FINAL : PAPER - 18

CORPORATE FINANCIAL REPORTING

FINAL

STUDY NOTES

The Institute of Cost Accountants of India

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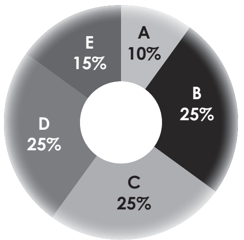
Syllabus

The syllabus comprises the following topics and study weightage:

A	Generally Accepted Accounting Principles	10%
B	Business Combinations – Accounting & Reporting	25%
C	Group Financial Statements	25%
D	Developments in Financial Reporting	25%
E	Government Accounting in India	15%



ASSESSMENT STRATEGY

There will be written examination paper of three hours.

OBJECTIVES

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

Learning Aims

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

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

Skill set required

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

Section A: Generally Accepted Accounting Principles (GAAP)	**10%**
1. Evolution and Convergence of International Accounting Standards	
Section B: Business Combinations – Accounting & Reporting	**25%**
2. Accounting for Business Combinations	
Section C: Group Financial Statements	**25%**
3. Consolidated Financial Statements	
Section D: Developments in Financial Reporting	**25%**
4. Sustainability Reporting	
5. Accounting and Reporting of Financial Instruments and other External Reporting	
6. Share based payments	
7. Voluntary Disclosures	
8. Reporting through XBRL (Extended Business Reporting Language)	
Section E: Government Accounting in India	**15%**
9. Government Accounting Standards in India [issued by the Government Accounting Standards Advisory Board (GASAB)] – overview and application in Government Accounting, accounting and reporting procedures	

SECTION A: GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP) [10 MARKS]

1. Evolution and Convergence of International Accounting Standards

(a) GAAP in India, Hierarchy of GAAP in India

(b) International Financial Reporting Standards (IFRSs)

(c) Relative view of AS and IFRSs

(d) Accounting Standards (AS) – applicability, interpretation, scope and compliance

SECTION B: BUSINESS COMBINATIONS – ACCOUNTING AND REPORTING [25 MARKS]

2. Accounting for Business Combinations (as per Ind AS)

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

(b) Accounting in books of vendor/ transferor company

(c) Accounting for investment in subsidiary

(d) Accounting for holding companies (including chain holdings, cross holdings, multiple holdings)

(e) Corporate financial restructuring

(f) Reconstruction schemes, De-merger

(g) Notes to Accounts - relevance related to published Financial Statements

(h) SPVs

SECTION C: GROUP FINANCIAL STATEMENTS [25 MARKS]

3. Consolidated Financial Statements

(a) Consolidation of foreign - Holding Company, Subsidiary Company and Associate Company including multiple sub subsidiaries.

(b) Concept of a group, Purposes of consolidated financial statements, Consolidation procedures - Minority interest, Goodwill, Treatment Pre - acquisition profit and Post -acquisition profit and concept of Fair value at the time of acquisition

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

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

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

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

SECTION D: DEVELOPMENTS IN FINANCIAL REPORTING
[25 MARKS]

4. Sustainability Reporting

(a) Concept of Triple Bottom Line Reporting

(b) Global Reporting Initiative (GRI)

(c) International Federation of Accountants (IFAC)

5. Accounting and Reporting of Financial Instruments and other External Reporting

(a) Meaning, recognition, de-recognition and offset, compound financial instruments

(b) Measurement of financial instruments

(c) Hedge Accounting

(d) External Reporting under capital market regulations, Disclosures

(e) Annual Reports-Statutory requirement and External report, Preparation of Financial Information, Disclosure of post balance sheet events

(f) Financial reporting across the world with reference to reporting under US and UK laws

(g) AS 30, 31, 32

6. Share based payments in Ind AS

(a) Meaning, Equity settled transactions, Transaction with employees and non-employees

(b) Determination of fair value of equity instruments

(c) Vesting conditions, Modification, cancellation and settlement, Disclosures

7. Voluntary Disclosures

(a) Disclosure issues

(b) Value Added Statements

(c) Economic Value Added, Market Value Added, Shareholders' Value Added

(d) Human Resource Accounting

(e) Financial reporting by mutual funds, Non-banking finance companies, Merchant Bankers, Stock and Commodity market intermediaries

(f) Management discussion and analysis

8. Reporting through XBRL (Extended Business Reporting Language)

SECTION E: GOVERNMENT ACCOUNTING IN INDIA [15 MARKS]

9. Government Accounting in India

(a) General Principles

(b) Comparison with commercial accounting

(c) Role of Comptroller and Auditor General of India

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

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

(f) Government Accounting and Reporting

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Study Note - 1

EVOLUATION AND CONVERGENCE OF INTERNATIONAL ACCOUNTING STANDARDS

This Study Note includes

1.1 Framework of Accounting
1.2 US GAAPs
1.3 International Accounting Standards
1.4 International Financial Reporting Standards
1.5 Indian Accounting Standards
1.6 Comparative Analysis of the Indian Accounting Standards, IFRS and USGAAP
1.7 Presentation of Financial Statements (Schedule III)

1.1 FRAMEWORK OF ACCOUNTING

1.1.1 INTRODUCTION

Most of the world's work is done through organizations-groups of people who work together to accomplish one or more objectives. In doing its work, an organization uses resources-Iabor, materials, various services, buildings, and equipment. These resources need to be financed, or paid for. To work effectively, the people in an organization need information about the amounts of these resources, the mean of financing them and the results achieved through using them. Parties outside the organization need similar information to make judgments about the organization. Accounting is a system that provides such information.

Organizations can be classified broadly as either for-profit or nonprofit. As these names suggest, a dominant purpose of organizations in the former category is to earn a profit, whereas organizations in the latter category have other objectives, such as governing, providing social services, and providing education. Accounting is basically similar in both types of organizations.

1.1.2 MEANING OF ACCOUNTING

The Committee on Terminology set up by the American Institute of Certified Public Accountants formulated the following definition of accounting in 1961:

"Accounting is the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof.

As per this definition, accounting is simply an art of record keeping. The process of accounting starts by first identifying the events and transactions which are of financial character and then be recorded in the books of account. This recording is done in Journal or subsidiary books, also known as primary books. Every good record keeping system includes suitable classification of transactions and events as well as their summarization for ready reference. After the transaction and events are recorded, they are transferred to secondary books. i.e. Ledger. In ledger transactions and events are classified in terms of income, expense, assets and liabilities according to their characteristics and summarized in profit & loss account and balance sheet. Essentially the transactions and events are to be measured in terms of money. Measurement in terms of money means measuring at the ruling currency of a country, for example, rupee in India, dollar in the U.S.A. and like. The transactions and events must have at least in par, financial characteristics. The inauguration of a new branch of a bank is an event without having financial character, while the business disposed of by the branch is an event having financial character.

Accounting also interprets the recorded, classified and summarized transactions and events.

1.1.3 OBJECTIVES AND FUNCTIONS OF ACCOUNTING

The main objectives are Systematic recording of transactions, Ascertainment of results of recorded transactions and the financial position of the business, providing information to the users for rational decision-making and to know the solvency position. The functions of accounting are Measurement, Forecasting, Decision-making, Comparison & Evaluation, Control, Government Regulation and Taxation.

Accounting concepts

Accounting concepts define the assumptions on the basis of which financial statements of a business entity are prepared. Certain concepts are perceived, assumed and accepted in accounting to provide a unifying structure and internal logic to accounting process. The word concept means idea or notion, which has universal application. Financial transactions are interpreted in the light of the concepts, which govern accounting methods. Concepts are those basic assumptions and conditions, which form the basis upon which the accountancy has been laid. Unlike physical science, accounting concepts are only result of broad consensus. These accounting concepts lay the foundation on the basis of which the accounting principles are formulated.

Accounting principles

"Accounting principles are a body of doctrines commonly associated with the theory and procedures of accounting serving as an explanation of current practices and as a guide for selection of conventions or procedures where alternatives exists."

Accounting principles must satisfy the following conditions:

1. They should be based on real assumptions;
2. They must be simple, understandable and explanatory;
3. They must be followed consistently;
4. They should be able to reflect future predictions;
5. They should be informational for the users.

Accounting conventions

Accounting conventions emerge of accounting practices, commonly known as accounting, principles, adopted by various organizations above a period of time. These conventions are derived by usage and practice. The accountancy bodies of the world may change any of the convention to improve the quality of accounting information. Accounting conventions need not have universal application.

1.1.4 Fundamental Accounting Assumptions

The Financial Statements are prepared with the following three Fundamental Accounting Assumptions. Unless otherwise specified the readers of the Financial Statements assume that the Financial Statements are prepared in line with these assumptions. They are Going Concern, Consistency & Accrual. Accounting Standard 1 describes them as follows

Going Concern: The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

Consistency It is assumed that accounting policies are consistent from one period to another.

Accrual Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. (The considerations affecting the process of matching costs with revenues under the accrual assumption are not dealt with in this Statement.)

1.1.5 Limitations of Accounting

The Financials Statements are prepared on the basis of the above-mentioned assumptions, conventions and the Accounting Principles which the accountant chooses to adopt. These bring in lot of subjectivity to the Financial Statements and hence these basis assumptions conventions and principles become the limitation of accounting.

The Financial Statements as the name states, accounts only for the items that can be measured by Money. There are lots of items that money cannot measure but still are the most valuable assets for the enterprise, like Human Resources, which the Financial Statements does not depict.

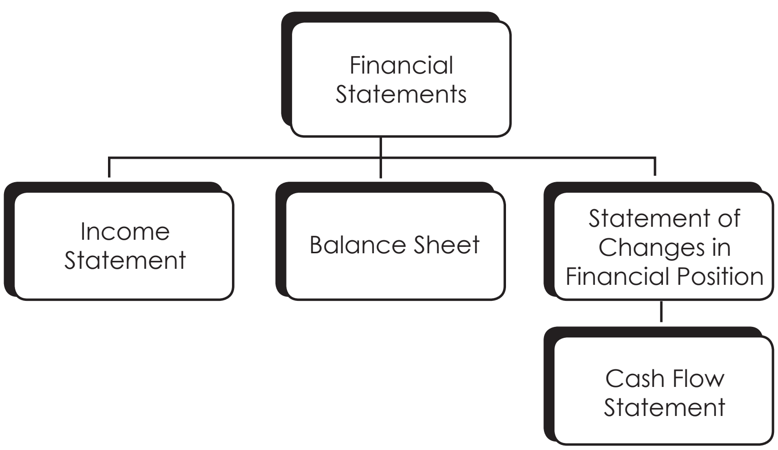
The language of accounting has certain practical limitations and, therefore, the financial statements should be interpreted carefully keeping in mind all various factors influencing the true picture.

1.1.6 Financial Statements

Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, a statement of profit and loss (also known as 'income statement'), a cash flow statement and those notes and other statements and explanatory material that are an integral part of the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with financial information about business and geographical segments, and disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in a financial or annual report.

1.1.7 Component of Financial Statement

Financial statements comprise a number of statements prepared at the end of each financial year to assess the various financial activities and strength of an enterprise.



Financial Statement Components	Source /Type of Companies
Profit and Loss Account Schedule and Notes Forming Part thereto	Under section 129 of the companies Act in accordance with the provisions of the Companies Act and the Indian GAAP, to be prepared by all the companies. As per section 133(3B) all applicable accounting standards should be followed. Otherwise reasons of departure from accounting standards and financial effect should be disclosed. Compliance with accounting standards without any deviation is mandatory for the listed companies as per clause 50 of the Listing Agreement vide SEBI Circulars SMRP/ Policy/Cir-44/01, Aug 31,2001
Cash Flow Statement	As per clause 32 of the Listing Agreement vide SEBI circular SMD-II/Policy/cir-80/2000 February 4, 2000. Cash Flow Statement should be prepared in accordance with the requirements of AS- 3 issued by the ICAI. To be prepared by listed companies.
Consolidated Financial Statements	Applicable to listed companies as per the SEBI circular SMRP/policy/cir-44/01,Aug.31,2001 Companies Listed in a recognized stock exchange shall be mandatorily required to publish Consolidated Financial Statements in the annual report in addition to the individual financial Statements shall be mandatory. To be prepared in accordance with AS-21 and AS-23. Section 134 requires that board's Report shall include a Director's Responsibility Statement in which it is to be indicated that in the preparation of annual accounts, the applicable accounting standards are followed.

1.1.8 Frame Work

The conceptual Framework for Financial Reporting issued by the IASB has stated the following uses of the general purpose financial statements by the cross-section of users:

(a) to decide when to buy , hold or sell any equity investment,

(b) to assess the accountability of management,

(c) to assess the ability of the entity to pay and provide other benefits to its employees,

(d) to assess the security for amounts lent to the entity,

(e) to determine taxation policies,

(f) to determine distributable profits and dividends,

(g) to prepare and use national income statistics,

Important shortcoming of financial statements is that they are prepared to meet the common information needs of a wide range of users. They may fall short of specific information needs of the users.

To meet the above – stated uses, financial statements provide information about an entity's assets, liabilities, equity, and income and expenses, including gains and losses, other changes in equity and cash flows. That information, along with other information in the notes, assists users of financial statements in predicting amount, timing and degree of certainty of the entity's future cash flows.

1.1.9 Users and their Information Needs

The Framework discusses objective of financial statements, qualita tive characteristics that determine the usefulness of information con tained in the financial statements, definition, recognition and measure ment of the elements from which financial statements are constructed and concepts of capital and capital maintenance.

Identification of user of financial statements and their information needs are just theoretical as general purpose financial statements can not satisfy the specific information need of various user groups. The Framework has identified the following user groups and their informa tion needs:

USERS OF FINANCIAL STATEMENTS AND THEIR INFORMATION NEEDS

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

Management of the entity has access to financial as well as non-financial information for the purpose of decision making. In fact, the financial statements are the outcome in financial terms of all the managerial decisions taken during the accounting period. Still the management might use the published financial information with a view to evaluate performance, financial position and cash flow of the entity. Truly speaking management use of financial statements is very low.

1.1.10 Objective of Financial Statements

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. This would guide in deciding statements, their contents and disclosures.

A set of general purpose financial statements focus on financial position, performance and cash flows of an entity which could be used by any user group to assess investment decision, employment stability or growth, debt servicing, business continuity and ability to make societal contribution. General purpose financial statements are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

A complete set of financial statements as worked out in Para 10 of IAS 1 is the outcome of the Framework which in turn is linked to subserve the information need of various user-groups. It comprises of:

(a) a statement of financial position as at the end of the period;

(b) a statement of comprehensive income for the period ;

(c) a statement of changes in equity for the period;

(d) a statement of cash flows for the period;

(e) notes, comprising a summary of significant accounting policies and other explanatory information; and

(f) a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

Notes, comprising a summary of significant accounting policies and other explanatory information are important components of financial statements as they explain various elements of financial statements. Disclosure of risks adds to the information content of the financial statements.

Earning per share information contained in the Income Statement is focused information to shareholders as regards entity's performance. Information regarding diluted earning improves the information com munique working out the effect of possible equity dilution actions. Similarly, segment reporting is intended to provide disaggregated infor mation based on operating and / or geographic segments, consolidated financial statements focus on providing aggregated financial informa tion for the entity-group as a whole, related party disclosures are intended to highlight non-market oriented transactions, if any. Thus the origination and improvement in disclosure and presentation standards have the purpose of making a set of general purpose financial statements useful to the diverse user-groups.

1.1.11 Elements of Financial Statements

Three elements relating to the Statement of Financial Position (Balance Sheet) are asset, liability and equity and two elements related to Statement of Comprehensive Income are income and expense.

Definition of elements of financial statements · An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Equity is the residual interest in the assets of the entity after deducting all its liabilities.

Income is increases in economic benefits during the accounting period in the form of inflows or enhancement of assets or decreases of liabilities that result in increases in equity, other than those relating to contribu tions from equity participants.

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Assets - Recognition of assets as covered in various IFRSs like IAS 16 Property, Plant and Equipment, IAS 17 Leases, IAS 38 Intangible Assets in general and concept of assets enshrined in any standard should follow the definition stated in the Framework. Features of an asset-

(i) The future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Potential to contribute may be either productive (e.g., Property, Plant and Equipment) or convertibility into cash or cash equivalent (e.g., Receivables).

(ii) Future economic benefit embodied in an asset flows to the entity in different manner and accordingly to be tested for asset recognition:

- usage in the production of goods and services ;

- exchange for other assets ;
- use to settle a liability ;
- Distribution to owners.

(iii) Assets are not necessarily characterised by physical form (like property, plant and equipment). Copyright, trademark (intangibles), etc. also qualify as assets based on the concept of future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity.

(iv) Assets signified by legal right (assets under lease) may not be with ownership right. Still they are recognized as assets based on con cept of future economic benefit embodied in an asset has the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity. Another example is know-how wherein the entity may not have ownership right on the technology but the right to use only which has the potential to contribute to the flow of cash and cash equivalents to the entity.

(v) The assets of an entity result from past transactions or other past events. Transactions or events expected to occur in the future do not in themselves give rise to assets.

(vi) There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Incurring expenditure (development expenditure may not satisfy the test of asset) is not conclusive proof of asset creation. On the other hand, incurrence of expenditure is not an essential condition for asset recognition (asset may arise out of Government grant).

In absence of any specific standard, recognition of asset is guided by

Paras 49(a), 53-59 of the Framework.

Liabilities- An essential characteristic of a liability is that the entity has a present obligation.

1.1.12 Analysis of the term Obligation:

(i) It is duty to perform in a particular manner, for example to pay interest of a loan at the end of every quarter and repay the principal on a specific date.

(ii) It may be legally enforceable but that is not a necessary condition.

Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. An announcement to pay bonus to employees becomes an obligation because of normal business practice or custom although there is no legally enforceable agreement.

1.1.13 Characteristics of a Liability:

(i) Normally liability arises from present obligation. But future obliga tion may also create liability if they are irrevocable. A forward contract to buy goods is irrevocable; therefore, gain or loss on such contract is evaluated and recognized as an asset or a liability.

(ii) Liabilities result from past transactions or other past events. Even an irrevocable future obligation arises from past transactions or commitment (events) only.

(iii) Normally liabilities are measurable in money terms. Sometimes liabilities are estimated which are termed as provisions. Frame work defines the term liability broadly that includes provisions.

(iv) Settlement of liability means giving up resources embodying economic benefits. Liabilities are settled in any of the following ways-

- payment cash or transfer of other assets ;
- provision of services (services are rendered or to be rendered)
- replacement by a new obligation;
- conversion of an obligation into equity;
- extinguished by way of waiver from the creditors.

Unless specifically covered by a standard, recognition of a liability should be in accordance with Paras 49(b), 60-64 of the Framework.

Equity - Equity is the residual interest in the assets of the entity after deducting all its liabilities. It is presented in the statement of financial position in a classified manner which helps the user-groups (particularly the investors) in decision making. In a corporate entity, funds contri buted by shareholders, retained earnings, reserves representing appropriations of retained earnings (capital redemption reserve) and reserves representing capital maintenance adjustments may be shown separately.

Reserves may be created in accordance with statutory requirement (for example there is a requirement of compulsory transfer to reserve for dividend payment in India) or to satisfy tax laws (for example investment reserve as per Indian Income-tax Act).

Income- Income encompasses revenue and gain. While the former arises out of ordinary activities of an entity, gain is not the outcome of the ordinary activities. Examples of revenue are (z) sale of goods, (it) rendering services, (iil) income, royalties and dividend arising out of use of entity 's assets by others.

Gains represent other items that meet the definition of income. They may arise in the course of ordinary activities of an entity. Gains may be realised or unrealised. Examples are profit on sale of non-current assets, fair value gain on assets, surplus on settlement of liabilities, etc. Although they are not different by nature from revenue, they are presented in the income statement as separate elements. Gains are often presented net of related expenses.

Unless specifically covered by a standard, recognition of income should be in accordance with Paras 69-77 of the Framework. However, gains may also arise from activities other than ordinary activities.

Expense - Expenses encompass expenses that arise in the course of the ordinary activities of the entity and losses. Examples of expenses that arise in the course of the ordinary activities of the entity are cost of sales, wages, repairs and depreciation. They usually take the form of an outflow or depletion of assets. On the other hand, losses do not arise in the course of the ordinary activities of the entity. They may realised or unrealized. Examples are loss on sale of non-current assets, fair value loss on assets, loss on settlement of liabilities, losses resulting from disasters such as fire and flood, etc.

Unless specifically covered by a standard, recognition of income should be in accordance with Paras 69-73 and 78-80 of the Framework.

1.1.14 Measurement Basis

Elements of financial statements, i.e. assets, liabilities, equity, income and expense, are measured using different measurement bases like historical cost, current cost, realizable (settlement) value and present value.

Under the historical cost assets are recognized at cash or cash equivalent paid or at the fair value of consideration agreed upon at the time of acquisition. Similarly, liabilities are recognized at cash or cash equiva lents received against the obligation. In some cases, liabilities are recog nized at cash or cash equivalents expected to be paid in futures (for example, provision for warranty claim, income-tax liability).

Current cost signifies current entry value of an asset if replaced cur rently. For a liability it represents undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

Under the realisable (settlement) value assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values. Settlement value of a liability means undiscounted amounts of cash or cash equivalents expected to be paid to satisf y the liabilities in the normal course of business.

Under the present value assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

Various IFRSs explain the measurement bases of relevant transactions and other events. In absence of a specific guidance, an entity may follow a suitable measurement base out of historical cost, current cost, realiz able value and present value.

1.1.15 Recognition of financial elements

Recognition is a process of incorporating an item of asset, liability or equity in the statement of financial position (balance sheet) or an item of income or expense in the statement of income, or an item (like dividend, fair value gain of available for sale financial instruments) in th e state ment of changes in equity.

General recognition principles are explained in the following table:

RECOGNITION PRINCIPLES OF FINANCIAL STATEMENT ELEMENTS

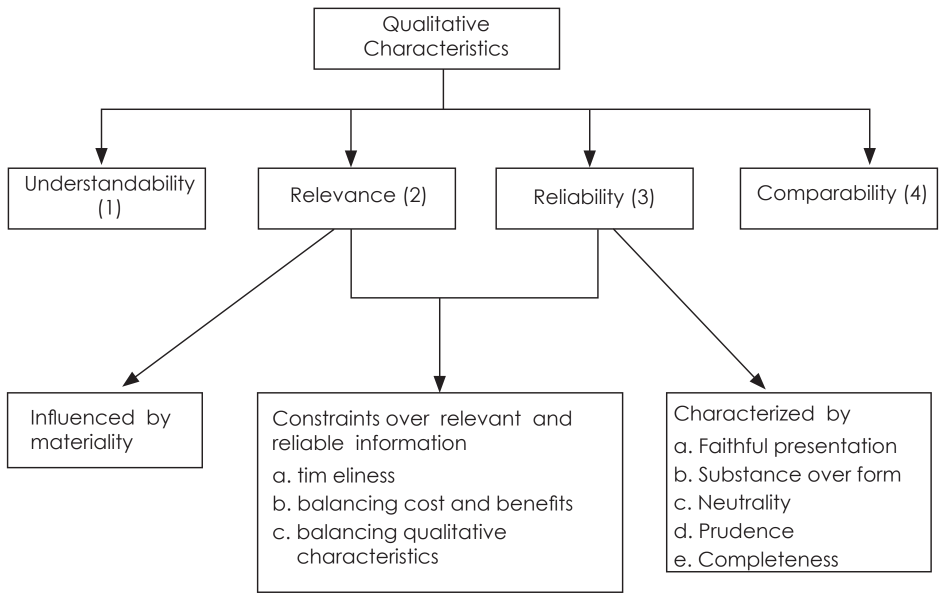
Principles	Para reference to Framework	Details
1. Fundamental principles	83	i. Economic benefits embodied in the el emen t will flow to or from the entity ii. Cost or value can be measured reliably. Recognition of any element of financial state- ments shall be tested against these two fun damen - tal principles. That apart specific standard would prescribe additional recognition criteria.
2. Disclosure is no remedy for recognition failure	82	Elements of financial statement are recognized when the fundamental principles sta ted in Para 83 of the Framework or any additional criteria stated in a specific standard applicable to that element are satisf ied. Failure to recognize an el ement ca nnot be rectified by disclosure of accounting policy or by way of notes.
3. Materiality	84	Recognition of an element of financial statements should satisfy the materiality test (refer to Paras 29 and 30 of the Framework).
4. Use of probability	85	In case there exists uncertainty as regards flow of resou rce embodying economic benefit to or from the entity, the concept of probability is used for measurement of value of the transaction or other events. For example, for measuring liability arising out of warranty claim, an entity can use historical data of claim to assign probability of claim.
Reliability of measurement		
5. Estimation of cost or value	86	If a reasonable estimate of the cost or value cannot be made of an item, it is not recognised in the balance sheet or income statement. The fundamental reliability premise is that cost or value of an element should be reliably measurable. Of course, use of probability as stated in Para 85 is
8. Recognition after subsequent initial recognition	87	An item may satisfy recognition test to initial failure as uncertainties attached to the failure flow of economic benefit and reliable measure- ment are removed because of some subsequent events.

Principles	Para reference to Framework	Details
9. Disclosure of an item which failed the recognition test	88	Disclosure is required even if an item fails recognition test which is relevant to the evaluation of financial position, performance and changes in financial position of an entity by the users of financial statements.
Recognition of assets		
10. Fundamental when principles of asset benefits recognition	89	An asset is recognised in the balance sheet it is probable that the future economic will flow to the entity and the asset has a cost or value that can be measured reliably.
	90	Asset is not recognized if it is improbable that a future economic benefit will flow beyond the current accounting period.
Recognition of liabilities		
11. Fundamental principle of recognition of liabilities	91	A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.
Recognition of Income		
12. Fundamental principle of income recognition	92	Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measu red reliably.
13. Income should be earned	93	The practice of recognizing income when it is earned follows from the prudence that underlying economic benef it would flow to the entity and it can be reliably measured. Author's comment: Perhaps recognition of fair value change as income under IAS 39 or IAS 40 does not satisfy this test in many circumstances.
Recognition of Expense		
14. Fundamental principle d expense recognition	94	Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably,
15. Matching of costs and revenues	95	Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process is also referred to as the matching of costs with revenues. It involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events. Examples, cost of goods sold.
16. Technique of systematic and rational allocation of expense	96	When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the in come statement on the basis of systematic and rational allocation procedures. Examples, depreciation and amortization.

Principles	Para reference to Framework	Details
17. Expenditure having no economic benefits beyond current period	97	Expenditure which does not have any economic benefits beyond current period is treated as an expense.
18. Expense arises from recognition of liability	98	Expense is recognized when liability is recognized that is not settled immediately or against which no cash and cash equivalent is received. Example, outstanding expense.

1.1.16 Qualitative Characteristics

Qualitative characteristics are the attributes that make the informa tion provided in financial statements useful to users. Four principal qualitative characteristics are presented in following figure. On an overall count, financial statements should reflect fair presentation.



Qualitative Characteristics

1. **Understandability:** Information provided in financial statements should be readily understandable by the users having reasonable know ledge of business and economic activities and accounting and a willing ness to study the information with reasonable diligence.

2. **Relevance:** Information must be relevant to the decision-making needs of users. If the information can influence the economic decisions of users by helping them to evaluate past, present or future events or confirming, or correcting, their past evaluations is considered as relevant. The information has predictive as well as confirmatory role. Information about financial position and past performance is frequently used as the basis for predicting future financial position and perfor mance. Level of profit may be the basis of confirmation of debt service capacity, dividend payment, etc.

   Classified information like classified balance sheet has better predictive ability. Similarly, an income statement which presents operating profit and unusual items separately has better predictive ability.

   Relevance is influenced by materiality and timeliness.

3. **Reliability:** An information is reliable if it is-

   - free from material error and bias and

   - presented faithfully which it either purports to represent or could reasonably be expected to represent.

   Example: There is a lawsuit against the entity which it believes as fructuous. However, the opponent party has made a widespread cam paign that it would win the case and get a claim of ₹ 10 million from the entity. Based on this market information, the entity should not recognize a liability as this information is not free from bias. It has relevance as it may affect the profit of the entity substantially but its reliability is equally important.

   Reliability is influenced by faithful presentation, substance over form, neutrality, prudence and completeness.

