

(iv) Face value of each equity share reduced to ₹8.

(v) Bills payable were paid off at a discount of 20%.

(vi) Cost of reconstruction ₹5000 paid off.

(vii) Company issued 20,000 new 10% preference shares @ ₹10 each for cash. Shares were fully subscribed by the public.

(viii) Surplus if any will be utilized to write down the value of other assets.

Make entries and prepare reduction A/c (re-organization A/c) **(CMA Final – 10 marks)**

Questioin: 4 The balance sheet as on 31st March, 1993 was as follows:

LIABILITIES	AMOUNT	ASSETS	AMOUNT
Share capital:			
2,00,000 equity shares of ₹10		Fixed Assets	11,40,000
each, ₹5 paid	10,00,000	Patents and copy rights	80,000
6,000 8% pref. shares of ₹100	6,00,000	Investment at cost	65,000
9% debentures	6,00,000	(market value Rs 55,000)	
Accrued int. on debentures	1,08,000	**Current assets:**	
Bank overdraft	1,50,000	Stock	4,00,000
Accrued int. on bank overdraft	15,000	Debtors	4,39,000
current liabilities-		Bank	10,000
Creditors	69,000	Profit and loss A/C	4,08,000
	25,42,000		**25,42,000**

Note: preference dividends are in arrear for one year.

(1) Preference shareholders to give up their claim, inclusive of dividends, to the extent of 30% and desire to be paid off.

(2) Debenture holders agree to give up their claims to interest in consideration of their interest being enhanced to 12%.

(3) Bank agrees to give up 50% of its interest outstanding in consideration of its being paid off at once.

(4) Creditors would like grant a discount of 5% if they are paid immediately.

(5) Balance of profit & loss Account, patent and copy rights and debtors of ₹30,000 to be written off.

(6) Fixed assets to be written down by ₹34,000.

(7) Investments are to reflect their market value.

(8) To the extent not specifically stated, equity shareholders suffer on reduction on their rights. Cost of reconstruction is ₹3,350.

Draft journal entries in the books of the company assuming that the scheme has been put through fully with the equity shareholders bringing in necessary cash to pay off the parties and to leave a working capital of Rs 30,000, and prepare the Balance sheet after reconstruction. **(CA-INTER Nov-1993)**

Questioin: 5 Vidushi Ltd. decided to reorganize following a period of adverse trading conditions. The balance sheet of the company as on 31 March, 2017 showed the following:

Liabilities	₹	Assets		₹
Authorized and issued capital:		Goodwill		55,000
20,000, 8% cumulative preference shares of		Freehold property at cost		60,000
₹10 each	2,00,000	Leasehold property:		
15,000 equity shares of ₹10 each	1,50,000	Cost	1,40,000	
Security premium account	5,000	Less: depreciation	18,000	1,22,000
9% Debenture (secured against property)		Plant and machinery:		
Accrued interest on debentures	60,000	Cost	2,20,000	
Creditors	2,700	Less: depreciation	60,000	1,60,000
Bank overdraft	85,000	Trade investment at cost		40,000
	96,000	Stock		30,000
		Debtors		60,000
		Discount on debentures		2,500
		Profit and loss Account		69,200
	5,98,700			**5,98,700**

Preference dividends are in arrears for four years.

Subsequent to the approval of the court of a scheme for the reduction of capital, the following steps were taken:

(i) The preference shares were reduced to ₹7.50 per share and the equity shares were reduced to ₹2 per share. After reduction, preference shares and equity shares were consolidated into ₹10 shares. The authorized capital was restored to Rs. 2,00,000 8% cumulative preference shares and ₹1,50,000 equity shares, both of ₹10 each.

(ii) One new equity share of ₹10 was issued for every ₹40 of gross preference dividend in arrears.

(iii) The balance on security premium account was utilized.

(iv) The debenture holders took over the freehold property at an agreed figure of ₹75,000 and paid the balance to the company after deducting the amount due to them.

(v) Plant and machinery was written down to ₹1,40,000.

(vi) Trade investment was sold for ₹32,000.

(vii) Goodwill, discount on debentures, debts of ₹8,600 and obsolete stock of ₹10,000 were written off.

(viii) Contingent liability for which no provision had been made was settled at ₹7,000 and of the amount ₹6,300 was recovered from the insurers.

(ix) Available cash is deposited in bank overdraft.

Pass journal entries and prepare the balance sheet after completion of the scheme. **(CMA Final – 12 marks)**

Questioin: 6 The Balance sheet of A & CO. Ltd. as on 31-12-2017 is as follows:

CAPITAL+ LIABILITY	Amount	ASSETS	Amount
Share capital:		**Fixed assets :**	
4,000 6% cum. preference shares of		Freehold property	4,25,000
₹100 each.	4,00,000	Plant	50,000
		Patent	37,500
		Goodwill	1,30,000
75,000 Equity Shares of ₹10 each	7,50,000	Trade investment(at cost)	55,000
6% debentures (secured on			
freehold property)	3,75,000	**Current assets:**	
accrued interest on debenture	22,500	Debtors	4,85,000
current liabilities:		Stock	4,25,000
bank overdraft	1,95,000	Deferred advertising	1,00,000
creditors	3,00,000	Profit and loss account	4,35,000
director's loan	1,00,000		
TOTAL	**21,42,500**	**TOTAL**	**21,42,500**

THE COURT APPROVED A SCHEME OF RE-ORGANISATION TO TAKE EFFECT ON 1-1-2018, WHEREBY:

1. The preference share to be written down to ₹75 each and equity shares to ₹2 each.
2. Of the preference share dividends, which are in arrears for four years, three fourth to be waived and equity shares of ₹2 each to be allotted for the remaining quarter.
3. Accrued interest on debentures to be paid in cash.
4. Debentures-holders agreed to take over freehold property, book value ₹1,00,000 at a valuation of ₹1,20,000 in part repayment of their holding and to provide additional cash of ₹1,30,000 secured by a floating charge on the company's assets at an interest rate of 8% p.a.
5. Patents, goodwill and deferred advertising to be written off.
6. Stock to be written off by ₹65,000.
7. Amount of ₹68,500 to be provided for bad debts.
8. Remaining freehold property to be re-valued at ₹3,87,500.
9. Trade investment be sold for ₹1,40,000.
10. Directors to accept settlement of their loans as to 90% thereof by allotment of equity shares of ₹2 each and as to 5% in cash, and balance 5% being waived.
11. There were capital commitments totaling ₹2,50,000. These contracts are to be cancelled on payment of 5% of the contract price as penalty.

You are required to show journal entries and prepare the balance sheet of the company. **(Ans: ₹12,49,000)**

Questioin: 7 (**SHARE SURRENDER)** The balance sheet of revise Ltd as at 31st March,2024 was as follows:

LIABILITIES	AMOUNT	ASSETS	AMOUNT
Share capital:		**Fixed Assets:**	
10,000 equity shares of Rs 100		Machineries	1,00,000
each fully paid	10,00,000	**Current assets:**	
Unsecured loan:		Stock	3,20,000
12% debentures	2,00,000	Debtors	2,70,000
Accrued interest on debenture	24,000	Bank	30,000
current liabilities-		Profit and loss A/C	6,00,000
Creditors	72,000		
Provision for income tax	24,000		
	13,20,000		**13,20,000**

It was decided to reconstruct the company for which necessary resolution was passed and sanctions were obtained from appropriate authorities. Accordingly, it was decided that:

(a) Each share be sub-divided into 10 fully paid equity shares of ₹10 each.

(b) After sub-division, each shareholder shall surrender to the company 50% of his holding, for the purpose of re-issue to debenture holders and creditors as necessary.

(c) Out of the shares surrendered, 10,000 shares of ₹10 each shall be converted into 12% preference shares of ₹10 each fully paid up.

(d) The claims of the debenture-holders shall be reduced by 75%, in consideration of the reduction, the debenture holders shall receive preference shares of ₹1,00,000 which are converted out of shares surrendered.

(e) Creditors claim shall be reduced to 50%, it is to be settled by the issue of equity shares of ₹10 each out of shares surrendered.

(f) The shares surrendered and not re-issued shall be cancelled.

You are required to show the journal entries giving effect to the above and the resultant balance sheet.

(Ans: Balance sheet total ₹7,20,000) (CMA Final – 10 marks)

Questioin: 8 . Following is the balance sheet of Mohan chemicals Ltd. as at 31st march 2023:

LIABILITIES	AMOUNT	ASSETS	AMOUNT
12,000 7% pref. share capital of		Goodwill and trade mark at cost	4,18,000
₹50 each fully paid	6,00,000	Building at cost (Less: dep)	3,00,000
15,000 equity shares of ₹50 each			
fully paid up	7,50,000	Plant, machine& furniture	2,68,000
loans	5,73,000	Stock in trade	3,50,000
Sundry creditors	2,07,000	Sundry debtors	3,78,000
Other current liabilities	35,000	P& L Account	4,51,000
	21,65,000		**21,65,000**

Note: preference dividends are in arrear for 5 years.

The company is now earning profit is badly in need of additional working capital. The following scheme of reconstruction has been approved by both the classes of shareholders and has been sanctioned by the court.

(a) Equity shares be reduced to ₹2.50 per share and equity shareholders to subscribe, in cash, three equity shares of ₹2.50 each for each equity share now held.

(b) To issue four fully paid new 5% preference Shares of ₹10 each plus 6 fully paid new equity shares of

₹2.50 each to preference shareholders for each preference share now held.

(c) Several loan creditors lending ₹1,50,000 have agreed to settle by converting their loans into 12,000 5% preference as fully paid shares.

(**d)** In addition to shares to be subscribed by the directors under (a) above they have agreed to subscribe, in cash, for 40,000 equity shares of ₹2.50 each.

(e) Share capital thus reduced is to be applied in writing off the debit balance in the profit and loss Account. Balance remaining thereafter should be used to write down the value of Goodwill and trademarks Account.

Show the necessary journal entries recording this scheme and prepare the Balance sheet after reconstruction.

Questioin: 9 . The Balance Sheet of Y limited as on 31st March 2023 was as follows:

Liabilities	**Amount**	**Assets**	**Amount**
Subscribed capital :		Goodwill	10,00,000
500,000 Equity shares of	50,00,000	Patent	5,00,000
Rs 10 each fully paid up		Land and building	30,00,000
20,000, 9%preference	20,00,000	Plant and machinery	10,00,000.
shares@100 fully paid		Furniture and fixtures	2,00,000
10% First debentures	6,00,000	Computers	3,00,000
10% Second debentures	10,00,000	Trade investment	5,00,000
outstanding interest on		Debtors	5,00,000
debenture	1,60,000	Stock	10,00,000
Trade creditors	5,00,000	Discount on issue of	
Directors loan	1,00,000	Debentures	1,00,000
Bank Overdraft	1,00,000	Profit and loss account	15,00,000
outstanding liabilities	40,000		
provision for tax	1,00,000		
	96,00,000		**96,00,000**

Note- preference dividends are in arrears for last three years

A holds 10% first debentures for ₹4,00,000 and 10% second debentures for ₹6,00,000. He is also creditors for ₹1,00,000. B holds 10% first debentures for ₹2,00,000 and 10% second debentures for ₹4,00,000 and is also creditors for ₹50,000.

The following scheme of reconstruction has been agreed upon and duly approved by court:

(i) All the equity shares be converted into fully paid equity shares of ₹5 each.

(ii) The preference shares be reduced to ₹50 each and the preference shareholders agree to forgo their arrears of preference dividends in consideration of which 9% Preference shares are to be converted into 10% Preference shares.

(iii) Mr. A is to cancel ₹6,00,000 of his total debt including interest on debentures and to pay ₹1 lakh to the company and to receive new 12% debentures for the balance amount.

(iv) Mr B is to cancel ₹3,00,000 of his total debt including interest on debentures and to accept new 12% debentures for the balance amount.

(v) Trade creditors (other than A and B) agreed to forego 50% of their claim.

(vi) Directors to accept settlement of their loans as to 60% thereof by allotment of equity shares and balance being waived.

(vii) There were capital commitment totalling ₹3,00,000. These contracts are to be cancelled on payment of 5% of the contract price as a penalty.

(viii) The directors refund ₹1,10,000 of the fees previously received by them.

(ix) Reconstruction expenses paid ₹10,000

(x) The taxation liability of the company is settled at ₹80,000 and the same is paid immediately.

(xi) The assets are revalued as under:

Land and Building	28,00,000
Plant and Machinery	4,00,000
Stock	7,00,000
Debtors	3,00,000
Computers	1,80,000
Furniture and fixtures	1,00,000
Trade investment	4,00,000

Pass journal entries for all the above mentioned transactions including amount to be written off of Goodwill, Patents, and Loss in profit & loss Account and Discount on issue of debentures. Prepare Bank account and working of allocation of interest on debentures between A and B. **(CA Final 16 marks) Nov 2003**

Answer:

		Dr.	*Cr.*
(i)	Equity Share Capital (Rs. 10 each) A/c	Dr. 50,00,000	
	To Equity Share Capital (₹5 each) A/c		25,00,000
	To Reconstruction A/c		25,00,000
	(Being conversion of 5,00,000 equity shares of Rs. 10 each fully paid into same number of fully paid equity shares of ₹5 each as per scheme of reconstruction.)		
(ii)	9% Preference Share Capital (₹100 each) A/c	Dr. 20,00,000	
	To 10% Preference Share Capital (₹50 each) A/c		10,00,000
	To Reconstruction A/c		10,00,000
	(Being conversion of 9% preference share of Rs. 100 each into same number of 10% preference share of ₹50 each and claims of preference dividends settled as per scheme of reconstruction.)		
(iii)	10% First Debentures A/c	Dr. 4,00,000	
	10% Second Debentures A/c	Dr. 6,00,000	
	Trade Creditors A/c	Dr. 1,00,000	
	Interest on Debentures Outstanding A/c	Dr. 1,00,000	
	Bank A/c	Dr. 1,00,000	
	To 12% New Debentures A/c		7,00,000
	To Reconstruction A/c		6,00,000

	(Being ₹6,00,000 due to A (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)		
(iv)	10% First Debentures A/c	Dr. 2,00,000	
	10% Second Debentures A/c	Dr. 4,00,000	
	Trade Creditors A/c	Dr. 50,000	
	Interest on Debentures Outstanding A/c	Dr. 60,000	
	To 12% New Debentures A/c		4,10,000
	To Reconstruction A/c		3,00,000
	(Being ₹3,00,000 due to B (including creditors) cancelled and 12% new debentures allotted for balance amount as per scheme of reconstruction.)		
(v)	Trade Creditors A/c	Dr. 1,75,000	
	To Reconstruction A/c		1,75,000
	(Being remaining creditors sacrificed 50% of their claim.)		
(vi)	Directors' Loan A/c	Dr. 1,00,000	
	To Equity Share Capital (₹5) A/c		60,000
	To Reconstruction A/c		40,000
	(Being Directors' loan claim settled by issuing 12,000 equity shares of ₹5 each as per scheme of reconstruction.)		
(vii)	Reconstruction A/c	Dr. 15,000	
	To Bank A/c		15,000
	(Being payment made for cancellation of capital commitments.)		
(viii)	Bank A/c	Dr. 1,10,000	
	To Reconstruction A/c		1,10,000
	(Being refund of fees by directors credited to reconstruction A/c.)		
(ix)	Reconstruction A/c	Dr. 10,000	
	To Bank A/c		10,000
	(Being payment of reconstruction expenses.)		
(x)	Provision for Tax A/c	Dr. 1,00,000	
	To Bank A/c		80,000
	To Reconstruction A/c		20,000
	(Being payment of tax for 80% of liability in full settlement.)		
(xi)	Reconstruction A/c	Dr. 47,20,000	
	To Goodwill A/c		10,00,000
	To Patent A/c		5,00,000
	To Profit and Loss A/c		15,00,000
	To Discount on issue of Debentures A/c		1,00,000
	To Land and Building A/c		2,00,000
	To Plant and Machinery A/c		6,00,000
	To Furniture & Fixture A/c		1,00,000
	To Computers A/c		1,20,000
	To Trade Investment A/c		1,00,000
	To Stock A/c		3,00,000
	To Debtors A/c		2,00,000
	(Being writing off of losses and reduction in the value of assets as per scheme of reconstruction.)		

Question 10. The balance sheet of R Ltd. at 31st March, 2021 was as follows:

	₹		₹
Share capital :		Intangibles assets	68,000
Authorized	14,00,000	Freehold premises at cost	1,40,000
Issued		Plant and equipment at cost	
64,000 8% cumulative preference shares of		Less depreciation	2,40,000
Rs. 10 each fully paid.	6,40,000	Investments in shares in	
64,000 equity shares of Rs. 10 each Rs. 7.5		Q Ltd. at cost	3,24,000
paid	4,80,000	Stocks	2,48,000
Loans from directors	60,000	Debtors	3,20,000
Sundry creditors	4,40,000	Deferred revenue expenditure	48,000
Bank overdraft	2,08,000	Profit and loss account	4,40,000
	18,28,000		**18,28,000**

Note: the arrear preference dividends amount to ₹51,200.

A scheme of reconstruction was duly approved with effect from 1 April 2021 under the conditions stated below:

(a) The unpaid amount on the equity shares would be called up.
(b) The preference shareholders would forego their arrear dividends. In addition, they would accept a reduction of ₹2.5 per share. The dividend rate would be enhanced to 10%.
(c) The equity shareholders would accept a reduction of ₹7.5 per share.
(d) R Ltd. holds 21,600 shares in Q Ltd. this represents 15% of the share capital of that company. Q Ltd. is not a quoted company. The average net profit (after tax) of the company is ₹2,50,000. The shares would be valued based on 12% capitalization rate.
(e) A bad debt Provision at 2% would be created.
(f) The other assets would be valued as under:

	₹
Intangibles	48,000
Plant	1,40,000
Freehold premises	3,80,000
Stocks	2,50,000

(g) The profit and loss account debit balance and the balance standing to the debit of the deferred revenue expenditure account would be eliminated.
(h) The directors would have to take equity shares at the new face value of ₹2.5 per share in settlement of their loan.
(i) The equity shareholders, including the directors, who would receive equity shares in settlement of their loans, would take up two new equity shares for every one held.
(j) The preference shareholders would take up one new preference share for every four held.
(k) The authorized share capital would be restated to ₹14,00,000.
(l) The new face values of the shares – preference and equity – will be maintained at their reduced levels.

You are required:

1. to prepare the necessary ledger accounts to effect the above ; and
2. To prepare the balance sheet of the company after reconstruction.

Question 11. Following is the Balance Sheet as at March 31, 2024:

					(Rs. '000)
Liabilities	**Max Ltd.**	**Mini Ltd.**	**Assets**	**Max Ltd.**	**Mini Ltd.**
Share capital:			Goodwill	20	–
Equity shares of Rs. 100 each	1,500	1,000	Other fixed assets	1,500	760
9% Preference shares of Rs. 100 each	500	400	Debtors Stock	651 393	440 680
General reserve	180	170	Cash at bank	26	130
Profit and loss account 12% Debentures of Rs. 100 each	– 600	15 200	Own debenture (Nominal value Rs. 2,00,000)	192	
Sundry creditors	415	225	Discount on issue of debentures	2	
			Profit and loss account	411	
	3,195	**2,010**		**3,195**	**2,010**

On 1.4.2024, Max Ltd. adopted the following scheme of reconstruction:

(i) Each equity share shall be sub-divided into 10 equity shares of ₹10 each fully paid up. 50% of the equity share capital would be surrendered to the Company.

(ii) Preference dividends are in arrear for 3 years. Preference shareholders agreed to waive 90% of the dividend claim and accept payment for the balance.

(iii) Own debentures, face value, of ₹80,000 were sold at ₹98 cum-interest and remaining own debentures were cancelled.

(iv) Debenture holders of Rs. 2,80,000 agreed to accept one machinery of book value of Rs. 3,00,000 in full settlement.

(v) Creditors, debtors and stocks were valued at ₹3,50,000, ₹5,90,000 and ₹3,60,000 respectively. The goodwill, discount on issue of debentures and Profit and Loss (Dr.) are to be written off.

(vi) The Company paid ₹15,000 as penalty to avoid capital commitments of ₹3,00,000.

On 2.4.2024 a scheme of absorption was adopted. Max Ltd. would take over Mini Ltd. The purchase consideration was fixed as below:

(a) Equity shareholders of Mini Ltd. will be given 50 equity shares of ₹10 each fully paid up, in exchange for every 5 shares held in Mini Ltd.

(b) Issue of 9% preference shares of ₹100 each in the ratio of 4 preference shares of Max Ltd. for every 5 preference shares held in Mini Ltd.

(c) Issue of one 12% debenture of ₹100 each of Max Ltd. for every 12% debentures in Mini Ltd.

You are required to give Journal entries in the books of Max Ltd. and draw the resultant Balance Sheet as at 2nd April, 2024 as per acquisition method. **(20 Marks) (CA Final – Nov. 2005 modified)**

Question 12. The following is the Balance Sheet as at 31st March, 2024 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 Preference Shares of ₹ 100 each fully paid	4,00,000	Stock in Trade	2,75,000
Securities Premium	20,000	Trade Debtors	1,50,000
General Reserve	60,000	Bank Balances	65,000
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, 2024.

(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 2024, 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. (Creditors balance at the end is to be ascertained)

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, 2024.

Question 13. The following are the Balance Sheet of Rito Ltd. and Arima Ltd. as on March 31, 2024.

(**amount in lakhs)**

Liabilities	**RITO Ltd**	**ARIMA Ltd**	**Assets**	**RITO Ltd**	**ARIMA Ltd**
Equity shares of Rs 100 each fully paid up	600	300	Fixed assets- net of depreciation	810	255
Reserves and surplus	240	--	Investment (including investment in Arima ltd)	210	--
			Debtors	120	45
10% debentures	150	--	Cash at bank	75	--
Loan from banks	75	135	Profit & loss A/c	--	240
Bank overdraft	--	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 unpaid 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, 2024.**(ICMAI Study material)**

SECTION D- CONSOLIDATED FINANCIAL STATEMENTS AND SEPARATE FINANCIAL STATEMENTS

Topics covered:

Ind AS- 110

Ind AS- 27

Ind AS- 111

Ind AS- 28

Ind AS- 112

Chapter 6A- Ind AS-110

6.1. 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 statement, (b) Consolidated financial statements and (c) Separate financial statements.

Consolidated financial statements are required to be prepared by an Ind AS complied company if it holds shares in the investee company: -

(i) Entailing 20% or more voting rights having significant influence over the investee company (called Associate as per Ind AS 28).

(ii) Entailing joint control over the investee company (called a Joint Venture as per Ind AS 28)

(iii) Entailing control over investee company (called subsidiary company as per Ind AS 110).

- 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.
- No consolidation is required otherwise (i.e., for holding shares in investee not falling under above three clauses)and the investor company prepares only individual/standalone financial statements.

Detail study of Ind AS- 110:

The objective of Ind AS 110 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

To meet the objective, Ind AS 110:

(a) requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements;

(b) defines the principle of control, and establishes control as the basis for consolidation;

(c) sets out how to apply the principle of control to identify whether an investor control an investee and thereforemust consolidate the investee;

(d) sets out the accounting requirements for the preparation of consolidated financial statements; and

(e) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

However, a parent need not present consolidated financial statements if it meets all the following conditions:

(i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners,including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or otherregulatory organisation for the purpose of issuing any class of instruments in a public market; and

(iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with Ind ASs.

An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement withthe investee and has the ability to affect those returns through its power over the investee.

Thus, an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

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

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

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the investee's returns. Power arises from rights. Sometimes, power can be assessed straight forward from the voting rights through shareholdings. In other cases, the assessment will be more complex when power results from one or more contractual arrangements.

If another entity (including government, court, administrator, receiver, liquidator or regulator) has existing rights to direct the relevant activities, the investor does not have power over the investee even if it holds more than half of the voting rights in the investee.

Case 1: An investor acquires 45 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Has investor power over the investee?

Solution: In this case, on the basis of the absolute size of its holding and the relative size and arrangements of the other shareholdings, it appears that the investor has a sufficiently dominant voting interest to conclude that the investor has power over the investee**.**

Case 2: Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent ofthe voting rights of the investee. Has A power over the investee?

Solution: In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power. Additional evidences are needed to be considered for concluding whether A has power over the investee. If it is not clear, that the investor has power, the investor does not control the investee.

Case 3: Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. A shareholder agreement grants investor A the right to appoint, remove and setthe remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. Has A power over the investee?

Solution: In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive in determining whether the investor has rights sufficient to give it power. However, investor A determines that its contractual right to appoint, remove and set the remuneration of management is sufficient to conclude that it has power over the investee.

Case 4: Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of thevoting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 percent. There are no other arrangements that affect decision-making. Has A power over the investee?

Solution: In this case, the size of investor A's voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

Practical problems:

Question 1. On 31-3-2024, COC Ltd acquired 100% shares in Tata Ltd for Rs 3,65,000 payable in equity shares of Rs 10 each. Balance sheet on the date of acquisition of both companies are given below:

Equity and liabilities	COC Ltd	Tata Ltd	Assets	COC Ltd	Tata Ltd
Equity share capital	4,00,000	2,00,000	Plant and machinery	6,60,000	4,10,000
Profit and loss A/c	2,40,000	90,000	Debtors	2,50,000	1,40,000
12% debentures	3,90,000	2,20,000	Cash and bank	2,10,000	40,000
Creditors	90,000	80,000			
Total	**11,20,000**	**5,90,000**		**11,20,000**	**5,90,000**

After one year of operation, their Balance sheets on 31-3-2025 stood as follow:

Equity and liabilities	COC Ltd	Tata Ltd	Assets	COC Ltd	Tata Ltd
Equity share capital	7,65,000	2,00,000	Plant and machinery	8,30,000	4,00,000
Profit and loss A/c	2,90,000	1,00,000	Investment in Tata Ltd	3,65,000	---
12% debentures	4,50,000	2,60,000	Debtors	3,50,000	1,50,000
Creditors	1,20,000	1,20,000	Cash and bank	80,000	1,30,000
Total	**16,25,000**	**6,80,000**		**16,25,000**	**6,80,000**

Prepare consolidated balance sheet of COC Ltd as on 31-3-2024 and 31-3-2025 as per Ind AS 103 and Ind AS 110.

Question 2. On 31-3-2024, COC Ltd acquired 80% shares in Reliance Ltd for Rs 3,90,000 payable in equity shares of Rs 10 each at a premium of Rs 5 per share. Balance sheet on the date of acquisition of both companies are given below:

Equity and liabilities	COC Ltd	Reliance Ltd	Assets	COC Ltd	Reliance Ltd
Equity share capital	7,00,000	2,00,000	Plant and machinery	2,60,000	2,30,000
Retained earning	2,00,000	1,80,000	Building	7,50,000	5,20,000
15% borrowings	3,70,000	2,50,000	equipment	2,30,000	60,000
10% Bank loan	4,20,000	1,70,000	Debtors	1,50,000	50,000
Creditors	1,50,000	1,42,000	Stock	1,70,000	40,000
Bills payable	70,000	88,000	Cash and bank	3,50,000	1,30,000
Total	**19,10,000**	**10,30,000**		**19,10,000**	**10,30,000**

On date of acquisition, debtors and creditors were common with Rs 20,000. After one year of operation, their Balance sheets on 31-3-2025 stood as follow:

Equity and liabilities	COC Ltd	Reliance Ltd	Assets	COC Ltd	Reliance Ltd
Equity share capital	9,60,000	2,00,000	Plant and machinery	5,00,000	2,10,000
Retained earning	2,90,000	2,90,000	Building	6,50,000	1,50,000
Security premium	1,30,000		Investment in Tata Ltd	3,90,000	---
15% borrowings	3,70,000	2,00,000	Furniture	1,10,000	1,30,000
Loan from directors	2,70,000	70,000	Debtors	1,20,000	60,000
Bills payable	70,000	90,000	Bills receivables	2,30,000	90,000
Outstanding expenses	50,000	80,000	Cash and bank	80,000	1,30,000
			Inventories	60,000	1,60,000
Total	**21,40,000**	**9,30,000**		**21,40,000**	**9,30,000**

On 31-3-2025, COC Ltd had issued Rs 10,000 Bills receivables to Reliance Ltd. Prepare consolidated balance sheet of COC Ltd as on 31-3-202024 and 31-3-2025 as per Ind AS 103 and Ind AS 110.

Question: 3. From the following information prepare a consolidated balance sheet:

Balance Sheets as on 31st March 2025

Liabilities	H. Ltd.	S. Ltd.	Assets	H. Ltd.	S. Ltd.
Share Capital (in			PPE	2,20,000	1,50,000
shares of Rs. 20 each)	2,00,000	1,00,000	Investment in 3,000		
General Reserves	60,000	20,000	Shares of S. Ltd.	90,000	-
Profit and Loss Account	20,000	10,000			
Creditors	30,000	20,000			
	3,10,000	**1,50,000**		**3,10,000**	**1,50,000**

H Ltd. acquired its shares in S Ltd. on 1 April 2024, when S Ltd's reserves stood at Rs. 5,000 and its profit and loss account (Cr.) at Rs. 6,000.

Question: 4. The balance sheets of H. Ltd and its subsidiary S. Ltd as on 31 December 2024 were as follows:

Liabilities	*H Ltd.*	*S Ltd.*	*Assets*	*H Ltd.*	*S Ltd.*
Share Capital (shares			fixed Assets	16,000	10,000
of Re. 1 each)	10,000	6,000	Investments: 4,000		
General Reserve	4,000	-	Shares in S. Ltd.	4,000	-
Profit and Loss Account	4,000	1,800			
Creditors	2,000	2,200			
	20,000	10,000		20,000	10,000

The shares were purchased by H. Ltd. in S. Ltd. on 30 June 2024. On 1 January 2024, the profit and loss account of S. Ltd showed a loss of Rs. 3,000 which was written off from out of the profits earned during the year. Profits are earned uniformly over the year 2024. Prepare a consolidated balance sheet of H. Ltd. and S. Ltd. as on 31 December 2024 giving all workings.

Question: 5 (Unrealized Profit on Stock) A Ltd., acquires all the shares in B. Ltd., at cost of Rs.1,05,000 on 1 April 2024. The balance sheets of two companies on 31 March 2025 were as follows:

Liabilities	*A. Ltd.*	*B Ltd*	*Assets*	*A. Ltd.*	*B Ltd*
Share capital:			**Non-current assets**:		
Equity share capital of Rs 10 each	3,00,000	45,000	Freehold premises	1,65,000	28,000
			Machinery	70,000	26,000
Reserve and surplus:			Investment in shares of B Ltd	1,05,000	….
General reserve (1-4-24)					
Profit and loss account	1,00,000	2,000	**Current assets**:		
	90,000	36,000	Stock	62,000	18,000
Creditors			Debtors	35,000	14,000
	10,000	14,000	Cash	63,000	11,000
	5,00,000	**97,000**		**5,00,000**	**97,000**

(i) The creditors of B Ltd. include 5,000 due to A ltd for purchases on which A Ltd made a profit of Rs.1,000.

(ii) The stock of B Ltd, includes Rs. 3,000 of the above purchases from A Ltd. Make necessary adjustments and show a consolidated balance sheet as on 31-3-2025.

Question: 6 (Loss by fire and unrealized profit) The following balance sheets as on 31-3-25 are presented to you:

Liabilities	*H Ltd.*	*S Ltd.*	*Assets*	*H Ltd.*	*S Ltd.*
Share Capital:			PPE	3,50,000	1,00,000
Equity share capital of			Stock	90,000	90,000
Rs 100 each	5,00,000	2,00,000	Debtors	60,000	30,000
Reserve and surplus:			Investment in 6%		
General Reserve	1,00,000	….	debentures in S Ltd at	60,000	….
Profit and Loss Account	80,000	….	cost		
Non-current liabilities:				1,20,000	…..
6% Debentures	…..	1,00,000	Investment in 1500		
Current liabilities:			shares of S ltd at Rs 80		
Creditors	75,000	45,000		…..	1,00,000
			Profit and loss account	75,000	25,000
			Cash		
	7,55,000	**3,45,000**		**7,55,000**	**3,45,000**

H Ltd. acquired the shares on 1 August 2024. The profit and loss account of S Ltd. showed a debit balance of Rs. 1,50,000 on 1st April 2024. During November 2024, goods costing Rs. 6,000 were destroyed by fire against which insurer paid only Rs. 2,000. Trade creditors of S Ltd. include Rs.20,000 for goods supplied by H Ltd. on which H Ltd. made a profit of Rs. 2,000. Half of the goods were still in stock on 31-3-2025. Prepare a consolidated balance sheet.

Question 7. The following are the extract Balance Sheet of H & S Company as on 31-03-2025

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
Profit and Loss A/c (1.4.24)	5,000	4,000	Shares in S Ltd. (800)	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 01-10-2024. S limited has a balance of ₹ 4,000 in General Reserve on 01- 04-2024. On the account of fire, goods costing ₹ 2,000 of S Limited were destroyed in June, 2024. The loss has been charged to the Profit and Loss Account for the year.

Required to prepare a consolidated Balance Sheet. **(ICMAI Study material)**

Hints: Post acquisition profit =Rs 4,500; NCI on DOA= Rs 2,500;

NCI on DOC = Rs 3,400;Capital Reserve= Rs 8,000.

Question: 8 (contingent liabilities) Balance sheets of H Ltd. and S Ltd. on 31 March 2025 were as under:

Liabilities	H Ltd.	S Ltd.	Assets		H Ltd.	S Ltd.
Equity Shares of			Land and Buildings		2,50,000	2,00,000
Rs. 100 each	5,00,000	3,00,000	Plant and Machinery		1,25,000	1,60,000
General Reserve on			Stock		70,000	80,000
1.4.2024	90,000	51,000	Debtors		1,20,000	1,05,000
Profit and Loss Account			2,000 Shares in S. Ltd.		2,95,000	-
Balance on 1.4.2024	60,000	24,000	Bills Receivable		30,000	-
Profit for 2024-25	1,10,000	84,000	Cash		10,000	5,000
Creditors	1,40,000	71,000				
Bills Payable	-	20,000				
	9,00,000	**5,50,000**			**9,00,000**	**5,50,000**

H Ltd acquired shares in S Ltd on 1.1.2025. S Ltd issued all bills payable to H. Ltd. Bills receivable of H. Ltd. include bills of S Ltd. for Rs. 12,000. Sundry debtors of S Ltd. include Rs. 10,000 owing by H Ltd. Stock of H Ltd. includes goods worth Rs. 15,000 purchased from S Ltd. for which the latter company has charged profit at 25% on cost. Contingent liability for bills discounted by H Ltd. is 25,000. Prepare consolidated balance sheet.