4. **Comparability:** It facilitates comparison of financial statements of an entity through time in order to identify the trends in its financial position and performance. To ensure comparability IAS 1 requires consistency of presentation. Normally, an entity shall retain the presentation and classification of items in the financial statements from one period to the next. Exceptions are stated in Para 45(a) and (b) of IAS 1 [Refer to Chapter 4].

To ensure comparability IAS 1 requires disclosure of comparative information in respect of the previous period for all amounts reported in the current period's financial statements. It has to include comparative information for narrative and descriptive information when it is rele vant to an understanding of the current period's financial statements.

Materiality- Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. It depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Often separate line item or sub-item is decided based on materiality. National level law may specify materiality limit for separate disclosure of an item.

Faithful presentation - Financial information is fraught with the risk of faithful presentation not primarily because of bias but for inherent measurement difficulties. It is more so in fair value measure ment as compared to historical cost measurement. However, IFRSs have set out unbiased measurement principles, application of which will lead to faithful presentation.

Substance over form - Transaction and other events should be presented based on substance not in accordance with the legal form. Example is recognition of assets by economic benefits not by ownership.

Neutrality - Financial information should be free from bias. In case of 'earning management' or 'creative accounting' information is pre sented with an objective to achieve pre-determined result. The resultant financial statements are not reliable as they lack neutrality.

Prudence - Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. The exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions.

Completeness - The information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Constraint on relevant and reliable information- Important con straints are (1) timeliness, (it) balance between benefit and cost, (iit) balance between qualitative characteristics.

Timeliness - A piece of information loses relevance if there is delay in the reporting of information. Normal frequency of financial reporting is one year. This is because the concept of interim financial reporting has gained ground.

However, the management is required to balance between timeliness and reliability. A premature disclosure of information without judging all aspects may turn out to be unreliable whereas too much delay in disclosure would make the disclosure redundant.

Balance between benefit and cost - The benefits derived from informa tion should exceed the cost of providing it. But the costs do not necessar ily fall on those users who enjoy the benefits. Of course, the evaluation of benefits and costs is substantially a judgmental process.

Balance between qualitative characteristics - This is aimed at achieving a balance between two or more qualitative characteristics.

True and Fair View

Financial statements are frequently described as showing a true and fair view of, or as presenting fairly, the financial position, performance and changes in financial position of an entity. The IASB Framework does not deal with this concept. However, the application of the principal qualitative characteristics and appropriate accounting standards nor mally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.

True' and 'fair' are two undefined qualitative expressions the law uses to describe a standard for external financial reporting. This lack of definition allows professional judgment and establishment of meaning through usage. These terms require an element of professional judgment by those involved in the process. They mean that in the final analysis what is true and fair is ultimately up to the courts to decide. The intent behind the legal use of such terms is related to a wider moral stance of the society.

The nature of truth, whether it is absolute or relative, whether it exists · as a reality, an incontrovertible thing, or as an abstraction, whether it is dependent or independent of the believerl observer and whether any statement can be proven or merely falsified are all aspects that have been applied to accounting theory and research. 'Fair' (and 'fairness') is also open to varying degrees of interpretation and application. Both

truth and fairness may vary according to time and place, and may be relative to the framework within which they reside. Chastney (1975) suggests in order to achieve a true and fair view financial reports should present information both impartially and in a manner that a reader can understand clearly. The AICPA 1986 definition of fairness in accounting, however, applies to the application of judgment to established rules, and is concerned with fairness in presentation rather than fairness as neutrality between different interests.

In a legal opinion sought by the UK Accounting Standards Board (ASB), Hoffman and Arden (1983), while concluding 'true and fair ew' is a legal concept, stated that the courts will treat compliance with accepted accounting principles as prima facie evidence that accounts are true and fair, and equally the converse would apply. An accounting standard upheld by the law becomes an authoritative source of law itself. Yet case law would suggest that compliance with the rules is in itself insufficient to comprise a 'true and fair view' or 'fair presentation'.

The 'true and fair view' concept is one of two competing but not mutually exclusive legal standards for financial reporting quality that have been subject to debate on their meaning, use and importance. The other is 'present fairly in conformity with generally accepted accounting principles' (GAAP). While the former is closely identified with judgment and is used in the United Kingdom, the European Union, India, Singapore, Australia and New Zealand, the latter is the standard for United States financial reporting and tends to be more rule based.

Lee (1982), Rutherford (1985) and Walton (1993) inclined towards explaining 'true and fair view' in terms of generally accepted accounting principles rather than accepting the concept as an independent quality. Such definitions depend on the acceptance that the consistent applica tion of accounting principles amounts to a 'true and fair view'. This viewpoint has been gaining ground among professional accounting bodies.

The American equivalent to 'true and fair view'- The American equivalent to true and fair view is 'present fairly in conformity with GAAP', which is also never been clearly defined. It could mean:

(1) Fairly presented and also in accordance with generally accepted accounting principles.

(2) Fairly presented because it is in accordance with generally accepted accounting principles.

American Institute of CPAs' Statement on Auditing Standards (No. 69): The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles in the Independent Auditor's Report (issued in 1991) specifies adherence to five criteria for an auditor to claim that thefinancial statements are fairly presented in accordance with GAAP. These five criteria are:

(1) The accounting principles selected and applied have general acceptance.

(2) The accounting principles are appropriate in the circumstances.

(3) The financial statements, including the related notes, are informative of matters that may affect their use, understanding and interpretation.

(4) The information presented in the financial statements is classified and summarised in a reasonable manner; that is, it is not too detailed nor too condensed.

(5) The financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows, stated within a range of acceptable limits.

These criteria suggest that the AICPA looks financial statements as fairly presented because they accord with GAAP. However, to define fairness in terms of GAAP does not solve the definition as the GAAP is based on a multitude of estimations.

The IASB view - Para 13 of IAS-1 "Presentation of Financial Statements" states that-

Financial statements shall present fairly the financial position, financial performance and cash flows of an entity . Fair presentation requires the faithful presentation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRS, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.

Para 15, IAS 1 further explains that virtually in all circumstances a fair presentation is achieved by compliance with applicable IFRSs. This para states three additional criteria to achieve fair presentation:

a. an entity should select and apply accounting policies in accordance with IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors".

b. an entity should present information, including accounting policies in a manner that provides relevant, reliable, comparable and under standable information.

c. an entity should provide additional disclosures when compliance with specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events, and conditions on the entity's financial position and financial perfor mance.

Indian position - Section 129 of the Companies Act requires that every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of the financial year and every profit and loss account shall give a true and fair view of the profit or loss of the company during the financial year. However, the term "true and fair" is not explained in the Companies Act.

The term "true and fair" means that accounts have been prepared-

- in accordance with the requirements of the Companies Act and other applicable legislations; and
- in accordance with generally accepted accounting principles and policies.

In India, generally accepted accounting principles and policies are available in the accounting standards and various other documents issued under Section 133 of the Companies Act, 2013.

Schedule III to the Companies Act includes certain disclosure require ments for the preparation and presentation of financial statements. These instructions do not exhaustively cover the accounting principles and policies to be adopted on various accounting issues and the disclo sure requirements for corporate financial reporting in a transparent manner. Accordingly, it becomes necessary to follow accounting stan dards or other pronouncements of the ICAI.

However, accounting standards and other pronouncements of the ICAI are different on many counts with the international accounting stan dards and accordingly, even if the accounts are prepared following Indian accounting standards and other GAAPs (Generally Accepted Accounting Principles), it is unlikely to be considered as "fair" in many developed countries including the USA, the EU and the UK

In Indian context, the financial statements shall reflect true and fair view if the following conditions are fulfilled:

- Balance Sheet is drawn up as per the requirements of Schedule III and in the form given in Part I of the said Schedule;
- Profit and Loss Account is drawn up as per the requirements of Part II of Schedule III;
- Proper books of account are maintained as required in section 128; i.e. proper books of account are maintained with respect to-
    a. all sums of money received in respect of receipts and all sums of money paid in respect of expenditure,
    b. all sales and purchases of goods by the company,
    c. assets and liabilities of the company, and
    d. cost records relating to utilisation of material or labour or to other items of costs in case of companies engaged in the production, processing, manufacturing or mining activities, if required by the Central Government;

Proper books of account are to be maintained following double entry system of book-keeping and accrual basis of accounting; Balance Sheet and profit and loss account are prepared following generally accepted accounting principles and policies; i.e. (i) accounting policies adopted by the company are consistent with generally accepted accounting principles and policies, (ii) financial statements reflect substance of the transactions and events that took place during the financial year, and (iii) disclosures are consistent with the accounting standards and other relevant pronounce ments of the ICAI.

Section 129 of the Companies Act, 2013 requires that every profit and loss account and balance sheet shall comply with the accounting standards.

1.1.17 Capital Maintenance

Capital maintenance concept is inherent in the profit measurement process comparing assets, liabilities and equity of two different account ing dates. However, under IFRS based accounting model, profit is measured matching expenses and income. Of course, expenses are matched with related revenue if they are directly related. For indirect expenses like depreciation and amortization, the inherent method is systematic allocation over the useful life. Various assets and liabilities are measured following a mixture of historical cost, current cost (entry value), realizable value (exit value) and present value (economic value). So income and expense are the outcome of such heterogeneous valua tion system. No specific capital maintenance concept is adhered to.

Of course, in theory there are two concepts - financial capital mainte nance and physical capital maintenance. Under financial capital main tenance concept, profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power. Under physical capital maintenance concept, profit is earned only if the physical produc tive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

In the context of IAS 29 Financial Reporting in Hyperinflationary Economies preparation of current cost financial statements is required by application of specific price index. It approximates specific current cost of assets and thereby the framework has indirectly adopted physi cal capital maintenance concept.

1.2 US GAAPs

GAAP refers to accounting policies and procedures that are widely used in practice. Unlike India where accounting has its basis in law, US GAAP has evolved to be a collection of pronouncements issued by a particular accounting organization. US GAAP are the accounting rules used to prepare financial statements for publicly traded companies and many private companies in United States. Generally accepted accounting principles for local and state governments operates under different set of assumptions, principles, and constraints, as determined by the Governmental Accounting Standards Board. (GASB).

In the United States, as well as in other countries practicing under the English common law system, the government does not set accounting standards, in the belief that the private sector has the better knowledge and resources. The Securities and Exchange Commission (SEC) has the ultimate authority to set US accounting and financial reporting standards for public (listed) companies. The SEC has delegated this responsibility to the private sector led by the Financial Accounting Standards Board (FASB). Other private sector bodies including the American Institute of Certified Public Accountants (AICPA) and the FASB's Emerging Issues Task Force(EITF) also establish authoritative accounting Standard Board(FIN) also provide implementation and interpretation guidance. The SEC has the Statutory authority to establish GAAP for filings made with it. While allowing most of the Standard settings to be done in the private sector, the SEC is still very active in both its oversight responsibility as well as establishing guidance and interpretations, as it believes appropriate. US GAAP have the reputation around the world of being more perspective and detailed than accounting standards in other countries. In order to organize and make clear what is meant by US GAAP, a GAAP hierarchy has been established which contains four categories of accounting principles. The sources in the higher category carry more weight and must be followed when conflicts arise. The table given below summaries the current GAAP hierarchy for financial statements of non-governmental entities.

1.2.1 Established Accounting Principles in the US

Category(a)

Financials Accounting Standards Board(FASB) statements and Interpretations, American Institute of Certified Public Accountants (AICPA), Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins(ARB).

Category(b)

FASB Technical Bulletins, cleared AICPA Industry Audit and Accounting Guides, and cleared AICPA Statement of Position (SOPs).

Category(c)

Consensus positions of the FASB Emerging Issues Task Force (EITF) and cleared Accounting Standards Executive Committee of AICPA(ACSEC)Practice Bulletins.

Category(d)

AICPA Accounting Interpretations, FASB Implementation Guides (QSAs), and widely recognized and prevalent Industry practices.

1.2.2 Other Accounting literature

Other accounting literature, including FASB concepts statements, APB Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; Pronouncements of other professional associations or regulatory agencies ; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles.

The US GAAP provisions differ somewhat from International Financial Reporting Standards though efforts are underway to reconcile the differences so that reports created under international standards will be acceptable to the SEC for companies listed on US markets.

1.2.3 AICPA

The AICPA sets generally accepted professional and technical standards for CPAs in many areas. Until the 1970's, the AICPA held a monopoly in this field. In the 1970's however, it transferred its responsibility for setting generally accepted accounting principles (GAAP) to the newly formed Financial Accounting Standards Board (FASB). Following this, it retained its standards setting function in areas such as financial statement auditing, professional ethics, attest services, CPA firm quality control , CPA tax practice and financial planning practice. Before passage of the Sarbanes-Oxley law, AICPA standards in these areas were considered "generally accepted" for all CPA practitioners.

Accounting Principles Board(APB) Opinions were published by Accounting Principles Board(APB). APB was the main organization setting the US GAAP and its opinions are still an important part of it.

1.2.4 FASB

The Financial Accounting Standards Boards(FASB) is private, not-for- profit organization whose primary purpose is to develop generally accepted accounting principles in the United States (US GAAP). The FASB's mission for the private sector is similar to that of the Governmental Accounting Standards Board for local and state governments in the United States. The FASB was created in1973, replacing the Accounting Principles Board of the American Institute of Certified Public Accountants (AICPA). The FASB.s mission is 'to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information."

The U.S. Securities and Exchange Commission (SEC) has statutory authority to establish financial accounting and reporting standards for publicly held companies under Securities Exchange Act of 1934. The SEC designated the FASB as the organization responsible for setting accounting standards for public companies in the U.S.

FASB has so far issued 158 Statements of Financial Accounting Standards (FAS).

1.2.5 Components of US GAAP

Given below are important components of US GAAP:

- FASB Statement of Financial Accounting Standards (FAS).
- FASB Interpretations(FIN).
- FASB Statements of Financuai Accounting Concepts(FAS Conc.)
- FASB Technical Bulletins(FTB).
- AICPA Accounting Research Bulletins(ARB).
- AICPA Accounting Principles Board Opinions(APB Opinions)
- AICPA Accounting Interpretations(AIN)

Not only there are an extremely large number of different standards under US GAAP, the volume and complexity is also increasing. This complexity of US GAAP makes it critically important that the independent accountants that are assisting a company in filing with SEC are acknowledgeable and experts in US GAAP.

1.3 INTERNATIONAL ACCOUNTING STANDARDS

1.3.1 Introduction

The International Accounting Standard Board (IASB) was formulated and began in operations in 2001. The objective of IASB is as follows

"*Committed to developing, in public interest, asingle set of high quality, global accouting standards that require transparent and comparable information in general purpose financial statements*"

The IASB is selected, overseen and funded by the International Accounting Standards Committee (IASC) Foundation, consisting of 22 trustees. The responsibility of the trustees, besides others include,

- Appointment of members of the IASB and Standards Advisory Council and the IFRIC
- Monitoring the IASB's effectiveness and adherence to its due process and consultation procedures
- Establishing and maintaining appropriate financing arrangement
- Approve of the budget for the IASC Foundation and
- Responsibility for constitution changes.

1.3.2 Extract of the International Accounting Standards

The following are the Extract of the International Accounting Standards and International Financial Reporting Standards, prepared by IASC Foundation staff (The same has not been approved by the IASB. For the requirements reference must be made to International Financial Reporting Standards.)

International Accounting Standard 1

Presentation of Financial Statements

Objective

This Standard prescribes the basis for presentation of general purpose financial statements to ensure comparability both with the entity's financial statements of Previous periods and with the financial statements of other entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

Scope

An entity shall apply this Standard in preparing and presenting general purpose financial statements in accordance with International Financial Reporting Standards (IFRSs).

INTERNATIONAL ACCOUNTING STANDARD 2

Inventories

International Accounting Standard 2 *Inventories* (IAS 2) replaces IAS 2 *Inventories* (revised in 1993) and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. The Standard also supersedes SIC-1 *Consistency—Different Cost Formulas for Inventories.*

Reasons for revising IAS 2

The International Accounting Standards Board developed this revised IAS 2 as part of its project on Improvements to International Accounting Standards. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the project were to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements. For IAS 2 the Board's main objective was a limited revision to reduce alternatives for the measurement of inventories. The Board did not reconsider the fundamental approach to accounting for inventories contained in IAS 2.

Objective and scope

The objective and scope paragraphs of IAS 2 were amended by removing the words 'held under the historical cost system', to clarify that the Standard applies to all inventories that are not specifically excluded from its scope.

Scope clarification

IN6 The Standard clarifies that some types of inventories are outside its scope while certain other types of inventories are exempted only from the measurement requirements in the Standard. Paragraph 3 establishes a clear distinction between those inventories that are entirely outside the scope of the Standard (described in paragraph 2) and those inventories that are outside the scope of the measurement requirements but within the scope of the other requirements in the Standard.

INTERNATIONAL ACCOUNTING STANDARD 7

Cash Flows Statements

Objective

Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation. The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.

Scope

An entity shall prepare a statement of cash flows in accordance with the requirements of this Standard and shall present it as an integral part of its financial statements for each period for which financial statements are presented.

This Standard supersedes IAS 7 Statement of Changes in Financial Position, approved in July 1977.

Users of an entity's financial statements are interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be the case with a financial institution. Entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. Accordingly, this Standard requires all entities to present a statement of cash flows.

INTERNATIONAL ACCOUNTING STANDARD 8

Accounting Policies, Changes in Accounting Estimates and Errors

Objective

The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.

Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in IAS 1 *Presentation of Financial Statements.*

Scope

This Standard shall be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

The tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are accounted for and disclosed in accordance with IAS 12 *Income Taxes.*

INTERNATIONAL ACCOUNTING STANDARD 10

Events after the Balance Sheet Date

Objective

The objective of this Standard is to prescribe:

(a) when an entity should adjust its financial statements for events after the reporting period; and

(b) the disclosures that an entity should give about the date when the financial statements were authorised for issue and about events after the reporting period.

The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate.

Scope

This Standard shall be applied in the accounting for, and disclosure of, events after the reporting period.

INTERNATIONAL ACCOUNTING STANDARD 11

Construction Contracts

Objective

Accounting for construction contracts involves measurement and recognition of costs and revenue in the books of "Contractor". Objective of this standard is the allocation of contract revenue and contract costs to the period in which the work is performed.

Scope

This Standard shall be applied in accounting for construction contracts in the financial statements of contractors.

Definitions

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

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

A fixed price contract is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

A cost plus contract is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs, plus a percentage of these costs or a fixed fee.

INTERNATIONAL ACCOUNTING STANDARD 12

Income Taxes

Objective

The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:

(a) The future recovery (settlement) of the carrying amount of assets (liabilities) that are recognized in an entity's statement of financial position; and

(b) Transactions and other events of the current period that are recognized in an entity's financial statements.

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

Scope

This Standard shall be applied in accounting for income taxes.

INTERNATIONAL ACCOUNTING STANDARD 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. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

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

INTERNATIONAL ACCOUNTING STANDARD 17

Leases

Objective

The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosure to apply in relation to leases.

Scope

This Standard shall be applied in accounting for all leases other than:

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and

(b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.

However, this Standard shall not be applied as the basis of measurement for:

(a) property held by lessees that is accounted for as investment property (see IAS 40 Investment Property);

(b) investment property provided by lessors under operating leases (see IAS 40);

(c) biological assets held by lessees under finance leases (see IAS 41 Agriculture);

or

(d) biological assets provided by lessors under operating leases (see IAS 41).

INTERNATIONAL ACCOUNTING STANDARD 18

Revenue

Objective

Income is defined in the Framework for the Preparation and Presentation of Financial Statements as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants. Income encompasses both revenue and gains. Revenue is income that arises in the course of ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends and royalties.

The objective of this Standard is to prescribe the accounting treatment of revenue arising from certain types of transactions and events.

The primary issue in accounting for revenue is determining when to recognize revenue. Revenue is recognised when it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provides practical guidance on the application of these criteria.

Scope

This Standard shall be applied in accounting for revenue arising from the following transactions and events:

(a) the sale of goods;

(b) the rendering of services; and

(c) the use by others of entity assets yielding interest, royalties and dividends.

INTERNATIONAL ACCOUNTING STANDARD 19

Employee Benefits

Objective

The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognise:

(a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

(b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Scope

This Standard shall be applied by an employer in accounting for all employee benefits, except those to which IFRS 2 Share-based Payment applies.

INTERNATIONAL ACCOUNTING STANDARD 20

Accounting for Government Grants and Disclosure of Government Assistance

Scope

This Standard shall be applied in accounting for, and in the disclosure of, government grants and in the disclosure of other forms of government assistance.

This Standard does not deal with:

(a) the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of a similar nature;

(b) government assistance that is provided for an entity in the form of benefits that are available in determining taxable income or are determined or limited on the basis of income tax liability (such as income tax holidays, investment tax credits, accelerated depreciation allowances and reduced income tax rates);

(c) government participation in the ownership of the entity;

(d) government grants covered by IAS 41 *Agriculture*.

INTERNATIONAL ACCOUNTING STANDARD 21

The Effects of Changes in Foreign Exchange Rates

International Accounting Standard 21 The Effects of Changes in Foreign Exchange Rates (IAS 21) replaces IAS 21 The Effects of Changes in Foreign Exchange Rates (revised in 1993), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. The Standard also replaces the following

Interpretations:

- SIC-11 *Foreign Exchange—Capitalisation of Losses Resulting from Severe Currency Devaluations*
- SIC-19 *Reporting Currency—Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*
- SIC-30 *Reporting Currency—Translation from Measurement Currency to Presentation Currency*.

Scope

IN5 The Standard excludes from its scope foreign currency derivatives that are within the scope of IAS 39 *Financial Instruments*: Recognition and Measurement. Similarly, the material on hedge accounting has been moved to IAS 39.

INTERNATIONAL ACCOUNTING STANDARD 23

Borrowing Costs

Objective

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.

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.

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.

This Standard uses the following terms with the meanings specified:

Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds.

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

Borrowing costs may include:

(a) interest on bank overdrafts and short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of finance leases recognised in accordance with IAS 17 *Leases*; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

INTERNATIONAL ACCOUNTING STANDARDS 24

Related Party Disclosures

Objective

The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

Scope

This Standard shall be applied in:

(a) identifying related party relationships and transactions;

(b) identifying outstanding balances between an entity and its related parties;

(c) identifying the circumstances in which disclosure of the items in (a) and (b) is required; and

(d) determining the disclosures to be made about those items.

This Standard requires disclosure of related party transactions and outstanding balances in the separate financial statements of a parent, venturer or investor presented in accordance with IAS 27 Consolidated and Separate Financial Statements.

Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements. Intragroup related party transactions and outstanding balances are eliminated in the preparation of consolidated financial statements of the group.

INTERNATIONAL ACCOUNTING STANDARD 26

Accounting and Reporting by Retirement Benefit Plans

Scope

This Standard shall be applied in the financial statements of retirement benefit plans where such financial statements are prepared.

Definitions

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

Retirement benefit plans are arrangements whereby an entity provides benefits for employees on or after termination of service (either in the form of an annual income or as a lump sum) when such benefits, or the contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the entity's practices.

Defined contribution plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon.

Defined benefit plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on employees' earnings and/or years of service.

Funding is the transfer of assets to an entity (the fund) separate from the employer's entity to meet future obligations for the payment of retirement benefits.

For the purposes of this Standard the following terms are also used:

Participants are the members of a retirement benefit plan and others who are entitled to benefits under the plan.

Net assets available for benefits are the assets of a plan less liabilities other than the actuarial present value of promised retirement benefits.

Actuarial present value of promised retirement benefits is the present value of the expected payments by a retirement benefit plan to existing and past employees, attributable to the service already rendered.

Vested benefits are benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

INTERNATIONAL ACCOUNTING STANDARD 27

Consolidated and Separate Financial Statement

Objective

The objective of IAS 27 is to enhance the relevance, reliability and comparability of the information that a parent entity provides in its separate financial statements and in its consolidated financial statements for a group of entities under its control. The Standard specifies:

(a) the circumstances in which an entity must consolidate the financial statements of another entity (being a subsidiary);

(b) the accounting for changes in the level of ownership interest in a subsidiary;

(c) the accounting for the loss of control of a subsidiary; and

(d) the information that an entity must disclose to enable users of the financial statements to evaluate the nature of the relationship between the entity and its subsidiaries.

INTERNATIONAL ACCOUNTING STANDARD 28

Investment in Associates

Introduction

International Accounting Standard 28 *Investments in Associates* replaces IAS 28 *Accounting for Investments in Associates* (revised in 2000) and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. The Standard also replaces the following Interpretations:

- SIC-3 *Elimination of Unrealized Profits and Losses on Transactions with Associates*
- SIC-20 *Equity Accounting Method—Recognition of Losses*
- SIC-33 *Consolidation and Equity Method—Potential Voting Rights and Allocation of Ownership Interests*.

Scope

The Standard does not apply to investments that would otherwise be associates or interests of ventures in jointly controlled entities held by venture capital organizations, mutual funds, unit trusts and similar entities when those investments are classified as held for trading and accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. Those investments are measured at fair value, with changes in fair value recognized in profit or loss in the period in which they occur.

Furthermore, the Standard provides exemptions from application of the equity method similar to those provided for certain parents not to prepare consolidated financial statements. These exemptions include when the investor is also a parent exempt in accordance with IAS 27 *Consolidated and Separate Financial Statements* from preparing consolidated financial statements (paragraph 13(b)), and when the investor, though not such a parent, can satisfy the same type of conditions that exempt such parents (paragraph 13(c)).

INTERNATIONAL ACCOUNTING STANDARD 29

Financial Reporting in Hyperinflationary Economies

This Standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.

INTERNATIONAL ACCOUNTING STANDARD 31

Interests in Joint Ventures

Introduction

IN1 International Accounting Standard 31 *Interests in Joint Ventures* (IAS 31) replaces IAS 31 *Financial Reporting of Interests in Joint Ventures* (revised in 2000), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged.

Scope

The Standard does not apply to investments that would otherwise be interests of venturers in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities when those investments are classified as held for trading and accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. Those investments are measured at fair value, with changes in fair value being recognised in profit or loss in the period in which they occur. Furthermore, the Standard provides exemptions from application of

proportionate consolidation or the equity method similar to those provided for certain parents not to prepare consolidated financial statements. These exemptions include when the investor is also a parent exempt in accordance with IAS 27 *Consolidated and Separate Financial Statements* from preparing consolidated financial statements [paragraph 2(b)], and when the investor, though not such a parent, can satisfy the same type of conditions that exempt such parents [paragraph 2(c)].

INTERNATIONAL ACCOUNTING STANDARD 32

Financial Instruments: Presentation

Objective

The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in IAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in IFRS 7 *Financial Instruments: Disclosures*.

Scope

This Standard shall be applied by all entities to all types of financial instruments except:

(a) thos e interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures*. However, in some cases, IAS 27, IAS 28 or IAS 31 permits an entity to account for an interest in a subsidiary, associate or joint venture using IAS 39; in those cases, entities shall apply the disclosure requirements in IAS 27, IAS 28 or IAS 31 in addition to those in this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.

(b) employers' rights and obligations under employee benefit plans, to which IAS 19 *Employee Benefits* applies.

(c) [deleted]

(d) insurance contracts as defined in IFRS 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies IAS 39 in recognising and measuring the contracts, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.

(e) financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15–32 and AG25–AG35 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IAS 39).

(f) financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies, except for

  (i) contracts within the scope of paragraphs 8–10 of this Standard, to which this Standard applies,

  (ii) paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.

This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

(a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;

(b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

(c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and

(d) when the non-financial item that is the subject of the contract is readily convertible to cash. A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and accordingly, is within the scope of this Standard.

INTERNATIONAL ACCOUNTING STANDARD 33

Earnings per Share

Objective

The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share, so as to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity. Even though earnings per share data have limitations because of the different accounting policies that may be used for determining 'earnings', a consistently determined denominator enhances financial reporting. The focus of this Standard is on the denominator of the earnings per share calculation.

Scope

This Standard shall apply to

(a) the separate or individual financial statements of an entity:

 (i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or

 (ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market; and

(b) the consolidated financial statements of a group with a parent:

 (i) whose ordinary shares or potential ordinary shares are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets) or

 (ii) that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing ordinary shares in a public market.

An entity that discloses earnings per share shall calculate and disclose earnings per share in accordance with this Standard.

When an entity presents both consolidated financial statements and separate financial statements prepared in accordance with IAS 27 *Consolidated and Separate Financial Statements*, the disclosures required by this Standard need be presented only on the basis of the consolidated information. An entity that chooses to disclose earnings per share based on its separate financial statements shall present such earnings per share information only in its statement of comprehensive income. An entity shall not present such earnings per share information in the consolidated financial statements.

If an entity presents the components of profit or loss in a separate income statement as described in paragraph 81 of IAS 1 *Presentation of Financial Statements* (as revised in 2007), it presents earnings per share only in that separate statement.

INTERNATIONAL ACCOUNTING STANDARD 34

Interim Financial Reporting

Objective

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors, and others to understand an entity's capacity to generate earnings and cash flows and its financial condition and liquidity.

Scope

This Standard does not mandate which entities should be required to publish interim financial reports, how frequently, or how soon after the end of an interim period. However, governments, securities regulators, stock exchanges, and accountancy bodies often require entities whose debt or equity securities are publicly traded to publish interim financial reports. This Standard applies if an entity is required or elects to publish an interim financial report in accordance with International Financial Reporting Standards. The International Accounting Standards Committee* encourages publicly traded entities to provide interim financial reports that conform to the recognition, measurement, and disclosure principles set out in this Standard. Specifically, publicly traded entities are encouraged:

(a) to provide interim financial reports at least as of the end of the first half of their financial year; and

(b) to make their interim financial reports available not later than 60 days after the end of the interim period.

Each financial report, annual or interim, is evaluated on its own for conformity to International Financial Reporting Standards. The fact that an entity may not have provided interim financial reports during a particular financial year or may have provided interim financial reports that do not comply with this Standard does not prevent the entity's annual financial statements from conforming to International Financial Reporting Standards if they otherwise do so.

If an entity's interim financial report is described as complying with International Financial Reporting Standards, it must comply with all of the requirements of this Standard. Paragraph 19 requires certain disclosures in that regard.

INTERNATIONAL ACCOUNTING STANDARD 36

Impairment of Assets

Introduction

International Accounting Standard 36 *Impairment of Assets* (IAS 36) replaces IAS 36 Impairment of Assets (issued in 1998), and should be applied:

(a) on acquisition to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004.

(b) to all other assets, for annual periods beginning on or after 31 March 2004. Earlier application is encouraged.

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. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss and prescribes disclosures.

Scope

This Standard shall be applied in accounting for the impairment of all assets, other than:

(a) inventories (see IAS 2 Inventories);

(b) assets arising from construction contracts (see IAS 11 Construction Contracts);

(c) deferred tax assets (see IAS 12 Income Taxes);

(d) assets arising from employee benefits (see IAS 19 Employee Benefits);

(e) financial assets that are within the scope of IAS 39 Financial Instruments: Recognition and Measurement;

(f) investment property that is measured at fair value (see IAS 40 Investment Property);

(g) biological assets related to agricultural activity that are measured at fair value less estimated point-of-sale costs (see IAS 41 Agriculture);

(h) deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4 Insurance Contracts; and

(i) non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

INTERNATIONAL ACCOUNTING STANDARD 37

Provisions, Contingent Liabilities and Contingent Assets

Objective

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to enable users to understand their nature, timing and amount.

Scope

This Standard shall be applied by all entities in accounting for provisions, contingent liabilities and contingent assets, except:

(a) those resulting from executory contracts, except where the contract is onerous; and

(b) [deleted]

(c) those covered by another Standard.

INTERNATIONAL ACCOUNTING STANDARD 38

Intangible Assets

Objective

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

Scope

This Standard shall be applied in accounting for intangible assets, except:

(a) intangible assets that are within the scope of another Standard;

(b) financial assets, as defined in IAS 32 *Financial Instruments: Presentation*;

(c) the recognition and measurement of exploration and evaluation assets (see IFRS 6 *Exploration for and Evaluation of Mineral Resources*); and

(d) expenditure on the development and extraction of, minerals, oil, natural gas and similar non-regenerative resources.

INTERNATIONAL ACCOUNTING STANDARD 39

Financial Instruments: Recognition and Measurement

Objective

The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in IAS 32 *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in IFRS 7 *Financial Instruments: Disclosures*.

Scope

This Standard shall be applied by all entities to all types of financial instruments

INTERNATIONAL ACCOUNTING STANDARD 40

Investment Property

Objective

The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

Scope

This Standard shall be applied in the recognition, measurement and disclosure of investment property.

INTERNATIONAL ACCOUNTING STANDARD 41

Agriculture

Objective

The objective of this Standard is to prescribe the accounting treatment and disclosures related to agricultural activity.

Scope

This Standard shall be applied to account for the following when they relate to agricultural activity:

(a) biological assets;

(b) agricultural produce at the point of harvest; and

(c) government grants covered by paragraphs 34–35.

1.4 INTERNATIONAL FINANCIAL REPORTING STANDARDS

IFRS 1: FIRST TIME ADOPTION OF IFRS

- IFRS-1 requires an entity to comply with each IFRS effective at the reporting date for its first IFRS financial statements. In particular, the IFRS requires an entity to do the following in the opening IFRS balance sheet that it prepares as a starting point for its accounting under IFRSs:
- Recognise all assets and liabilities whose recognition is required by IFRSs;
- Do not recognise items as assets or liabilities if IFRSs do not permit such recognition;
- Reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, which are different type of asset, liability or component of equity under IFRSs; and
- Apply IFRSs in measuring all recognised assets and liabilities.
- Who is first time adopter?
- An entity's first IFRS financial statements are the first annual financial statements in which the entity adopts IFRSs, by an explicit and unreserved statement in those financial statements of compliance with IFRSs.

Opening IFRS Balance Sheet & Comparative Balance Sheet

- An entity has to prepare an opening IFRS Balance Sheet at the date of transition to IFRSs.
- This should be the starting point for its accounting under IFRSs.
- It is not required to present that opening balance sheet in its first IFRS based financial statements.

- However, to comply with IAS -1 "Presentation of Financial Statements" , an entity's IFRS based financial statements should include at least one year of comparative information under IASB GAAP [Para 36 , IFRS-1].

Example:

Company B proposes to prepare and present IFRS for the calendar year 2012, i.e. Balance Sheet Date 31.12.2012. How should the company carry out transition?

Steps to be taken

- Prepare opening IFRS Balance Sheet as on 1.1.2012 – this is termed as transition date; the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.
- The company has to present comparative information for one year, such comparatives should be as per IASB GAAP – so it has to restate the accounts of 2011 as per IFRS.
- Prepare and present first IFRS based Financial Statements for 2012 ; it is the first annual financial statements in which an entity adopts IFRSs by an explicit and unreserved statement.
- Then effectively the company has apply IFRS on and from 1.1.2011.
- Accounting policies: Select its accounting policies based on IFRSs in force at 31st Dec, 2012.

Paras 7-9 of IFRS- 1 requires adoption of current version of IFRSs which would enhance comparability because information in a first time adopter's first financial statements is prepared on a consistent basis over time and would provide comparative information prepared using latest version of the IFRSs.

Moreover, the entity will get exemptions from applying certain standards as given in Paras 13-34B , 36-36C and 37 of IFRS-1.

Actions at a Glance

- Recognise all assets and liabilities whose recognition is required by IFRSs
- Do not recognise items as assets or liabilities which IFRSs do not permit
- Reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs
- Carry out measurement of all assets and liabilities so recognized / re-classified in accordance with IFRSs
- Change in accounting policies
- Applying exemptions: The first time adopter may elect for exemptions granted in Paragraphs 13-25H and 36A-36C of IFRS-1.

Prohibition of retrospective application of some aspects of other IFRSs

The first time adopter should follow the prohibition of applying retrospective application relating to:

(i) Derecognizing of financial assets and financial liabilities ,

(ii) Hedge accounting ,

(iii) Estimates, and

(iv) Assets classified as held for sale and discontinued operations. [Paragraphs 26-34B of IFRS-1]

IFRS-2 SHARE BASED PAYMENTS

- IFRS-2 Share Based Payment was issued by the International Accounting Standards Board in February 2004. The Standard has been effective since 2005.

- IFRS 2 requires an entity to recognise share-based payment transactions in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity.

Types of Share Based Transactions

These are of three types –

1. Equity-settled transactions for goods or services acquired by an entity
2 Cash settled but price or value of the goods or services is based on equity instruments of the entity and.
3. Transactions for goods or services acquired by the entity in which either the entity can settle or supplier can claim settlement by equity instruments of the entity.

Recognition of Share Based Payment

The following are recognition criteria under Paras 7-9 of IFRS-2 :

(i) The goods or services received or acquired in a share-based payment transaction are recognised when the goods are obtained or as the services are received. The entity shall recognise a corresponding increase in equity is recognised if the goods or services were received in an equity-settled transaction.

(ii) The goods or services received or acquired in a share-based payment transaction are recognised when the goods are obtained or as the services are received. The entity shall recognise a corresponding increase in liability if the goods or services were acquired in a cash-settled transaction. For example, in case of employee stock option, it is difficult to assess the fair value of the service rendered, and therefore, the transaction should be measured at fair value of the equity.

(iii) The goods or services received in a share-based payment transaction may qualify for recognition as an asset. If they are not so qualified then they are recognised as expense.

For example, **inventories (which forms part of operating activities acquired through a share based payment, the entity should pass the following journal entries :**

Purchases A/c Dr.

To Equity Share Capital A/c (face value component)

To Securities Premium A/c (premium component)

Timing of Recognition

- The term 'service acquired or received has' has wider connotation in the context of 'vesting period' and 'vesting condition'. If employees are granted share options conditional upon the achievement of a performance condition as well as length of service , the length of the vesting period would vary depending on when that performance condition is satisfied and it would available only to the eligible category of employees .

Example

- An entity plans to grant 100 equity shares per employee of Class-I , 50 equity shares of per employee of Class –II and 30 equity shares per employee of Class –III if PAT of company exceeds $ 1000 million on a cumulative basis.
- This benefit will be available only such employees who will continue till the end of the financial year in which the target performance achieved.
- The entity would estimate the length the vesting period in terms of estimated time required to achieve the performance, say 3 years , and percentage of employees under different class who will continue till the end 3rd financial year from the grant date.

Assume the following % of employees will continue:

Class –I : 90% of 100 employees,

Class –II : 80% of 200 employees and

Class –III : 70% of 800 employees.

The fair value per equity share as on the grant date is RO100.

Then initial value of the share based payment works out to be –

RO 33,80,000 [100 shares × 90% × 100 employees + 50 shares × 80% × 200 employees + 30 shares × 70% × 800 employees] × RO 100.

This will be allocated over three years which is the expected vesting period.

- In transaction of equity settled share based payment, if the counterparty is not required to complete a specified period of service to be eligible to unconditionally entitled to the grant then it is presumed that the required service has been completed. So the transaction should be recognised in full on the grant date [Para 14, IFRS-2].
- There are generally situations in employee stock option that the eligible employees should complete specified service period.
- In such a case the transaction should be recognised over the vesting period. If the employee is granted share options conditional upon performance condition (other than market condition), then the options vest during the expected fulfilment period.
- Market conditions are adjusted in the fair value of option. [Para 15, IFRS-2].

IFRS 3: BUSINESS COMBINATIONS

- A **Business** is integrated set of activities, and assets conducted and managed for the purpose of providing (a) a return to investors and (b) lower costs or other economic benefits to policyholders or participants. It is generally consists of inputs, processes, and resulting outputs that are or will be used to generate revenue. A business can be part of a whole entity / company. But a standalone asset may or not be a business. Paragraphs B 7-B12 of IFRS 3 explain various identification criteria of business.
- A **Business Combination** is an act of bringing together of separate entities or businesses into one reporting unit. The result of business combination is one entity (the acquirer) obtains control of one or more businesses. If an entity obtains control over other entities which are not businesses, the act is not a business combination.

Recognition of assets and liabilities

"As of the acquisition date, the acquirer shall recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree" [Para 10, IFRS 3].

Check List

- Identify assets and liabilities within the Framework for Preparation and Presentation Financial Statements and;
- Check the liabilities which do not arise out of business combination ;
- Recognise assets (like identifiable intangibles) which were not recognised by the acquiree since these were internally generated intangibles ;
- Do not recognise any liability which constitute remunerations to the past owners of the acquiree or its employees for future services or which constitute reimbursement of the acquirer's acquisition costs;

- Identification of assets or liabilities which are assumed because of pre-existing relationship – the acquirer takes over the sundry debtors of the acquiree which was due by the acquirer for goods purchased or services received. The acquirer takes over all assets and liabilities of the acquiree excluding cash. This example, debtors of the acquiree should excluded from the list of assets acquired as it was a pre-existing relationship.
- Consider exception of recognition principle for contingent liabilities stated in Paras 22& 23 , IFRS 3;
- Effect of deferred tax [Paras 24-25, IFRS 3] ;
- Employee benefits [Para 26, IFRS 3];
- Indemnification assets [Paras 27-28, IFRS 3];
- Operating lease [Paras B28-30, Appendix B, IFRS 3];
- Reaquired Rights [Paras B35-36, Appendix B, IFRS 3];
- Share based awards [Para 30, IFRS 3]
- Assets held for sale [Para 31, IFRS 3]

IFRS 4: INSURANCE CONTRACTS

Objective

The objective of this IFRS is to specify the financial reporting for insurance contracts by any entity that issues such contracts (described in this IFRS as an insurer) until the Board completes the second phase of its project on insurance contracts.

In particular, this IFRS requires:

(a) limited improvements to accounting by insurers for insurance contracts.

(b) disclosure that identifies and explains the amounts in an insurer's financial statements arising from insurance contracts and helps users of those financial statements understand the amount, timing and uncertainty of future cash flows from insurance contracts.

Scope

An entity shall apply this IFRS to:

(a) Insurance contracts (including reinsurance contracts) that it issues and reinsurance contracts that it holds.

(b) Financial instruments that it issues with a discretionary participation feature (see paragraph 35). IFRS 7 Financial Instruments: Disclosures requires disclosure about financial instruments, including financial instruments that contain such features.

This IFRS does not address other aspects of accounting by insurers, such as accounting for financial assets held by insurers and financial liabilities issued by insurers (see IAS 32 Financial Instruments: Presentation, IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7), except in the transitional provisions in paragraph 45.

An entity shall not apply this IFRS to:

(a) product warranties issued directly by a manufacturer, dealer or retailer (see IAS 18 Revenue and IAS 37 Provisions, Contingent Liabilities and Contingent Assets).

(b) employers' assets and liabilities under employee benefit plans (see IAS 19 Employee Benefits and IFRS 2 Share-based Payment) and retirement benefit obligations reported by defined benefit retirement plans (see IAS 26 Accounting and Reporting by Retirement Benefit Plans).

(c) contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (for example, some licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease (see IAS 17 Leases, IAS 18 Revenue and IAS 38 Intangible Assets).

(d) financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the issuer may elect to apply either IAS 39, IAS 32 and IFRS 7 or this Standard to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

(e) Contingent consideration payable or receivable in a business combination (see IFRS 3 Business Combinations).

(f) Direct insurance contracts that the entity holds (ie direct insurance contracts in which the entity is the policyholder). However, a cedant shall apply this IFRS to reinsurance contracts that it holds.

For ease of reference, this IFRS describes any entity that issues an insurance contract as an insurer, whether or not the issuer is regarded as an insurer for legal or supervisory purposes.

A reinsurance contract is a type of insurance contract. Accordingly, all references in this IFRS to insurance contracts also apply to reinsurance contracts.

IFRS 5: NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Objective

The objective of this IFRS is to specify the accounting for assets held for sale, and the presentation and disclosure of discontinued operations. In particular, the IFRS requires:

(a) Assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and

(b) Assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.

Disposal group

- It is a group of assets (and directly associated liabilities) which are to be disposed of through a single transaction.
- The group includes goodwill acquired in business combination if the group is a cash generating unit to which goodwill has been allocated in accordance with the requirements of Paras 80-87 of IAS-36 Impairment of Assets.
- A cash generating unit is the smallest identifiable group of assets that generates cash inflow and that such cash inflow is largely independent of other assets or group assets of the entity.

Discontinued Operations

A component of entity which is either disposed of or classified as held for sale ; and

- represents a major separate line of business or geographical area of operations or
- is part of single co-ordinated plan to dispose of a major separate line of business or geographical area of operations, or
- is a subsidiary acquired exclusively with a view to resale.

Classification criteria

- management is committed to a plan to sell
- the asset is available for immediate sale
- an active programme to locate a buyer is initiated
- the sale is highly probable, **within one year** of classification as held for sale (subject to exceptions stated in Para 9, IFRS-5)
- the asset is being actively marketed for sale at a sales price reasonable in relation to its fair value
- actions required to complete the plan indicate that it is unlikely that plan will be significantly changed or withdrawn.

The criteria 'sale is highly probable, **within one year** of classification as held for sale' needs is not evidenced when the management is indecisive whether the particular asset will be sold or leased out.

Basic principles

- The basic principle of classifying ' non-current assets held for sale and disposal groups' is that the carrying value is expected to be realised through a sale transaction rather than through continuing use.
- Assets should be available for immediate sale in their present conditions subject to only the terms and conditions which are usual and customary for sales of such assets. Sale must highly probable.

Measurement & Presentation

- Under this standard assets that meet the criteria to be classified as ' held for sale' should be measured at the lower of carrying amount and fair value less cost to sell , and it will not be required to charge depreciation on such assets. These assets should separately presented on the face of the balance sheet. Result of 'discontinued operations' should presented separately in the Income Statement.

Classification criteria met after the balance sheet date

- If the classification criteria for an asset or disposal group are met after the balance sheet, the entity should not classify such asset or disposal group as held for sale.
- If these criteria are met after the balance sheet date but before the authorization of financial statements, information stated Para 41(a) , (b) & (d) of IFRS-5 should disclosed in notes. [Para 41(a) : description of non-current assets ; (b) description of the circumstance of sale, expected manner and timing of sale and (d) reportable segment to which such assets is presented in accordance with IFRS-8].

Nature of disposal	**Should the transaction be classified as Held for Sale?**
Sale of 51% of a 100% owned subsidiary, with the remaining 49% becoming an equity accounted associate.	Yes, as the group lost the control
Sale of 44% of a 100% subsidiary. The group continues to control and consolidate the subsidiary.	No, the group continues to control the same assets as previously but has sold an economic interest in those assets
Sale of 75% of a 90% owned subsidiary. The remaining 15% is accounted for as an AFS.	Yes, since it will be recovered principally through a sale transaction
Sale of 30% of a 35% interest in an associate. The remaining interest of 5% is accounted for as an AFS.	Yes, since it will be recovered principally through a sale transaction
Sale of 5% of a 35% owned associated. The remaining interest of 30% continues to be classified as an associate and equity accounting is followed.	No, since it will not be recovered principally through a sale transaction

IFRS 6: EXPLORATION FOR AND EVALUATION OF MINERAL ASSETS

The objective of this IFRS is to specify the financial reporting for the exploration for and evaluation of mineral resources.

In particular, the IFRS requires:

(a) limited improvements to existing accounting practices for exploration and evaluation expenditures.

(b) entities that recognise exploration and evaluation assets to assess such assets for impairment in accordance with this IFRS and measure any impairment in accordance with IAS 36 Impairment of Assets.

(c) disclosures that identify and explain the amounts in the entity's financial statements arising from the exploration for and evaluation of mineral resources and help users of those financial statements understand the amount, timing and certainty of future cash flows from any exploration and evaluation assets recognised.

Scope

An entity shall apply the IFRS to exploration and evaluation expenditures that it incurs.

The IFRS does not address other aspects of accounting by entities engaged in the exploration for and evaluation of mineral resources.

An entity shall not apply the IFRS to expenditures incurred:

(a) before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.

(b) after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

IFRS 7: FINANCIAL INSTRUMENTS-DISCLOSURES

The objective of this IFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

The principles in this IFRS complement the principles for recognising, measuring and presenting financial assets and financial liabilities in IAS 32 Financial Instruments: Presentation and IAS 39 Financial Instruments: Recognition and Measurement.

This IFRS shall be applied by all entities to all types of financial instruments, except:

(a) those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures*.

However, in some cases, IAS 27, IAS 28 or IAS 31 permits an entity to account for an interest in a subsidiary, associate or joint venture using IAS 39; in those cases, entities shall apply the disclosure requirements in IAS 27, IAS 28 or IAS 31 in addition to those in this IFRS. Entities shall also apply this IFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in IAS 32.

(b) employers' rights and obligations arising from employee benefit plans, to which IAS 19 *Employee Benefits* applies.

(c) [deleted]

(d) insurance contracts as defined in IFRS 4 *Insurance Contracts*. However, this IFRS applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this IFRS to *financial guarantee contracts* if the issuer applies IAS 39 in recognising and measuring the contracts, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.

(e) financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies, except that this IFRS applies to contracts within the scope of paragraphs 5–7 of IAS 39.

This IFRS applies to recognised and unrecognised financial instruments. Recognised financial instruments include financial assets and financial liabilities that are within the scope of IAS 39. Unrecognised financial instruments include some financial instruments that, although outside the scope of IAS 39, are within the scope of this IFRS (such as some loan commitments).

This IFRS applies to contracts to buy or sell a non-financial item that are within the scope of IAS 39 (see paragraphs 5–7 of IAS 39).

IFRS 8: OPERATING SEGMENT

The IFRS specifies how an entity should report information about its operating segments in annual financial statements and, as a consequential amendment to IAS 34 Interim Financial Reporting, requires an entity to report selected information about its operating segments in interim financial reports. It also sets out requirements for related disclosures about products and services, geographical areas and major customers. The IFRS requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments or aggregations of operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the same basis as is used internally for evaluating operating segment performance and deciding how to allocate re sources to operating segments.

Identification of segments

The requirements of the IFRS are based on the information about the components of the entity that management uses to make decisions about operating matters.

The IFRS requires identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance. IAS 14 required identification of two sets of segments—one based on related products and services, and the other on geographical areas. IAS 14 regarded one set as primary segments and the other as secondary segments.

A component of an entity that sells primarily or exclusively to other operating segments of the entity is included in the IFRS's definition of an operating segment if the entity is managed that way. IAS 14 limited reportable segments to those that earn a majority of their revenue from sales to external customers and therefore did not require the different stages of vertically integrated operations to be identified as separate segments.

1.5 INDIAN ACCOUNTING STANDARDS

Indian Accounting Standards

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

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

The diversity demands unification to the extent possible to develop Generally Accepted Accounting Practices (GAAP).

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

The Accounting Standard will apply to "General Purpose Financial statement" e.g. Balance Sheet, Profit & Loss A/c, Statement, Schedules and Notes forming Integral part, issued for use by the Shareholders, Members, Creditors, Employees, and Public at large. AS are intended or items, which are considered material. AS to apply prospectively unless otherwise intended.

AS because of the very nature of these cannot override Local Regulation including the order of the Honourable High Courts as far as these relate and contain preparation and presentation of financial statements.

1.5.1 Companies (Accounting Standards) Rules, 2006.

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

Criteria for classification of companies under the Companies (Accounting Standards) Rules, 2006

Small and Medium-Sized Company (SMC) as defined in Clause 2(f) of the Companies (Accounting Standards) Rules, 2006:

(f) "Small and Medium Sized Company" (SMC) means, a company-

(i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(ii) which is not a bank, financial institution or an insurance company;

(iii) whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;

(iv) which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and

(v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation: For the purposes of clause (f), a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

Non-SMCs

Companies not falling within the definition of SMC are considered as Non- SMCs.

General Instructions for Small and Medium Companies

SMCs shall follow the following instructions while complying with Accounting Standards under these Rules:-

The SMCs that does not disclose the information in line with the exemption provided by the Rules shall disclose the same in the following manner.

"The Company is a Small and Medium Sized Company (SMC) as defined in the General Instructions in respect of Accounting Standards notified under the Companies Act, 2013. Accordingly, the Company has complied with the Accounting Standards as applicable to a Small and Medium Sized Company."

Where a company, being an SMC, has qualified for any exemption or relaxation previously but no longer qualifies for the relevant exemption or relaxation in the current accounting period, the relevant standards or requirements become applicable from the current period and the figures for the corresponding period of the previous accounting period need not be revised merely by reason of its having ceased to be an SMC. The fact that the company was an SMC in the previous period and it had availed of the exemptions or relaxations available to SMCs shall be disclosed in the notes to the financial statements.

If an SMC opts not to avail of the exemptions or relaxations available to an SMC in respect of any but not all of the Accounting Standards, it shall disclose the standard(s) in respect of which it has availed the exemption or relaxation.

If an SMC desires to disclose the information not required to be disclosed pursuant to the exemptions or relaxations available to the SMCs, it shall disclose that information in compliance with the relevant accounting standard. Consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

The SMC may opt for availing certain exemptions or relaxations from compliance with the requirements prescribed in an Accounting Standard, provided that such a partial exemption or relaxation and disclosure shall not be permitted to mislead any person or public.

1.5.2 Applicability of Accounting Standard to Non-Corporate Entities:

Criteria for classification of Non-corporate entities for applicability of Accounting Standards

Level I Entities

Non-corporate entities which fall in any one or more of the following categories, at the end of the relevant accounting period, are classified as Level I entities:

(i) Entities whose equity or debt securities are listed or are in the process of listing on any stock exchange, whether in India or outside India.

(ii) Banks (including co-operative banks), financial institutions or entities carrying on insurance business.

(iii) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees fifty crore in the immediately preceding accounting year.

(iv) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year.

(v) Holding and subsidiary entities of any one of the above.

Level II Entities (SMEs)

Non-corporate entities which are not Level I entities but fall in any one or more of the following categories are classified as Level II entities:

(i) All commercial, industrial and business reporting entities, whose turnover (excluding other income) exceeds rupees forty lakh but does not exceed rupees fifty crore in the immediately preceding accounting year.

(ii) All commercial, industrial and business reporting entities having borrowings (including public deposits) in excess of rupees one crore but not in excess of rupees ten crore at any time during the immediately preceding accounting year.

(iii) Holding and subsidiary entities of any one of the above.

Level III Entities (SMEs)

Non-corporate entities which are not covered under Level I and Level II are considered as Level III entities.

Applicability of Accounting Standards to Non-corporate Entities (As on 1.4.2008)

(I) Accounting Standards applicable to all Non-Corporate Entities in their entirety (Level I, Level II and Level III)

AS 1 Disclosures of Accounting Policies

AS 2 Valuation of Inventories

AS 4 Contingencies and Events Occurring After the Balance Sheet Date

AS 5 Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

AS 6 Depreciation Accounting

AS 7 Construction Contracts (revised 2002)

AS 9 Revenue Recognition

AS 10 Accounting for Fixed Assets

AS 11 The Effects of Changes in Foreign Exchange Rates (revised 2003)

AS 12 Accounting for Government Grants

AS 13 Accounting for Investments

AS 14 Accounting for Amalgamations

AS 16 Borrowing Costs

AS 22 Accounting for Taxes on Income

AS 26 Intangible Assets

(II) Exemptions or Relaxations for Non-corporate Entities falling in Level II and Level III (SMEs)

(A) Accounting Standards not applicable to Non-corporate Entities falling in Level II in their entirety:

AS 3 Cash Flow Statements

AS 17 Segment Reporting

(B) Accounting Standards not applicable to Non-corporate Entities falling in Level III in their entirety:

AS 3 Cash Flow Statements

AS 17 Segment Reporting

AS 18 Related Party Disclosures

AS 24 Discontinuing Operations

(C) Accounting Standards not applicable to all Non-corporate Entities since the relevant Regulators require compliance with them only by certain Level I entities

- (i) AS 21, Consolidated Financial Statements
- (ii) AS 23, Accounting for Investments in Associates with Consolidated Financial Statements
- (iii) AS 27, Financial Reporting of Interests in Joint Ventures (to the extent of requirements relating to Consolidated Financial Statements)

(D) Accounting Standards in respect of which relaxations from certain requirements have been given to Non-corporate Entities falling in Level II and Level III (SMEs):

(i) Accounting Standard (AS) 15, Employee Benefits (revised 2005)

As explained in the summary of the Standards.