Question 9. On 31-3-2024, COC Ltd acquired 100% shares in Wipro Ltd for Rs 9,60,000 payable in equity shares of Rs 10 each at a premium of Rs 5 per share. Balance sheet on the date of acquisition of both companies are given below:

Particulars	COC Ltd		Wipro Ltd	
Assets	**31-3-2025**	**31-3-2024**	**31-3-2025**	**31-3-2024**
1. Non-current assets:				
Plant & equipment	7,00,000	8,00,000	3,60,000	4,00,000
Building	2,00,000	2,00,000	90,000	1,00,000
Financial assets:				
Investments in Wipro Ltd	9,60,000	--		
Other investments	7,00,000	7,00,000	80,000	60,000
2. Current assets:				
Inventories	4,00,000	5,00,000	2,80,000	2,00,000
Trade receivables	6,50,000	8,00,000	4,30,000	4,80,000
Cash and cash equivalents	7,60,000	4,00,000	2,40,000	2,00,000
	43,70,000	**34,00,000**	**12,80,000**	**14,40,000**
Equity share capital	21,40,000	15,00,000	3,00,000	3,00,000
Other equity:				
General reserves	6,20,000	5,00,000	2,20,000	1,80,000
Profit and loss	3,50,000	2,80,000	2,70,000	2,50,000
Security premium	4,20,000	1,00,000	20,000	20,000
Non-current liabilities				
10% Borrowings	6,00,000	6,00,000	3,50,000	4,00,000
Current liabilities:				
Trade payable	1,50,000	1,30,000	70,000	90,000
Short term borrowings	90,000	2,90,000	2,50,000	2,00,000
	43,70,000	**34,00,000**	**14,80,000**	**14,40,000**

On the date of acquisition Plant and equipment of Wipro Ltd were valued at Rs 5,00,000. Prepare consolidated balance sheet of COC Ltd as on 31-3-2024 and 31-3-2025 as per Ind AS 103 and Ind AS 110.

Question: 10. The following are the balance sheets of X Ltd. and its subsidiary Y Ltd. as at 31 March 2024:

Liabilities	X Ltd.	Y Ltd.	Assets	X Ltd.	Y Ltd.
Equity Shares of			Equipment	2,50,000	95,000
Rs. 10 each	4,00,000	1,00,000	**Investment**:		
Profit & Loss Account	50,000	20,000	9,000 Equity Shares		
External Liabilities	7,50,000	4,80,000	in Y Ltd. on		
			1 April 2023	1,40,000	
			Other current Assets	8,10,000	5,05,000
	12,00,000	**6,00,000**		**12,00,000**	**6,00,000**

On 1.4.2023, Profit and loss account of Y Ltd. showed a credit balance of Rs. 8,000 and equipment of Y Ltd. was revalued by X Ltd. at 20% above its book value of Rs. 1,00,000 (but no such adjustment effected in the books of Y Ltd.). Prepare the consolidated Balance Sheet as at 31 March, 2024.

Question 11. Balance sheet of P Ltd and S ltd as on 31st march 2024 are as follow

Equity and liabilities	P Ltd	S Ltd		P Ltd	S Ltd
Equity share capital	75,000	15,000	PPE	50,000	24,000
Retained earning	25,000	7,500	Investments	25,000	--
Loan from P Ltd	--	10,000	Loan to S Ltd	10,000	--
Creditors	10,000	9,500	Inventory	24,000	6,000
Bills payable	13,000	….	Bills receivables	14,000	12,000
	1,23,000	**42,000**		**1,23,000**	**42,000**

i. P Ltd acquired 11,250 shares in S Ltd on 1st July 2023 by issuing 2 equity shares for every 3 equity shares held.

Face value and market price per equity share of P Ltd are Re 1 and Rs 3 respectively. This has not been accounted yet.

ii. Receivable of S Ltd comprise receivables from P ltd.

iii. Retained earnings of S Ltd on date of acquisition Rs 3,500.

iv. Fair value of NCI on date of acquisition Rs 7,000.

v. Inventory of S consist of purchase made entirely from P. P had sold on mark up of 10% on cost.

vi. PPE which were stood at Rs 30,000 on 1st April 2023 were revalued at Rs 40,000 on date of acquisition.

Prepare CFS as per Ind AS 110.

Question 12. On 31-3-2024, COC Ltd acquired 70% shares in Maruti Ltd for Rs 4,05,000 payable in equity shares of Rs 10 each. Balance sheet on the date of acquisition of both companies are given below:

Equity and liabilities	COC Ltd	Maruti Ltd	Assets	COC Ltd	Maruti Ltd
Equity share capital	5,00,000	2,00,000	Plant and machinery	6,60,000	4,10,000
Profit and loss A/c	1,40,000	90,000	Inventories	1,50,000	1,10,000
12% debentures	3,90,000	2,20,000	Debtors	1,00,000	30,000
Creditors	90,000	80,000	Cash and bank	2,10,000	40,000
Total	**11,20,000**	**5,90,000**		**11,20,000**	**5,90,000**

On date of acquisition, inventories and debtors of Maruti Ltd were valued at Rs 1,60,000 and Rs 50,000 respectively. After one year of operation, their Balance sheets on 31-3-2025 stood as follow:

Equity and liabilities	**COC Ltd**	**Maruti Ltd**	**Assets**	**COC Ltd**	**Maruti Ltd**
Equity share capital	9,05,000	2,00,000	Plant and machinery	8,30,000	4,00,000
Profit and loss A/c	3,50,000	1,50,000	Investment in Maruti Ltd	4,05,000	---
Creditors	4,10,000	3,30,000	Inventories	2,00,000	1,50,000
			Debtors	1,50,000	1,00,000
			Cash and bank	80,000	30,000
Total	**16,65,000**	**6,80,000**		**16,65,000**	**6,80,000**

Prepare Consolidated financial statement as per Ind AS 103 and Ind AS 110 assuming that revalued inventories have been sold during 24-25 but revalued debtors are still existing at the end of 31-3-2025.

Question 13. Company P Ltd. (a listed company) acquires 60% shares in company Q Ltd. on 1-4-23 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. NCI is to be calculated by Fair value method. 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)**	
	1-4-23 book value	**1-4-23 Fair Value**	**31-3-24 book value**	**1-4-23**	**31-3-24**
PPE	184000	200000	196000	276000	300000
Investment in Q					138000
Inventories	45000	50000	58000	68000	80000
Non-current 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 Payables	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 1-4-23 based on Ind AS 103.
(b) Prepare consolidated balance sheet and separate balance sheet of P on 31-3-24. Ignore depreciation

Question 14. Company P Ltd. acquires 60% shares of company S Ltd. on 1/4/24 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 31-03-2025 amounted to 60 and 70 respectively. **(₹ Lakhs)**

	On 1-4-24			On 31-3-25	
	P	S	FV of S	P Ltd	S Ltd
PPE	680	440	700	720	500
Investment in S ltd				360	
Current assets	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 under acquisition method and prepare CBS on 1-4-24 and on 31-3-25.

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 1-4-24 (Abstract) (₹ Lakhs)

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

Question 15: Deleted from syllabus 2022…. Be happy

TREATMENT OF DIVIDEND AS PER Ind AS 27 and Ind AS 110

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 from 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.

If the dividend of the subsidiary firm have been declared 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.

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.

Question 16. P Ltd acquires 60% shares in Q Ltd on 1.10.2023 at Rs 30,000. Q makes profits Rs 20,000 in the year 2023-24 and declared dividend Rs 9,000. NCI is valued at proportionate net assets. Abstracts of separate Balance sheet of P Ltd (dividend from subsidiary not accounted) and individual balance sheet of Q Ltd as at 31.03.2024 given below

	P Ltd	**Q Ltd**
Property, plant and equipment	50,000	30,000
Investments in shares of Q at cost	30,000	
Current assets	20,000	28,000
	1,00,000	58,000
Equity shares (Rs 10)	60,000	25,000
Other equity	25,000	15,000
Trade payables	15,000	9,000
Dividend payables		9,000
	1,00,000	**58,000**

Show consolidated Balance sheet and separate Balance sheet in the book of P ltd. **(RTP)**

Question 17. P Ltd acquires 60% shares in Q on 1-10 - 2023. Q makes profits 10,000 in the year 2023-24 and declared dividend 6,000. NCI is valued at 12,000 at acquisition. Dividend is not yet accounted in the book of P Ltd.

Balance Sheet as at 31-03-2024 **(₹ Lakhs)**

	P	Q
PPE	50,000	30,000
Investment in shares of Q	21,000	
Current Assets	20,000	14,000
Total	**91000**	**44000**
Equity Shares	60,000	25,000
Other Equity	16,000	4,000
Trade Payables	15,000	9,000
Dividend Payable		6, 000
Total	**91000**	**44000**

Show consolidated and Separate Balance sheet in books of P.

Question 18. P Ltd acquired 60% shares of S ltd on 1.7.2024. Fair value of NCI on date of acquisition was Rs 12,000.

Statement of profit and loss of P Ltd and S Ltd for the year ended on 31-12-24 are given below:

	P ltd	S Ltd
Turnover	1,00,000	54,000
Less: cost of sale	49,000	28,500
Gross profit	51,000	25,500
Less administrative expense	20,000	9,500
Profit before tax	31,000	16,000
Less: tax	5,400	4,000
Profit after tax	25,600	12,000

Out of the above profits, P declared dividend of Rs 10,000 and S declared dividend of Rs 6,000. Entry for payable was passed in the book of both the companies but entry for receivable was not passed by P Ltd.

Balance sheet of P Ltd and S Ltd on 31-12-24 are given below:

	P Ltd	S Ltd
Tangible assets	58,250	29,000
Investments	21,000	---
Inventories	7,750	4,000
Trade receivables	8,000	6,000
Other current assets	4,000	3,000
Total	**99,000**	**42,000**
Equity share capital	59,400	25,000
Retained earning	15,600	6,000
Trade payable	14,000	5,000
Dividend payable	10,000	6,000
Total	**99,000**	**42,000**

Prepare consolidated financial statement on 31 December 2024, assume that in Separate financial statement, investments are recorded at FVTOCI (Ind AS 109)

Question 19. Z Ltd. purchased 80% shares in C Ltd. on 1-10-2021 at 2,40,000. C Ltd. at 31-03-2021 had issued Share Capital 2,00,000 and Other Equity 60,000. For year ending on 31-03-2022 C Ltd. made profits 30,000 and declared dividend 40,000. NCI measured at fair value.

Find NCI on date of acquisition and on 31-03-2022. (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): In consolidated accounts

	NCI		**Goodwill**
	Acquisition date	**31-03-12**	
(i) NCI= 20/80*240000(consideration for 80%)	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 represented by Equity on acquisition = 260000+50%*30,000 = 2,75,000			
(ii) Goodwill = a+b-c =			25,000

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

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

	Consolidated	
	01-10-2021	**31-03-2022**
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	2,08,000	
Dividend Receivable	32,000	

Question: 20 (Dividend already shown in the balance sheet) The following is a summary of the balances in the books of Black Ltd., and Bird Ltd., as on 31 March, 2024:

Credit	**Black Ltd.**	**Bird Ltd.**
Fully paid Equity Shares of Re. 1 each	3,00,000	1,80,000
General Reserves	50,000	40,000
Profit and Loss Account	98,500	44,400
6% Debentures (Rs.100 each)	--	20,000
Dividend Payable	30,000	18,000
Creditors	1,47,000	61,000
	6,25,500	**3,63,400**
Debits		
PPE	2,41,500	2,20,000
1,35,000 Equity Shares in Bird Ltd. at cost	2,25,000	
Dividend receivables	13,500	
Other Current Assets	1,45,500	1,43,400
	6,25,500	**3,63,400**

You ascertain the following:

(a) Black Ltd. acquired the shares in Bird Ltd. on 31st March,2023

(b) The General reserve of Bird Ltd. was the same on 31 March, 2023. The balance of the profit and loss account of Bird Ltd.

	Rs.
Balance on 31 March, 2023	28,000
Net profit, year ended 31 March, 2024	34,400
	62,400
Less: Dividends Payable	18,000
	44,400

You are required to prepare a consolidated balance sheet of Black Ltd. and its subsidiary company, Bird Ltd. as on 31 March, 2024. Ignore taxation. Workings are to be shown.

Question 21. Ram Ltd acquired 60% ordinary shares of Rs 100 each of Krishan Ltd on 1st October 2023. On 31st March 2024 the summarised Balance sheets of the two companies were as given bellows:

	Ram Ltd	**Krishan ltd**
Property, plant and equipment		
Land and building	3,00,000	3,60,000
Plant and machinery	4,80,000	2,70,000
Investment in krishan ltd	8,00,000	--
Inventory	2,40,000	72,800
Financial assets:		
Trade receivables	1,19,600	80,000
Cash	29,000	16,000
Total	**19,68,600**	**7,98,800**
Equity share capital of Rs 100	10,00,000	4,00,000
Other equity		
Retained earnings	1,14,400	1,64,000

Other reserves	6,00,000	2,00,000
Financial liabilities:		
Bank overdraft	1,60,000	--
Trade payable	94,200	34,800
	19,68,600	**7,98,800**

The retained earnings of Krishan Ltd showed a credit balance of Rs 60,000 on 1st April 2023 out of which a dividend of 10% was paid on 1st November. Ram Ltd has credited the dividend received to its retained earnings. Fair value of Plant and machinery as on 1st October 2023 was 4,00,000. The rate of depreciation on plant and machinery is 10%.

Following are the increase on comparison of fair value as per respective Ind AS with book value as on 1st October 2023 which are to be considered while consolidating Balance sheets.

Land and building Rs 2,00,000

Inventories Rs 30,000

Trade payables Rs 20,000

Prepare consolidated balance sheet as per Ind AS 110 assume that all revalued assets and liabilities exist at the end of the year.

Treatment of Bonus Shares issued by subsidiary company as per Ind AS 110:-

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.

Question: 22 (Issue of bonus shares from pre-acquisition profits) Strong Ltd. acquired 3,200 equity shares of Weak Ltd. on 31.3. 2024.The summarized balance sheets of the two companies on that date are given below:

Liabilities	Strong.	Weak	Assets	Strong	Weak
	Ltd.	Ltd.		Ltd.	Ltd.
Share Capital			Land & Buildings	3,00,000	3,60,000
(Rs. 100 each fully			Plant & Machinery	4,80,000	3,18,800
paid-up)	10,00,000	4,00,000	Investments in		
General Reserve	4,80,000	3,40,000	Weak Ltd. at cost	6,80,000	-
Profit & Loss Account	1,14,400	72,000	Stocks	2,40,000	72,000
Bank Loan	1,60,000	-	Sundry Debtors	88,000	80,000
Bills Payable (including			Bills Receivable		
Rs. 8,000 to			(including		
Strong Ltd.)	-	16,800	Rs. 6,000 from		
Sundry Creditors	94,400	18,000	Weak Ltd.)	31,600	-
			Cash at Bank	29,200	16,000
	18,48,800	**8,46,800**		**18,48,800**	**8,46,800**

You are supplied with the following information:

(a) Weak Ltd., made a bonus issue on 31 March 2024 of one equity share for every four shares held by its shareholders. Effect has not yet been given in the accounts for this.

(b) Sundry creditors of Strong Ltd. included Rs. 24,000 due to Weak Ltd. Prepare the consolidated balance sheet as at 31 March 2024 in the books of Strong Ltd. Show your working clearly.

Question: 23 (Bonus issue from post-acquisition profits) A Ltd. acquired 2,000 equity shares of Rs. 100 each in B Ltd. on 31 March 2024. The summarized balance sheets of the two companies as on 31 March 2025 were as follow**:**

	A Ltd	**B Ltd**
PPE	7,00,000	2,50,000
Investment in B Ltd (2000 shares)	3,00,000	
Current assets	4,00,000	2,00,000
	14,00,000	**4,50,000**
Equity share capital (Rs 10 each)	8,00,000	2,50,000
General reserves	3,00,000	50,000
Profit and loss account	1,00,000	1,00,000
creditors	2,00,000	50,000
Total	**14,00,000**	**4,50,000**

B Ltd. had a credit balance of Rs. 50,000 in the reserves and Rs. 20,000 in the profit and loss account when A Ltd. acquired shares in B Ltd. B Ltd. issued bonus shares in the ratio of one for every five shares held out of the profits earned during 2024-25. This is not shown in the above balance sheet of B Ltd. Prepare a consolidated balance sheet of A Ltd. and its subsidiary on 31 March 2025, giving all necessary workings.

Question:24. The following are the balance sheets of H. Ltd. and S. Ltd. as on 30 September 2024:

Liabilities	**H. Ltd. Rs.**	**S. Ltd. Rs.**	**Assets**	**H. Ltd. Rs.**	**S. Ltd. Rs.**
Equity Shares of			Goodwill	60,000	40,000
Rs. 100 each	5,00,000	2,00,000	Machinery	1,00,000	60,000
12% Preference Shares			Vehicles	1,80,000	70,000
of Rs. 100 each	1,00,000	50,000	Furniture	50,000	30,000
General Reserve	1,00,000	60,000	Shares in S.Ltd.		
Profit & Loss Account	1,50,000	90,000	at Cost	3,80,000	-
Creditors	60,000	70,000	Stock	70,000	1,40,000
Income Tax payable	70,000	60,000	Debtors	1,00,000	1,65,000
			Bank Balance	40,000	25,000
	9,80,000	**5,30,000**		**9,80,000**	**5,30,000**

The following further information is furnished:

(1) H. Ltd. acquired 1,200 equity shares and 400 preference shares on 1.10.2023 at a cost of Rs. 2,80,000 and Rs.1,00,000 respectively.

(2) The profit and loss account of S. Ltd. had a credit balance of Rs. 30,000 as on 1.10.2023 and that of general reserve on that date was Rs. 50,000.

(3) On 1.4.2024, S. Ltd. issued one equity share for every three shares held as bonus shares at a face value of Rs. 100 per share out of its general reserve. No entry has been made in the books of H. Ltd. for receipt of these bonus shares.