(ii) AS 19, Leases

Certain paragraphs relating to Disclosure requirements

Level III entities.

(iii) AS 20, Earnings Per Share

Diluted earnings per share (both including and excluding extraordinary items) is not required to be disclosed by non-corporate entities falling in Level II and Level III and information required by paragraph 48(ii) of AS 20 is not required to be disclosed by Level III entities if this standard is applicable to these entities.

(iv) AS 28, Impairment of Assets

Non-corporate entities falling in Level II and Level III are allowed to measure the 'value in use' on the basis of reasonable estimate thereof instead of computing the value in use by present value technique. Consequently, if a non-corporate entity falling in Level II or Level III chooses to measure the 'value in use' by not using the present value technique, the relevant provisions of AS 28, such as discount rate etc., would not be applicable to such an entity. Further, such an entity need not disclose the information required the Standard.

(v) AS 29, Provisions, Contingent Liabilities and Contingent Assets

Disclosure Requirement as laid in the Standards are not applicable to Level II and Level III Enterprises.

(E) AS 25, Interim Financial Reporting, does not require a non-corporate entity to present interim financial report. It is applicable only if a non-corporate entity is required or elects to prepare and present an interim financial report. Only certain Level I non-corporate entities are required by the concerned regulators to present interim financial results, e.g., quarterly financial results required by the SEBI. Therefore, the recognition and measurement requirements contained in this Standard are applicable to those Level I non-corporate entities for preparation of interim financial results.

ADVANTAGES :

1. It provides the accountancy profession with useful working rules.
2. It assists in improving quality of work performed by accountant.
3. It strengthens the accountant's resistance against the pressure from directors to use accounting policy which may be suspect in that situation in which they perform their work.
4. It ensures the various users of financial statements to get complete crystal information on more consistent basis from period to period.
5. It helps the users compare the financial statements of two or more organisaitons engaged in same type of business operation.

DISADVANTAGES :

1. Users are likely to think that said statements prepared using accounting standard are infallible.
2. They have been derived from social pressures which may reduced freedom.
3. The working rules may be rigid or bureaucratic to some user of financial statement.
4. The more standards there are, the more costly the financial statements are to produce.

Accounting Standard No.	Title of Accounting Standard
AS-1	Disclosure of Accounting Policies
AS-2	Valuation of Inventories (Revised)
AS- 3	Cash Flow Statements (Revised)
AS-4	Contingencies and Events (Occurring after the Balance Sheet Date)
AS-5	Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies (Revised)
AS-6	Depreciation Accounting
AS-7	Construction Contracts (Revised)
AS- 8	Accounting for Research and Development (stands withdrawn after introduction of AS-26)
AS-9	Revenue Recognition
AS-10	Accounting for Fixed Assets.
AS-11	The Effect of Changes in Foreign Exchange Rates (Revised)
AS-12	Accounting for Government Grants
AS-13	Accounting for Investments
AS-14	Accounting for Amalgamations
AS-15	Employee Benefits (Revised)
AS-16	Borrowing Cost
AS-17	Segment Reporting
AS-18	Related Party Disclosures
AS-19	Leases
AS-20	Earnings Per Share
AS-21	Consolidated Financial Statements
AS-22	Accounting for Taxes on Income
AS-23	Accounting for Investment in Associates in Consolidated Financial Statements
AS-24	Discontinuing Operations
AS-25	Interim Financial Reporting

AS-26	Intangible Assets
AS-27	Financial Reporting of Interests in Joint Venture
AS-28	Impairment of Assets
AS-29	Provisions, Contingent Liabilities and Contingent Assets
AS-30	Financial Instruments: Recognition and Measurement
AS 31	Financial Instruments: Presentation
AS 32	Financial Instruments: Disclosures

Applicability of Accounting Standards:

A three tier classification has been framed to ensure compliance of accounting standards for reporting enterprises.

Level I Enterprises:

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

Level II Enterprises:

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

Level III Enterprises:

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

Accounting Standard	Applicability (Based on the three tier classification)
AS1,2,4-16,22,26,28	All Enterprises
AS 3,17,18,24,	Not applicable to Level II and Level III enterprises in their entirety.
AS 19,20,29	All enterprises but relaxation given to Level I and Level II enterprises for certain disclosure requirements.
AS 21,23,27	Not applicable to Level II and Level III enterprises
AS 25	Not mandatorily applicable to Level II and Level III enterprises
AS 30,31,32	W.e.f. accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years.

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

AS-1: DISCLOSURE OF ACCOUNTING POLICIES

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

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

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

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

Areas involving different accounting policies by different enterprises are

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

Factors governing the selection and application of accounting policies are:

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

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

Changes in Accounting Policies:

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

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

The following are not considered as changes in accounting policies:

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

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

Fundamental Accounting Assumptions

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

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

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

(c) *Accrual:*

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

   (ii) Extends to matching revenue against relevant costs.

Examples:

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

   — The policy appears to be correct.

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

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

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

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

AS-2: VALUATION OF INVENTORIES

At the outset AS -2 excludes the following though appears to be inventory in common parlance:

(a) Work-in-progress in construction contract and directly related service contract (ref: AS-2), inventories not forming part of construction work-in-progress will attract AS-2

(b) Work-in-progress arising in the ordinary course of business of service providers Shares, debentures and other financial instruments held as stock-in-trade (ref: AS-13 as Current Investments)

(c) Livestock, agricultural and forest product, mineral oil/gasses as measured at net realizable value as per trade practices at certain stage of production.

AS-2 covers inventories as an item of assets which are

(a) held for sale in the ordinary course of business

(b) in the process of production for such sale

(c) in the form of material or supplies for the process of production or rendering of service

Inventories are valued at lower of cost or net realizable value (NRV)

(a) Cost to include purchase price, conversion and other costs incurred in bringing the inventories to their present location and condition.

An enterprise should use the same cost formula for all inventories having similar nature and use - specific cost, FIFO, weighted average, standard cost, adjusted selling price

(b) Net realizable value is the estimated selling price in the ordinary course of business reduced by the estimated cost to bring the item in saleable condition, considered on each balance sheet date, usually on item by item basis or under suitable group of similar or related item.

Disclosure under AS-2

(a) the accounting policy adopted in measuring inventories

(b) the cost formula used

(c) carrying amount (value) of inventory commonly classified under Raw Material and Components, Work in Progress, Finished goods and Stores, Spares and Loose tools.

(d) Schedule-III and AS-2 disclosure are at par.

Illustration 1.

Raw materials purchased at ₹10 per kg. price of materials is on the decline. The finished goods in which the raw material is incorporated are expected to be sold at below cost. 1,000 kgs of raw material is in stock at the year-end. Replacement cost is ₹8 per kg. How will you value the inventory?

Solution:

As per para 24 of AS-2, on valuation of inventories, material and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when there is a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realizable value, the materials are written down to net realizable value.

Hence, the value of stock of 1,000 kgs. of raw materials will be valued at ₹8 per kg. The finished stock should be valued at cost or net realizable value, whichever is lower.

Illustration 2.

Inventories are valued at cost except for finished goods and by products, finished goods are valued at lower of cost of realizable values and by products are valued at realizable value. Comment on the accounting policy.

Solution:

The accounting policy followed by the company is at par with AS-2.

Illustration 3.

Cost of Production of product A is given below:

Raw material per unit	₹150
Wages per unit	₹50
Overhead per unit	₹50
	₹250

As on the balance sheet date the replacement cost of raw material is ₹110 per unit. There are 100 units of raw material on 31.3.15.

Calculate the value of closing stock of raw materials in the following conditions:

(i) If finished product is sold at ₹ 275 per unit, what will be the value of closing stock of raw material?

(ii) If finished product is sold at ₹ 230 per unit, what will be the value of closing stock of raw material?

Solution:

(i) The realizable value of the product is more than the total cost of the product. The cost of raw material per unit is more than the replacement cost, hence, raw materials should be valued on actual cost.

Therefore, the value of raw materials: 100 units x ₹150 per unit= ₹15,000

(iii) The realizable value of the product is less than the total cost of the product. Though the cost of raw material per unit is more than the replacement cost, hence, raw materials should be valued on replacement cost.

Therefore, the value of raw materials: 100 units x ₹110 per unit= ₹11,000

AS-3 (REVISED): CASH FLOW STATEMENT

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

- **Cash** comprises cash on hand and demand deposits with banks.
- **Cash equivalents** are short term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value.
- **Cash flows** are inflows and outflows of cash and cash equivalents.
- **Operating activities** are the principal revenue-producing activities of the enterprise and other activities that are not investing or financing activities.
- **Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- **Financing activities** are activities that result in changes in the size and composition of the owners' capital (including preference share capital in the case of a company) and borrowings of the enterprise.

Methods of preparing Cash Flow Statement:

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

Example:

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

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

Indirect Method Cash Flow Statement [Paragraph 18(b)]	(₹ '000)
Cash flows from operating activities	
Net profit before taxation, and extraordinary item	3,350
Adjustments for:	
Depreciation	450
Foreign exchange loss	40
Interest income	(300)
Dividend income	(200)
Interest expense	400
Operating profit before working capital changes	3,740
Increase in sundry debtors	(500)
Decrease in inventories	1,050
Decrease in sundry creditors	(740)
Cash generated from operations	3,550
Income taxes paid	(1,860)
Cash flow before extraordinary item	1,690
Proceeds from earthquake disaster settlement	180
Net cash from operating activities	1,870

Illustration 4.

Oriental Bank of Commerce, received a gross ₹4,500 crores demand deposits from customers and customers withdrawn ₹4,000 crores of demand deposits during the financial year 2014-15. How would you classify such cash flows?

Soltuion:

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

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

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

For the purpose of AS-4 the meaning is restricted to condition or situation at the Balance Sheet date, the financial effect of which is to be determined by future events which may or may not occur.

AS-4 does not deal with the following subjects, though may result in contingencies in respect of:

a) Liabilities of Life and General Insurance out of policies issued by the enterprise.

b) Obligations under retirement benefit plan/scheme

c) Commitment arising from long-term lease contract

Estimates are required to be made for the amounts to be stated in the financial statement for many ongoing and recurring activities of an enterprise. Distinction should be made between an event that is certain and that is uncertain.

Contingent losses depend on the outcome of the contingencies. It should be provided by way of a charge in the statement of profit/loss

a) if it is probable that future events will confirm after taking into account the probable recovery in this respect, that an asset has been impaired or a liability has been incurred as at the B/S date, and

b) a reasonable estimate of the resulting loss can be estimated otherwise the existence of the contingent loss should be disclosed in the financial statements.

Provisions for contii1gencies are not made in respect of general or unspecified business risk since they do not relate to conditions or situations existing at the B/S date.

The disclosure requirements apply only for those contingencies or events which affect the financial position of the enterprise to a material extent stating:

a) The nature of contingency;

b) The uncertainty which may affect the future outcome;

c) The estimate of the financial effect;

d) A statement that such an estimate cannot be made;

Contingent gains are not recognized because of uncertainty of realization; however, there is no restriction to disclose as such in the 'Notes to Accounts' in a manner not likely to mislead the users of the financial statements.

Events occurring after the B/S date or those significant events, both favourable and unfavourable that occur between the B/S date and the date of approval of the financial statements by the appropriate authority (e.g. Board of Directors of a company) can be of:

a) Those which provide further evidence of condition that existed at the B/S date adjusting events (e.g. insolvency of a customer that occur after B/S date)

b) Those which are indicative of conditions that arose subsequent to the B/S date non-adjusting events (loss due to earthquake, war)

Events occurring after the B/S date but indicative of the enterprise ceases to be a going concern (destruction of major production plant by fire after B/S date) needs to be considered and evaluated to justify "going concern concept" for preparation of Financial statements.

Illustration 5.

The assets in a factory of a limited company was damaged due to a fire break out on 15th April. The Loss is estimated at ₹ 50 crores out of which ₹35 crores will be recoverable from the insurers. Explain briefly how the loss should be treated in the final account for the previous year.

Solution:

This has to be shown as a disclosure by way of note to account.

Illustration 6.

Board of Directors of a limited company approved the financial account for the year 2014-15 on 31st July, 2015. The following events occurred before the approval of financial statements by Board of Directors. State how would you deal with these situations:

(a) The Board of Directors at their meeting on June 30, 2015 has recommended a dividend of 10% to be paid to the shareholders after it is approved at the annual general meeting.

(b) A debtor, who was declared insolvent on 10th July 2015. The total outstanding amount was ₹2 lacs as on 31st March, 2015.

Solution:

(a) Proposed Dividend must be shown in the Balance Sheet.

(b) A provision for loss should be provided in the books.

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

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

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

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

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

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

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

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

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

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

b) disposal of fixed asset/long term investments

c) effect of legislative changes with retrospective application

d) settlement of litigation

e) other reversal of provisions

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

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

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

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

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

The use of reasonable estimate based on then available information circumstances are an essential part of the preparation of financial statement. There may arise a need to change the estimate on the basis of new information more experience or subsequent development. The revision in estimate does not bring the adjustment within the definition of an extraordinary item or prior period item.

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

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

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

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

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

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

Example of various disclosures under AS-5

1. change in depreciation method: change in accounting policy
2. useful life reduced but no change: change in accounting estimate in depreciation method
3. arithmetical error in depreciation computation: prior period item
4. due to oversight depreciation incorrectly computed: prior period item
5. fixed asset destroyed in earth quake: extraordinary item
6. major disposal of fixed items: ordinary activity (exceptional item)

7. maintenance provision no longer required since major part of the assets no longer exist: the write-back. if material should be disclosed as exceptional item and not as extraordinary' or prior period item.

Example:

Mr.Pradip an employee of CCL Ltd.went on leave with a pay for 9 months on 1.1.2015 upto 30.09.2015. His monthly pay was ₹25,000. While preparing the financial statement on 30.6.2015 for the year ended 31.03.15, the expense of salary of Mr.Pradip for 3 months (1.1.15 to 31.03.15) was not provided due to omission. When Mr.Pradip joined on 1.10.15, the whole salary for 9 months was duly paid to him.

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

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

If Mr. Pradip was terminated from service on 1.1.15 and was re-instated in service by the Court on 30.09.15 with full pay protection(i.e. total salary was rewarded to him). As the employee was re-instated in service as per the Court's Order as on 1.10.2015, the following entry should be made:

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

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

AS-6 (REVISED) DEPRECIATION ACCOUNTING

Deprecation is a measure of the wearing out consumption or other loss of value of a depreciable asset due to use efflux of time or obsolescence through technology and market changes and also includes amortization of assets having predetermined life.

Different accounting policies are followed by different enterprises, hence disclosure is necessary to appreciate the view presented in the financial statements.

Depreciation has a significant effect in determining and presenting financial position and operating results.

A depreciable asset must fulfill the following criteria:

a) expected to be used for more than one accounting period

b) limited useful life

c) held for use in the production or supply of goods and services, for rental, for administrative purposes, and not for sale in the ordinary course of business.

Specific exclusions from the scope of AS-6:

1. Forest, plantation and similar regenerative resource
2. Wasting asset, expenditure or a exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources.
3. R&D expenditure
4. Goodwill
5. Livestock

Depreciation charge for a period is usually recognized as an expense unless included in carrying amount (e.g. depreciation of manufacturing plant is included in the cost of conversion of inventories or depreciation of assets used for development activities may be treated as an intangible assets or capital reduced)

Useful life is either:

(a) the period over which a depreciable asset is expected to be used by the enterprise or (b) on the basis of production or similar units obtainable from the use of assets.

A change in depreciation method will arise in the following situation:

a) adoption is required by the statute, or

b) for compliance with the relevant AS, or

c) it is considered that the change would result in more appropriate presentation of the financial statements

When the change is adopted, the depreciation is reworked with reference to the date of the asset put to use by the enterprise, the deficiency/surplus is adjusted in the P/L A/c in the year of change given effect with appropriate disclosure since as per AS 6. This is considered as a change in the Accounting Policy.

Change in depreciation method always applies retrospectively.

Disclosure under AS-6: The following information should be disclosed in the financial statement

1) Historical cost/substituted cost of each class of depreciable asset

2) Total depreciation for the period with respect to (1)

3) Accumulated depreciation: Additional disclosure as part of disclosure of other accounting policies

    a) Depreciation method used

    b) Depreciation rate or the useful lives of the assets, if they differ from rates specified in the governing statute If any depreciable asset is disposed of, discarded, demolished or destroyed, the net surplus or deficiency, if material should be disclosed separately (in contrast with the concept of Block under I.T Act '61)

In case the depreciable assets are revalued, the depreciation should be provided as the revalued amount on the estimate of remaining useful life of such assets. Disclosure should be made in the year of revaluation, if the same has a material effect on the amount of depreciation.

Illustration 7.

Plant has useful life of 10 years. Depreciable amount of ₹30 lakhs. The company has charged depreciation under SLM. At the end of the 6^{th} year, the balance useful life was re-estimated at 8 years.

Solution:

The depreciation will be charged from the 7^{th} year:

$$= \frac{30-(30/10)\times 6}{8} = 1.5$$

Illustration 8.

B Ltd. Purchased certain plant and machinery for ₹ 50 lakhs. 20% of the cost net of CENVAT credit is the subsidy component to be realized from a State Government for establishing industry in a backward district. Cost includes excise ₹ 8 lakhs against which CENVAT credit can be claimed. Compute depreciable amount.

Solution:

We shall have to determine the historical cost of the plant and machinery.

Purchase Price	₹ 50 lakhs
Less: Specific Excise duty against which CENVAT is available	₹ 8 lakhs
Original Cost of the machinery for accounting purposes	₹ 42 lakhs
Less: Subsidy @ 20% of ₹42 lakhs	₹ 8.4 lakhs
Depreciable Amount	₹ 33.6 lakhs

Note: As CENVAT Credit on Capital Goods can be availed upto 50% in the first year of acquisition and the balance in the next year, an alternative treatment may also be considered.

The original cost of the plant and machinery can be taken at ₹ 50 lakhs and a sum of ₹ 8.4 lakhs can be transferred to deferred income account by way of subsidy reserve. The portion of unavailed CENVAT Credit is also required to be reduced from cost.

AS-7(REVISED): ACCOUNTING FOR CONSTRUCTION CONTRACTS

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

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

For the purpose of this statement construction contract covers:

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

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

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

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

A construction contract may be

a) a fixed-price contract with/without escalation

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

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

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

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

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

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

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

Contract revenue comprises of

a) revenue agreed in the contract

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

c) incentive payment (degree of certainty and reliability)

d) penalties due to delay in execution

Contract costs comprise of

a) directly related to specific contract

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

Contract cost and revenue are recognized for accounting only when the outcome of the construction contract can be measured reliably with regard to the stage of completion of the contracts activity at its B/S date. All expected losses should recognized as an expense for the contract.

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

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

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

A) An enterprise should enclose

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

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

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

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

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

 2. The amount of advance received and amount retained

C) An enterprise should present

 a) Gross amount due from customer is an asset

 b) Gross amount due to customer is a liability

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

Illustration 9.

A Company undertook to pay contract for a building for ₹ 40lakhs. As on 31.3.2015, it incurred a cost of ₹ 6 lakhs and expects that there will be ₹ 36 lakhs more for completing the building. It has received ₹ 4 lakhs as progress payment. What is the degree of completion?

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

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

AS-8 ACCOUNTING FOR RESEARCH & DEVELOPMENT

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

AS-9 REVENUE RECOGNITION

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

a) sale of goods

b) rendering of service

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

a) construction contracts

b) lease/hire purchase agreement

c) govt. grants/subsidies

d) insurance contract of insurance companies

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

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

NOTE:

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

ICAI recommends disclosure in the manner :

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

Illustration 10.

AB Ltd. Seeks you advise about the treatment of the following in the final statement of accounts for the year ended 31st March 2015:

"As a result of a recent announced price revision, granted by the Government of India with effect from 1st July, 2014, the company stands to receive ₹ 6 lakhs from its customers in respect of sales made in 2014-15"

Solution:

The company is preparing the financial statements for the year ended 31.3.15. Due to price revision granted by the Government of India, the company has to receive an additional sales revenue of ₹ 6 lakhs in respect of sales made during the year 2014-15.

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

In view of the above statement, if there is no uncertainty exists as to the collect ability of ₹ 6 lakhs, it should be recognized as revenue in the financial statements for the year ended 31.3.15.

Illustration 11.

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

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

Solution:

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

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

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

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

Illustration 12.

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

Solution:

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

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

AS-10: ACCOUNTING FOR FIXED ASSETS

Fixed assets for the purpose of the statement are those held by an enterprise with the intention of being used for the purpose of producing or providing goods or services and not held for sale in the normal course of business and applies to financial statements prepared on historical cost/substituted cost basis.

The following items need special consideration and normally not covered under this statement. unless the expenditure on individual items are separable and identified.

a) forest plantation and regenerative natural resources

b) wasting assets and non-generative resources (mineral rights. exploration of mineral, oil and natural gas)

c) expenditure on real estate development

d) livestock

Apart from direct cost, all directly attributable cost to bring the asset concerned to their working condition for intended use also forms the part of fixed asset.

Subsequent expenditure after the initial capitalization that increases the future benefits from the existing assets beyond the previously assessed standard of performance (e.g. increase in" quality of output, substantial reduction in operating cost) is capitalized to form the gross book value.

Financial statements are normally prepared on the basis of historical cost but sometimes a part or all of fixed assets, are restated (revalued) and substituted for historical cost. The commonly accepted and preferred method of restating is by appraisal by a competent valuer.

As per Schedule III, every B/S subsequent to revaluation shall disclose the increased figure with the date of increase in place of the original cost for the first 5(five) years, but the fact of such revaluation will continue to be disclosed till such time such assets appear in the B/S.

Revaluation is made for an entire class of assets or the selection of assets on a systematic basis (fact of which should be appropriately stated).

An increase in net book value arising on revaluation of fixed assets should be credited to "Owner's Fund" under "Revaluation Reserve" unless the decrease on any previously revaluation recorded as a change in P/L A/c or "Revaluation Reserve" if increase in previous occasion was credited thereto.

All material items retired from active use and not disposed off should be stated at the lower of net book value or net realizable value as a separate item in the Schedule of Fixed Assets.

Depreciation as per AS-6 should be charged on the total value of fixed assets including revalued portion.

Disclosure in addition to AS-1 and AS-6, should be made under AS-l0 in the following lines:

a) Gross and net book value of fixed assets at the beginning and end of an accounting period with additions, disposals, acquisitions and other movements.

b) Expenditures incurred on account of fixed assets in the course of constructional acquisition

c) Revalued amounts substituted for historical cost, the basis of selection for revaluation, the method adopted, the year of appraisal, involvement of external valuer.

d) The revalued amounts of each class of fixed assets are presented in the B/S separately without netting off the result of revaluation of various classes of fixed assets.

Illustration 13.

A company has scrapped a semi-automatic part of a machine(not written off) and replaced with a more expensive fully automatic part, which has doubled the output of the machine. At the same time the machine was moved to more suitable place in the factory, which involved the building of new foundation in addition to the cost of dismantling and re-erection. The company wants to charge the whole expenditure to revenue. As an auditor, what would you do in this situation?

Solution:

If the subsequent expenditure increases the expected future benefits from the asset beyond its pre-assessed standard of performance then as per AS-10 it should be capitalized. Otherwise, it should be treated as an expense. In this case, the replacement of semi-automatic part with a fully automatic part has doubled the output of the machine thus, it has increased future benefits beyond the machines pre-assessed standard performance, hence this expenditure should be capitalized as part of cost of the machine. However, the expenses for shifting the machine and building of a new foundation in addition to the cost of dismantling and re-erection do not contribute to any new future benefits from the existing asset. They only serve to maintain performance of the machine. Hence, this cost should be charged to revenue.

Illustration 14.

A publishing company undertook repair and overhauling of the machinery at a cost of ₹ 5 lakhs to maintain them in good condition and capitalized the amount, as it is more than 25% of the original cost of the machinery. Advice.

Solution:

The size of the expenditure is not the criteria to decide whether subsequent expenditure should be capitalized. The important question is whether the expenditure increases the future benefits from the asset beyond its pre-assessed standard of performance as per AS-10. Only then it should capitalize. Since, in this case, only the benefits are maintained at existing level, the expenditure should not be capitalized.

Illustration 15.

Hero Ltd. purchased a machine of ₹ 50 lakhs including excise duty of ₹ 10 lakhs. The excise duty is Cenvatable under the excise laws. The enterprise intends to avail CENVAT credit and it is reasonably certain to utilize the same with reasonable time. How should the excise duty of ₹ 10 lakhs be treated?

Solution:

The following journal entries should be recorded:

In the year of acquisition:	(₹ Lakhs)	
Machinery A/c	Dr. 40	
CENVAT Credit Receivable A/c	Dr. 5	
CENVAT Credit Deferred A/c	Dr. 5	
To Supplier's A/c		50
In the next year:		
CENVAT Credit Receivable A/c	Dr. 5	
To CENVAT Credit Deferred A/c		5

Illustration 16.

A company purchased a machinery in the year 2014-15 for ₹ 90 lakhs. A balance of ₹ 10 lakhs is still payable to the suppliers for the same. The supplier waived off the balance amount during the financial year 2016-17. The company treated it as income and credited to profit and loss account during 2016-17. whether accounting treatment of the company is correct?

Solution:

As per para 9.1 of AS-10, the cost of fixed assets may undergo changes subsequent to its acquisition or construction on account of exchange fluctuation, price adjustments, changes in duties or similar factors. Considering para 9.1 the treatment done by the company is not correct. ₹ 10 lakhs should be deducted from the cost of the fixed assets.

Illustration 17.

Z Ltd.purchased a machine costing ₹ 5 lakhs for its manufacturing operations and paid transportation costs ₹ 80,000. Z Ltd. spent an additional amount of ₹ 50,000 for testing and preparing the machine for use. What amount should Z Ltd. record as the cost of the machine?

Solution:

As per Para 20 of AS-10, the cost of the fixed asset should comprise its purchase price and any attributable cost of bringing the asset to its working condition for its intended use. In this case, the cost of machinery includes all expenditures incurred in acquiring the asset and preparing it for use. Cost includes the purchase price, freight and handling charges, insurance cost on the machine while in transit, cost of special foundations, and costs of assembling, installation and testing. Therefore, the cost to be recorded is ₹ 6,30,000 (= 5,00,000 + 80,000 + 50,000)

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

The statement applies mandatorily in respect of:

a) Accounting for transaction in foreign currencies

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

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

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

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

c) Weighted average in the above line.

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

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

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

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

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

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

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

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

Disclosure under AS -11: An enterprise should disclose:

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

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

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

d) Foreign currency risk management policy.

Illustration 18.

	Exchange Rate
Goods purchased on 24.3.15 of US $1,00,000	₹ 46.60
Exchange rate on 31.3.2015	₹ 47.00
Date of actual payment 5.6.2016	₹ 47.50

Calculate the loss/gain for the financial years 2014-15 and 2015-16.

Solution:

As per AS-11, all foreign currency transactions should be recorded by applying the exchange rate at the date of transaction. Therefore, goods purchased on 24.03.2015 and corr sponding creditor would be recorded at ₹ 46.60

= 1,00,000 x 46.60 = 46,60,000

As per AS-11, at the balance sheet date all monetary items should be reported using the closing rate. Therefore, the creditors of US $1,00,000 outstanding on 31.3.2015 will be reported as:

1,00,000 x 47.00= 47,00,000.

Exchange loss ₹ 40,000 (= 47,00,000 – 46,60,000) should be debited in Profit and Loss Account for 2014-15.

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

1,00,000 x 47.50 = 47,50,000 -47,00,000 = ₹50,000 should be debited to profit or loss for the year 2014-15.

Illustration 19.

Z Ltd. acquired a machine on 1.4.2014 costing US $ 1,00,000. The suppliers agreed to the following terms of payment:

1.4.2014	:	down payment 50%
1.4.2015	:	25%
1.4.2016	:	25%

The company depreciates machinery @ 10% on the Straight Line Method. The rate of exchange is steady at US \$ 1= ₹40 upto 30.9.2015. On 1.10.2015, due to an official revaluation of rates, the exchange rate is adjusted to US \$ 1= ₹48.