[CA. (Final) November 1985 Modified]

ACCOUNTING OF CHAIN HOLDING

Question 25. Prepare the consolidated balance sheet as on 31 March 2024 of a group of companies comprising COC Ltd, S Ltd and SS Ltd. their balance sheets on that date are given below. (in lakhs)

	COC Ltd	S Ltd	SS Ltd
Non-current assets:			
Property, plant and equipment	640	720	600
Investments:			
32 lakhs shares in S ltd	340		
24 lakhs shares in SS Ltd		280	
Current assets:			
Inventories	420	140	100
Trade receivables	460	200	420
Cash and bank	228	40	40
Total	**2088**	**1380**	**1160**
Equity and liabilities	**COC Ltd**	**S Ltd**	**SS Ltd**
Shareholder's equity			
Share capital (Rs 10 each)	1000	400	320
Other equity:			
Reserves	180	100	80
Retained earnings	160	50	60
Current liabilities:			
Trade payables	748	830	700
Total	**2088**	**1380**	**1160**

The following additional information is available:

i. COC Ltd holds 80% shares in S Ltd and S Ltd holds 75% shares in SS Ltd. their holdings were acquired on 30th September 2023.

ii. The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

iii. On 1st April, 2023 the following balances stood in the books of S Ltd and SS Ltd: (in lakhs)

	S Ltd	SS Ltd
Reserves	80	60
Retained earning	20	30

iv. Rs 10 lakhs included in the inventory figure of S Ltd, is inventory which has been purchased from SS Ltd at cost plus 25%.

v. The parent company has adopted an accounting policy to measure non-controlling interest by proportionate net assets method.

Question 26: Prepare Consolidated Balance Sheet (CBS) of a group of P Ltd., Q Ltd. and R Ltd. for which the abstracts of Balance sheets on 31-03-2024 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
Debtors	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:			
Dividend payable		50	
Creditors	500	250	200
Bills Payables	100	90	70
Total	**1660**	**1050**	**690**

Control was acquired on 30-09-2023 when fair value of PPE was in excess of carrying amount by Rs 50 of Q and Rs 30 Lakhs of R.

On 01-04-2023 the balances:

	Q	**R**
Other Equity	100	50

NCI is measured at fair value. Inventory of Q included Rs 16 purchased from R at cost plus 33.33%. Bills Receivables of R includes 30 from P and Bills payable of P includes 40 from R. **(ICMAI Study material modified)**

Question 27. Prepare the consolidated balance sheet as on 31 March 2012 of a group of companies comprising P Ltd, S Ltd and SS Ltd. their balance sheets on that date are given below.

	P Ltd	**S Ltd**	**SS Ltd**
Non-current assets:			
Property, plant and equipment	320	360	300
Investments:			
32 lakhs shares in S ltd	340		
24 lakhs shares in SS Ltd		280	
Current assets:			
Inventories	220	70	50

Financial assets:			
Debtors	260	100	220
Bills receivables	72	--	30
Cash and bank	228	40	40
Total	**1440**	**850**	**640**
Equity and liabilities	**P Ltd**	**S Ltd**	**SS Ltd**
Shareholder's equity			
Share capital (Rs 10 each)	600	400	320
Other equity:			
Reserves	180	100	80
Retained earnings	160	50	60
Current liabilities:			
Financial liabilities			
Creditors	470	230	180
Bills payables:			
P Ltd		70	
SS Ltd	30		
Total	**1440**	**850**	**640**

The following additional information is available:

(i) P Ltd holds 80% shares in S Ltd and S Ltd holds 75% shares in SS Ltd. their holdings were acquired on 30th September 2011.

(ii) The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

(iii) On 1st April, 2011 the following balances stood in the books of S Ltd and SS Ltd: (in lakhs)

	S Ltd	**SS Ltd**
Reserves	80	60
Retained earning	20	30

(iv) ₹10 lakhs included in the inventory figure of S Ltd, is inventory which has been purchased from SS Ltd at cost plus 25%.

(v) The parent company has adopted an accounting policy to measure non-controlling interest at fair value(quoted market price) applying Ind AS 103. Assume market price of S ltd and SS Ltd are the same as respective face values. **(ICAI Study material)**

Question 28. X Ltd. acquires 80% of equity of Y Ltd. on 31-03-2013 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 31-03-2014 and 31-03-2015, 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.

(ICMAI Study material)

ACCOUNTING OF CHANGES IN CONTROL OF PARENT COMPANY

Question 29. On 1-4-24 BM Ltd. acquired 80% share of CM Ltd. at 10,00,000, when the fair value of its net assets was 10,00,000. During 1-4-24 to 31-3-25 CM Ltd made TCI of Rs 1,20,000. On that date BM sold 20% holding to outsiders at 2,80,000. Pass journal entries for sale of partial holding retaining control. **(ICMAI Study material)**

Question 30. DQ Ltd acquired 60% shares of RK Ltd. on 1-4-24. Fair value of net assets at the time of acquisition was 3,00,000. In 24-25, RK made a profit of 60,000. Individual and consolidated balance sheets as at 31-3-25:

	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 1-4-25 DQ acquired further 10% shares of RK at 46,000. NCI is measured at proportionate carrying amount. Pass journal entry for change in holding and prepare Separate and Consolidated balance sheet as at 01-04-2025. **(ICMAI Study material)**

ACCOUNTING TREATMENT OF LOSS OF CONTROL OVER SUBSIDIARY COMPANY:

If a parent loses control of a subsidiary, it shall:

(a) Derecognise the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost and also the carrying amount of any non-controlling interests(NCI) in the former subsidiary.

(b) Recognise:

(i) any investment in the subsidiary which is retained at its fair value when the control is lost. This fair value will be starting point for other Ind AS. (E.g. it will be considered as fair value for Ind AS 109 and deemed cost for Ind AS 28)

(ii) The fair value of the consideration received.

(iii) Recognise the gain/loss associated with loss of control in P/L A/c.

Journal entry of losing control for CFS:

Consideration A/C Dr (FV)
Investment A/C Dr (FV)
NCI A/c Dr (CA)
Liabilities A/C Dr (CA)
To Assets A/C (CA)
To goodwill A/C (CA)
To other equity (balancing figure)

Imp note: Parent company shall account for all amounts recognised in OCI in relation to subsidiary (when control is lost) as if it had directly disposed of related assets and liabilities.
E.g. revaluation profit related to subsidiary transfer from OCI to other equity using Ind AS 16.

A parent might lose control of a subsidiary in two or more arrangements (transactions). However, such multiple transactions may be accounted 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.

Question 31. In March 2021 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares. The carrying amount of goodwill is Rs 20,000 at march 2021 calculated using the partial goodwill method. On 31 march 2021, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at Rs 12 per share, raising Rs 3,00,000. The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were 4,50,000 excluding goodwill. Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholders and make journal entry for giving effect. **(ICAI Study material)**

Question 32. A parent company purchased 80% interest in a subsidiary for Rs 1,60,000 on 1 April 2021 when the fair value of the subsidiary's net assets was Rs 1,75,000. Goodwill of Rs 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of Rs 8,000 was charged in the consolidated financial statements to 31 march 2023. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 march 2024 for Rs 2,00,000. The book value of the subsidiary, net assets in the consolidated financial statements on the date of the sale was Rs 2,25,000 (not including goodwill of Rs 12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write down was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than carrying value. The parent company carried the investment in the subsidiary at cost, as permitted by Ind AS 27. Calculate the gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 2024 also make journal entry in both set of books. **(ICAI Study material)**

Question 33. COC Ltd has a number of wholly owned subsidiaries including P ltd as on 31st March 2024. P ltd consolidated statement of financial position and the group carrying amount of P ltd assets and liabilities at 31 March 2024 are as follows: **(in lakhs)**

Particulars	Consolidated	Group carrying amount of P ltd assets and liabilities
Non-current assets:		
Goodwill	380	180
Building	3,240	1,340
Current assets:		
Inventories	140	40
Trade receivables	1,700	900
Cash	3,100	1,000
Total	**8,560**	**3,460**
Equity		
Share capital	1,600	
Other equity (retained earnings)	4,260	
Current liabilities:		
Trade payables	2,700	900
Total	**8,560**	**900**

Prepare consolidated balance sheet after disposal as on 31st March 2025 when COC Ltd group sold 100% shares of P Ltd to independent party for 3000 lakhs. **(ICAI Study material)**

Question 34. COCO Ltd has a number of wholly owned subsidiaries including TATA Motors as on 31st March 2024. TATA Motors ltd consolidated statement of financial position and the group carrying amount of TATA Motors ltd assets and liabilities at 31 March 2024 are as follows:

Particulars	Consolidated	Group carrying amount of P ltd assets and liabilities
Non-current assets:		
Goodwill	190	90
Building	1,620	670
Current assets:		
Inventories	70	20
Trade receivables	850	450
Cash	1,550	500
Total	**4,280**	**1,730**
Equity		
Share capital	800	
Other equity(retained earnings)	2,130	
Current liabilities:		
Trade payables	1,350	450
Total	**4,280**	**450**

Prepare consolidated balance sheet after disposal as on 31st March 2024 when COCO Ltd group sold 90% shares of TATA Motors Ltd to independent party for Rs 1000 lakhs.

IND AS 110: CONSOLIDATED FINANCIAL STATEMENTS-SUMMARISED THEORY

BEFORE STARTING THEORY KEEP IN YOUR MIND THAT concept of control is purely based on SUBSTANCE OVER FORM.

1. **Objective:** The objective of Ind AS 110 is to **establish principles for the presentation and preparation of consolidated financial statements** when an entity controls one or more other entities.

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

Exception 1. Subsidiary of parent company may not prepare CFS if :

(a) It is parent of one or more subsidiary company.

(b) All its owners are informed and they do not object.

(c) Instruments are not traded in public market, nor it is in process of issuing instruments in public market.

(d) Its ultimate or intermediate parent prepares CFS which is available for public use and complies with Ind AS.

1 Mark question for exam: S Ltd is a subsidiary of P Ltd and parent of SS Ltd and P Ltd is operating outside India and prepares CFS as per US GAAP. Whether S Ltd is exempted from preparing CFS as per Ind AS 110.

Exception 2. Companies dealing in post- employment benefits plan or other long term benefit plan are exempted from preparing CFS.

Exception 3. Investment entity need not present CFS if required as per this Ind AS to measure all its subsidiaries at FVTPL. (Such entities held investments exclusively for trade).

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.

Important for exam: 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.

(a) Power over the investee: An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities (i.e. the activities that significantly affect the investee's returns, such as voting rights, right to appoint/remove key managerial persons, right through contractual arrangements etc)

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 right 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, and consequently does not control the investee.

NOTE -- Protective rights means right designed to protect the interest of the party holding those rights without giving that party power over the entity to which rights relate.

(b) Exposure, or rights, to variable returns from its involvement with the investee: 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.

(c) The ability to use its power over the investee to affect the amount of the investor's returns. (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 does not control an investee when it exercises decision-making rights delegated to it.

Illustration 1. 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% 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 2. Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. 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 3. 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 4. 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 5. 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 6. 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. ACCOUNTING REQUIREMENTS

(**A**) A parent shall prepare **CFS** 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 of preparing Consolidated financial statements:

(i) Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

(ii) Offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary.

(iii) 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 AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

(Important for exam) 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 7. 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?

Answer: 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.

<u>Some more points to be considered while preparing CFS</u>

1. 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.

2. **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 non-controlling 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.

3. 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.

4. **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.

5. 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.

6. 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.

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 (FVTPL) 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 Ind AS 110 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.

Ind AS-111 – JOINT ARRANGEMENTS

Objectives: The objective of Ind AS 111 is to establish principles for financial reporting by entities that have an interest in joint arrangements.

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.

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.
At least two of all the parties must have joint control.

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.

Note: Arrangement means agreement (or contract) which **may be oral, written or implied.**

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.

Note: At least two of all the parties must have shared control as joint operators or joint venturers.

Question 1. X Ltd and Y Ltd form a new joint arrangement (JA Ltd). Article of association of JA Ltd include a clause that states all shareholders must unanimously agree on the relevant activities of the entity.

No other agreement is entered into by the shareholders to manage the activities of JA Ltd. should the arrangement satisfy contractual arrangement test of Ind AS 111 to define the arrangement of joint arrangement?

Answer: The clause included in articles of association of JA Ltd is sufficient for the definition of a Joint arrangement to be met as per Ind AS 111. It is assumed that articles of association of JA Ltd is in order as per the companies Act and are legally binding.

Question 2. Entity C and entity D operates in a telecommunication industry and entered into a joint arrangement in order to combine their 5G access networks. The purpose of this arrangement is to reduce operating cost for both parties, make capital infrastructure savings and obtain economies of scale from jointly managing and maintaining a consolidated network.

All significant decisions about strategic investing and financing activities are decided by a simple majority of the voting rights. Entity C and entity D each have one vote in the decision making process. Discuss whether it is a joint arrangement or not.

Answer: The contractual arrangement does not explicitly require unanimous consent, but the fact that all decisions must be made by majority leads to implicit joint control.
Since all decisions about the relevant activities require consent of both parties, so the arrangement is a joint arrangement.

Question 3. STD Ltd is owned by numerous shareholders with the following holdings:

A owns 51%, B owns 30% and the rest of the shares are widely held by other investors altogether 19%.
STD Ltd's AOA require a 75% majority to approve decision about any of the entity's relevant activities. They also outline that each shareholder is entitled to vote in proportion to its respective ownership interest. Is STD Ltd jointly controlled?

Answer: STD Ltd is jointly controlled by shareholders A and B based on their ownership interest (collectively 81%), they must act together to make decisions regarding STD Ltd' relevant activities.
Shareholder A does not control STD Ltd, as it cannot unilaterally make decisions because a 75% majority is required.

Question 4. Two entities E and F, set up an entity and signed a joint operating agreement. The board contains three directors appointed by and representing each entity. The board is the entity's main decision-making body. Decisions are made by simple majority. Each party has a 50% interest in the net profit generated. Discuss whether the entity is jointly controlled by E and F.

Answer: Entities E and F are likely to have joint control, because each party has a 50% interest in net profit and both have a right to appoint three directors.
This is because the three directors representing a single shareholder would generally be presumed to vote in accordance with the wishes of the shareholder.
So, the consent of both entity E and F would be required for decision making and this would represent joint control.

Question 5. Company AB and company CD enter into an agreement for the production and sale of garments. In the industry, there are three activities that will significantly make impact on the return of the arrangements:

i. **Production of the garments**: company AB makes all the decisions for this activity.
ii. **Sales and marketing activities**: company CD makes all the decisions for these activities.
iii. **Both the companies must approve all financial related matters.**

Discuss whether company AB and CD have joint control over the arrangement?

Answer: In the first two matters, unanimous consent is not required as long as parties are working within the approved budgets and financial constraints. Thus, the parties have liberty to perform their respective responsibilities.
Here, the parties have to examine which of the three activities most significantly affect the returns of the arrangement.

If any of the first two activities determine the profits of the arrangement significantly, there is no joint control over the arrangement.

However, there may be the case where the financial policies majority impact the execution of other two activities and hence determine the profit of the arrangement.
Since unanimous consent is required for the financial policies, management may conclude that there is joint control.

Question 6. There is an arrangement in which Ram and Shyam each have 35% of the voting rights in the arrangement with the remaining 30% being widely dispersed. Decision about the relevant activities require approval by a majority of the voting rights. Do Ram and Shyam have joint control over the arrangement?

Answer: Ram and Shyam have joint control over the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both Ram and Shyam agreeing.

Question 7. An arrangement has three parties:
Om has 50% of the voting rights in the arrangement and Jay and Jagdish each have 25%. The contractual arrangement between Om, Jay and Jagdish specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement.
Discuss the different combinations of joint control that can affect the decision making of the relevant activities of the arrangement?

Answer: Om can block any decision, it does not control the arrangement because it needs the agreement of either Jay or Jagdish.
Om, Jay and Jagdish collectively control the arrangement. However there is more than one combination of parties that can agree to reach 75% of the voting rights(i.e. either Om and Jay or Om and Jagdish).

In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to take decisions about the relevant activities of the arrangement.

Question 8. Hari and Ram enter into a contractual arrangement to buy a two storied building, which they will lease to other parties.
Hari will be responsible for leasing first floor and Ram will be responsible for leasing second floor. They can make all decisions related to their respective floor and keep all the income with respect to their floor.

Ground floor will be jointly managed. All decisions with respect to ground floor must be unanimously agreed between Hari and Ram. Discuss the applicability of Ind AS 111.

Answer: There are three arrangements:
First floor that Hari controls and hence will not be accounted under Ind AS 111.
Second floor that Ram controls and hence will not be accounted under Ind AS 111.
Ground floor that Hari and Ram jointly control is a joint arrangement within the scope of Ind AS 111.

Question 9. Electronics Ltd. is established by two investors R Ltd. and S Ltd. The investors are holding 60% and 40% of the voting power of the investee respectively.

As per the articles of association of Electronics Ltd., both the investors have right to appoint 2 directors each on the board of Electronics Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether Electronics Ltd. is controlled by a single investor or is jointly controlled by both the investors.

Answer: The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor. Hence, Electronics Ltd. is jointly controlled by both the investors. R Ltd. holding majority of the voting rights is not relevant in this case since the voting rights do not given power over the relevant activities of the investee

Question 10. Entity A and Entity B established a contractual arrangement whereby the decision related to relevant activities are required to be taken by unanimous consent of both the parties. However, in case of any dispute with any vendor or customer of the arrangement, entity A has right to take necessary decisions for the resolution of disputes including decisions of going for the arbitration or filing a suit in court of law. Whether the arrangement is a joint arrangement?

Answer: The arrangement is a joint arrangement since the contractual arrangement requires decisions about relevant activities to be taken by unanimous consent of both the parties. The right available with entity A to take decisions for resolution of disputes will not prevent the arrangement from being a joint arrangement.

Type of Joint Arrangement: An entity shall determine the type of joint arrangement in which it is involved. A joint arrangement is either:

(a) a joint operation, or

(b) 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.**

Basis of classification between joint operation and joint venture:

i. The structure of the joint arrangement (i.e. structured or unstructured)

Note A: unstructured arrangement will always be called joint operation.
Note B: Structured arrangement may be joint operation or joint venture.

ii. When the joint arrangement is structured **through separate vehicle** (i.e. separate entity), then **we should also consider the terms of contractual arrangement**. (i.e**. whether parties have claim over assets and liabilities or net assets)**

Features/ characteristics of joint operation:

i. They are not structured through separate vehicle.
ii. In case of structured entity, parties have right to assets and obligation for liabilities relating to the arrangement or they have right to the corresponding revenue and obligations for the corresponding expenses.

Example of joint operation: Gas pipeline connects two points between Mumbai and Pune by distance of about of 150 km. Gas pipeline is owned jointly along with equipment by two companies A Ltd and B Ltd. the joint operation states that the maintenance of the oil pipeline will also be shared on an equal basis by two parties. Each party will recognise his share in pipeline in Balance sheet and include his share of expenses in the statement of profit and loss.

Example of joint venture: Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50% 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.

Question 11. P Ltd. and Q Ltd. are two construction entities and they have entered into a contractual arrangement to jointly construct a metro rail project.

The construction of metro rail project involves various activities such as construction of infrastructure (like metro station, control room, pillars at the centre of the road, etc.) for the metro, laying of the tracks, acquiring of the coaches of the metro, etc. The total length of the metro line to be constructed is 50 kms. As per the arrangement, both the parties are responsible to construct 25 kms each. Each party is required to incur its own cost, use its own assets, incur the liability and has right to the revenue from their own part of the work. Determine whether the arrangement is a joint operation or not?

Answer: The arrangement is a joint operation since the arrangement is not structured through a separate vehicle and each party has rights to the assets, and obligations for the liabilities relating to their own part of work in the joint arrangement.

Question 12. RS Ltd. and MN Ltd. entered into a contractual arrangement to run a business of providing cars of hire. The cars will be owned by both the parties jointly. The expenses to run the car (like driver salary, petrol, maintenance, insurance, etc.) and revenues from the business will be shared between both the parties as agreed in the contractual arrangement. Determine whether the arrangement is a joint operation or not?

Answer: The arrangement is a joint operation since the arrangement is not structured through a separatevehicle.

Question 13. Two entities have established a partnership firm with each party having 50% share in the netprofits of the firm. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Answer: In this case, the parties to the arrangement should evaluate whether the legal form creates separation between the partners and the partnership firm. If the parties conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this wouldbe a joint operation. If the assessment of legal form of the partnership firm indicates that the firm is a joint operation then there is no need to evaluate any other factors and it is concluded that the partnership firm is a joint operation.

Accounting treatment of Joint arrangement:

i. In case of Joint operation:

1. No separate book of joint operation is maintained.
2. In the separate Financial statements of parties of Joint operations:

A joint operator shall recognise in relation to its interest in a joint operation:
(i) Its assets, including its share of any assets held jointly;
(ii) Its liabilities, including its share of any liabilities incurred jointly;
(iii) Its revenue from the sale of its share of the output arising from the joint operation; and
(Iv) Its expenses, including its share of any expenses incurred jointly.

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 above paragraph, if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation.

Further, if a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the Ind AS applicable to that interest.**(Either Ind AS 28 or Ind AS 109)**

Question 14. P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the capital of PQ. However, the contractual terms of the joint arrangement states that P has the rights to all of Machinery and the obligation to pay Bank Loan in PQ. P and Q have rights to all other assets in PQ and obligations for all other liabilities in PQ in proportion to their share of capital (i.e. 50% each). PQ's balance sheet is as follows:

BALANCE SHEET of PQ			
Liabilities		**Assets**	
Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		**3,00,000**
How should P record in its financial statements its rights and obligations in PQ?			

Answer: Under Ind AS 111, P should record the following in its financial statements, to account for its rights in the assets of PQ and its obligations for the liabilities of PQ.

Machinery	2,50,000
Cash	25,000
Capital	75,000
Bank Loan	75,000
Other Loan	37,500

II. In case of Joint Venture:-

Accounting treatment in the Financial statements of parties to a joint arrangement classified as Joint venture:

(a) In consolidated financial statement:

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.

(b) **In separate financial statement:** In its separate financial statements, a joint ventures shall account for its interest in a joint venture in accordance **Ind AS 27.**

Accounting by an entity that is a party to the joint venture but does not have joint control:

A party that participates in, but does not have joint control of, a joint venture shall also account for its interest in the arrangement in its **separate and consolidated financial statements** as follows:

Whether the party has significant influence over the joint venture?	
Yes	No
Account in separate and consolidated financial statements as per **Ind AS 27and Ind AS 28** respectively	Account as per requirements of **Ind AS 109**

Question 15. Company P Ltd. (a listed company) invests in 25% shares of company Q Ltd. on 01.04.2023 at a cost of ₹66,000, paid by cash. During the financial year 2023-2024, Q made profits of ₹20,000 and other comprehensive income of ₹10,000. P does have joint control of Q, a joint venture

(a) Pass the journal entries in books of P at the time of purchase of shares.

(b) Show the relevant accounting treatment at the end of the year for:

(i) Consolidated financial statements, and

(ii) Separate financial statements

Solution: Journal Entry on 01.04.2023 for, both, Consolidated and separate financial statements:

Investment A/c Dr.	66,000	
To, Bank A/c		66,000

Journal Entry on 31-03-2024 for consolidated financial statement:

For consolidated accounts Ind AS 28 requires the recognition of investment by equity method.

Investment A/c	7,500	
To Profit and Loss A/c		5,000
To Other Comprehensive Income A/c		2,500

Working Note: Change in investee's Net Assets = ₹20,000 +₹10,000 = ₹30,000;Share of P = 25% of ₹30,000 = ₹7,500.

Investor's Profit or loss includes 25% of ₹20,000 = ₹5,000 and

other comprehensive income includes25% of ₹10,000 = ₹2,500.

Ind AS- 28 (Investments in associates and joint venture)

Objective:- The objective of this Standard is to prescribe the accounting for investments in associates and to set out the requirements for the **application of the equity method** when accounting for investments in associates and joint ventures.

Scope:- This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee.

Definitions:

i. **An associate is an entity over which the investor has significant influence.**

ii. **Significant influence**:- 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 (eg through subsidiaries), 20% or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case.

The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

(a) representation on the board of directors or equivalent governing body of the investee;
(b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
(c) material transactions between the entity and its investee;
(d) interchange of managerial personnel; or
(e) provision of essential technical information.

Further clarification on significant influence:

An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity **(called potential voting rights).**

The existence and effect of potential voting rights that are **currently exercisable** are also considered while assessing whether an entity has significant influence.

Potential voting rights which are not currently exercisable, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event. Such voting rights are not considered for evaluating significant influence.

Equity Method of accounting:

Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income (OCI).

Question 1: On 1st April 2024, COC Ltd acquired 30% equity shares of X Ltd for Rs 2,80,000. Fair value of net assets of X Ltd were Rs 6,00,000. Show its treatment in the books of COC Ltd assuming COC Ltd earned profit of Rs 1,40,000 for the year ended on 31st March 2025.

JOURNAL ENTRIES IN THE BOOK OF INVESTOR (CONSOLIDATED FINANCIAL STATEMENT)

I. Initial recognition on date of acquisition:

Investment in associate/ J.V A/c Dr (cost price)

To bank account

Recognition of goodwill/capital reserve – we compare the investment cost with share in fair value of net assets of associate/JV and then we calculate goodwill/capital reserve.

- **If goodwill comes** – no entry is made. Disclose it in bracket in CFS.
- **If capital reserve –** it is separately recognised by passing an entry and it becomes part of other equity in CFS:

Investment account Dr

To other equity (capital reserve)

II. Recognition of share in profit or loss:

a. In case of profit:

Investment in Associate/ JV A/c Dr (share in profit)

To profit and loss A/c

b. In case of loss:

Profit and loss A/c Dr (with share in loss)
To investment in associate/JV

III. Dividend received from associate/ JV:

Bank account Dr (amount of dividend received)

To investment account

IV. Share in OCI (e.g. foreign exchange gain, revaluation profit etc)

Investment in associate/ JV Dr

To share in OCI

It means following amount is shown CFS:

Investment at cost in associate/JV	XX
(Including goodwill/capital reserve)	
+/- post acquisition share in profit/loss and OCI	XX
- Dividend received	XX
+/- additional depreciation/saving in depreciation	XX
- Unrealised profit elimination to the extent of investor share	XX
- Impairment loss to the extent of investor share	XX
Value of investment as per equity method in CFS	XX

Question 2: COC Ltd acquired 40% shares of Reliance Ltd on 1 April 2024, the price paid Rs 12,00,000. On date of acquisition, fair value of net assets of Reliance Ltd was 25,00,000. Reliance Ltd reported profit of Rs 4,00,000 and paid dividend of Rs 1,00,000 for 24-25. Make entries and calculate amount of investment to be shown in CFS as per equity method.

Question 3: COC Ltd acquired 30% shares of Tata Ltd on 1 April 2024, the price paid Rs 18,00,000. On date of acquisition, fair value of net assets of Tata Ltd was 90,00,000. Tata Ltd reported profit of Rs 5,00,000 and OCI of Rs 2,00,000 for the year 24-25. Tata Ltd paid dividend of Rs 1,50,000 to its shareholders for 24-25. Make entries and calculate amount of investment to be shown in CFS as per equity method.

Solution:

1-4-24	Investment in Tata Ltd account Dr To Bank account (being investment acquired)	18,00,000	18,00,000
	Investment in Tata Ltd account Dr To capital reserve account	9,00,000	9,00,000
31-3-25	Investment in Tata Ltd account Dr To Profit & loss account To OCI account (share in profit recognised in CFS)	2,10,000	1,50,000 60,000
31-3-25	Bank account Dr To Investment in Tata Ltd (dividend received)	1,50,000	1,50,000

Working notes:

Net assets on DOA	90,00,000
Net worth of investment on DOA (90,00,000 X 30%) Amount paid for acquiring investment	27,00,000 18,00,000
Gain on acquiring investment	9,00,000 (capital reserve)

Note 1: In case of impairment loss, entry for impairment loss will be as follow:

Profit and loss account Dr

To Investment in Tata Ltd

Note 2: impairment loss can be checked on total value of investment but not on goodwill calculated separately.

Note 3: In case dividend is receivable (Not received) from investee company. Journal entry will be:

Dividend receivable account Dr 1,50,000

To Investment in Tata Ltd account 1,50,000

Question 4: COC Ltd acquired 20% shares of Wipro Ltd on 1 April 2024, the price paid Rs 15,00,000. On date of acquisition, fair value of net assets of Wipro Ltd was 60,00,000. Wipro Ltd reported loss of Rs 2,00,000 for the year 24-25. COC Ltd received dividend of Rs 6,000 from Wipro Ltd. Make entries and calculate amount of investment to be shown in CFS as per equity method.

Question 5: Pranay Ltd acquired 25% shares of W Ltd on 1 April 2018, the price paid Rs 5,00,000. On date of acquisition, fair value of net assets of W Ltd was 24,00,000. W Ltd reported loss of Rs 8,00,000 in 18-19 and Rs 30,00,000 for the year 19-20. But in 20-21, W ltd reported profit of Rs 40,00,000. Make entries and calculate amount of investment to be shown in CFS as per equity method for each year after acquisition.

Question 6: Karan Ltd acquired 25% shares of X Ltd on 1 April 2024, the price paid Rs 8,00,000. On date of acquisition, fair value of net assets of X Ltd was 30,00,000. Karan Ltd had revalued Building of X Ltd at Rs 5,00,000 (book value Rs 4,00,000) on date of acquisition. Rate of depreciation charged by X Ltd on building was 10%. But rate of depreciation charged by Karan Ltd was 15% on its building.

X Ltd reported profits of Rs 4,00,000 in 24-25 and declared dividend of Rs 2,50,000. Make entries and calculate amount of investment to be shown in CFS as per equity method for the year ended on 31st march 2025.

Question 7. Bhim ltd acquired 30% shares in Jaggu Ltd for Rs 4,50,000 on 1 April 2024. Fair value of net assets on DOA were Rs 15,00,000. During 24-25, Jaggu Ltd reported profit of Rs 1,20,000. During the year Bhim Ltd had sold goods costing Rs 60,000 at profit of 20% on cost to Jaggu Ltd and 40% of such goods are still unsold with Jaggu Ltd. make entries and calculate amount of investment to be shown in CFS.

Question 8. Bhim ltd acquired 40% shares in Chutki Ltd for Rs 3,50,000 on 1 April 2024. Fair value of net assets on DOA were Rs 12,00,000. During 24-25, Chutki Ltd reported profit of Rs 1,50,000. During the year Chutki Ltd had sold goods costing Rs 50,000 at profit of 25% on cost to Bhim Ltd and goods costing Rs 20,000 (cost to Bhim) are still unsold with Bhim Ltd. make entries and calculate amount of investment to be shown in CFS.

Question 9. Ram Ltd acquired 40% ordinary shares of Rs 100 each of Krishan Ltd on 1st October 2024. On 31st March 2025 the summarised Balance sheets of the two companies were as given bellows:

	Ram Ltd	**Krishan ltd**
Property, plant and equipment	7,80,000	6,30,000
Investment in krishan ltd	8,00,000	--
Inventory	2,40,000	72,800
Financial assets	1,19,600	80,000
Cash	29,000	16,000
Total	**19,68,600**	**7,98,800**
Equity share capital of Rs 100	10,00,000	4,00,000
Profit and loss account	7,14,400	3,64,000
Bank overdraft	1,60,000	--
Trade payable	94,200	14,800
Dividend payable	…..	20,000
	19,68,600	**7,98,800**

The other equity of Krishan Ltd showed a credit balance of Rs 1,60,000 on 1st April 2024.

PPE which stood at Rs 7,00,000 on 1st April 2025 was valued at Rs 8,00,000 on 1st October 2024. Rate of depreciation **charged by Ram Ltd on PPE is 15% p.a.**

Following are the increase on comparison of fair value as per respective Ind AS with book value as on 1st October 2024 which are to be considered while consolidating Balance sheets.

Inventories	Rs 30,000
Financial assets	Rs 10,000
Trade payables	Rs 20,000

Prepare consolidated balance sheet as per Ind AS 28 assume that all revalued assets and liabilities exist at the end of the year except inventory.

Question 10. Company P Ltd. (a listed company) acquires 20% shares in company Q Ltd. on 1-4-24 at a cost of Rs. 46,000, paid by cash. During the financial year 24-25, Q made profits of Rs. 20,000 and other comprehensive income of Rs. 10,000.

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. **(ICMAI STUDY MATERIAL)**

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 = 20,000+10,000 = 30,000; share of P = 20% of 30,000 = 6,000.

Investor's Profit or loss includes 20% of 20,000 = 4,000 and

other comprehensive income includes 20% of 10,000 = 2,000.

(ii) The year end for the separate financial statements of P, Investment is valued at cost at Rs. 46,000 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.

Exemptions from applying the equity method:

i. An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope of Ind AS 110 or if all the following apply:

- **(a)** The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.
- **(b)** The entity's debt or equity instruments are not traded in a public market.
- **(c)** The entity did not file, nor is it in the process of issuing any class of instruments in a public market.
- **(d)** The ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with Ind ASs.

ii. When an investment in an associate or a joint venture is held by an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss(FVTPL) in accordance with Ind AS 109.

iii. When an investment in an associate or a joint venture is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss(FVTPL) in accordance with Ind AS 109.

Question 7: MNO Ltd holds 15% of the voting power of DEF Ltd. PQR Mutual fund (which is subsidiary of MNO Ltd) also holds 10% voting power of DEF Ltd. Hence MNO Ltd holds total 25% voting power of DEF Ltd and accordingly has significant influence over DEF Ltd. how should MNO Ltd account for investment in DEF Ltd in its consolidated financial statements.

Answer: The 15% interest which is held directly by MNO Ltd should be measured as per equity method of accounting. However, with respect to the 10% interest which is held through a mutual fund, MNO Ltd, can avail the exemption from applying the equity method to that 10% interest and instead measure that investment at fair value through profit or loss (FVTPL).

Classification as held for sale: An entity shall apply Ind AS 105 to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale.

Discontinuing the use of the equity method: -- An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:

(a) If the investment becomes a subsidiary, the entity shall account for its investment in accordance with Ind AS 103, Business Combinations, and Ind AS 110.

(b) If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value(assumed deemed cost for other Ind AS).

Multiple choice question:

1. Consolidated financial statements are required to be prepared by an Ind AS complied company if it holds……. shares in the investee company.

a. entailing 20% or more voting rights having significant influence over the investee company (called Associate as per Ind AS 28)

b. entailing joint control over the investee company (called a Joint Venture as per Ind AS 28)

c. entailing control over investee company (called subsidiary company as per Ind AS 110)

d. All of the above

2._______________ requires that when consolidated financial statements are prepared the investor company shall also prepare individual/standalone financial statements, which are named as separate financial statements.

a. Ind AS 27

b. Ind AS 28

c. Ind AS 110

d. Ind AS 112

3. An investment entity is an entity that

a. obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services

b. commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both

c. measures and evaluates the performance of substantially all of its investments on a fair value basis

d. All of the above

4. Ind AS 103 states that the acquirer obtaining control over acquiree, recognises and measures in its consolidated financial statements at the acquisition date

a. the identifiable assets acquired, the liabilities assumed at Fair Value

b. any non-controlling interest in the acquiree at Fair Value or at Proportionate Value

c. the goodwill acquired in the business combination or a gain on bargain purchase

d. All of the above

5. As per Ind AS 112: Disclosure of Interests in Other Entities, an entity shall disclose information about significant judgements and assumptions it has made (and changes to those judgements and assumptions)in determining

a. that it has control of another entity, i.e. an investee as described in paragraphs 5 and 6 of Ind AS 110, Consolidated Financial Statements

b. that it has joint control of an arrangement or significant influence over another entity

c. the type of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle

d. All of the above

6.________________ is the contractually agreed sharing of control of an arrangement, which exists onlywhen decisions about the relevant activities require the unanimous consent of the parties sharing control.

a. Joint control

b. joint operation

c. Significant influence

d. Associate

7. A_____________is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

a. Joint control

b. joint operation

c. Significant influence

d. Associate

8. ______________ 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.

a. Joint control

b. joint operation

c. Significant influence

d. Associate

9. The___________is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investors share of the investees net assets.

a. Acquisition method

b. Pooling of interest method

c. Equity method

d. None of the above

10. An____________is an entity over which the investor has significant influence.

a. Joint control

b. joint operation

c. Significant influence

d. Associate

11. Disclosure requirements for holding interest in other entity are dealt in……..

1. Ind AS 103
2. Ind AS 110
3. Ind AS 112
4. Ind AS 111

12. Consolidated financial statements are required to be prepared as per ………under Equity Method when investor company has significant influence or joint control over the investee company.