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

Working Notes:

2014-15:

1. Original Cost of the machine = \$1,00,000 x ₹40 = ₹40,00,000
2. Depreciation (SLM) @ 10% = ₹4,00,000

2015-16:

1. Original Cost of the machine upto 30.9.2015 = ₹40,00,000
2. Revised cost of the machine as on 1.10.2015

Due to official revaluation of exchange rates, the US \$ 1 = ₹48. There is a foreign exchange loss of ₹ 8 for each dollar liability. The total loss on foreign currency fluctuation was \$25,000 x ₹8 = ₹2,00,000. This has to be added to the original cost of the machine. Therefore, revised cost of the machine as on 1.10.2015 is ₹42,00,000 (i.e. ₹40,00,000 + ₹2,00,000)

		₹
The revised cost of the machine as on 1.10.2015 :		
Original Cost on 1.4.2014		40,00,000
Less: Depreciation:		
1.4.2010 to 31.3.2015	4,00,000	
1.4.2011 to 30.9.2015	2,00,000	6,00,000
		34,00,000
Add: Loss on foreign exchange fluctuation as on 1.10.2015		2,00,000
		36,00,000
Depreciation:		
1.4.2015 to 30.9.2015	(40,00,000 x 10/100 x 6/12)	2,00,000
1.10.2015 to 31.3.2016	$\left(\frac{36,00,000 \times 6}{8.5 \times 12}\right)$	2,11,765
Total Depreciation for the year 2015-16		4,11,765

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

Profit and Loss Account (extract)

for the year ended 31st March, 2016

Particulars	₹	Particulars	₹
To Depreciation on Machinery	4,11,765		

Balance Sheet (extract) as at 31st March, 2016

Liabilities	₹	***Assets***		₹
Current Liabilities	12,00,000	Fixed Assets		
Creditors for Supply of Machinery		Machinery (at cost)	40,00,000	
		Add: Adj.for foreign		
		Exchange fluctuation	2,00,000	
			42,00,000	
		Less: Accumulated		
		Depreciation	8,11,765	
				33,88,235

AS -12: ACCOUNTING FOR GOVERNMENT GRANTS

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

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

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

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

a) Effects of changing prices or in supplementary information

b) Government assistance other than grants.

c) Ownership participation by government.

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

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

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

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

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

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

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

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

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

Disclosure under AS-12

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

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

Illustration 20.

Z Ltd. has set up its business in designated backward area which entitles it to receive as per a public scheme announced by the Government of India, a subsidy of 25% of the cost of investment. Having fulfilled the conditions laid down under the scheme, the company on its investment of ₹100 lakhs in capital assets during its accounting year ending on 31st March, 2015, received a subsidy of ₹25 lakhs in January, 2015 from the Government of India. The Accountant of the company would like to record the receipt as an item of revenue and to reduce the losses on the Profit and Loss Account for the year ended 31st March, 2015. Is his action justified?

Solution:

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

The company has received ₹25 lakhs subsidy for investment in capital assets which are depreciable in nature. In view of the provisions under AS-12, the subsidy amount ₹25 lakhs received should not be credited to the Profit and Loss Account for the year ended 31st March, 2015. the subsidy should be recognized and credited to the Profit and Loss Account in the proportion of depreciation charge over the life of the subsidized assets.

Illustration 21.

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

"The company purchased on 1.4.2014 a special purpose machinery for ₹50 lakhs. It received a Central Government grant for 20% of the price. The machine has an effective life of 5 years".

Solution:

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

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

AS-13: ACCOUNTING FOR INVESTMENTS

The Standard deals with accounting for investments in the financial statements of an enterprise and relevant disclosure requirement. Investments are assets held for earning income, capital appreciation or for other benefits to the investing enterprise, obviously investments held as 'stock-in-trade' are not 'Investments'.

The following are outside the purview of AS-13:

a) Recognition of income on investment as dealt with under AS-9 (Revenue Recognition)

b) Operating or Finance Lease.

c) Investment of retirement benefit plans and Life Insurance Enterprise.

d) Mutual fund, Asset Management Companies, Banks, Public Financial Institution, enacted under specific Act/Companies Act, 2013.

Reasons, type, purposes etc varies widely and for this the standard is set to harmonize the accounting.

Cost of investment, means and includes,

a) Acquisition charges e.g. brokerage, fees, duties etc.

b) If acquired by issue of shares/securities, the acquisition cost is the fair market value, may be with reference to issue price determined by statutory authorities.

Fair market value may be determined with reference to market value or net realizable value (net of expenses to be incurred) or net of recovery of cost (dividend or interest accrued and included in the price of investments).

Current investment/Short term investment:

a) Readily realizable and not intended to be held for more than a year from date of investment.

b) The carrying amount on the reporting date is taken at lower of cost or fair value to prudently account for the unrealized losses but not the unrealized gains, considering individual or category of investments (not on overall basis).

c) Any reduction to the fair value and any reversal to such reduction is included in the P/L Account.

Long-term investment:

a) Investments held otherwise even if readily marketable are long term investments

b) Intended to protect, facilitate and furtherance to existing operation, also known as Trade investments (not meant to provide additional cash resources)

c) Long-term investments are normally carried at cost unless there is a permanent diminution in the value when the same is recognized in the carrying amount by charging or reversing through P/L Account.

d) The carrying amount is determined on individual investment basis.

   On disposal, the difference between the carrying amount and the net proceed of disposal is recognized in the P/L Account.

   Investment in Property is in Land or Building, not intended for occupation substantially for use by or in the operation of the Investing Enterprise, should be treated as long-term investment.

Reclassification of Investments:

1) Long term to current : Take lower of cost and "carrying amount"

2) Current to Long term: Take lower of cost and " fair value"

Disclosure under AS-13:

a) Accounting policy for determination of carrying amount

b) Income separately for long-term and current investments, at gross i.e. inclusive of TDS.

c) Profit or loss on disposal and changes in carrying amount separately for long term and current investments.

d) Significant restrictions on the right of ownership, realisability of investments or the remittance of income and proceeds of disposal.

e) The aggregate amount of quoted and unquoted investments and aggregate market value of quoted investments.

f) other specific disclosure as required by Statute governing the enterprise, (e.g. Schedule III requires classifications to be disclosed in terms of Govt. or Trust securities, shares, debentures or bonds, investment properties others)

Illustration 22.

In preparing the financial statements of X Ltd.for the year ended 31st March, 2015, you come across the following information. State with reasons, how would you deal with them in the financial statements:

"An unquoted long term investment is carried in the books at a cost of ₹ 5 lakhs. The published accounts of the unlisted company received in June 2016 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 1 lakh".

Solution:

As per AS-13, the long term investments should be carried in the financial statements at cost. If there is a diminution in the value of long term investments, which is not temporary in nature, provision should be made for each investment individually. Any reduction in the carrying amount should be charged to the Profit and Loss Account.

The long term investments are carried at a cost of ₹ 5 lakhs in the books of accounts. The value of investments fall down to ₹ 1 lakh due to cash losses and the declining market share of the company in which the investments were made.

In view of the provision contained in AS-13, the carrying amount of long-term investments should be brought down to ₹ 1 lakh and ₹ 4 lakhs should be charged to Profit and Loss Account for the year ended 31st March, 2016.

Illustration 23.

A company has invested a substantial amount in the shares of another company under the same management. The market price of the shares of the aforesaid company is about half of that at which these shares were acquired by the company. The management is not prepared to provide for the fall in the value of shares on the ground that the loss is only notional till the time the shares are actually sold?

Solution:

As per AS-13, for the purpose of determining carrying amount of shares the investment has to be classified into long-term and current; in the instant case, it appears that the investment is long-term, hence it should be carried at cost, unless there is a permanent diminution in value of investment. At the market price, investment is half of its cost. The reduction appears to be heavy and permanent, hence the provision for permanent diminution(decrease) in value of investment should be made. The contention of management is not as per AS-13.

Illustration 24.

MAGIC Bank has classified its total investment on 31.3.2015 into three categories: (a) held to maturity (b) available for sale (c) held for trading.

Held to maturity investment is carried at acquisition cost less amortised amount. Available for sale are carried at marked to market. Held for trading investments are valued at weekly intervals at market rates or as per the prices declared by FIMMDA. Net depreciation, if any, is charged to revenue and net appreciation, if any, is ignored. Comment on the policy of the bank in accordance with AS-13.

Solution:

As per para 2(d) of AS-13, the accounting standard is not applicable to bank, insurance company, mutual funds. In this case, MAGIC Bank is a bank, therefore AS-13 does not apply here. For the banks, the RBI has issued guidelines for classification and valuation of the investment. Therefore, the MAGIC Bank should comply with RBI guidelines.

AS -14: ACCOUNTING FOR AMALGAMATIONS

Amalgamation refers to an amalgamation as per the provision of the Companies Act, 2013 or any other law applicable to Companies. Sections 230 to 232 if Companies Act, 2013 governs the provisions of amalgamation.

Amalgamation may be categorized broadly as:

I) **Merger :** - genuine pooling of assets and liabilities and shareholder's interest of the amalgamation companies.

II) **Purchase:** - the shareholder of the acquired company do not continue to have proportionate share in the combined company or where the business of the former is not intended to be continued.

Amalgamation in the nature of merger:

a) All the assets and liabilities of the transferor company are taken over by the transferee company.

b) Such assets and liabilities are incorporated without any adjustment (except to ensure uniformity of accounting policies) in the financial statements of the transferee.

c) At least 90 percent equity holders of transferor become equity shareholders of transferee by virtue of the amalgamation.

d) The consideration for the amalgamation is discharged by equity shareholders in the transferee, except for fractional shares by cash.

e) The business of the transferor is intended to be carried on by the transferee.

Amalgamation in the nature of Purchase:

Absence/non-fulfillment of one or more conditions as above will make the amalgamation in the nature of purchase.

Accounting methods:

1) **Merger - Pooling of interest method: -**

   (a) In preparing the balance sheet of the transferee company after amalgamation, line by line addition of the respective assets and liabilities of the transferor and transferee company should be made except for share capital;

   (b) If Purchase Consideration is **more** than Share capital(equity + preference) of the transferor company, the difference will be adjusted with Reserves. No goodwill can be created or recognized since there is no acquisition. If Purchase consideration is less than share capital, such shall be recognized as Capital Reserve, as per the Expert Advisory Committee (EAC) of the ICAI, April 2004.

2) **Purchase method:**

   a) The transferee record the assets and liabilities at their existing carrying amount or by allocating the consideration to individual identifiable assets and liabilities (even may be unrecorded in transferors' financial statements) at fair value on the date of amalgamation;

   b) If Purchase consideration is **more** than the value of net asset acquired by transferee be recognized as "Goodwill" in the financial statement. (if feasible and practicable, the goodwill is amortised over the useful life, otherwise over a period of not exceeding 5 years). In a **reverse** situation it is Capital Reserve which cannot be transferred to General Reserve.

   c) In case of amalgamation in the nature of purchase the identity of reserves other than Statutory Reserve (Development Allowance/ Investment Allowance Reserve under I.T Act), is not preserved.

Disclosure under AS-14 (in the first financial statement after the amalgamation)

a) Names and general nature of business of the amalgamating companies

b) Effective date of amalgamation for accounting purpose

c) The method of accounting used

d) Particulars of the scheme sanctioned under statute

e) Additional disclosure for merger

   1. Description and number of shares issued

   2. Percentage of each company's equity shares exchanged under amalgamation

   3. The amount of difference between the consideration and the value of net identifiable assets acquired and treatment thereof

f) Additional disclosure under 'Purchase' method

   1. Consideration for the amalgamation and a description of the consideration paid or contingently payable

   2. Amount of difference as above and the treatment/amortization period for goodwill

g) Where the scheme sanctioned under a statute prescribes a different treatment other than AS-14, for better understanding:

   1. A description of the accounting treatment and reasons for variation with AS-14

   2. Deviation in the accounting treatment as prescribed in he scheme under statute as compared to AS-14, if followed had there been no treatment prescribed by the scheme.

Illustration 25.

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

Solution:

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

For X Ltd. Purchase consideration = ₹ 25 lakhs

Less: Share capital of X Ltd = ₹ 20 lakhs

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

For Y Ltd. Purchase Consideration = ₹28 lakhs

Less: Share Capital of Y Ltd = ₹30 lakhs

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

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

Illustration 26.

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

Solution:

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

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

AS-15: EMPLOYEE BENEFITS

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

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

a) Defined Contribution Plans (DCP):

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

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

 3) Excess if any is treated as prepayment

b) Defined Benefit Plans (DBP):

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

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

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

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

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

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

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

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

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

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

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

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

Disclosure under AS-15:

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

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

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

Treatment of Voluntary Retirement scheme payments:

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

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

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

Illustration 27.

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

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

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

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

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

Solution:

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

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

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

Illustration 28.

In the context of relevant Accounting Standards, give your comment on the following matter for the financial year ending 31st March, 2015:

"Increase in pension liability on account of wage revision in 2014-15 is being provided for in 5 instalments commencing from that year. The remaining liability of ₹300 lakhs as redetermined in actuarial valuation will be provided for in the next 2 years"

Solution:

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

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

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

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

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

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

AS-16: BORROWING COST

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

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

Examples of qualifying assets:

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

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

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

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

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

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

Conditions for capitalization of borrowing costs:

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

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

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

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

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

Accounting treatment of borrowing cost as per AS-16:

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

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

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

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

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

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

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

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

Disclosure under AS- 16

a) Accounting Policy adopted

b) Amount of borrowing cost capitalized during the accounting period

Illustration 29.

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

Solution:

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

Illustration 30.

X Ltd. has obtained an institutional loan of ₹ 800 lakhs for modernization and renovation of its machinery. Machinery acquired under the modernization scheme and installation completed on 31.3.15 amounts to ₹ 600 lakhs. ₹ 80 lakhs has been advanced to suppliers for additional assets and balance loan of ₹120 lakhs has been utilized for working capital purpose. The total interest paid for the above loan amounted to ₹80 lakhs during 2014-15.

You are required to state how the interest on the institutional loan is to be accounted in the year 2014-15.

Solution:

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

Illustration 31.

Happy Ltd.has taken a loan of US $10 lakhs on 1st April, 2014, for a specific project at an interest rate of 10% p.a., payable annually. On 1st April, 2014, the exchange rate between the currencies was ₹45 per US $. The exchange rate, as at 31st March, 2015, is ₹ 48 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, 2014.

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

(a) Interest for the period = US $10,00,000 x 10% x ₹48 per US $ = ₹ 48,00,000

(b) Increase in the liability towards the principal amount = US $ 10,00,000 x (48-45)= ₹30,00,000.

(c) Interest that would have resulted if the loan was taken in Indian currency = US $ 10,00,000 x 45 x 15% = ₹67,50,000

(d) Difference between interest on local currency borrowing and foreign currency borrowing = ₹67,50,000 – ₹ 48,00,000 = ₹ 19,50,000

Therefore, out of ₹30,00,000 increase in the liability towards principal amount, only ₹ 19,50,000 will be considered as the borrowing cost. Thus, total borrowing cost would be ₹67,50,000 being the aggregate of interest of ₹48,00,000 on foreign currency borrowings (as per Para 4(a) of AS-16) plus the exchange difference to the extent of difference between interest on local currency borrowing and interest on foreign currency borrowing of ₹19,50,000. Thus, ₹67,50,000 would be considered as the borrowing cost to be accounted for as per AS-16 and the remaining ₹10,50,000 would be considered as the exchange difference to be accounted for as per AS-11 "The Effects of Changes in Foreign Exchange Rates".

Illustration 32.

On 30.4.2015 MNC Ltd.obtained a loan from the bank for ₹50 lakhs to be utilized as under:

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

In March 2011, construction of shed was completed and machinery installed. Delivery of truck was not received. Total interest charged by the bank for the year ended 31.3.15 was ₹90 lakhs. Show the treatment of interest as per AS-16.

Solution:

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

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

AS 17: SEGMENT REPORTING

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

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

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

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

a) The nature of product/service;

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

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

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

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

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

a) Significant difference in risk and rewards;

b) Internal MIS and organization structure;

c) Essential factors that defines a business segment.

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

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

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

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

a) extra ordinary item as AS-5

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

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

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

Segment result is segment revenue less segment expense

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

a) income tax asset

b) general enterprise asset/H.O asset

Segment liabilities are worked out or above basis but excluding:

a) income tax liabilities

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

For primary segment disclosure required for:

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

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

c) total carrying amount of segment assets;

d) total amount of segment liabilities;

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

For secondary segment, disclosure required for:

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

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

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

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

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

   1. segment revenue from external customers

   2. total carrying amount of segment assets

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

Additional disclosure required for

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

2) in a reverse situation, disclosure for

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

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

Illustration 33.

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

Solution:

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

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

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

Illustration 34.

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

₹ ('000)

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

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

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

Solution:

M Ltd.
Segmental Report

(₹ in '000)

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

Sales Revenue by Geogr aphical Market

(₹ in '000)

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

Illustration 35.

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

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

Solution :

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

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

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

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

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

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

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

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

Illustration 36.

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

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

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

Solution:

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

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

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

Or

+ 10% or more of segment result

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

Or

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

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

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

AS -18: RELATED PARTY DISCLOSURE

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

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

However disclosure is not required

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

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

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

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

(a) to control the other party

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

Definition

a) Control:

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

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

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

b) Significant Influence:

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

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

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

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

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

Type of disclosure under AS-18

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

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

   (i) the name of transacting related party

   (ii) description of the relationship between parties

   (iii) description of nature of transaction

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

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

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

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

AS -19: LEASES

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

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

Types of lease

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

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

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

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

Applicability

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

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

Definitions

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

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

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

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

3. ***Gross Investment (= MLP+URV)*** – Gross investment in lease is the sum of the following:
   - Minimum lease payment (from the standpoint of Lessor) and
   - Any unguaranteed residual value accruing to the Lessor.
4. ***Interest rate implicit in the lease*** – When the Lessor gives an asset on lease (particularly on finance lease), the total amount, which he receives over lease period by giving the asset on lease, includes the element of interest plus payment of principal amount of asset. The rate at which the interest amount is calculated can be simply called implicit rate of interest. It can be expressed as under:-

It is the discount rate at which

Fair Value of leased Asset	=Present value of [Minimum lease payment (in respect of Lessor)]
(At the inception of lease)	+ Any unguaranteed residual value accruing to the Lessor.

5. ***Contingent Rent*** – Lease Rent fixed on the basis of percentage of sales, amount of usage, price indices, market rate of interest is called contingent rent. In other words, lease rent is not fixed, but it is based on a factor other than time.
6. ***Minimum lease payments [MLP]***
   - For Lessor = Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (by or on behalf of lessee) – contingent Rent – cost for service and tax to be paid by the reimbursed to Lessor + residual value guaranteed by third party.
   - For Lessee = Total lease rent to be paid by lessee over the lease terms + any guaranteed residual value (for lessee) – contingent rent – cost for service and tax to be paid by and reimbursed to Lessor.
7. ***Lease includes Hire Purchase*** – The definition of a 'lease' includes agreements for the hire of an asset, which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These agreements are commonly known as hire purchase agreements.

Accounting for Finance Lease – In the books of Lessee

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

Accounting for Finance Lease – In the books of Lessor

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

  Net Investment = Gross Investment – Unearned Finance Income.

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

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

- Recognition of Finance Income

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

Accounting for Operating Lease- In the books of Lessor:

- Record leased out asset as the fixed asset in the balance sheet.
- Charge depreciation as per AS-6
- Recognize lease income in profit & loss account using straight line method. If any other method reflects more systematic allocation of earning derived from the diminishing value of leased out asset, that approach can be adopted.
- Other costs of operating lease should be recognized as expenses in the year in which they are incurred.
- Initial direct cost of the lease may be expensed immediately or deferred.

Accounting for operating lease – In the Books of Lessee

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

"Sale and Lease back"

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

Accounting treatment of Sale and Lease back

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

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

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

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

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

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

(B) If Sale price "above" fair value

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

Example 2: H Ltd. sold machinery having WDV of ₹ 400 Lakhs to B Ltd. for ₹ 500 Lakhs and the same machinery was leased back by B Ltd. to H Ltd. The Lease back is operating lease.

Comment if –

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

b) Fair value is ₹ 600 lakhs

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

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

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

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

Answer:

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

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

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

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

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

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

Illustration 37.

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

Solution:

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

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

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

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

Illustrations

Problem on leasing

Illustration 38.

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

Lease Term = 4 years

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

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

Guaranteed Residual Value = ₹ 1,00,000

Expected Residual Value = ₹ 2,00,000

Implicit Interest Rate = 14.97%

Do the accounting in the book of lease?

Solution :

Present value of minimum lease payment

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

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

Apportionment of finance lease : Rate of Interest 14.97%

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

Books of Milind Softex

Lease Rent Account

Year	Particulars	Amount ₹	Particulars	Amount ₹
1st year	To, Bank A/c	5,00,000	By, Finance Charges A/c	2,22,393
			By, Lease liability A/c	2,77,607
		5,00,000		5,00,000
2nd year	To, Bank A/c	5,00,000	By, Finance Charges A/c	1,80,835
			By, Lease liability A/c	3,19,165
		5,00,000		5,00,000
3rd year	To, Bank A/c	5,00,000	By, Finance Charges A/c	1,33,056
			By, Lease liability A/c	3,66,944
		5,00,000		5,00,000
4th year	To, Bank A/c	5,00,000	By, Finance Charges A/c	78,126
			By, Lease liability A/c	5,21,874
		5,00,000		5,00,000

Lease Liability Account (Lessor)

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

Extract of Profit and Loss Account

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

Extract balance Sheet

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

Illustration 39.

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

Lease Term = 4 years

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

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

Guaranteed Residual Value = ₹ 1,00,000

Expected Residual Value = ₹ 2,00,000

Implicit Interest Rate = 14.97%

How the accounting is done in the book of lessor ?

Solution :

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

Net investment in lease = Gross investment – unearned finance income

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

= ₹20,00,000 + ₹1,00,000 + ₹1,00,000

= ₹22,00,000

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

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

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

Apportionment of MLP into Capital recovery & Finance income

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

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

Illustration 40.

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

Solution:

Journals

In the books of Amit

	Particulars		Dr. ₹	Cr. ₹
1st	**Purchase of Computers:**			
	Computer A/c	Dr.	44,000	
	To, Bank A/c			44,000
	Payment of first Year's Lease:			
	Bank A/c	Dr.	22,000	
	To, Lease Rent A/c			22,000
	Depreciation for First Year:			
	Depreciation A/c	Dr.	17,600	
	To, Computer A/c			17,600
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	17,600	
	To, Depreciation A/c			17,600
	Lease Rent A/c	Dr.	22,000	
	To, Profit & Loss A/c			22,000
2nd	**Payment of Second Year's Lease:**			
	Bank A/c	Dr.	13,640	
	To, Lease Rent A/c			13,640
	Depreciation for Second Year:			
	Depreciation A/c	Dr.	10,560	
	To, Computer A/c			10,560
	Transfer to Profit & Loss Account:			
	Profit & Loss A/c	Dr.	10,560	
	To, Depreciation A/c			10,560
	Lease Rent A/c	Dr.	13,640	
	To, Profit & Loss A/c			13,640

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

In the books of Sumit

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

AS -20: EARNING PER SHARE (EPS)

Disclosure under AS-20:

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

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

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

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

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

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

   1. the amount used as the numerator and a reconciliation of those amounts to the net profit/ loss for the accounting period.

   2. the weighted average number of equity shares used as the denominator and a reconciliation of those denominator to each other.

   3. the nominal value of shares along with EPS figure.

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

Basic EPS:

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

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

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

Impact of bonus element in rights issue on EPS denominator:

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

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

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

ii) Potential equity shares are:

a) debt instruments/preference share convertible into equity shares

b) share warrants

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

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

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

Illustration 41.

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

Accounting year: 2014-15				
Date	Description	Shares Issued (Nos)	Buyback (Nos)	O/S
01/04/2014	Op. Balance	1800	-	1800
30/09/2014	Issued for Cash	600	-	2400
29/02/2015	Buyback	-	300	2100
31/03/2015	Cl. Balance	2400	300	2100

Solution:

Weighted average number

(a) (1800 x 5/12) + (2400 x 5/12) + (2100 x 2/12) i.e. 2100 shares

or

(b) (1800 x 12/12) + (600 x 7/12) - (300 x 2/12) i.e. 2100 shares

Illustration 42.

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

Bonus issued on 1-1-16 : 2 equity shares for each Equity Share outstanding at 31-12-16 i.e. ₹ 40,00,000.

Solution:

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

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

Illustration 43.

Compute EPS:

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

Net profit for 2015-16 ₹ 15,00,000

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

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

d) Right price: ₹ 15/-

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

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

Computation:

1) Theoretical ex-right fair value per share:

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

i.e. 1,20,00,000/6,00,000 = ₹ 20/-

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

3) Computation of EPS:

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

AS -21: CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements are presented by the parent or holding enterprise to provide financial information about the economic activities of its group - information about the parent and subsidiaries as a single economic entity revealing economic resources controlled by the group, the obligation of the group and the result that the group achieved with its resources.

AS-21 lays down the principles and procedures for preparation and presentation of consolidated financial statements in the backdrop of the facts that the Companies Act 2013 doesn't provide for consolidation vis-à-vis the compliance to be made by listed companies in terms of AS-21.

Thus in parent enterprise's separate financial statements, investment in subsidiaries should be accounted for as per AS-13, i.e. Accounting for Investments.

The consolidated financial statements even if made voluntarily should comply with AS -21.

The key note is the control by the parent which means and includes:

i) the ownership, directly or indirectly through subsidiary/subsidiaries of more than 50% of the voting power of an enterprise or,

ii) control of the composition of the Board of Directors or Governing Body (e.g. in the form of restriction, holding a position and right in nomination exercisable by the parent with reference to the subsidiary) as the case may be so as to obtain economic benefits from its activities.

Further "Control" is also further screened to exclude a subsidiary if;

a) it is intended to be temporary i.e. the subsidiary is acquired and held exclusively with a view to subsequent disposal in near further, in other words not intended for long term purpose.

b) there is long term restriction on the subsidiary which significantly impair its ability to transfer funds to the parent enterprise. (e.g. embargo on fund transfer by foreign subsidiary-severe devaluating currency)

In above cases investment would be valued as per AS -13 and not AS-21. AS- does not deal with the specific AS as under:

i) AS-14 - Accounting for Amalgamation

ii) AS-23 - Accounting for Investment in Association

iii) AS-27 - Accounting for investment in Joint Venture

Since schedule III is not tailored to the presentation of consolidated financial statement. ICAI has provided general guideline vide GC-5/2002 which broadly states that the following principles should be served:

a) notes which are necessary for presenting a true and fair view of the consolidated finance statements should be included as an integral part thereof.

b) Only the notes involving items, which are material, need to be disclosed and the materiality is judged in the context of consolidated financial statement. Applicability of other Accounting Standard, in the preparation and presentation of consolidated statements are stated below:

    (i) irrespective of the format followed, the minimum disclosure under various mandatory standards should be made.

AS-1: disclosure of accounting policies (e.g. going concern)

AS-22: accounting for taxes and income as applicable to the individual entity only cannot be given setoff treatment in CFS.

Specific items to AS in respect of balances of individual enterprise and not as a group e.g. "Current Investment valued at lower of cost or market price" Segmental information on consolidated numbers of individual enterprise in the group only.

Disclosure relating -to operating lease (AS-19) would not be required since the same is setoff and eliminated at consolidated level.

Related party transaction, within the group would not require discloser since eliminated at consolidated level.

Accounting related treatment for in consolidated financial statements:

a) Consolidation should be made on line by line basis by adding together like items- assets, liabilities, income and expense

b) All group balances and group transactions and unrealized profits arising thereon should eliminated

c) Dividend - minority share when paid is deduced from opening "Minority Interest" A/c and the portion attributable to parent is eliminated from Consolidated Reserves.

d) Excess of cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary on date of investment is recognized as 'goodwill' or in reverse situation as 'capital reserve' and the 'minority interest' as a liability separately in the consolidated financial statement as a distinct item.

e) When carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered

f) Usually consolidated financial statements are drawn upto the same date for reporting. In case, the reporting dates are different, the subsidiary normally prepares statements as at the same date of the parent. However, impracticable, different dates may be reported but the difference should not be more than six months with adjustments made for the effects, of significant transactions during the intervening period in respect all the items in the financial statements pertaining to that transaction e.g. cost of sales, inventory, unrelated gains, inter group balances. If not material otherwise, may be adjusted in income statement.

g) AS-21 permits the use of different accounting policies and estimates between group members, as long as the proportion of these in the in the context of the CFS are properly disclosed and explained.

h) AS-21 allows the use of financial statements of the subsidiary for the immediately preceding period if the financial statements as on the date of investments are not available or impracticable to draw the financial statements as on that date. As stated earlier, effects of significant transactions or events occur between the two dates are made.

i) I several investments are Trade over time to make it 51% control, goodwill may be determined when the last investment is made to bring the slake to 51% or alternatively on each step-up investment basis.

j) Goodwill is determined on the basis of carrying value of assets/liabilities of the subsidiary at the balance sheet date, thus fair value accounting for acquisition is not permitted under AS-21.

k) Where a group has acquired several subsidiaries, some resulting in goodwill and others a capital reserve, set off is not made for consolidation purpose.

Disclosure in terms of AS-21

a) Disclosure should be made in accordance with the format of the parent company's financial statements. Further disclosure under all the mandatory accounting standards when material and also compliance with General Classification no. 5/2002 should be made in order to ensure comparability for one period to the next, supplementary information about the effect of acquisition and disposal of subsidiaries on the financial position at the reporting date and results for the reporting period with comparative preceding period amount, should be disclosed.

b) Reasons for exclusion from consolidation of subsidiaries should be disclosed. List of all subsidiaries-name, country of incorporation/residence, proportion of ownership interest and if different proportion of voting power.

c) Nature of relationship if the parent does not own directly or indirectly more than 50% of voting power of the subsidiary.

d) Names of subsidiary/subsidiaries of which reporting dates are different from that of the parent and the difference in reporting dates.

AS-22: ACCOUNTING FOR TAXES ON INCOME

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

Tax expense = current tax + deferred tax

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

Deferred tax is the tax effect of timing difference.

The difference accounts for:

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

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

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

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

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

Permanent differences do not result in deferred taxes.

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

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

Situations which leads to Deferred Tax:

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

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

Impact of such timing differences may lead to:

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

  Profit and Loss A/c………..Dr.

  To Deferred Tax Liability A/c

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

  Deferred Tax Asset A/c……….Dr.

  To Profit and Loss A/c

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

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

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

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

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

Disclosure under AS-22 Mandatory :

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

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

Illustration 44.

From the following information for R Ltd. for the year ended 31st March, 2015, calculate the deferred tax asset/liability as per AS-22

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

Solution:

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

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

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

Tax expense = Current tax + Deferred tax

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

Therefore, Deferred Tax Liability as on 31.3.2015 = ₹ 3,00,000 – ₹ 30,000 = ₹ 2,70,000.

Amount of tax to be debited in Profit and Loss Account for the year 31.03.2015:

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

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

= 3,60,000

Illustration 45.

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

Solution:

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

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

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

Profit and Loss A/c…………Dr. 5.94

To Deferred Tax Liability A/c 5.94

Illustration 46.

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

Solution:

Om Limited

Calculation of Deferred Tax Asset/Liability

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

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

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

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

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

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

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

b) Participation in policy making process

c) Material transaction between investor and investee.

d) Interchange of managerial personnel

e) Provision of essential technical information

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

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

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

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

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

Non applicability of AS-23:

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

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

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

2) Equity method of accounting is also not applicable if

   a) it has no investment in Association

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Illustration 47.

X holds, 25% share in Y Ltd at a cost of ₹5 lakhs as on 31-03-2015. Out of Y's shares capital and reserve ₹20 Lakh each.

For the year ended 31-03-2015 Y made a profit of ₹80,000 and 50% distributed as dividend. In the CFS, the value (carrying amount) as at 31.03.2015 will be as under:

	₹ in Lakhs
Cost of shares in Y Ltd.	5.00
Share of Reserve	5.00
Share of profit	0.20
	10.20
Less: dividend received	0.10
Value of investment as at 31.03.15	10.10

Illustration 48.

Style Ltd. acquired 30% of Ugly Ltd.'s shares on April 10,2015, the price paid was ₹ 20,00,000.

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

Further, Ugly Ltd reported a net income of ₹3,00,000 and paid dividends of ₹1,00,000. Style Ltd. has subsidiary on 31.3.15. Calculate the amount at which the investment in Ugly Ltd should be shown in the consolidated Balance Sheet of Style Ltd. as on 31.3.15.

Solution:

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

Value of the investment as per equity method

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

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

AS-24: DISCONTINUING OPERATION

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

Prerequisites to determine 'discontinuing operation' –

1. The enterprise in term a single plan:

    a) disposing substantially in its entirety e.g. by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholder, or

    b) disposing in piecemeal manner e.g. selling off the assets-and settling its liabilities individually or

    c) terminating through abandonment

2. That represent, a separate major line of business or geographical area of operation, and

3. That can be distinguished operationally for financial reporting purpose.

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

a) gradual or evolutionary phasing out of a product line or class of service

b) abrupt discontinuing of several products within an ongoing line of business

c) shifting of some production or marketing activities for a particular line of business from one location to another

d) closing of a factory to achieve productivity improvements or other cost savings. 'discontinuing operation' are expected to occur infrequently, but resulting income or expenses arising thereof needs to be disclosed in terms of AS-5 to explain the performance of the enterprise for the period.

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

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

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

a) the operating assets/liabilities of the component can be directly attributed to it.

b) revenue can be directly attributed to it

c) at least a majority of operating expenses can be directly attributed to it.

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

Discontinuing process need not necessarily arise out of binding sale agreement but relates back to the announcement of a detailed, formal plan approved by the Board of Directors /Governing

Body, if precedes sales agreement and therefore require initial disclosure event/transaction. However the announcement must demonstrate the commitment to discontinue resulting into a constructive obligation for the enterprise. Requirement of initial disclosure in the financial statement for the period in which the event of discontinuing operation occur, are:

1. A description of discontinuing operation
2 The date and nature of initial disclosure event
3. Probable date or period by which the discontinuance is expected to be completed
4. Carrying amount of the total of assets to be disposed off and the total of liabilities to be settled as of the Balance sheet date
5. The amount of revenue and expenses in respect of ordinary activities attributable to the discontinuing operation during the current financial reporting period.

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

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

Disclosure under AS-24

1. By way of a note in the financial statement in respect of each discontinuing operation, in addition to disclosure on the face of the statements of profit/loss in respect of:
   a) the amount of pre-tax profit/loss from ordinary activities, income tax expense as attributable to discontinuing operation, during the current financial reporting period; and
   b) the amount of pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to the discontinuing operation.
2. Comparative information for prior period that is presented in financial statements prepared after the initial disclosure should be restated to segregate assets, liabilities revenue expense and cash flows of continuing and discontinuing operations.
3. AS-24 does not provide for the principles to recognize and measure profit/loss in respect of discontinuing operation and therefore, other accounting standards would be applicable e.g. AS-4, AS-10 and other AS as and when applicable.

Illustration 49.

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

Solution:

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

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

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

Illustration 50.

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

Solution:

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

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

Illustration 51.

B Ltd. is a software company, has subsidiary C Ltd. B Ltd.hold 70% shares in C Ltd. During 2014-15, B Ltd. sold its entire investment in C Ltd. Is it a discontinuing operation?

Solution:

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

Hence, it is not a discontinuing operation.

Illustration 52.

C Ltd.has three major lines of business: steel, tea and power generation. It has decided to sell the tea division during the financial year 2014-15. A sale agreement has been entered into on 30th September 2014 with P Ltd. under which the tea division shall be transferred to P Ltd. on 31st March, 2015. Is it a discontinuing operation?

Solution:

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

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

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

AS-25: INTERIM FINANCIAL REPORTING

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

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

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

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

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

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

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

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

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

The standard itself does not categorize the enterprise or frequency of interim financial report and the time limit for presentation from the end of an interim period, but if it is required to prepare and present, it should comply with AS-25.

Instances for interim financial report:

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

(ii) incase of merger and amalgamation

(iii) for IPO purpose

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

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

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

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

Form and contents of interim financial statement:

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

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

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

Contents of a condensed Interim Financial Statements as a minimum:

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

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

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

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

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

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

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

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

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

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

a) Balance Sheet:

   (1) As at the end of current interim period

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

b) Statement of Profit and Loss:

   (1) For the current period

   (2) Cumulative for the current financial year to date

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

c) Cash flow Statement:

   (1) Current financial year to date

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

Illustration 53.

S Ltd. presents interim financial report quarterly on 1.4.2014. S Ltd.has carried forward loss of ₹800 lakhs for income tax purpose for which deferred tax asset has not been recognized. S Ltd.earns ₹ 600 lakhs; ₹700 lakhs; ₹750 lakhs and ₹800 lakhs respectively in the subsequent quarters, excluding the carried forward losses. Income tax rate is 30%. Calculate the amount of tax expense to be reported in each quarter.

Solution:

The estimated payment of the annual tax on ₹2,850 lakhs earnings for the current year = ₹ (2,850 – 800) lakhs = ₹2,050 lakhs.

Therefore, tax = 30% of ₹2,050 lakhs = ₹615 lakhs.

Average annual effective tax rate = (615/2,850) x 100 = 21.58%

Tax expense to be shown: ₹ lakhs

1st quarter = 600 x 21.58% =129.48

2nd quarter = 700 x 21.58% =151.06

3rd quarter = 750 x 21.58% =161.85

4th quarter = 800 x 21.58% =172.64

Illustration 54.

M Ltd. presents interim financial report(IFR) quarterly, earns ₹800 lakhs pre-tax profit in the first quarter ending 30.6.14 but expect to incur losses of ₹250 lakhs in each of the remaining three quarters. Effective income tax rate is 35%. Calculate the income-tax expense to be reported for each quarter as per AS-25.

Solution:

Tax expense to be reported in each of the quarters are:

1st quarter = 800 x 35% = ₹280.00 lakhs

2nd quarter = (250) x 35% = ₹ (87.5)lakhs

3rd quarter = (250) x 35% = ₹ (87.5)lakhs

4th quarter = (250) x 35% = ₹ (87.5) lakhs

Annual Tax Expense = ₹17.5 lakhs

AS – 26: INTANGIBLE ASSETS

An intangible asset is an identifiable non-monetary asset, without physical substance held for production or supply of goods and services for rental to others or for administrative purposes.

AS-26:

(i) prescribes the accounting treatment for intangible assets that are not specifically covered in other accounting standard;

(ii) recognizes an intangible asset on fulfillment of certain criteria;

(iii) deals with deferment of expenses except in a few specific instances.

However AS -26 does not apply to:

a) Intangible assets covered by other accounting standards e.g. AS-2 (valuation of inventories), AS-7 (accounting for construction contracts), AS-22 (accounting for taxes on income), leases falling within scope of AS-19, goodwill on amalgamation (AS-14) and on consolidation (AS-21).

b) Mineral rights and expenditure on the exploration .for or development and extraction of minerals, oils, natural gas and similar non-generative resources and intangible assets arising in insurance enterprises from contracts with policy holders however, computer software expenses, start up cost pertaining to above activities are covered by AS-26).

c) Discount Premium on borrowings.

AS-26 applies, among other things, to expenditure on advertisement, training, startup, R&D activities, Rights under Licensing Agreement for motion picture video recording, plays, manuscript, patents and copyrights, the criteria is that expenditure should provide future economic benefits to an enterprise.

Sometimes, an asset may incorporate both tangible and intangible component and it is practically inseparable. "Judgment is required to determine the applicability of AS-10 (fixed asset) and AS-26 (intangible asset).

Example:

(1) computer software which is integral part and without that the computer-controlled machine cannot operate - treated as fixed asset.

(2) computer software, not an integral part of related' hardware - treated as. an intangible asset,

Essential criteria for recognition of an intangible asset:

a) *identifiable:*- It must be separate from goodwill and the enterprise could rem. sell: exchange or distribute the future economic benefits attributable to the asset without disposing of future economic benefits that flow from other assets in the same revenue earning activity - but goodwill cannot be meaningfully transferred to a new owner without also selling the other assets or the operation of the business. e.g. patents, copyrights, license, brand name, import quota, computer software, lease hold right, marketing rights, technical know-how etc.

b) *control:*- The enterprise has the power to obtain the future economic benefits, flowing from the underlying resources and also can restrict the access of others I to those benefits (not necessarily legal right and may be in some other way – I market and technical knowledge may give rise to future economic benefit).

c) *future economic benefits:*- An enterprise should asses the probability of future economic benefits using reasonable and supportable assumptions that represent best estimate of the set of economic conditions that will exist over the useful life of the asset on the basis of weight age to external evidence available at the time of initial recognition.

d) Cost can be measured reliably :

   i) Initially recognized at cost - purchase price, taxes duty and other directly attributable expenses to make the asset ready for its intended use, if acquired separately - purchase consideration in the form of cash or other monetary asset.

   ii) In exchange for shares or securities at fair value of those shares or securities.

   iii) In exchange or part exchange for another asset - as per AS-10.

The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed or allocated on a reasonable and consistent basis for creating, producing and making the asset ready for its intended use, but in no case once treated as an expense, cannot be reversed for capitalization even if the essential criteria for recognition are complied with a later date.

Normally the following cost are not recognized for internally generated intangible asset:

1) selling, administrative and other general overhead unless directly attributable.

2) clearly identified inefficiencies and initial operating loses incurred before an asset achieves planned performance.

3) expenditure on training the staff to operate the asset.

Subsequent expenditure on an internally generated intangible asset after its purchase or completion is normally treated as expense unless it is assessed to generate future economic benefits over and above the originally assessed standard of performance or it can be measured and reliably attributed to the concerned intangible asset.

Amortization is the systematic allocation of the depreciable amount (cost less residual value usually "NIL" unless determined in terms of committed value by a third party or determined by active market price) of an intangible asset over its useful life (period of time for use, number of production or other similar units expected to obtain or legal restriction).

Under AS-26, useful life shall not exceed 10 years from the date the asset is available for use unless there is persuasive evidence to establish useful life longer than 10 years provided the enterprise

(a) amortizes over the best estimated useful life

(b) estimates the recoverable amount at least annually to identify the impairment loss

(c) disclose the reasons and factors in determining a longer life.

The amortization period and the amortization method should be reviewed at least at each, financial year and if the expected life is revised, the amortization period is revised accordingly but in no case it would tantamount to inappropriate deferment to later years.

AS-5 will be relevant in this regard as to what constitutes a change in accounting policy and what constitutes a change in estimate e.g. a change from straight-line to diminishing method or vice-versa would be change in accounting policy whereas reduction in the amortization period is change in accounting estimate.

Disclosure under AS-26

A) General

   1. for each class of intangible asset distinguishing between internally generated and others

      (a) useful lives and amortization rates used

      (b) amortization method used

      (c) gross carrying amount and the accumulated amortization including impairment loss at the beginning and end of the reporting period

      (d) a reconciliation of the carrying amount (opening balance/addition/ disposal/ impairment/loss charged/reversed/amortization for the period and other changes)

   2. class of intangible asset by grouping of a similar nature and use by the enterprise informa tion on impaired intangible asset under AS-28 change in accounting policy or accounting estimate as per AS-5 reasons for amortization beyond 10 years with list of factors considered in determining the useful life.

   3. Description, the carrying amount and remaining amortization period of any individual asset what is material to the financial statement as a whole.

   4. Existence and carrying amount of intangible assets whose title is restricted and the carrying amount of intangible asset pledged as security for liabilities.

   5. Amount of commitments for acquisition of intangible assets.

B) R&D expenditure: R&D expense (that is directly attributable or reasonably allocated on a consistent basis) recognized as an expense during the period.

C) Other information: encouraged to disclose a description of only fully amortized intangible asset but still in use.

Specific guideline for internally generated computer software - criteria for capitalization: apart from the broad recognition principles, AS-26 provides for specific guidance on internally generated computer software.

(a) At preliminary project stage, it is not recognized as an asset since the enterprise cannot demonstrate then exists as an asset from which future economic benefit will follow (making strategic decision, determination of performance requirements alternative means to achieve specified performance requirements. determination of technology to achieve performance requirements and selection of consultant to assist in development and/or installation of the software)

(b) At development stage involving detailed program design, coding working model in operative version for all major planned function and testing to bring it to a completed version together with related documentation and training material.

At this stage the internally generated computer software can be recognized as an asset on satisfying

1. The technical feasibility to make it available for internal use
2. Intention to complete to perform individual functions e.g. commitment for funding the project.
3. Ability to use the software
4. Usefulness of the software to generate future economic benefit
5. Availability of technical, financial and other resources to complete the development and use
6. Reliably measure the expenditure to the software development b) cost has some connotation as described earlier in the standard.

(c) Accounting for software acquired or purchased should meet with the basic principle of AS-26 as discussed elsewhere in this standard.

For computer software considering the fact technological change and obsolescence.It is 3-5 years of useful life, which needs to be reasoned in the disclosure.

Expenditure for Website:

The expenditure for purchasing, developing, maintaining and enhancing hardware (servers, internet connection) related to web site are accounted for under AS-10 (fixed asset).

The expenditure may be incurred internally when developing enhancing and maintaining its own website in the context of planning, application and infrastructure development, graphical design and content development and operating stage which are directly attributable or allocable on a reasonable basis to creating, producing and preparing the asset for intended use. The nature of each activity should be evaluated to decide web site stage of development.

Accounting treatment and recognition:

(a) planning stage expenditure are akin to research cost and recognized as expense when incurred.

(b) expenditure arising onward development stage complying with the development criteria (refer to computer software) should be recognized as an Intangible asset.

Illustration 55.

On February 2015, J Ltd.bought a trademark from I Ltd. for ₹50 lakhs. J Ltd. retained an independent consultant, who estimated the trademark's remaining life to be 14 years. Its unamortized cost on I ltd. records was ₹35 lakhs. J Ltd.decided to amortize the trademark over the maximum period allowed. In J Ltd.'s Balance Sheet as on 31st December 2015, what amount should be reported as accumulated amortization?

Solution:

As per para 23 of AS-26, intangible assets should be measured initially at cost therefore. J Ltd. should amortize the trademark at its cost of ₹50 lakhs. The unamortized cost on the seller's books ₹35 lakhs is irrelevant to the buyer. Although the trademark has a remaining useful life of 14 years, intangible assets are generally amortized over a maximum period of 10 years as per AS-26. Therefore, the maximum amortization expense and accumulated amortization is ₹5 lakhs (₹50 lakhs/10).

Illustration 56.

During 2014-15, A Ltd.incurred organization costs/preliminary expenses of ₹40,000. What portion of the organization costs will A Ltd. defer to years subsequent to the 2014-15?

Solution:

As per para 56(a) of AS-26, organization costs /preliminary expenses are those incurred in the formation of a corporation. Since uncertainty exists concerning the future benefit of these costs in future years, they are properly recorded as an expense in 2014-15.

Illustration 57.

D Ltd. is developing a new distribution system of its material, following the costs incurred at different stages on research and development of the system:

Year ended 31.3	Phase/Expenses	Amount (₹ In lakhs)
2012	Research	8
2013	Research	10
2014	Development	30
2015	Development	36
2016	Development	50

On 31.3.12, D Ltd. identified the level of cost savings at ₹ 16 lakhs expected to be achieved by the new system over a period of 5 years, in addition this system developed can be marketed by way of consultancy which will earn cash flow of ₹10 lakhs per annum. D Ltd.demonstrated that new system meet the criteria of asset recognition as on 1.4.2014.

Determine the amount/cash which will be expensed and to be capitalized as intangible assets, presuming that no active market exist to determine the selling price of product i.e. system developed. System shall be available for use from 1.4.2012.

Solution:

As per AS-26, research cost of ₹18 lakhs to be treated as an expense in respective year ended 31st March 2012 and 2013 respectively.

The development expenses can be capitalized from the date the internally generated assets (new distribution system in this given case) meet the recognition criteria on and from 1.4.2012. Therefore, cost of ₹30 + 36 + 50 = ₹116 lakhs is to be capitalized as an intangible asset.

However, as per para 62 of AS-26, the intangible asset should be carried at cost less accumulated amortization and accumulated impairment losses.

At the end of 31st March, 2016, D Ltd. should recognize impairment loss of ₹22.322 lakhs = (116 - 93.678) and carry the new distribution system at ₹ 93.678 lakhs in the Balance Sheet as per the calculation given below:

Impairment loss is excess of carrying amount of asset over recoverable amount. Recoverable amount is higher of two i.e. value in use (discounted future cash inflow) and market realizable value of asset.

The calculation of discounted future cash flow is as under assuming 12% discount rate.

(₹ Lakhs)

Year	Cost Savings	Inflow by introducing the system	Total cash inflow	Discounted at 12%	Discounted cash flow
2017	16	10	26	0.893	23.218
2018	16	10	26	0.797	20.722
2019	16	10	26	0.711	18.486
2020	16	10	26	0.635	16.51
2021	16	10	26	0.567	14.742
					93.678

No amortization of asset shall be done in 2012 as amortization starts after use of asset which is during the year 2016-17.

Illustration 58.

M.S. International Ltd. is developing a new production process. During the financial year ending 31st March, 2015, the total expenditure incurred was ₹50 lakhs. This process met the criteria for recognition as an intangible asset on 1st December, 2014. Expenditure incurred till this date was ₹22 lakhs. Further expenditure incurred on the process for the financial year ending 31st March, 2016 was ₹80 lakhs. As at 31st March, 2016, the recoverable amount of know-how embodied in the process is estimated to be ₹72 lakhs. This includes estimates of future cash outflows as well as inflows.

You are required to calculate:

(i) Amount to be charged to Profit and Loss A/c for the year ending 31st March, 2015 and carrying value of intangible as on that date.

(ii) Amount to be charged to Profit and Loss A/c and carrying value of intangible as on 31st March, 2016. Ignore depreciation.

Solution:

As per AS 26 'Intangible Assets'

(i) For the year ending 31.03.2015

(a) Carrying value of intangiblet as on 31.03.2015:

At the end of financial year 31st March 2015, the production process will be recognized (i.e. carrying amount) as an intangible asset at a cost of ₹28 lakhs (expenditure incurred since the date the recognition criteria were met, i.e., on 1st December 2014).

(b) Expenditure to be charged to Profit and Loss account: The ₹ 22 lakhs is recognized as an expense because the recognition criteria were not met until 1st December 2015. This expenditure will not form part of the cost of the production process recognized in the balance sheet.

(ii) For the year ending 31.03.2016

(a) Expenditure to be charged to Profit and Loss account:

(₹ in lakhs)

Carrying Amount as on 31.03.2015	28
Expenditure during 2015 – 2016	80
Total book cost	108
Recoverable Amount	72
Impairment loss	36

₹ 36 lakhs to be charged to Profit and loss account for the year ending 31.03.2016.

(b) Carrying value of intangible as on 31.03.2016:

(₹ in lakhs)

Total Book Cost	108
Less: Impairment loss	36
Carrying amount as on 31.03.2016	72

AS-27: FINANCIAL REPORTING OF INTEREST IN JOINT VENTURE

AS-27 is applicable for accounting in joint venture interest and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturer and investors, regardless of the structure or forms under which the joint venture activities take place,

The statement provides for display and disclosure requirement for accounting for the investment in the stand-alone and consolidated financial statements of the venturer.

A joint venture is a contractual arrangement between two or more parties undertaking an economic activity, subject to joint control (control is the power to govern the financial and operating policies of an economic activity to obtain benefit from it).

The arrangement may be:

a) Jointly controlled operations

b) Jointly controlled asset

c) Jointly controlled entities

In the event an enterprise by a contractual arrangement establishes joint control over an entity which is a subsidiary of that enterprise within the meaning of AS-21(CFS), it will be treated as joint venture as per AS-27. Joint control requires all the venturers to jointly agree on key decisions, else decision cannot be taken, as such even a minority holder (owner) may enjoy joint control.

Contractual arrangement is normally made in writing touching upon:

(a) The activity, duration and reporting obligation

(b) The appointment of the board of director/governing body and the respective voting rights/ capital contribution/sharing by ventures of the output, income, expenses or results of the joint venture.

Contractual arrangement and joint control together makes an activity a joint venture, (investment in Associates in which the investor has significant influence is covered by AS-23)

Some joint ventures involve use of own fixed assets and other resources on its own and obligation of its own.

For its interest in jointly controlled operations, a venturer should recognize in its separate financial statements and consequently in its CFS,

(a) the assets that it controls and the liabilities it incurs

(b) the expense it incurs and the share of income earned from the joint venture.

As the above are already recognized in stand-alone financial statements of the venturer and consequently in the CFS, there us no requirement for adjustment or other consolidation procedure, when the venturer present the CFS. Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture.

Some joint ventures involve joint control; by means of joint ownership by the venturers of one or more assets contributed/acquired for the purpose of joint venture - the asset are used to obtain economic benefit for the venturers, agreeing to share the output from the assets and sharing of expenses incurred.

In respect of jointly controlled assets, each venturer recognize in its separate financial statement and consequently in its CFS:

a) Share of the jointly controlled assets under distinct head of each asset and not as an investment

b) Any liability incurred (e.g. financing its share of the assets)

c) Share of joint liability in respect of the venturer

d) Any income from sale or use of its share of the output in the joint venture and share of expenses.

e) Expense is incurred in respect of its in the joint ventures e.g. financing the venturer’s interests in the asset and selling its share of output The treatment of jointly controlled assets, recognizes the substance and economic reality (legal from of the joint venture) separate financial statements may not be prepared for the joint venture itself.

A jointly controlled entity involves the establishment of a corporation, partnership or lither entity in which each venturer has an interest as per contractual arrangement.

a) in a separate/stand alone financial statement of each venturer, the interest in a jointly controlled entity should be accounted for as an investment as per AS-13 only the resources contributed, forms a part of the investment and the share’ of joint venture result is treated in the income statement of the venturers.

b) proportionate consolidation for joint venture is applied in case where the preparation and presenting a CFS is required, reflecting the substance and economic reality of the arrangement in the CFS. Many of the procedure in this regard are similar to AS-21 and require to be followed for treatment and disclosure.

Joint venture interest in the financial statements, of an investor is treated appropriately in terms of AS-13, AS-21 or AS-23 in CFS but for separate financial statements is should be accounted for as per *AS-13.*

Disclosure under AS-27:

In separate and CFS in respect of:

a) Aggregate amount of contingent liabilities unless the probability of loss is remote separately from other contingent liabilities in relation to:

   1. Its interest in joint venture and its share in each of the contingent liabilities incurred jointly

2. Its share of the contingent liability of the joint ventures themselves for which it is contingently liable.

3. Those liabilities which arise because of the venturer is contingently liable for the liability of other venturers.

b) Aggregate of commitments in respect of joint venture separately from other commitments in respect of:

1. Capital commitment of its own and shares in the capital commitment incurred jointly with other ventures in relation to the joint venture.

2. Share of capital commitment of the joint ventures themselves

c) A list of all joint ventures and description of interest in significant joint venture and for jointly controlled entities the properties of ownership interest name of the country of incorporation/ residence.

Illustration 59.

N Ltd has 80% shares in a joint venture with Suzuki Ltd. N Ltd. sold a plant WDV ₹20 lakhs for ₹30 lakhs. Calculate how much profit N Ltd. should recognize in its book in case joint venture is:

(a) jointly controlled operation;

(b) jointly controlled asset;

(c) jointly controlled entity.

Solution:

As per AS-27, in case of jointly controlled operation and jointly controlled assets joint venture, the venture should recognize the profit to the extent of other venturer's interest.

In the given case, N Ltd. should recognize profit of:

= ₹(30 – 20)lakhs = ₹10 x 20%= ₹2 lakhs only.

However, in case of jointly controlled entities N Ltd. should recognize full profit of ₹10 lakhs in its separate financial statement. However, while preparing consolidated financial statement it should recognize the profit only to the extent of 20% i.e. ₹ 2 lakhs only.