1. Ind AS 28
2. Ind AS 27
3. Ind AS 110
4. Ind AS 1

13. When investor company has control over the investee company (subsidiary) consolidated financial statements are required to be prepared as per Ind AS 110 by recognising assets, liabilities, non-controlling interest on the………, but recognising goodwill or gains from bargain purchase at the ……………..as per Ind AS 103.

1. reporting date; acquisition date.
2. reporting date; acquisition date.
3. Acquisition date; acquisition date
4. None of the above.

14. An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with………..

1. Ind AS 28
2. Ind AS 111
3. Ind AS 27
4. Ind AS 1

15. a parent need not present consolidated financial statements if it meets all the following condition/conditions:

- **a.** 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;
- **b.** 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);
- **c.** 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; a
- **d.** its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with Ind ASs.
- **e.** All of the above

16. 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.

(d) All of the above

17. 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……..

1. Ind as 110
2. Ind as 109
3. Ind as 28
4. Ind as 111

18. Company P Ltd. (a listed company) invests in 24% shares of company Q Ltd. on 01.04.2023 at a cost of ₹66,000,paid by cash. During the financial year 2023-2024, Q made profits of ₹20,000 and other comprehensive income of ₹10,000. At the year end, in the separate financial statements of P Ltd, Investment is valued at cost at ………

1. ₹66,000
2. ₹70,800
3. ₹73,200
4. None of the above.

19. Company A Ltd. (a listed company) invests in 24% shares of company B Ltd. on 01.04.2023 at a cost of ₹66,000,paid by cash. During the financial year 2023-2024, B Ltd made profits of ₹20,000 and other comprehensive income of ₹10,000. At the year end, in the consolidated financial statements of A Ltd, Investment is valued at cost at ………

1. ₹66,000
2. ₹70,800
3. ₹73,200
4. None of the above

20. On 01.04.2023 BB Ltd. acquired 90% share of CM Ltd. at ₹10,80,000, when the fair value of its Net Assets was ₹10,00,000. During 01.04.2023 to 31.03.24 CM Ltd made TCI ₹2,00,000. On that date BM sold 15% holding to outsiders at ₹2,20,000. Calculate the amount of NCI by proportionate method to be shown in CFS after sale of partial holding.

1. 1,00,000
2. 2,50,000
3. 3,20,000
4. 3,00,000

21. On 01.07.2023 BB Ltd. acquired 90% share of CM Ltd. at ₹21,60,000, when the fair value of its Net Assets was ₹20,00,000. During 01.04.2023 to 31.03.24 CM Ltd made TCI ₹4,00,000. On that date BM sold 15% holding to outsiders at ₹4,40,000. Calculate the amount of NCI by fair value method to be shown in CFS after sale of partial holding.

1. 7,00,000
2. 6,75,000
3. 6,80,000
4. 5,75,000

1-D	**2-A**	**3-D**	**4-D**	**5-D**	**6-A**	**7-B**	**8-C**	**9-C**	**10-D**
11-C	**12-A**	**13-B**	**14-C**	**15-E**	**16-D**	**17-B**	**18-A**	**19-C**	**20-D**
21-B									

Ind AS- 27 – SEPARATE FINANCIAL STATEMENTS

1. Introduction: A company shall prepare financial statements for every financial year as required by law. A parent company in a group of companies shall prepare consolidated financial statements as per Ind AS 110,and further it shall prepare separate financial statements as per Ind AS 27.

A company having investments in associates or joint ventures prepares financial statements using equity method of accounting as per Ind AS 28; in addition, it shall also prepare separate financial statements as per Ind AS 27.

Thus a company presenting consolidation or applying equity method shall in addition present separate financial statements. **A company exempted from consolidation or from applying equity method may prepare separate financial statements as its only financial statements**.

2. Objective: The objective of this Standard is to prescribe the accounting and disclosure requirements

for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

3. Scope: This Standard shall be applied in accounting for investments in subsidiaries, joint ventures and associates when an entity elects, or is required by law, to present separate financial statements.

4. Definition: Separate financial statements are those presented by a parent (i.e an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or at a value based on Ind AS 109.

5. When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:

(a) at cost, or
(b) in accordance with Ind AS 109.

6. An entity shall recognise a dividend from a subsidiary, a joint venture or an associate in profit or loss in itsseparate financial statements when its right to receive the dividend is established.

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

8. In case of exemption from consolidation or use of equity method, the entity shall disclose:

(i) that the financial statements are separate financial statements
(ii) that the exemption is used and
(iii) a list with details of investments in subsidiaries, joint ventures and associates.

CLASS NOTES: (HELPFUL FOR REVISION BEFORE EXAM)

1. OBJECTIVE: - To prescribe the accounting and disclosure requirements for investment in subsidiaries, Joint venture, and associates when an entity prepares separate financial statements.

2. 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.

Note: - It is not compulsory to prepare SFS as per Ind AS-27. But it is compulsory to prepare SFS as per companies act 2013 in India.

3. i. Accounting treatment of Investment in subsidiary, Joint venture and associates in case of an investment company in separate financial statement:

Cost price	**OR**	As per Ind AS-109 (FVTPL)

- If investment in subsidiary, Joint Venture or associate is classified as held for sale, it should be measured at **Fair value as per Ind AS-105.**

ii. Accounting treatment of Investment in subsidiary, Joint venture and associates in case of an investment company in separate financial statement:

- An investment entity values its investment in subsidiary, Joint venture and associates **at Fair Value through Profit and Loss Account (FVTPL) only.**

iii. Accounting treatment of Investment in subsidiary, Joint venture and associates in case of change in identity of the entity in separate financial statement:

Case 1. When a parent entity ceases to be an investment entity:

- The entity shall account for investment in subsidiary, JV or associate either:

(a) at cost, or

(b) as per Ind AS-109

Treatment in SFS-- When a parent entity ceases to be an investment entity (It means it becomes non-investment company): -

Previously as investment company:	Previously at Fair Value (FVTPL) as per Ind AS-109	Previously at Fair Value (FVTPL) as per Ind AS-109
Now, non-investment company:	(a) at cost	(b) as per Ind AS-109- FVTPL.
	Fair value of investment on date of change of status will be assumed to be deemed cost at that date.	**No change required**

Case 2. When a Non-investment company becomes an investment company:

- **In separate financial statement:**

Previously recorded at cost price	Previously recorded at Fair Value as per Ind AS-109 (FVTPL)	Previously recorded at Fair Value Through OCI (FVTOCI) as per Ind AS-109 (FVTOCI as per option selected)
Now at FVTPL as per Ind AS-109	Now at FVTPL as per Ind AS-109.	Now at FVTPL as per Ind AS-109.
The difference between previous carrying amount and its fair value at the date of change will be transferred to SPL.	No change required	The cumulative amount of any Fair value adjustments previously recognised in OCI shall be transferred to SPL(assuming investment has been disposed off on the date of change).

(8) Treatment of dividend received from subsidiary, Joint venture or associates in Separate Financial Statement:-

- Recognise only when right to receive has been established.
- Journal entry:-

Dividend receivable/ Bank account Dr

To SPL account

(**9**) The entity shall apply the same accounting for each category of investments (based on whether it is Subsidiary or J.V or Associate)

(10) Disclosure requirements:

- An entity shall apply all applicable Ind ASs when providing disclosures in its separate financial statements.
- When a parent, in accordance with paragraph 4(a) of Ind AS 110, elects not to prepare consolidated financial statements and instead prepares separate financial statements, it shall disclose in those separate financial statements:
  - the fact that the financial statements are separate financial statements;
  - that the exemption from consolidation has been used;
  - the name and principal place of business (and country of incorporation, if different) of the entity whose consolidated financial statements that comply with Ind ASs have been produced for public use;
  - and the address where those consolidated financial statements are obtainable.

- a list of significant investments in subsidiaries, joint ventures and associates, including:
  (i) the name of those investees.
  (ii) the principal place of business (and country of incorporation, if different) of those investees.
  (iii) its proportion of the ownership interest (and its proportion of the voting rights, if different) held in those investees.
- a description of the method used to account for the investments in subsidiaries, joint ventures and associates.

- When an investment entity that is a parent prepares separate financial statements as its only financial statements, it shall disclose that fact. The investment entity shall also present the disclosures relating to investment entities required by Ind AS 112, Disclosure of Interests in Other Entities.

Multiple choice questions:

1. ……… are those presented by a parent 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.

(a) Separate financial statements
(b) Individual financial statement
(c) Both, (a) and (b)
(d) Consolidated financial statement

2. Financial statements in which the equity method is applied are ……..

(a) Separate financial statements
(b) Individual financial statement
(c) Both, (a) and (b)
(d) Consolidated financial statement

3. The financial statements of an entity that does not have a subsidiary, associate or joint venture's interest in a joint venture are called …………

(a) Separate financial statements
(b) Individual financial statement
(c) Both, (a) and (b)
(d) Consolidated financial statement

4. Exception of preparing CFS as per Ind AS- 110 is mentioned in …….

(a) paragraph 4(a) of Ind AS 110
(b) paragraph 17 of Ind AS 28
(c) Para 8
(d) Para 8A

5 . Exception of preparing CFS by equity method as per Ind AS- 28 is mentioned in …….

(a) paragraph 4(a) of Ind AS 110.
(b) paragraph 17 of Ind AS 28
(c) Para 8
(d) Para 8A

6. When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost, or in accordance with ……...

(a) Ind AS 110

(b) Ind AS 28

(c) Ind AS 1

(d) Ind AS 109

7. Investments accounted for at cost shall be accounted for in accordance with ……., when they are classified as held for sale or included in a disposal group that is classified as held for sale.

(a) Ind AS 110

(b) Ind AS 28

(c) Ind AS 105

(d) Ind AS 109

8. An entity shall recognise a dividend from a subsidiary, a joint venture or an associate in profit or loss in its …………….when its right to receive the dividend is established.

(a) separate financial statements

(b) Individual financial statement

(c) Both, (a) and (b)

(d) Consolidated financial statement

9. When a parent, in accordance with paragraph 4(a) of Ind AS 110, elects not to prepare consolidated financial statements and instead prepares separate financial statements, it shall disclose in those separate financial statements:

(a) the fact that the financial statements are separate financial statements;

(b) that the exemption from consolidation has been used;

(c) the name, address and principal place of business of the entity whose consolidated financial statements that comply with Ind ASs have been produced for public use;

(d) All of the above

Answer:

1	2	3	4	5	6	7	8	9	
A	D	B	A	B	D	C	A	D	

Ind AS- 112: Disclosure of interest in other entities

1. Objective:

A. The objective of this Standard is to require an entity to disclose information that enables users of its financial statements to evaluate:

(a) the nature of, and risks associated with, its interests in other entities; and

(b) the effects of those interests on its financial position, financial performance and cash flows.

B. To meet the objective in para A, an entity shall disclose:

(a) the significant judgements and assumptions it has made in determining:

(i) the nature of its interest in another entity or arrangement;

(ii) the type of joint arrangement in which it has an interest:

(iii) that it meets the definition of an investment entity, if applicable; and

(b) information about its interests in:

(i) subsidiaries;

(ii) arrangements and associates; and

(iii) structured entities that are not controlled by the entity (unconsolidated structured entities).

C. If the disclosures required by this Ind AS, together with disclosures required by other Ind ASs, do not meetthe objective in para-A, an entity shall disclose whatever additional information is necessary to meet that objective.

2. Scope:

A. This Ind AS shall be applied by an entity that has an interest in any of the following:

(a) subsidiaries

(b) joint arrangements (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.

(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.

Disclosures:

3. **About significant judgements and assumptions:** An entity shall disclose information about significantjudgements and assumptions it has made (and changes to those judgements and assumptions) in determining:

   (a) that it has control of another entity,

   (b) that it has joint control of an arrangement or significant influence over another entity; and

   (c) the type of joint arrangement (ie joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

4. **Example of significant judgements and assumptions:**

An entity shall disclose, for example, significant judgements and assumptions made in determining that:

(a) it does not control another entity even though it holds more than half of the voting rights of the other entity.

(b) it controls another entity even though it holds less than half of the voting rights of the other entity.

(c) it is an agent or a principal.

(d) it does not have significant influence even though it holds 20% or more of the voting rights of another entity.

(e) it has significant influence even though it holds less than 20% of the voting rights of another entity.

5. **About investment entity status:**

When a parent determines that it is an investment entity in accordance with paragraph 27 of Ind AS 110, the investment entity shall disclose information about significant judgements and assumptions it has made in determining that it is an investment entity.

6. **About change of status:**

When an entity becomes, or ceases to be, an investment entity, it shall disclose the change of investment entity status and the reasons for the change. In addition, an entity that becomes an investment entity shall disclose the effect of the change of status on the financial statements for the period presented, including:

(a) the total fair value, as of the date of change of status, of the subsidiaries that cease to be consolidated;

(b) the total gain or loss, if any, calculated in accordance with paragraph B101 of Ind AS 110; and

(c) the line item(s) in profit or loss in which the gain or loss is recognised (if not presented separately).

SECTION E–RECENT DEVELOPMENTS IN FINANCIAL REPORTING

Number	Topics to be covered
1.	Sustainability reporting
2.	Global reporting initiative (GRI)
3.	4P Bottom Line reporting
4.	Corporate Social Responsibility (CSR) Reporting
5.	Integrated reporting (IR)
6.	Business responsibility reporting (BRR)
7.	XBRL Reporting
8.	Environmental, social and governance (ESG)
9.	Human resource reporting
10.	Value added statement
11.	Economic value added and market value added
12.	Quarterly earnings call management.

E.1 Sustainability reporting

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.

Many large corporations such as The Boeing Company, PricewaterhouseCoopers, The Procter & Gamble Company, Sony Corporation, and Toyota Motor Corporation etc. 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 social impacts, and hence its contributions (positive or negative) towards the goal of sustainable development.

There are three forms/aspects of sustainability that are considered by the organisations are:

- **Social sustainability activities** focus on maintaining mutually beneficial relationships with employees, customers, suppliers 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.

Together these three pillars of sustainability are often referred as 'People-Planet-Profit'.

Through this process, an organization identifies its significant impacts on the economy, the environment and society and discloses them in accordance with a globally accepted standard.

Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. (Brundt land)

It suggests that sustainability reporting should recognise the interdependence of economic, social and environmental factors; and the importance of inter-generational timescales.

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.

E.2 The Global Reporting Initiative (GRI):

The Global Reporting Initiative (GRI) is considered as **the best-known framework for voluntary reporting of environmental and social performance** by business and other organizations worldwide.

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.

E.3 CONCEPT OF 4P BOTTOM LINE REPORTING:

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 careand environmental clean-up. Now the question that arises in the mind of the proponents of full-cost accounting is 'How do we perform a full societal cost benefit analysis?' In this respect, the 4P bottom line adds three more "bottom lines", namely, people (social) and planet (environmental/ecological) and purpose (spiritual) concerns.

The concept of '4P bottom line 'incorporates two technical terminologies **– 'Quadruple' and 'Bottom Line'.**

We first understand these two for better understanding of the concept of 4P bottom line reporting.

- **Quadruple:** The Quadruple bottom line concept requires an organisation to measure and report on four dimensions viz. social, environmental, economic/ financial and spiritual performance of the organisation.
- **Bottom Line:** The "bottom line" refers to the "operating result", which is usually recorded at the very last line (or, bottom) of the income statement.

QBL reporting refers to the publication of economic, environmental and social and spiritual information in an integrated manner that reflects activities and outcomes across these four dimensions of a company's performance.

Quadruple bottom line reporting (QBLR) expands the traditional reporting framework to take into account social, environmental and spiritual performance in addition to financial performance at bottom line.

They are discussed hereunder:

- The first bottom line happens to be the bottom line of **the "income statement (i.e., Profit)".**
- The second bottom line is that of an organisation's **"people account**" which measures how socially responsible an organisation has been throughout its operations; **and**
- The third bottom line is that of the organisation's **"planet account"** which measures how environmentally responsible the company has been.
- The fourth bottom line lifts business activities to **a sacred form (i.e., Purpose).** It measures by how much more loving, understanding, happy, joyful, in touch with God the person has become while performing their business responsibilities. The fourth bottom line relate business with happiness of stakeholders.

The benefits emerging from 4P bottom line reporting are discussed hereunder:

(i) Enhancement of reputation and brand: 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.

(ii) Securing a social license to operate: Communities and stakeholders generally, are likely to be more supportive of companies that communicate openly and honestlyabout their management and performance in relation to environmental, social and economic factors and spiritual.

(iii) Attraction and retention of high calibre employees: Existing and prospective employees have expectationsabout corporate environmental, social and economic behaviour, and include such factors in their decisions regarding working for an organisation.

(iv) 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.

(v) 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 4P's issues is central to obtaining a differentiated position in the market place.