AS-28: IMPAIRMENT OF ASSETS

An asset is impaired if its carrying amount exceeds the amount to be recovered through use or sale of the asset and given the situation the standard requires the enterprise to recognize an impairment loss i.e. the amount by which the carrying amount of an asset exceeds its recoverable amount.

Impairment loss is a normal expense and thus will have impact on distributable profit and other provisions of the company's act and applicable enactment (Acceptance of Deposit Rules, BIFR etc)

Impairment loss may be discussed in the following areas:

1) Impairment loss on a specific asset;

2) Impairment loss for a cash generating unit;

3) Impairment loss for discontinuing operation.

Impairment Loss = Carrying amount of the Asset – Recoverable amount.

Carrying amount is the amount at which asset is shown in the Balance Sheet.

Recoverable amount of an asset is higher of:

- Net selling price
- Value in use

Net Selling Price= Expected realizable value of an asset – cost of disposal

Net Selling price can be obtained from:

- Active market for the asset
- Binding sale agreement
- Best estimate based on information

Value in Use= Present value of estimated future cash flow arising from the use of asset + residual value at the end of its useful life.

Present value is calculated by applying discount rate to future cash flows.

Estimated cash flows includes :

- Cash inflows from continuing use of the asset
- Projected cash outflows to generate cash inflows from continuing use of the asset.
- Net cash flows if any to be received(or paid) for the disposal of the asset at the end of its useful life.

Estimated cash flows excludes:

- Cash flows from financing activities
- Payment /refund of income tax

Discount rate: It is the cost of capital to be applied to calculate the present value of estimated cash flows and is based on the following factors:

- Pre-tax rate
- Current market assessment of time value of money after considering specific risk of the asset.
- Enterprises weighted average cost of capital or incremental financial cost.
- The current rate of inflation is also considered.

AS-28 does not apply to:

- inventories (as per AS 2);
- construction contract assets (as per AS 7);
- deferred tax assets (as per AS 22);
- investments covered by AS-13 and financial instruments, because other AS provide for recognizing and measuring these assets.

1) **Assessment for impairment of assets needs to be made at the B/S date: as to any indication in this context based on external or internal source of information.**

External sources:

- Market value changes with passage of time or normal use (typewriter on invention of computer)
- Adverse effect in the light of technological, market, economic, or legal environment in which the enterprise operates.

- Change in market rate of interest or returns on investment affect the discount rates used to assess an assets value in use (if the effect is not a short-term phenomenon).
- Carrying amount of the net asset, exceeds its market capitalization (determined by future growth, profitability, threat of new products/entrants etc).

Internal sources:

- Obsolescence /physical damage is evident.
- Indication obtained internally that economic performance of an asset has worsened or likely to worse than expected.
- Continuous cash loss may indicate that one or more of the business division is impaired.

Assessment for impairment should be made on individual asset basis, except when;

(i) The asset value in use cannot be estimated to be close to the net se1ling price i.e. future cash flow from continuing use of the asset cannot be estimated to be negligible or there is no plan to dispose of the assets in near future.

(ii) The asset does not generate cash inflows from continuing use that are largely independent of those from other assets.

In the exceptional case as above, the value in use/recoverable amount can be determined with regard assets cash generating units (generate cash inflows from outside the reporting enterprise and independent of cash inflows from other assets / group of assets.

2) Impairment Loss to a cash generating unit :

Cash generating unit (CGU): The smallest group of an asset for which cash flows can be determined independently.

Even if the cash flows can determined independently, aggregation of cash generating units becomes necessary in some situations.

To determine impairment loss of a CGU, we have to follow 'bottom up' or 'top down' test.

3) Impairment Loss for discontinuing operation :

In this type of situation, the impairment loss shall depend on the way the discontinuing operation is disposed off:

a) substantially in its entirety;

b) as piecemeal sales;

c) by abandonment.

Illustration 60.

X Ltd.purchased a machinery on 1.1.2009 for ₹20 lakhs. WDV of the machine as on 31.3.15 ₹12 lakhs. The Recoverable amount of the machine is ₹11 lakhs. What is the impairment loss?

Solution:

Impairment Loss = Carrying amount – Recoverable Amount

= ₹12 lakhs – ₹11 lakhs = ₹ 1 lakh.

llustration 61.

Carrying amount ₹200 lakhs. Net Selling Price ₹210 lakhs. Value in use ₹ 220 lakhs. What is the impairment loss?

Solution:

Carrying amount ₹200 lakhs

Recoverable amount ₹ 220 lakhs (being the higher of net selling price and value in use)

Since, recoverable amount is more than carrying amount of the asset, there will arise no impairment loss.

llustration 62.

C Ltd.acquired a machine for ₹3.2 crores on 1.1.2012. It has a life of 5 years with a salvage value of ₹40 lakhs. Apply the test of impairment on 31.3.2015:

(a) Present value of future cash flow ₹1.3 crores

(b) Net selling price ₹1.2 crores

Solution:

Carrying amount of the asset: [3.2 – (3.2 – 0.4) x 39/60] = 1.38 crores.

Time period for use of the asset: 1.1.2012 to 31.3.2015 = 39 months

Total life period of the asset= 5 years = 60 months.

Recoverable amount: being the higher of present value and net selling price = ₹1.3 crores.

Impairment Loss = ₹(1.38 – 1.3) crores= ₹0.08 crores.

AS 29: PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

The objective of this Standard is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

The objective of this Standard is also to lay down appropriate accounting for contingent assets.

This standard is not applicable to:

- Financial instruments carried at fair value
- Insurance enterprises
- Contract under which neither party has performed any of its obligations or both parties have partially performed their obligation to an equal extent
- AS 7,AS 15,AS 19 and AS 22.

A provision is a liability which can be measured only by using a substantial degree of estimation.

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

An obligating event is an event that creates an obligation that results in an enterprise having no realistic alternative to settling that obligation.

A contingent liability is:

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognized because:

  (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation;

  or

  (ii) a reliable estimate of the amount of the obligation cannot be made.

A contingent asset is a possible asset that arises from past events the existence of which will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the enterprise.

Present obligation - an obligation is a present obligation if, based on the evidence available, its existence at the balance sheet date is considered probable, i.e., more likely than not.

Possible obligation - an obligation is a possible obligation if, based on the evidence available, its existence at the balance sheet date is considered not probable.

A restructuring is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an enterprise; or

(b) the manner in which that business is conducted.

Past Event- A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the enterprise has no realistic alternative to settling the obligation created by the event.

Best Estimate: The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date. The amount of a provision should not be discounted to its present value.

Risks and Uncertainties: The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.

Future Events : Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

Disclosure:

For each class of provision, an enterprise should disclose:

(a) the carrying amount at the beginning and end of the period;

(b) additional provisions made in the period, including increases to existing provisions;

(c) amounts used (i.e. incurred and charged against the provision) during the period; and

(d) unused amounts reversed during the period.

An enterprise should disclose the following for each class of provision:

(a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

(b) an indication of the uncertainties about those outflows. Where necessary to provide adequate information, an enterprise should disclose the major assumptions made concerning future events, as addressed in paragraph 41; and

(c) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

llustration 63.

There is a income tax demand of ₹2.5 lakhs against the company relating to prior years against which the company has gone on appeal to the appellate authority in the department. The ground of appeal deals with the points covering ₹1.8 lakhs of the demand. State how the matter will have to be dealt with in the financial account for the year.

Solution:

A provision of ₹0.7 lakhs and a contingent liability of ₹ 1.8 lakhs should be provided in the financial accounts for the year.

llustration 64.

A company follows a policy of refunding money to the dissatisfied customers if they claim within 15 days from the date of purchase and return the goods. It appears from the past experience that in a month only 0.10% of the customers claim refunds. The company sold goods amounting to ₹20 lakhs during the last month of the financial year. Is there any contingency?

Solution:

There is a probable present obligation as a result of past obligating event. The obligating event is the sale of the product. Provision should be recognized as per AS-29. The best estimate for provision is ₹2,000 (₹20 lakhs x 0.1%).

Illustration 65.

Mega Ltd. took a factory premises on lease on 1.4.2014 for ₹2,00,000 per month. The lease is operating lease. During March, 2015, Mega Ltd. relocates its operation to a new factory building. The lease on the old factory premises continues to be live upto 31.12.2017. The lease cannot be cancelled and cannot be sub-let to another user. The auditor insists that lease rent of balance 33 months upto 31.12.2017 should be provided in the accounts for the year ending 31.3.2015. Mega Ltd. seeks your advice.

Solution:

In accordance with AS 29 'Provisions, Contingent Liabilities and Contingent Assets' and ASI 30 'Applicability of AS 29 to Onerous Contracts', if an enterprise has a contract that is onerous, the present obligation under the contract should be recognized and measured as a provision. In the given case, the operating lease contract has become onerous as the economic benefit of lease contract for next 33 months up to 31.12.2017 will be nil. However, the lessee, Mega Ltd., has to pay lease rent of ₹ 66,00,000 (i.e.2,00,000 p.m. for next 33 months).

Therefore, provision on account of ₹66,00,000 is to be provided in the accounts for the year ending 31.03.15. Hence auditor is right.

AS-30: Financial Instruments: Recognition and Measurement

The objective of this Standard is to establish principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

Requirements for presenting information about financial instruments are in Accounting Standard (AS) 31, *Financial Instruments: Presentation.* Requirements for disclosing information about financial instruments are in Accounting Standard (AS) 32, *Financial Instruments:*

Definitions:

The terms defined in AS 31, *Financial Instruments: Presentation* are used in this Standard with the meanings specified in paragraph 7 of AS 31. AS 31 defines the following terms:

- financial instrument

- financial asset
- financial liability
- equity instrument

and provides guidance on applying those definitions.

Definition of a Derivative:

A derivative is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

(a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');

(b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and

(c) it is settled at a future date.

Definitions of Four Categories of Financial Instruments :

A financial asset or financial liability at fair value through profit or loss is a financial asset or financial liability that meets either of the following conditions.

(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if it is:

  (i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term; or

  (ii) part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

  (iii) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

(b) Upon initial recognition it is designated by the entity as at fair value through profit or loss.

Accounting Standard (AS) 32, Financial Instruments: Disclosures , requires the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through profit or loss, including how it has satisfied these conditions.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity other than:

(a) those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that meet the definition of loans and receivables; and

(c) those that the entity designates as available for sale.

An entity should not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

(a) those that the entity intends to sell immediately or in the near term, which should be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;

(b) those that the entity upon initial recognition designates as available for sale; or

(c) those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which should be classified as available for sale.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments, or (c) financial assets at fair value through profit or loss.

Definition of a financial guarantee contract

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Definitions Relating to Recognition and Measurement

The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

Derecognition is the removal of a previously recognised financial asset or financial liability from an entity's balance sheet.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Definitions Relating to Hedge Accounting

A firm commitment is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

A forecast transaction is an uncommitted but anticipated future transaction.

Functional currency is the currency of the primary economic environment in which the entity operates.

A hedging instrument is (a) a designated derivative or (b) for a hedge of the risk of changes in foreign currency exchange rates only, a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.

A hedged item is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged.

Hedge effectiveness is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument.

Embedded Derivative:

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

AS 31: Financial Instruments: Presentation

The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in Accounting Standard (AS) 30.

Definitions

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

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.

A financial asset is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

- (i) to receive cash or another financial asset from another entity; or
- (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and is:

- (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
- (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

(a) a contractual obligation:

- (i) to deliver cash or another financial asset to another entity; or
- (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

   (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

   (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity 's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial Instruments: Recognition and Measurement and are used in this Standard with the meaning specified in AS 30.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- financial asset or financial liability at fair value through profit or loss
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale
- transaction costs.

In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

In this Standard, 'entity' includes individuals, partnerships, incorporated bodies, trusts and government agencies.

AS 32: Financial Instruments: Disclosures

The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks.

The principles in this Accounting Standard complement the principles for recognising, measuring and presenting financial assets and financial liabilities in Accounting Standard

(AS) 30, Financial Instruments: Recognition and Measurement and Accounting Standard (AS) 31, Financial Instruments: Presentation.

Significance of financial instruments for financial position and performance

An entity should disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

Balance sheet

Categories of financial assets and financial liabilities

The carrying amounts of each of the following categories, as defined in AS 30, should be disclosed either on the face of the balance sheet or in the notes:

(a) financial assets at fair value through profit or loss, showing separately

  (i) those designated as such upon initial recognition and

  (ii) those classified as held for trading in accordance with AS 30;

(b) held-to-maturity investments;

(c) loans and receivables;

(d) available-for-sale financial assets;

(e) financial liabilities at fair value through profit or loss, showing separately

  (i) those designated as such upon initial recognition and

  (ii) those classified asheld for trading in accordance with AS 30; and

(f) financial liabilities measured at amortised cost.

Financial assets or financial liabilities at fair value through profit or loss

If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through profit or loss, it should disclose:

(a) the maximum exposure to credit risk of the loan or receivable (or group of loans or receivables) at the reporting date.

(b) the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

(c) the amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:

  (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to **market risk**; or

  (ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset. Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate or index of prices or rates.

(d) the amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.

If the entity has designated a financial liability as at fair value through profit or loss in accordance with AS 30, it should disclose:

(a) the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:

  (i) as the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk ,or

(ii) using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

(b) the difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

Reclassification

If the entity has reclassified a financial asset as one measured:

(a) at cost or amortised cost, rather than at fair value; or

(b) at fair value, rather than at cost or amortised cost,

it should disclose the amount reclassified into and out of each category and the reason for that reclassification.

1.6 COMPARATIVE ANALYSIS OF THE INDIAN ACCOUNTING STANDARDS, IFRS AND USGAAP

True & Fair View: Under IFRS and IGAAP framework, there is an assumption that adoption of IFRS / IGAAP leads to a true and fair presentation, there is no such assumption under US GAAP.

Prudence Vs Rules: US GAAP essentially takes the cook book approach to set detailed accounting rules as compared to IFRS approach of setting a broad accounting principles and guidelines. Accounting principles in UG on a particular subject is scattered across various pronouncements whereas in IFRS it is concentrated in one or few accounting standards.

Comparative Position: Under IGAAP and IFRS, comparative financial figures are to be provided for one previous years, whereas under USGAAP (SEC requirement for listed companies) comparatives are to be provided for two previous years except for Balance Sheet.

Over-riding of Standards – IFRS permits that a company may withhold application of IFRS in extremely rare situation, where it is felt that application of IFRS would defeat the very objective of Financial reporting. Disclosure must be made for reason for override. No such override is generally permitted under IGAAP and US GAAP.

Reporting Elements - IFRS prescribes the minimum structure and content of financial statement including Statement of Changes in equity (in addition to Balance sheet, Income statement, Cash flow statement, notes comprising significant accounting Policy and other explanatory notes). Under US GAAP in addition to statement of changes in Equity, Statement of Comprehensive Income is required.

Both of these statements are NOT required under IGAAP.

FINANCIAL STATEMENTS

Indian GAAP: Balance sheet, Profit and loss account and Cash flows statement* (*only in case of listed companies). Comparative financial statements of previous period necessary.

US GAAP: Balance sheet, Income statement, Statement of stockholders' equity and statement of cash flows. Balance sheet for two years and Income statement, Statement of stockholders' equity and Cash flows statement for three years* (*two years for non-listed companies).

IFRS: Balance sheet, Income statement, Statement of changes in equity, cash flows statement and accounting policies and notes. Comparative information for previous period necessary.

BALANCE SHEET

Basis of Difference	IFRS	USGAAP	IGAAP
Format	IFRS does not prescribe any format, but stipulates minimum line items like PPE, Investment property, Intangible assets, Financial assets, Biological assets, inventory, receivables, etc.	US GAAP also does not prescribe any format , but Rule S-X of SEC stipulates for listed companies minimum line items to be disclosed either on face of Balance sheet or Notes to Accounts.	IGAAP provides two format of Balance Sheet- Horizontal and Vertical format (Part I of Schedule III to the Companies Act, 2013).
Order	Under IFRS, lineitems are presented in increasing order of liquidity.	Under US GAAP, items in assets and liabilities are presented in decreasing order of liquidity.	In IGAAP, line items are presented in increasing order of liquidity.
Consolidation	Consolidation of Financial statements of subsidiaries is not compulsory until it is required under some other law or regulation	Under US GAAP consolidation of results of Subsidiaries and Variable interest entity (FIN 46R) is compulsory	It is not mandatory for companies to prepare CFS under AS 21. However, listed enterprises are mandatorily required by listing agreement of SEBI to prepare and present CFS.
Current/Non-Current	An organisation has an option to adopt Current or Non current classification of assets and liabilities	Bifurcation into current & non-current items is cumpulsorily required.	No such requirement

Income Statement

Basis of Difference	IFRS	USGAAP	IGAAP
Format	IFRS does not prescribe any standard format for income statement but prescribes minimum disclosure includes revenue, finance costs, share of post tax results of JV and associates using equity method.	There is no prescribed format, SEC guidelines Rule S-X prescribe minimum line items to be shown on the face of income statement& suggest 2 alternatives a) a single step format where expenses are classified by function and b) a Multiple step format where Cost of sales is deducted from sales	Under Indian GAAP no format is prescribed, but minimum line items have been specified in Part II of Schedule III to Companies Act, 2013 including Aggregate Turnover, Gross Service revenue for Commission paid to Sole selling agent, Brokerage and discount on sales etc.
Prior Period Items	A prior period item/error should be corrected by retrospective effect by restatement of opening balance of assets, liabilities or equities	Mandates retrospective application of error and requires restatement of comparative opening balance with suitable footnote disclosure.	Requires separate disclosure of prior period in the current financial statement & no restatement of retained earnings are required.

Basis of Difference	IFRS	USGAAP	IGAAP
Discounting	IFRS provides that where the inflow of cash is significantly deferred without interest, discounting is needed.	US GAAP also permits discounting in certain cases for instance discounting is done in case of loans, debentures, bonds and upfront fees	There is no concept of discounting under IGAAP.
Change in accounting policy	IFRS requires retroactive application for the earliest period practical and adjustment of opening retained earning.	Requires prospective application of change in accounting policy and proforma disclosure of effect on income before extraordinary items on the face of income statement as separate section. Only in specific case retrospective is applicable	Under IGAAP, effect for change in accounting policy is given with prospective effect, if the same is material.
Bifurcation of Cost	There is no specific provision in this regard	Total cost is required to be shown separately under: a) Cost of Sales b) Sellingand Administration c) R & D	There is no specific provision in this regard. There are certain disclosure requirements under varied AS which should be complied.
Extra ordinary Events	Disclosure is prohibited	Nature should be both: a) Infrequent b) Unusual Disclosed separately on the face of Income Statement net of Taxes after results from operations	Distinct from the ordinary activities of the enterprise and, therefore, are not expected to recur frequently or regularly. The nature and the amount of each extraordinary item should be separately disclosed in the statement of P & L in a manner that its impact on current profit or loss can be perceived.

CASH FLOW STATEMENT

Basis of Difference	IFRS	USGAAP	IGAAP
Exemptions	No exemptions	Limited exemptions for certain investment entities	Unlisted enterprises, enterprises with a turnover less than ₹ 500 million and those with borrowings less than ₹100 million
Direct/Indirect Method	Both allowed	Both allowed	Both allowed. Listed companies- Indirect method Insurance companies- Direct Method

Periods to be presented	2 years	3 years	2 years
Interest paid	Operating and financing activity	Operating activity (to be disclosed by way of a note)	Financing. In case of a financial enterprise, operating activities
Interest received	Operating or investing activity	Operating activity	Investing. In the case of a financial enterprise, operating activity.
Dividends paid	Operating or financing	Financing	Financing
Tax payments	Operating	Operating (to be disclosed by way of a note)	Operating
Dividends received	Operating or investing	Operating	Investing. In the case of a financial enterprise, operating activity.

SHAREHOLDERS' EQUITY

Repurchase of own shares:

IGAAP

Entity may purchase its own shares provided it is in consonance with the complex legal requirements stipulated in the Companies Act and SEBI guidelines.

The excess of cost over par value may be adjusted against free reserves and securities premium.

Also, such shares are required to be cancelled, i.e. cannot be kept in treasury.

US GAAP

Repurchased for retiring stock, excess of cost over par value may be Charged entirely to retained earnings; or allocated between retained earnings and additional paid-in-capital (APIC); or charged entirely to APIC.

When stock repurchased for purposes other than retiring stock, the cost of acquired stock may be shown separately as a deduction from equity; or treated the same as retired stock.

IFRS

Similar to US GAAP. Repurchased stock is shown as a deduction from equity.

Statement of Changes in Shareholders' Equity

	Common Stock	Additional Paid in Capital	Retained Earnings	Treasury Stock(i.e. Buy Back)	Cumulative Translation adjustment	Accumulated other comprehensive income	Total
Balance at the beginning of the year							
Net income							
Other comprehensive income							
Dividend paid							
Cumulative translation adjustment							
Stock options							
Balance as at the end of the year							

Statement of changes in shareholders equity:

Indian GAAP – 2 years

Not Applicable. Share capital and reserves are disclosed by way of a schedule.

IFRS – 2 years

Primary statement Shows capital transactions with owners, movement in accumulated profits and reconciliation of equity. Other Comprehensive Income may be shown as a part of it.

US GAAP – 3 years

May be shown as a part of notes to accounts shows capital transactions with owners, movement in accumulated profits and reconciliation of equity.Other Comprehensive Income may be shown as a part of it.

Dividend on equity shares

IGAAP

Presented as a appropriation of profits.

Dividends are accounted in the year when Proposed.

US GAAP

Presented as a deduction in the statement of changes in shareholders' equity Cash Dividends are accounted in the year when Declared. Only in case of Stock dividend adjustments is done in accounts.

IFRS

Presented as a deduction in the statement of changes in shareholders' equity dividends are accounted in the year when Declared.

INVESTMENTS

IGAAP : AS 13

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

(A) Current Investments – Lower of Cost or Fair Value

(B) Long term Investments. – At cost. If Permanent decline then reduce the carrying value to declined FMV.

All changes in carrying value is taken to P&L

Reclassification – Long term to Current – at lower of cost and carrying amount.

Reclassification – Current to Long term – at lower of cost and Fair Value.

INVESTMENTS: US GAAP

(A) Held to Maturity – *At Cost*. (with discount or premium amortized over the effective yield basis). *Most Restrictive category*. securities can be so classified if there is positive intent and ability to hold (maintain the securities) till maturity.

(B) Available for Sale. – *At FMV*. Unrealized gain / loss due to Fair value are accounted under OCI. In case of Permanent decline, the reduction is taken to income statement.

(C) Trading Securities – *AT FMV*. Unrealized gains and losses are entirely taken to Income Statement.

Investment in unlisted securities is valued at cost .There are very stringent limitations on reclassification of Investments.

IF "HTM" securities are sold, use of this category is prohibited *Provision for diminution (in value of the long-term investment) created in earlier years cannot be reversed, whereas in Indian GAAP it can be reversed.*

INVESTMENTS: IFRS

(A) Held to Maturity – *At Cost*. (with discount or premium amortized over the effective yield basis). *Most Restrictive category*. securities can be so classified if there is positive intent and ability to hold (maintain the securities) till maturity.

(B) Available for Sale. – *At FMV*. Unrealized gain / loss due to Fair value are accounted under OCI. In case of Permanent decline, the reduction is taken to income statement.

(C) Trading Securities – *AT FMV*. Unrealized gains and losses are entirely taken to Income Statement.

Investment in unlisted securities can be valued at FMV.

There are very stringent limitations on reclassification of Investments.

IF "HTM" securities are sold, use of this category is prohibited for next two years.

CONSOLIDATION - SUBSIDIARIES

Indian GAAP

Based on controlling interest, control directly or indirectly through subsidiary (ies), by the virtue of holding the majority of voting shares or control over the board of directors.

IFRS

Based on voting control or power to govern.

The existence of currently exercisable *potential voting rights* is also taken into consideration. SPEs also need to be consolidated.

US GAAP

Controlling interest through majority ownership of voting shares or by contract.

Consolidate **variable interest entities (VIEs)** in which a parent does not have voting control but absorbs the majority of losses or returns.

CONSOLIDATION : VARIABLE INTEREST ENTITIES(VIE)

US GAAP – FIN 46(R)

VIE is an entity which satisfies any of the following conditions:

- The **equity investment** at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support.
- Equity investors **lack** either **(a) voting control**, or (b) an obligation to **absorb expected losses**, or (c) the right to receive expected residual returns.
- Equity investors have voting rights that are not proportionate to their economic interest, and activities of the entity involve or are conducted on behalf of an investor with disproportionately small voting interest.

A **VIE** is a thinly capitalized and is not self supportive entity.

The **primary beneficiary** (i.e one absorbing more than half of expected losses or receiving more than half of expected residual returns) needs to consolidate the VIE.

Exclusions from Consolidation – Subsidiaries – IFRS

Under IFRS, a parent may avoid consolidation if the parent is a wholly owned subsidiary or a partially owned subsidiary of another entity and its other owners, including those not entitled to vote, have been informed about and do not object to the parent not preparing consolidated financial statements the parent is neither listed nor it is in the process of listing the ultimate or any intermediate parent of the parent produces IFRS compliant consolidated financial statements.

Recent Changes

Temporary control (unless the intended period of holding is less than12 months) is not a justification for non consolidation.

Severe long term restrictions to transfer funds to the parent are not a justification for non-consolidation.

IMPAIRMENT OF ASSETS

Difference Criterion	IFRS and IGAAP	US GAAP
Timing of impairment review	Annually	Whenever events or changes in circumstances indicate that the carrying amount may not be recovered
Asset is impaired if	Recoverable amount < Carrying amount	Fair value < Carrying amount
Recoverable amount/ Fair Value	Recoverable amount is higher of ● Net Selling Price ● Value in use	Fair Value is the amount at which an asset or liability could be bought or settled in a current transaction between willing parties
Cash flows for calculating value in use/fair value	Use discounted cash flows for calculating the value in use	Use discounted cash flows for calculating the fair value
Reversal of impairment loss	Whenever there is a change in the economic conditions	Prohibited

BUSINESS COMBINATION

Indian GAAP:

If the combination satisfies the specified conditions, it is an amalgamation in the form of a merger (Pooling of Interest Method), else an amalgamation in the nature or purchase.

Pooling of Interest Method and Purchase Method allowed

US GAAP:

Acquisition of net assets that constitute a business or controlling equity interests of entities.

Prohibits Pooling of Interest.

IFRS:

Bringing together of separate entities or operations into one reporting entity.

Prohibits Pooling of Interest.

Issues	IFRS	USGAAP	IGAAP
Date of acquisition	When control is transferred	When assets received or equity issued	Date specified by the court or the purchase agreement
Valuation of assets and liabilities	Fair value	Fair value	In pooling of interests method-book value In purchase method-book value or fair value
Treatment of goodwill	Capitalize and test for impairment	Capitalize and test for impairment	Estimate the useful life and amortize accordingly
Negative goodwill	Recognized in the income statement	Reduce fair value of non-monetary assets	Disclose as capital reserve
Reverse acquisition	Acquisition accounting is based on substance. Accordingly legal acquirer is treated as acquiree and legal acquiree is treated as acquirer	Similar to IFRS	Acquisition accounting is based on form. Legal Acquirer is treated as acquirer and legal acquiree is treated as acquiree for legal as well as accounting purpose.

INTERNALLY GENERATED INTANGIBLE ASSETS

Issues	IFRS	USGAAP	IGAAP
Research Cost	Charge off	Charge off	Charge off
Development Cost	Capitalize if criterion is met	Charge off	Capitalize if criterion is met

MISCELLANEOUS PROBLEMS ON ACCOUNTING STANDARDS

(Answers to questions are based on Accounting Standards issued by ICAI prior to notification of "IND-AS" (Indian Accounting Standards notified by Ministry of Corporate Affairs Hence, "IND-AS" is not considered for this purpose)

Illustration 66.

How would you deal with the following in the annual accounts of a company for the year ended 31st March, 2015?

(a) The company has to pay delayed jute clearing charges over and above the negotiated price for taking delayed delivery of jute from the Suppliers' Godown. Upto 2013-14, the company has regularly included such charges in the valuation of closing stock. This being in the nature of interest the company has decided to exclude it from closing stock valuation for the year 2014-15. This would result into decrease in profit by ₹ 2.8 lakhs.