(vi) Reduced risk profile: The performance in respect of 4P has the capacity to affect the views of market participants about a company's exposure to, and management of risk. A communication policy that addresses these issues can play an important role in the company's overall risk management strategy.

(vii) Identification of potential cost savings: The 4P Bottom Line reporting often involves the collection and analysisof data on resource and materials usage, and the assessment of business processes. This can enable a company to better identify opportunities for cost savings through more efficient use of resources and materials.

(viii) 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 4P Bottom Line reporting provides a medium by which companies can engage with stakeholders and understand their priorities and concerns.

(ix) 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.

(x) Creation of sound basis for stakeholder dialogue: Publication of The 4P Bottom Line reporting provides a powerful platform for engaging in dialogue with stakeholders. Understanding stakeholder requirements and alignmentof business performance with such requirements is fundamental to business success.

(xi) Altruism and happiness of the stakeholders: The 4th P 'Purpose' makes business contribute to one's spirituality by serving a unique purpose in addition to financial, social, and environmental returns.

Prerequisites of implementation of QBL Reporting:

- QBL reporting would be of little relevance to the reporting company or its stakeholders if it is not aligned to the company's overall business strategy.
- A decision to move to full QBL reporting should not be taken lightly. Itmust have senior management endorsement and commitment, as it may have major resource implications, anda 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 QBL reporting include:

(i) clear definition of the role of QBL reporting in driving strategic business objectives; establishment of the resource and cost requirements;

(ii) awareness of associated legal implications; and

(iii) understanding the risks involved in publishing QBL information.

Key Challenges for Implementation:

The key challenges for implementation of QBL reporting framework are:

(i) Awareness of relevant issues associated with QBL reporting;

(ii) Understanding stakeholder requirements;

(iii) Aligning QBL reporting with objectives and risks; and

(iv) Determining and measuring performance indicators.

E.4 CORPORATE SOCIAL RESPONSIBILITY REPORTING (CSR Reporting)

What is CSR?

The WBCSD (World Business Council for Sustainable Development) 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."

CSR is generally understood as being the way through which a company achieves a balance of economic, environmental, social and purpose imperatives, while at the same time addressing the expectations of shareholders and stakeholders."

CSR in India: 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" which makes it mandatory (with effect from 1st April, 2014) for certain companies who fulfil 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.

Note: The section has used the word "companies" which shall also 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 which are given below:

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.

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;

• 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.

E.5 INTEGRATED REPORTING (IR)

Concept/Meaning/features of IR:

- 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 (i.e the total value created by a business) by considering non-financial resources such as human, social and intellectual capitals along with financial capital.
- The primary objective of integrated reporting is to help stakeholders analyse 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.

Value Creation and Six Capitals: For value creation companies should expand their reporting beyond the 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 as follows:**

- **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.
- **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).
- **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".
- **Social capital: -** Social capital means "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 competitors in the long term.
- informed decisions and improved overall performance.
- identify cost savings by analysing 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.

E.6 BUSINESS RESPONSIBILITY REPORTING

Introduction:

In 2012, the Securities Exchange Board of India (SEBI) passed a circular amongst the top 100 companies, making it mandatory for them 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:

BRR is more relevant for listed entities who have raised funds from the public and are obligated to make exhaustive continuous disclosures on a regular basis.

The annual report shall contain a business responsibility report describing the initiatives taken by the listed entity for an environmental, social and governance perspective, in the format as specified by the Board.

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.

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 (Business responsibility) INFORMATION

1. Details of Director/Directors responsible for BR
2. Principle-wise (as per NVGs) BR Policy/policies

SECTION E: PRINCIPLE-WISE PERFORMANCE

Nine Principles to Assess Compliance with Environmental, Social and Governance Norms as per National Voluntary Guidelines (NVG) :-

Principle 1: Businesses should conduct and govern themselves with Ethics, Transparency and Accountability.

Principle 2: Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle.

Principle 3: Businesses should promote the wellbeing of all employees.

Principle 4: Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

Principle 5: Businesses should respect and promote human rights.

Principle 6: Business should respect, protect, and make efforts to restore the Environment.

Principle 7: Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner.

Principle 8: Businesses should support inclusive growth and equitable development.

Principle 9: Businesses should engage with and provide value to their customers and consumers in a responsible manner.

E.7 Reporting through XBRL

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.**

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 'extensible Markup Language' (XML). It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet. It prescribes the manner in which the data can be "marked-up" or "tagged" to make it more meaningful to human readers as well as to computers-based system.

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.

2. TAGGING and TAXONOMY

XBRL Tagging is the process by which any financial data is tagged with the most appropriate element in an ACCOUNTING TAXONOMY.

TAXANOMY can be referred as Electronic Dictionary of reporting concept/element 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 electronic dictionary for reporting the business data as approved by the Central Government in respect of any documents or forms indicated in these rules.**

Taxonomy and accurate data tags allow preparation, validation, publication, exchange, consumption and analysis of business information of all kinds.

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.

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 organization's 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.

(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.

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.

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.

1.7 BENEFITS OF XBRL REPORTING: - The benefits of reporting under XBRL over traditional form are:

1. Automated Data Processing: The use of XBRL offers major benefits to the preparers and users of business and financial information by enabling this data to be exchanged and processed automatically by the software. XBRL identification tags reduce and eliminate the need for the data entry operator to manually key data into the software.

2. **More accurate and efficient**: **XBRL makes reporting more accurate and more efficient by using comprehensive definitions and accurate data tags**. Such data tags allow the preparation, validation, publication, exchange, consumption and analysis of business information of all kinds.

3. **Data Review**: Organisations can use software to automatically validate data electronically received through XBRL. **The software can help analyse the data and identify problems that accountants and auditors can examine.**

4. **Improved reporting quality:** XBRL provides its users with increased data integrity and uniformity. It also allows for increased transparency of public owned companies' financial records for view by 'interested' parties.

5. **Interchangeable:** Information in reports prepared using the XBRL standard is interchangeable between different information systems in entirely different organisations. This allows for the exchange of business information across a reporting chain. **The users who intend to report information, share information, publish information and allow straight through information processing rely on XBRL.**

6. **Cost and time savings:** Currently all companies file their reports with regulators using formats like the Portable Document Format (PDF) which has its inherent limitations. Moreover, the costs of sending, receiving, storing, validating and auditing the financial records in this format are comparatively higher. XBRL reduces the involved time and also the cost.

22. **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 predefined 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.

8. Tax authorities.

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**.

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.

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).

[A] Adoption of XBRL by Ministry of Corporate Affairs (MCA)

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.

After the issuance of Companies Act, 2013

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-l for the financial years commencing on or after April 1, 2014 using the XBRL taxonomy given in Annexure II, namely:

(i) all companies listed with any Stock Exchange(s) in India and their Indian subsidiaries; or

(ii) all companies having paid up capital of rupees five crore or above;

(iii) all companies having turnover of rupees hundred crore or above; or

(iv) all companies which were hitherto (until now) 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**

E.8. Environmental, social and governance:

Concept of ESG Reporting:

In today's competitive world, corporate organizations with a transparent and fair image receive added attention from various stakeholders. Especially, investors are increasingly applying various non- financial factors as part of their analysis process to identify material risks and growth opportunities.

In this process,corporates are being judged on three important aspects namely, economic, environmental and social aspects. Thus, ESG reporting has become immensely important.

Each and every corporate house needs to disclose all the facts and figures relating to its contributions made towards the protection of environment and society as well as it should disclose all the essential economic information in front of the stakeholders.

Importance of ESG Reporting:

ESG reporting refers to the disclosure of data covering the company's operations in three areas: Environmental,social and corporate governance.

The importance of ESG Reporting can be assessed based on the following five broad aspects:

a. ESG risks and opportunities have potential impact on shareholder's value.
b. Today, most of the investors wish to integrate the business with environment and society to generatesustainable profits in responsible manner.
c. ESG Reporting analyses how the business operations of the company impact the environment both directly as well as indirectly.
d. ESG Reporting analyses how a company manages relationships with its stakeholders, regardless of where it operates.
e. ESG reporting highlights on various dimensions of corporate governance.

ESG Criteria: ESG reporting requires identification and reporting information about the three criteria in a meaningful way. While, environmental criteria consider how a company performs as a steward of nature, social criteria examine how it manages relationships with employees, suppliers, customers, and the communities. Finally,governance deals with a company's leadership, executive pay, audits, internal controls, and shareholder rights. Accordingly, the following criteria are largely used in this context.

(A) **Environmental test criterion includes:**

a. Conservation of the natural world
b. Climate change and carbon emissions
c. Air and water pollution

d. Biodiversity
e. Deforestation
f. Energy efficiency
g. Waste management
h. Water scarcity

(B) Social test criterion includes

a. Consideration of people & relationships
b. Customer satisfaction
c. Data protection and privacy
d. Gender and diversity
e. Employee engagement
f. Community relations
g. Human rights
h. Labor standards

(C) Governance test criteria includes consideration of:

a. Standards for running a company
b. Board composition
c. Audit committee structure
d. Bribery and corruption
e. Executive compensation
f. Lobbying
g. Political contributions
h. Whistle blower schemes

E. 9. Human resource reporting:

Human Resources report is an analytical tool for displaying human resources-related facts, insights, and metricsto improve workforce performance, recruiting procedures, and other important HR operations.

By using HR-driven metrics, management can spot trends, identify inefficiencies, capitalise on strengths, and turn-around weaknesses.

Types of HR reports:

1. Employee information reports: Employee Information Reports provide all information on employees' data factors, such as employee headcount, employee turnover rates, diversity, revenue per employee, employee satisfaction percentage, employee engagement percentage, and average employee tenure, etc.

2. Recruitment reports: The following are some important metrics to track in recruitment reports:

- i. Number of candidates evaluated in a period
- ii. Rate of offer declination
- iii. Reasons for offer rejection
- iv. Total number of interviews
- v. Duration of the interview
- vi. Top channels for candidate sourcing
- vii. Active job postings by location, department, and other criteria
- viii. Candidates from the talent pool and their behaviour patterns

3. Performance management reports: It's critical to keep track of employees' goals, skill sets, feedback, and other information. Performance reportsprovide a logical starting point for appraising staff. Performance reports can also show how each employee is doing in terms of meeting their objectives.The following are some of the parameters for measuring performance:

- **i.** Employee evaluations
- **ii.** Time to productivity
- **iii.** The number of hours worked and revenue
- **iv.** Employee objectives and performance, as well as their improvements
- **v.** Peer reviews, etc.

The finance team is in charge of majority of the compensation provided to employees. Payroll, on the otherhand, is the responsibility of the HR department. To better understand compensation, keep track of salary reports, appraisal reports, paid time off reports, overtime compensation and dues reports, shift compensation,deductions, and financial reports based on each filter or criteria.

4. **Terminations Budget/Analysis:** This report contains the list of all employees who have been terminated from employment within a defined date range.

5. **Equal employment opportunity reports:** Equal employment opportunity is a pivotal concept for employees and employers alike. It ensures that the employment in an organization is not biased towards a specific gender, race or age group.

6. **Workplace Safety Reports:** It includes Employee Grievance Reports, compensation reports and safety reports.

E.10. Value added statement:

Concept of Value Added: 'Value-Added' is a basic and important measurement to judge the performance of an enterprise. It indicates the net value or wealth created by the manufacturer during a specified period. No enterprise can survive or grow, if it fails to generate wealth.

An enterprise may exist without making profit, but cannot survive without adding value. Value added is a more meaningful measure of corporate performance than conventional measures based on traditional financial accounting, and can be particularly useful for employee-oriented approach which will allow more fruitful discussions with employees.

The value added concept attempts to neutralise the distinction between capital and labour by focusing on the creation of wealth i.e., the fund from which all payments to capital, labour and the government must come.

The value-added concept also aligns corporate financial reporting with 'National Income Accounting'. Value added is included in the computation of Gross Domestic Product (GDP).

Value Added Statement: This is a financial statement that shows how much value (wealth) has been created by an enterprise through the utilisation of its capacity, capital, manpower, and other resources, and how it is then allocated among different stakeholders (employees, lenders, shareholders, government, etc.) within an accounting period.

In other words, these are financial statements that show how a business creates value and distributes that wealth to diverse stakeholders. Employees, shareholders, the government, creditors, and the wealth retained in the enterprise are among the numerous stakeholders.

A typical Value-Added Statement has two parts – Creation/Generation of Value Added and Distribution of Value Added.

I. **Creation or Generation of Value Added:** This part of the value-added statement describes how the value is generated. Here, value added is shown as the excess of turnover plus income from services over the cost of bought-in material and cost of services. The term 'turnover' is defined as the gross sale of goods plus sales tax (GST) and duties minus the amount of rebates, returns, commission, discounts and goods used for self-consumption.

II. **Application of Value Added:** This part describes how the value added is shared by the three contributing members viz., (a) employees, (b) government and (c) providers of capital. The remainder of the value added is reinvested in the business in the form of depreciation and retained earnings.

The following is a general format of Value-Added Statement.

Creation of Value Added: (a) **Sales** (including sales tax and excise duty but net of rebate, commission, returns, discounts and goods for self-consumption) (b) **Income from services** (e.g., royalty, dividend and interest, rent received etc.) (c) **Cost of bought-in materials** (consumption of raw materials, consumables,packing materials, stationery, fuel and oil, electricity, repairs etc.) (d) **Cost of bought-in services** (e.g., audit fees, insurance, rent paid, travelling expenses, advertisement, postage and telegram, subscriptions, other expenses)		
Added Value Created [(a)+(b) –(c) – (d)]		
Distribution of Value Added: (a) **To Employees** (e.g., wages and salaries, director's fees, contribution toP.F, ESI etc.) (b) **To Government** (e.g., duties and taxes) (c) **To Providers of Capital** (e.g., Interest and Dividend) (d) **Retained Earnings** (e.g., depreciation and retained profit) (e) **Loss on sale of assets**		
Disposal of Value Added [(a)+(b) +(c) + (d)]		

Uses of Value Added Statement: Value added reporting is not only useful for external purposes but also for internal decision making and performance measurement. The following are some of the uses of value-added reporting:

a. Value added is an alternative performance measure to profit.

b. Useful productivity measures can be devised using corporate value added. For example,

   i. Value added per rupee of capital employed

   ii. Value added per rupee of sales

   iii. Value added per rupee of labour cost

   iv. Value added per employee

   v. Value added per labour hour or machine hour

c. Resource allocation decisions may be based upon value added.

d. The value-added reporting is found useful by many companies for explaining company results to employees. One of the significant uses of the concept of value added is its incorporation in company incentive schemes or bonus schemes.

Question 1. The following are the balances in the account statements of X Ltd. for the year ended 31st March, 2024:

Particulars	Amount
Turnover	4,600
Plant and machinery net	2,160
Loss on sale of machinery	150
Depreciation on plant and machinery	400
Dividends to ordinary shareholders	292
Debtors	390
Creditors	254
Total stock of all materials, WIP and finished goods:	
Opening stock	320
Closing stock	400
Raw materials purchased	1,250
Cash at bank	196
Printing and stationery	44
Auditor's remuneration	56
Retained profits (opening balance)	1998
Retained profits for the year	576
Rent, rates and taxes	330
Other expenses	170
Ordinary share capital issued	3,000
Interest on borrowings	80
Income-tax for the year	552
Wages and salaries	654
Employees state insurance	70
P.F. contribution	56

Prepare a Value-Added Statement for the company for the year 2023-24. **(ICAI Study material)**

Solution: **value added statement for the year ended on 31st March 2024**

Particulars	Amount	Amount
Generation of Value Added:		
Turnover		4,600
Add: Increase in Stock of raw materials, WIP and FG		80
		4,680
Less. Cost of bought-in materials:		
Raw materials purchased	1,250	
Printing and Stationery	44	**1294**
Less: Cost of bought in services:		
Auditor's remuneration	56	
Rent, rates and taxes	330	
Other expenses	170	**556**
Total Value Added		**2,830**

Distribution of Value Added:		
To Employees		
Wages and salaries	654	
Employees state insurance	70	
P.F. contribution	56	
		780
To Government		
Income-tax for the year		**552**
To Providers of Capital		
Interest on borrowings	80	
Dividends	292	
		372
Re-invested in Business		
Depreciation on plant and machinery		
Retained profit for the year	400	
	576	**976**
Loss on sale of machinery:		**150**
Total Disposal of Added Value		**2,830**

Question.2 Prepare a value-added statement for the year ended on 31.3.2024 and reconciliation of total value added with profit before taxation, from the Profit and Loss Account of Futures Ltd. for the year ended on 31.3.2024:

		(in '000)
Income:		
Sales	24,400	
Other Income	508	24,908
Expenses:		
Operating cost	22,360	
Interest on Bank Overdraft	75	
Interest on 9% Debentures	1,200	23,635
Profit before Depreciation		**1,273**
Depreciation		405
Profit before tax		**868**
Provision for tax		320
Profit after tax		**548**

The following additional information are given:

(i) Sales represents Net sales after adjusting Discounts, Returns and GST

(ii) Operating cost includes ₹82,50,000 as wages, Salaries and Other benefits to Employees.

(iii) Bank Overdraft is temporary.

Question 3. Value Added Ltd. furnishes the following Profit and Loss A/c :

Profit and Loss A/c for the year ended 31st March, 2024

Income	**Notes**	**₹ ('000)**
Turnover	1	29,874
Other Income		1040
		30,914
Expenditure		
Operating expenses	2	28,693
Interest on 8% Debenture		987
Interest on Cash Credit	3	151
		29,831
Profit before depreciation		**1,083**
Less: Depreciation		(342)
Profit before tax		**741**
Provision for tax		376
Profit after tax		**365**
Less: Transfer to Fixed Assets replacement reserve		(65)
		300
Less: Dividend paid		(125)
Retained Profit		**175**

Notes:

(1) Turnover is based on invoice value and net of GST.

(2) Salaries, Wages and other employee benefits amounting to ₹ 14,761 ('000) are included in operation expenses.

(3) Cash Credits represents a temporary source of finance. It has not been considered as a part of capital.

(4) Transfer of ₹ 54 ('000) to the credit of deferred tax account is included in provision for tax.

Prepare value added statement for the year ended 31st March, 2024 and Reconcile total value added with profit after taxation and application of value added.

E.11. Economic value added and market value added:

Economic Value Added (EVA) is a performance measure developed by Stern Stewart & Co. (now known as Stern Value Management) to find the true economic profit generated by a company.

It is also called "**economic profit**," and provides a measurement of a company's economic success (or failure) over a period of time.

Economic profit can be calculated by taking a company's net after-tax operating profit and subtracting from it the product of the company's invested capital multiplied by its percentage cost of capital.

Economic Value Added (EVA) is the measure of economic profits after charging both cost of debt and cost of equity capital.

EVA = NOPAT - (WACC × Invested Capital/capital employed),

Where NOPAT = EBIT × (1 – t);

EBIT is Earnings Before Interest and Tax.

t = tax rate = Tax expenses/EBT

EBT is Earnings Before Tax.

Weighted Average Cost of Capital (WACC) = (We × Ke) + (Wd × Kd)

We = weight of Equity in capital structure

Wd = weight of Debt in capital structure

Ke = Cost of Equity Capital

Kd = Cost of Debt Capital

Question 4. NOPAT = Rs 5,00,000

Equity share capital = Rs 30,00,000

Borrowings = Rs 20,00,000

Cost of equity (Ke) = 12%

Cost of debt (Kd) = 15%

Calculate EVA.

Question 5. EBIT = Rs 6,00,000

Tax rate = 30%

Ratio of debt and equity in capital employed = 3:4

Cost of equity (Ke) = 10%

Cost of debt (Kd) = 15%

Calculate EVA.

Question 6. Profit after tax = Rs 3,60,000.

Tax rate = 40%

12% debentures = Rs 5,00,000

Equity share capital = Rs 10,00,000.

Calculate NOPAT.

Market Value Added:

Market value added (MVA), on the other hand, is **simply the difference between the current total market value of a company and the capital contributed by investors** (including both shareholders and debtholders). It is typically used for companies that are larger and publicly-traded.

MVA is not a performance metric like EVA but instead is a wealth metric, measuring the surplus value a company has generated in reflection of its future performance.

As a company performs well over time, investors will likely bid up to the prices of those shares in expectation of future earnings, causing the company's market value to rise. As this occurs, MVA measures the difference between the company's market value and the capital contributed by investors represents the excess price tag the market assigns to the company as a result of its expected future operating successes.

Question 7: current market value of the company = Rs 500 crores.

Equity share capital Rs 100 crores.

Preference share capital = Rs 60 crores.

12% debentures = Rs 40 crores.

Calculate Market Value added (MVA).

E.12. Quarterly earnings call management.

Concept of Earnings Call: An earnings call (also known as Earnings Conference Call) is a conference call (typically held in the form of a teleconference or a webcast) during which the management of a company announces and discusses the financial results of a company for a given quarter or a year. The calls are usually preceded or accompanied by a press release containing a summary of the financial results. Typical participants are investors, equity analysts, and business journalists. Earnings calls of large companies are often heavily covered in business news. The recording of the call as well as a transcript of the same are normally hosted in the official websiteof the company.

Frequency and Timing of Earnings Call: Earning calls are not legally mandated. So, a company may not actually have any earnings call. The cultureis, however, more prevalent in western countries and slowly becoming popular in India as well.

According to the National Investor Relations Institute, USA, 92% of companies represented by their members conduct earnings calls. In India also, most of the large publicly listed companies organise earnings conference call.

There is no general requirement for how far in advance notice of a call must be given. However, to ensurea fruitful discussion and to reach the target audience as much as possible, the call is generally announced a few days or weeks in advance. The schedule of the call is generally posted by the company in the Investor Relations section of their website.

Structure of an Earnings Call: Normally, an earnings call is found to have the following three parts.

A. Safe Harbour Statement: A typical earnings call starts with the safe harbour statement made by the company's management. The safe harbour statement generally warns the participants of the earnings presentation that the discussion of financial results may include forward-looking statements. Thus, the estimates of results based on theforward-looking statements may substantially differ from the actual results.

B. Presentation and Discussion of the Financial Results: After the safe harbour statement, the managers take over the call. In an earnings call, generally, a company is represented by C-level executives. Depending on a company and its corporate hierarchy, the number of participating executives may vary. However, the two key executives that are always present in the earnings call are the chief executive officer (CEO) and chief financial officer (CFO).

The executives present and discuss the financial results for the given reporting period. In addition, the managers provide an overview of the company's upcoming goals and milestones, as well as discuss how the plans will impact the future financial performance of the company.

C. Question and Answer Session: The final section of the earnings call is reserved for the Q&A session. During this session, investors, analysts, and other participants in the call have an opportunity to ask the management questions regarding the presented financial results. The representatives of the management answer the questions based on the data available with them. However, they may decline or defer their answers for certain questions.

Importance of Earnings Call:

Earnings calls are considered one of the key resources for investors and equity analysts. The information provided during earnings calls can be incorporated into the fundamental analysis of a company. In fundamental analysis, analysts can combine the information obtained during the event with the information presented in the management, discussion, and analysis (MD&A) section of the company's reports.

The importance of earnings calls is acknowledged by the fact that investors frequently plan their trades close to the date of an upcoming conference. Equity analysts use the information provided during such events to update their earnings estimates.

Due to this importance to the investors and analysts, now-a-days earnings calls are recognised as an important tool for corporate reporting.

Multiple Choice Questions:

1. The three pillars of sustainability are often referred to as: -

a. Planet – People – Profit
b. People – Planet – Profit
c. People – Profit – Planet
d. People – Plant – Profit

2. External benefits of sustainability reporting can include: -

a. Mitigating – or reversing – negative environmental, social and governance impacts
b. Improving reputation and brand loyalty
c. Enhanced perception on organisation's value
d. All of the above

3. International Integrated Reporting Council (IIRC) launched IR as a global framework in: -

a. November 2013
b. December 2012
c. November 2012
d. December 2013

4. As per the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, the following classes of companies were required to file the Financial Statements in XBRLForm only from the year 2010-2011

a. All companies listed in India and their subsidiaries
b. All companies having a paid-up capital of ₹5 crore (₹50 million) and above
c. All companies having turnover of ₹100 crore (₹1 billion) or above, excluding power and banking companies, insurance companies, Non-Banking Financial Companies and overseas subsidiaries of these companies
d. Any of the above

5. **A company required to furnish cost audit report and other documents to the Central Government under Section 148(6) of the Companies Act, 2013 and rules made thereunder, shall file such report and other documents using the XBRL taxonomy given in Annexure-III to the said Rule for the financial years on or after April 1, 2014 in e-Form……………….specified under the Companies (Cost Records and Audit) Rules,2014**

   a. CRA-2
   b. CRA-3
   c. CRA-4
   d. CRA-1

Answer:

1.	2.	3.	4.	5.
b.	d.	d.	d.	c.

2. Fill in the Blanks:

1. XBRL is managed by________________________________.
2. XML stands for____________________________________.
3. XBRL stands for____________________________________.
4. Economic Value Added (EVA) is a performance measure developed by___________________________to find the true economic profit generated by a company.
5. ______ is the accounting surplus generated by the business and distributable not only to the owners or the shareholders but also to other stakeholders i.e., the lenders, the employees and the government?

Answer:

1.	XBRL International Inc.	2.	extensible Markup Language
3.	extensible Business Reporting Language	4.	Stern Stewart & Co.
5.	Value Added		

SECTION F – Government accounting in India

GOVERNMENT ACCOUNTING –

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. It is also referred to as Public Finance Accounting.

FEATURES OF GOVERNMENT ACCOUNTING:

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 accounting system used by government and its institutions have to reveal how public funds and properties have been used for that people and society.

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.

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. It means no government office can make expenditure more than the amount allocated in the budget.

7. Mode of Transaction: All government transactions are supposed to be performed through banks.

8. Fund-based Accounting: The government is engaged in 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 of the books of accounts maintained by government departments, offices or institutions are audited by CA&G of India.

OBJECTIVES OF GOVERNMENT ACCOUNTING: The specific objectives can be stated as under:

1. To record revenues and expenditure relating to the government organizations as per the appropriate Act, Rules, and legal provisions as set by the government.

2. To provide reliable financial data and information about the operation of public fund.

3. To avoid the excess expenditures beyond the limit of the budget approved by the government.

4. To help in the preparation of various financial statements and reports.

5. To facilitate the auditing by the concerned government department.

6. To prevent misappropriation of government properties by maintaining the systematic records of cash and store items.

7. To facilitate for estimating the annual budget by providing historical financial data of government and expenditures.

GENERAL PRINCIPLES OF GOVERNMENT 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.
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.
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:** The transactions in government accounts shall represents the actual cash receipt and disbursement during a financial year.
6. **Form of Accounts:** The accounts of Government are kept in three parts namely, Consolidated Fund, Contingency Fund and Public Account.

COMPARISON BETWEEN GOVERNMENT ACCOUNTING AND COMMERCIAL ACCOUNTING:

Basis	**Government accounting**	**Commercial accounting**
1. Meaning	Applies to Government departments, offices.	Applies to Non-Government departments, offices
2. Objective	is maintained for recording and reporting the utilisation of public funds.	Is maintained to know the profit or loss for an accounting period and disclose the financial position of the entity.
3. Scope	More elaborate than that followed in commercial accounts.	Less elaborate than that followed in government accounts.
4. Budget	directly influenced by the government budgeting system.	does not follow the government budgeting system.
5. Basis	Prepared on cash basis	May be done on cash basis or accrual basis, or 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:	Strictly maintained by following the financial rules and provisions as set by the concerned government	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 stakeholders about the operating result and financial position of the business.
9. Auditing:	**CA&G of India**	**Professional auditors**

GOVERNMENT ACCOUNTING AND REPORTING:

(I) Comptroller 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.

(II) Pay and Accounts Office:

- The accounts of the Civil Ministries are compiled and maintained by the Pay and Accounts Offices.
- 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.

Role of Comptroller General of Accounts (CGA):

- 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.
- 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.

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. 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, GST and other 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.
- It accounts for flows for those transactions where the government merely acts as a banker.
- Examples of those are provident funds, small savings etc. These funds do not belong to the government. They have to be paid back at some time to their rightful owners.
- Because of this nature of the funds, expenditures from it are not required to be approved by the parliament.

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.
- Any expenditure incurred from this fund requires a subsequent approval from the parliament and the amount withdrawn is returned to the fund from the consolidated fund.

- The contingency fund of India is used at a time when there is a crisis in the nation e.g natural calamity and money is required to deal with it.
- The contingency fund of India is at the disposal of the president of India, who releases the funds on request of the union cabinet, who later gets an approval from parliament. A parliament approval is mandatory.
- 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.

COMPTROLLER 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, 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.
- 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 tenure of 6 years.
- 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.”
- 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.

ROLE, FUNCTION AND DUTIES OF THE COMPTROLLER & AUDITOR GENERAL (C&AG):

1. C & AG to compile and keeping of accounts of Union and States.

2. C & AG to prepare and submit accounts to the President, Governors of States and Administrators of Union territories having Legislative Assemblies.

3. Comptroller and Auditor General to give information and render assistance to the Union and States.

4. General provisions relating to audit: It shall be the duty of the CA&G:

- to audit all expenditure from the Consolidated Fund of India and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the purpose to which they have been applied.
- 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.

5. Audit of receipts and expenditure of bodies or authorities substantially financed from Union or State Revenues:

6. In the case of grants or loans given to other authorities or bodies, the CA&G shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfilment of the conditions subject to which such grants or loans were given.

7. Audit of receipts of Union or of States: It shall be the duty of the CA&G to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union territory 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 report thereon.

8. Audit of accounts of stores and stock: The CA&G 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.

Powers of Comptroller and Auditor General in connection with audit of accounts: The CA&G 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.

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 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 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 ensures Parliamentary control over government expenditure.

- The Public Accounts Committee was first set up in India in 1921 under the Montague Chelmsford Reforms.

- 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 comprising 15 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 Rajya 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.

Role of Public Accounts Committee (P.A.C):

1. The chief function of P.A.C. is to examine the audit report of C&AG after it is laid in the Parliament.

2. In examining the report of the 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 have not crossed the limits of parliamentary authorization.

3. 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 wasteful expenditure and lack of financial integrity in public services.

However, the committee cannot question the policies of the government. It only concerns itself with the execution of policy on its financial aspects.

4. 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. 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.

GOVERNMENT ACCOUNTING STANDARDS ADVISORY BOARD (GASAB):

- 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 (ICMAI), or his nominee

16. Principal Director in GASAB, as Member secretary.

Responsibilities of GASAB: - GASAB has the following responsibilities:

1. To propose standards that improve the usefulness of financial reports based on the needs of the users.

2. To formulate and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms.

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.

MISSION OF GOVERNMENT ACCOUNTING STANDARD ADVISORY BOARD (GASAB)

- The mission of the 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.
- 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.

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

The Union Government and the State Governments give Guarantees for repayment of borrowings within such limits, 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 equipment 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.

- **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 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.
- The Authority in the Government which prepares the Statement of Guarantees for inclusion and presentation in the Financial Statements shall apply this Standard.

Disclosure:

The Financial Statements of the Union Government, the State Governments and the Union Territory Governments shall disclose the following:

- maximum amount for which Guarantees have been given during the year, additions and deletions 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 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 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.

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. • 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.

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.

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. This is based on the system of governance in India, which follows three-tier pattern:

- With the Union Government at the apex (top),
- 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.

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.

The State Governments are required to devolve funds to various Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) upon them for discharging various functions such as education, health, rural housing, drinking water, etc.

Objective: The objectives of this Standard is 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.

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.

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.

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 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.

Important Definitions:
• **Charged and Voted Loans and Advances:** All loans to State Governments and Union Territory Governments made by the Union Government are **'charged' loans** whereas all other loans and advances are **'voted' loans** and advances. • **Loanee Entity:** It is an entity in whose favour a loan or an advance is sanctioned by 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 on 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.

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 LOSS OR GAIN BY EXCHANGE RATE VARIATION

Introduction: Indian rupee is the reporting currency for the financial statements of the Government.

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.

Scope: The Accounting Authority which prepares and presents the financial statements of the Government under the cash basis of accounting 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 gain by 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.

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.

Treatment of Loss or Gain by Exchange Rate Variation:
- All losses or gains by exchange rate variation in respect of Government transactions in foreign currencies shall be recognised as revenue loss or gain.

Disclosure:
The financial statements shall disclose the following details of foreign loans in the format given:
(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) interest paid on external debt; and
(i) closing rate of exchange applied.

IGAS — 9 GOVERNMENT INVESTMENTS IN EQUITY

Introduction:

The Union Government, State Governments, and Governments of Union Territories make investments in entities like Government companies, Statutory Corporations, other Joint Stock Companies and Cooperative Banks/ Societies, international bodies and authorities like the International Monetary Fund, Asian Development Fund, and International Finance Corporation.

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 only to government accounts being maintained on a cash basis.
It applies to investment in equity of the investee entities and not in debt, like debentures, bonds.

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 investee entity.

Loans converted into equity shall be treated as equity investments from the date on which such conversion takes plate, i.e. from the date on which details of conversion are entered in the books of the investee entity.

Measurement:

- The method of initial measurement of investments in the financial statements of the Government is the historical cost of the investment.
- 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.
- 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.
- 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.
- ➢ The amount of dividend received shall be reflected as revenue of the period.

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.

Objective: The objective of the IGAS 10 is to 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.

Scope: The proposed IGAS shall apply to the financial statements prepared by the Union and State Governments and Union Territories with legislature.

Measurement & Valuation:

The Public Debt and Other Obligations incurred by Governments shall be accounted and reported on the basis of Face Value.

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 with respect to internal debt;

(b) The opening balance, additions and discharges during the year, closing balance and net change in rupee terms with respect to external debt, wherever applicable;

(c) The opening balance, receipts and disbursements during the year, closing balance and net change in rupee terms with respect of other obligations.

(d) Interest paid by the governments on public debt, small saving, provident funds, and reserve funds and on other obligations.

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. Multiple Choice Questions:

1. **The Financial Statements of the Union Government shall disclose the following details under 'Loans andAdvances made by the Union Government' in the Annual Finance Accounts of the Union Government**

   a. the summary of Loans and Advances showing loanee group-wise details
   b. the summary of Loans and Advances showing Sector-wise details
   c. the summary of repayments in arrears from Governments and other loanee entities
   d. All of the above

2. **Consolidated Fund of India is the fund referred to in___________________of the Constitution of India**
   a. Article 266(1)
   b. Article 266(2)
   c. Article 266(3)
   d. Article 266(4)

3. **The financial statements of the Union Government, State Governments and the Union Territories with legislature shall disclose the following details concerning Public Debt and other obligations**

   a. the opening balance, additions and discharges during the year, closing balance and net change inrupee terms with respect to internal debt

   b. the opening balance, additions and discharges during the year, closing balance and net change inrupee terms with respect to external debt, wherever applicable

   c. the opening balance, receipts and disbursements during the year, closing balance and net change inrupee terms with respect of other obligations

   d. All of the above

4. **As per The Constitution of India, the Accounts of the Government are kept in**
   a. Consolidated Funds of India
   b. Public Accounts of India
   c. Contingency Funds of India
   d. All of the above

ALL THE BEST MY DEAR CMA STUDENT…...

BELIEVE ME… YOU ARE THE BEST….

YOU ARE GOING TO ROCK IN EXAM….

SOON YOU ARE GOING TO ADD 'CMA' BEFORE YOUR NAME…

YOUR SANTOSH SIR…...