(b) The company has obtained Institutional Term Loan of ₹ 700 lakhs for modernisation and renovation of its Plant & Machinery. Plant & Machinery acquired under the modernisation scheme and installation completed on 31st March, 2015 amounted to ₹ 600 lakhs, ₹ 70 lakhs has been advanced to suppliers for additional assets and the balance loan of ₹ 30 lakhs has been utilised for working capital purpose. The Accountant is on a dilemma as to how to account for the total interest of ₹ 63.00 lakhs incurred during 2014-15 on the entire Institutional Term Loan of ₹ 700 lakhs.

Solution:

(a) Para 29 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" states that a change in an accounting policy should be made only if the adoption of a different accounting policy is required by statute or for compliance with an accounting standard or if it is considered that the change would result in a more appropriate presentation of the financial statements of an enterprise. Therefore the change in the method of stock valuation is justified in view of the fact that the change is in line with the recommendations of AS 2 (Revised) 'Valuation of Inventories' and would result in more appropriate preparation of the financial statements. As per AS 2, this accounting policy adopted for valuation of inventories including the cost formulae used should be disclosed in the financial statements.

Also, appropriate disclosure of the change and the amount by which any item in the financial statements is affected by such change is necessary as per AS 1, AS 2 and AS 5. Therefore, the under mentioned note should be given in the annual accounts.

"In compliance with the Accounting Standards issued by the ICAI, delayed jute clearing charges which are in the nature of interest have been excluded from the valuation of closing stock unlike preceding years. Had the company continued the accounting practice followed earlier, the value of closing stock as well as profit before tax for the year would have been higher by ₹ 2.80 lakhs."

(b) As per para 6 of AS 16 'Borrowing Costs', borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred. Borrowing costs should be expensed except where they are directly attributable to acquisition, construction or production of qualifying asset.

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

The treatment for total interest amount of ₹ 63.00 lakhs can be given as:

Purpose	Nature	Interest to be capitalised	Interest to be charged to profit and loss account
		₹ in lakhs	₹ in lakhs
Modernisation and renovation of plant and machinery	Qualifying asset	63.00x600/700=54.00	
Advance to supplies for additional assets	Qualifying asset	63.00 x 70/700=6.30	
Working Capital	Not a qualifying asset		63.00 x 30 / 700 = 2.70
		60.30	**2.70**

*Accounting Standards Interpretation (ASI) 1 deals with the meaning of expression 'substantial period of time'. A substantial period of time primarily depends on the facts and circumstances of each case. However, ordinarily, a period of twelve months is considered as substantial period of time unless a shorter or longer period can be justified on the basis of the facts and circumstances of the case.

** It is assumed in the above solution that the modernization and renovation of plant and machinery will take substantial period of time (i.e. more than twelve months). Regarding purchase of additional assets, the nature of additional assets has also been considered as qualifying assets. Alternatively, the plant and machinery and additional assets may be assumed to be non-qualifying assets on the basis that the renovation and installation of additional assets will not take substantial period of time. In that case, the entire amount of interest, ₹ 63.00 lakhs will be recognized as expense in the profit and loss account for year ended 31st March, 2015.

Illustration 67.

A firm of contractors obtained a contract for construction of bridges across a river. The following details are available in the records kept for the year ended 31st March, 2015.

	₹ in lakhs
Total Contract Price	2,000
Work Certified	1,000
Work not certified	210
Estimated further Cost to Completion	990
Progress Payment Received	800
To be Received	280

The firm seeks your advice and assistance in the presentation of accounts keeping in view the requirements of AS 7 (Revised) issued by ICAI.

Solution:

(a)	Amount of foreseeable loss	₹ in lakhs
	Total cost of construction (1,000 + 210 + 990)	2,200
	Less: Total contract price	2,000
	Total foreseeable loss to be recognized as expense	200

According to Para 35 of AS 7 (Revised 2002), when it is probable that total contract costs will exceed total contract revenue, the expected loss should be recognized as an expense immediately.

(b)	Contract work-in-progress i.e. cost incurred to date are ₹ 1,210 lakhs	(₹ in lakhs)
	Work certified	1,000
	Work not certified	210
		1,210
	This is 55% (1,210/2,200 × 100) of total costs of construction.	

(c) Proportion of total contract value recognised as revenue as per para 21 of AS 7 (Revised).

55% of ₹ 2,000 lakhs = ₹ 1,100 lakhs

(d) Amount due from/to customers = Contract costs + Recognised profits – Recognised losses – (Progress payments received + Progress payments to be received) = [1,210 + Nil – 200 – (800 + 280)] ₹ in lakhs = [1,210 – 200 –1,080] ₹ in lakhs

Amount due to customers = ₹ 70 lakhs. The amount of ₹ 70 lakhs will be shown in the balance sheet as liability.

(e) The relevant disclosures under AS 7 (Revised) are given below:

	₹ in lakhs
Contract revenue	1,100
Contract expenses	1,210
Recognised profits less recognized losses	(200)
Progress billings (800 + 280)	1.080
Retentions (billed but not received from contractee)	280
Gross amount due to customers	70

Illustration 68.

In preparing the financial statements of Z Ltd. for the year ended 31st March, 2015, you come across the following information. State with reasons, how you would deal with them in the financial statements:

(a) An unquoted long term investment is carried in the books at a cost of ₹12 lakhs. The published accounts of the unlisted company received in May, 2015 showed that the company was incurring cash losses with declining market share and the long term investment may not fetch more than ₹ 1,20,000.

(b) The company invested 50 lakhs in April, 2015 in the acquisition of another company doing similar business, the negotiations for which had started during the financial year.

Solution:

As it is stated in the question that financial statements for the year ended 31st March, 20125 are under preparation, the views have been given on the basis that the financial statements are yet to be completed and approved by the Board of Directors.

(a) Investments classified as long term investments should be carried in the financial statements at cost. However, provision for diminution shall be made to recognise a decline, other than temporary, in the value of the investments, such reduction being determined and made for each investment individually. Para 17 of AS 13 'Accounting for Investments' states that indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. On these bases, the facts of the given case clearly suggest that the provision for diminution should be made to reduce the carrying amount of long term investment to ₹ 1,20,000 in the financial statements for the year ended 31st March, 2015.

(b) Para 3.2 of AS 4 (Revised) defines "Events occurring after the balance sheet date" as those significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which the financial statements are approved by the Board of Directors in the case of a company. Accordingly, the acquisition of another company is an event occurring after the balance sheet date. However no adjustment to assets and liabilities is required as the event does not affect the determination and the condition of the amounts stated in the financial statements for the year ended 31st March, 2015. Applying para 15 which clearly states that disclosure should be made in the report of the approving authority of those events occurring after the balance sheet date that represent material changes and commitments affecting the financial position of the enterprise, the investment of ₹ 50 lakhs in April, 2015 in the acquisition of another company should be disclosed in the report of the Board of Directors to enable users of financial statements to make proper evaluations and decisions.

Illustration 69.

(a) A Limited Company closed its accounting year on 30.6.2015 and the accounts for that period were considered and approved by the board of directors on 20th August, 2015. The company was engaged in laying pipe line for an oil company deep beneath the earth. While doing the boring work on 1.9.2015 it had met a rocky surface for which it was estimated that there would be an extra cost of ₹ 80 lakhs. You are required to state with reasons, how the event would be dealt with in the financial statements for the year ended 30.6.15.

(b) A Ltd. purchased fixed assets costing ₹ 5,100 lakhs on 1.1.15 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal installments. Exchange rates were 1 Dollar = ₹ 42.50 and ₹ 45.00 as on 1.1.15 and 31.12.15 respectively. First installment was paid on 31.12.15. The entire difference in foreign exchange has been capitalized.

You are required to state, how these transactions would be accounted for.

Solution:

(a) Para 3.2 of AS 4 (Revised) on Contingencies and Events Occurring after the Balance Sheet Date defines 'events occurring after the balance sheet date' as 'significant events, both favourable and unfavourable, that occur between the balance sheet date and the date on which financial statements are approved by the Board of Directors in the case of a company'. The given case is discussed in the light of the above mentioned definition and requirements given in paras 13-15 of the said AS 4 (Revised).

In this case the incidence, which was expected to push up cost became evident after the date of approval of the accounts. So that was not an 'event occurring after the balance sheet date'. However, this may be mentioned in the Directors' Report.

(b) As per para 13 of AS 11 (Revised 2003) 'The Effects of Changes in Foreign Exchange Rates', exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognized as income or expenses in the period in which they arise. Thus exchange differences arising on repayment of liabilities incurred for the purpose of acquiring fixed assets are recognized as income or expense.

Calculation of Exchange Difference:

Foreign currency loan = ₹ 5,100 lakhs / ₹ 42.50 = 120 Lakhs US Dollars.

Exchange difference = ₹120 lakhs US Dollars ₹ (45.00 – 42.50)

= ₹ 300 lakhs (including exchange loss on payment of first installment)

Therefore, entire loss due to exchange differences amounting ₹ 300 lakhs should be charged to profit and loss account for the year.

Illustration 70.

(i) Advise P Co. Ltd. about the treatment of the following in the Final Statement of Accounts for the year ended 31st March, 2015.

A claim lodged with the Railways in March, 2012 for loss of goods of ₹ 2,60,000 had been passed for payment in March, 2015 for ₹ 1,75,000. No entry was passed in the books of the Company, when the claim was lodged.

(ii) The notes to accounts of X Ltd. for the year 2014-15 include the following:

"Interest on bridge loan from banks and Financial Institutions and on Debentures specifically obtained for the Company's Project amounting to ₹ 1,80,80,000 has been capitalized during the year, which includes approximately ₹ 1,76,00,000 capitalised in respect of the utilization of loan and debenture money for the said purpose." Is the treatment correct? Briefly comment.

Solution:

(i) Prudence suggests non-consideration of claim as an asset in anticipation. So receipt of claims is generally recognised on cash basis. Para 9.2 of AS 9 on 'Revenue Recognition' states that where the ability to assess the ultimate collection with reasonable certainty is lacking at the time of raising any claim, revenue recognition is postponed to the extent of uncertainty involved. Para 9.5 of AS 9 states that when recognition of revenue is postponed due to the effect of uncertainties, it is considered as revenue of the period in which it is properly recognised. In this case it may be assumed that collectability of claim was not certain in the earlier periods. This is supposed from the fact that only ₹ 1,75,000 were collected against a claim of ₹ 2,60,000. So this transaction cannot be taken as a Prior Period Item.

In the light of revised AS 5, it will not be treated as extraordinary item. However, Para 12 of AS 5 (Revised) states that when items of income and expense within profit or loss from ordinary activities are of such size, nature, or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. Accordingly, the nature and amount of this item should be disclosed separately as per Para 12 of AS 5 (Revised).

(ii) The treatment done by the company is not in accordance with AS 16 'Borrowing Costs'. As per Para 10 of AS 16, to the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period. Hence, the capitalisation of borrowing costs should be restricted to the actual amount of interest expenditure i.e. ₹ 1,76,00,000. Thus, there is an excess capitalisation of ₹ 4,80,000. This has resulted in overstatement of profits by ₹ 4,80,000 and amount of fixed assets has also gone up by this amount.

Illustration 71.

State with reference to accounting standard, how will you value the inventories in the following cases:

(i) Raw material was purchased at ₹ 100 per kgs. Price of raw material is on the decline. The finished goods in which the raw material is incorporated is expected to be sold at below cost. 5,000 kgs. of raw material is on stock at the year end. Replacement cost is ₹ 90 per kg.

(ii) In a production process, normal waste is 3% of input. 5,000 MT of input were put in process resulting in a wastage of 180 MT. Cost per MT of input is ₹ 800. The entire quantity of waste is on stock at the year end.

(iii) Per kg. of finished goods consisted of:

Material cost	₹ 150 per kg.
Direct labour cost	₹ 40 per kg.
Direct variable production overhead	₹ 20 per kg.

Fixed production charges for the year on normal capacity of 2,00,000 kgs. is ₹ 10 lakhs. 1,000 kgs. of finished goods are on stock at the year end.

Solution:

(a) (i) As per Para 24 of AS 2 (Revised) on Valuation of Inventories, materials and other supplies held for use in the production of inventories are not written down below cost if the finished product in which they will be incorporated are expected to be sold at or above cost. However, when there has been a decline in the price of materials and it is estimated that the cost of the finished products will exceed net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.

Hence, in the given case, the stock of 5,000 kgs of raw material will be valued at ₹ 90 per kg. The finished goods, if on stock, should be valued at cost or net realisable value whichever is lower.

(ii) As per para 13 of AS 2 (Revised), abnormal amounts of waste materials, labour or other production costs are excluded from cost of inventories and such costs are recognised as expenses in the period in which they are incurred.

In this case, normal waste is 150 MT and abnormal waste is 30 MT.

The cost of 150 MT will be included in determining the cost of inventories (finished goods) at the year end. The cost of abnormal waste amounting to ₹ 24,000 (30 MT x ₹ 800) will be charged in the profit and loss statement.

(iii) In accordance with Paras 8 and 9 of AS 2 (Revised), the costs of conversion include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. The allocation of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.

Thus, cost per kg. of finished goods can be computed as follows:

	₹
Material cost	150
Direct labour cost	40
Direct variable production overhead	20
Fixed production overhead (₹10,00,000/2,00,000)	5
	215

Thus, the value of 1,000 kgs. of finished goods on stock at the year-end will be ₹ 2,15,000 (1,000 kgs. x ₹215).

Illustration 72.

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.3.2015

	₹ '000		₹ '000
Balance on 1.4.2014	400	Payment to Suppliers	2,600
Issue of Equity Shares	1,000	Purchase of Fixed Assets	1,200
Receipts from Customers	4,500	Overhead expense	200
Sale of Fixed Assets	200	Wages and Salaries	600
		Taxation	450
		Dividend	100
		Repayment of Bank Loan	800
		Balance on 31.3.2015	150
	6,100		6,100

Solution:

X LTD.

Cash Flow Statement for the year ended 31st March, 2015 (Using the direct method)

	₹ '000	₹ '000
Cash flows from operating activities		
Cash receipts from customers	4,500	
Cash payment to suppliers	(2,600)	
Cash paid to employees	(600)	
Cash payments for overheads	(200)	
Cash generated from operations	1,100	
Income tax paid	(450)	
Net cash from operating activities		650
Cash flows from investing activities		
Payment for purchase of fixed assets	(1,200)	
Proceeds from sale of fixed assets	200	
Net cash from investing activities		(1,000)
Cash flows from financing activities		
Proceeds from issuance of equity shares	1,000	
Bank loan repaid	(800)	
Dividend paid	(100)	
Net cash from financing activities		100
Net increase in cash and cash equivalents		(250)
Cash at beginning of the period		400
Cash at end of the period		150

Illustration 73.

A Ltd. acquired 45% of shares in B Ltd. as on 31.3.2015 for ₹ 5 lakhs. The Balance Sheet of B Ltd. as on 31.3.2015 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000
Fixed Assets	5,00,000
Investments	2,00,000
Current Assets	3,00,000
	10,00,000

During the year ended 31.3.2016 the following are the additional information available:

(i) A Ltd. received dividend from B Ltd., for the year ended 31.3.2015 at 40% from the Reserves.

(ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2016.

(iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.2016 on 30.4.2016.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS – 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on acquisition of B Ltd.'s shares.

(ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?

(iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

Solution:

In terms of AS 23 B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill

	₹ in lakhs
Cost of investment	5.00
Less: Share in the value of Equity of B.Ltd.	
as at the date of investment	
[45% of ₹10 lakhs (₹5 lakhs + ₹ 5 lakhs)]	4.50
Goodwill	**0.50**

(II) A LTD.

Consolidated Profit and Loss Account for the year ended 31st March, 2015 (extracts)

₹ in lakhs

	By	Share of profits in B Ltd.		3.15
	By	Dividend received from B Ltd. (5,00,000 x 40% x 45%)	0.90	
		Transfer to investment A/c	0.90	Nil

(III) A LTD.

Consolidated Balance Sheet as on 31.3.2015 (extracts)

₹ in lakhs

	Investment in B Ltd.		
	Share in B Ltd.' s Equity	4.50	
	Less: Dividend received	0.90	
		3.60	
	Add: Share of Profit for 2013– 2014	3.15	
		6.75	
	Add: Goodwill	0.50	7.25

Working Notes:

1. Dividend received from B Ltd. amounting to ₹ 0.90 lakhs will be reduced from investment value in the books of A Ltd. However goodwill will not change.
2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 2015. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 3.15 lakhs. Investment in B Ltd. will be increased by ₹ 3.15 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 3.15 lakhs in the consolidated financial statement of A Ltd.
3. Dividend declared on 30th April, 2015 will not be recognised in the consolidated financial statements of A Ltd.

Illustration 74.

XYZ Ltd., has undertaken a project for expansion of capacity as per the following details:

	Plan	Actual
	₹	₹
April, 2015	2,00,000	2,00,000
May, 2015	2,00,000	3,00,000
June, 2015	10,00,000	–
July, 2015	1,00,000	–
August, 2015	2,00,000	1,00,000
September, 2015	5,00,000	8,00,000

The company pays to its bankers at the rate of 12% p.a., interest being debited on a monthly basis. During the half year company had ₹ 10 lakhs overdraft upto 31st July, surplus cash in August and again overdraft of over ₹ 10 lakhs from 1.9.2015. The company had a strike during June and hence could not continue the work during June. Work was again commenced on 1st July and all the works were completed on 30th September. Assume that expenditure were incurred on 1st day of each month. Calculate:

(i) Interest to be capitalised.

(ii) Give reasons wherever necessary.

Assume:

(a) Overdraft will be less, if there is no capital expenditure.

(b) The Board of Directors based on facts and circumstances of the case has decided that any capital expenditure taking more than 3 months as substantial period of time.

Solution:

(a) XYZ Ltd.

Month	Actual Expenditure	Interest Capitalised	Cumulative Amount	
	₹	₹	₹	
April, 2015	2,00,000	2,000	2,02,000	
May, 2015	3,00,000	5,020	5,07,020	
June, 2015	–	5,070	5,12,090	Note 2
July, 2015	–	5,120	5,17,210	
August, 2015	1,00,000	–	6,17,210	Note 3
September, 2015	8,00,000	10,000	14,27,210	Note 4
	14,00,000	27,210	14,27,210	

Note:

1. There would not have been overdraft, if there is no capital expenditure. Hence, it is a case of specific borrowing as per AS 16 on Borrowing Costs.
2. The company had a strike in June and hence could not continue the work during June. As per Para 14 (c) of AS 16, the activities that are necessary to prepare the asset for its intended use or sale are in progress. The strike is not during extended period. Thus during strike period, interest need to be capitalised.
3. During August, the company did not incur any interest as there was surplus cash in August. Therefore, no amount should be capitalised during August as per Para 14(b) of AS 16.
4. During September, it has been taken that actual overdraft is ₹ 10 lakhs only. Hence, only ₹ 10,000 interest has been capitalised even though actual expenditure exceeds ₹ 10 lakhs.

Alternatively, interest may be charged on total amount of (₹ 6,17,210 + ₹ 8,00,000 = 14,17,210) for the month of September, 2015 as it is given in the question that overdraft was over ₹ 10 lakhs from 1.9.2015 and not exactly ₹ 10 lakhs. In that case, interest amount ₹ 14,172 will be capitalised for the month of September.

Illustration 75.

PQR Ltd.'s accounting year ends on 31st March. The company made a loss of ₹ 2,00,000 for the year ending 31.3.2015. For the years ending 31.3.2016 and 31.3.2017, 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 eight years and tax rate is 40%. By the end of 31.3.2015, 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 years ended 2016 and 2017 for tax purposes. Prepare a statement of Profit and Loss for the years ended 2015, 2016 and 2017.

Solution: Statement Of Profit And Loss

	31.3.2015	31.3.2016	31.3.2017
	₹	₹	₹
Profit (Loss)	(2,00,000)	1,00,000	1,20,000
Less: Current tax			(8,000)
Deferred tax:			
Tax effect of timing differences originating during the year	80,000		
Tax effect of timing differences reversed/adjusted during the year		(40,000)	(40,000)
Profit (loss) after tax effect	(1,20,000)	60,000	72,000

1.7 PRESENTATION OF FINANCIAL STATEMENTS (SCHEDULE III)

Meaning and Objective of Financial Statement

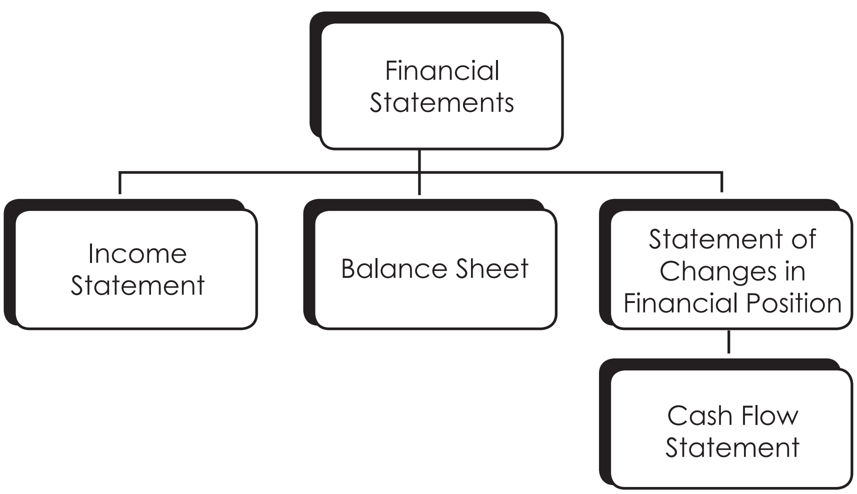
Financial statements are compilation of financial data, collected and classified in a systematic manner according to the accounting principles, to assess the financial position of an enterprise as regards to its profitability, operational efficiency, long and short – term solvency and growth potential.

Financial statements are basic and formal means through which management of an enterprise make public communication of financial information along with select quantitative details. They are structured financial representation of the financial position, performance and cash flows of an enterprise. Many users are rely on the general purpose financial statements as the major source of financial information and therefore, financial statements should be prepared and presented in accordance with their requirement. Of course, some of the users may have the power to obtain, information in addition to that contained in the financial statements. That does not undermine the dependence of the general users on the information contents of the financial statements.

Financial statements provide information about the financial position, performance and cash flows of an enterprise that is useful to wide range of users in making economic decisions. It means to show the results of the stewardship of management, or accountability of management, or the accountability of management for the resources entrusted to it.

Component of Finacial Statement

Financial statements comprise a number of statements prepared at the end of each financial year to assess the various financial activities and strength of an enterprise.



Financial Statements Components	Source /Type of Companies
Profit and Loss Account Schedule and Notes Forming Part thereto	Under section 129 of the companies Act in accordance with the provisions of the Companies Act and the Indian GAAP, to be prepared by all the companies. As per section 133 all applicable accounting standards should be followed. Otherwise reasons of departure from accounting standards and financial effect should be disclosed. Compliance with accounting standards without any deviation is mandatory for the listed companies as per clause 50 of the Listing Agreement vide SEBI Circulars SMRP/Policy/Cir-44/01, Aug 31, 2001

Financial Statements Components	Source /Type of Companies
Cash Flow Statement	As per clause 32 of the Listing Agreement vide SEBI circular SMD-II/ Policy/cir-80/2000 February 4, 2000. Cash Flow Statement should be prepared in accordance with the requirements of AS- 3 issued by the ICAI. To be prepared by listed companies.
Consolidated Financial Statements	Applicable to listed companies as per the SEBI circular SMRP/ policy/cir-44/01, August 31, 2001 Companies Listed in a recognized stock exchange shall be mandatorily required to publish Consolidated Financial Statements in the annual report in addition to the individual financial Statements shall be mandatory. To be prepared in accordance with AS-21 and AS-23. Section 134 requires that board's Report shall include a Director's Responsibility Statement in which it is to be indicated that in the preparation of annual accounts, the applicable accounting standards are followed.

FRAME WORK

The conceptual Framework for Financial Reporting issued by the IASB has stated the following uses of the general purpose financial statements by the cross-section of users:

(a) to decide when to buy , hold or sell any equity investment,

(b) to assess the accountability of management,

(c) to assess the ability of the entity to pay and provide other benefits to its employees,

(d) to assess the security for amounts lent to the entity,

(e) to determine taxation policies,

(f) to determine distributable profits and dividends,

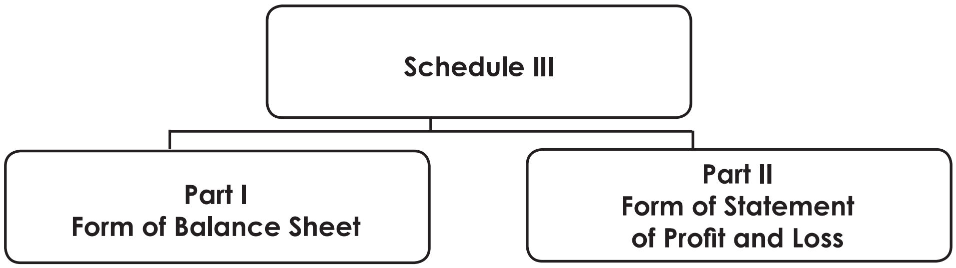
(g) to prepare and use national income statistics,

Important shortcoming of financial statements is that they are prepared to meet the common information needs of a wide range of users. They may fall short of specific information needs of the users.

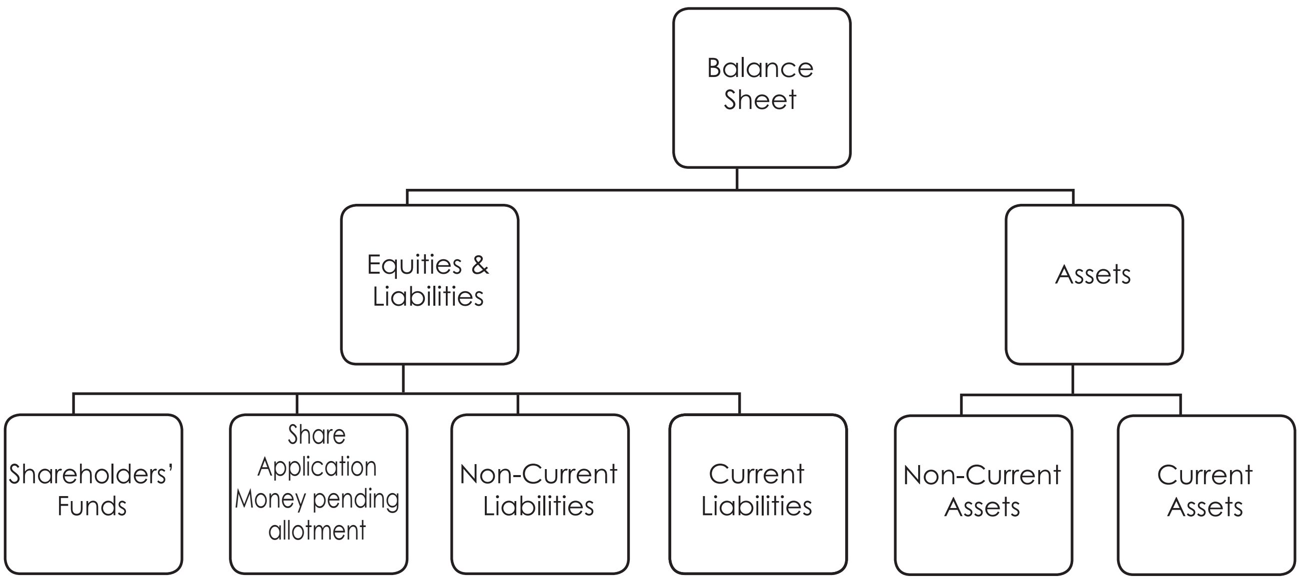
To meet the above – stated uses, financial statements provide information about an entity's assets, liabilities, equity, and income and expenses, including gains and losses, other changes in equity and cash flows. That information, along with other information in the notes, assists users of financial statements in predicting amount, timing and degree of certainty of the entity's future cash flows.

Applicability: In terms of powers conferred u/s 467 of the Companies Act, 2013, the Central Government replaced Existing Schedule III.

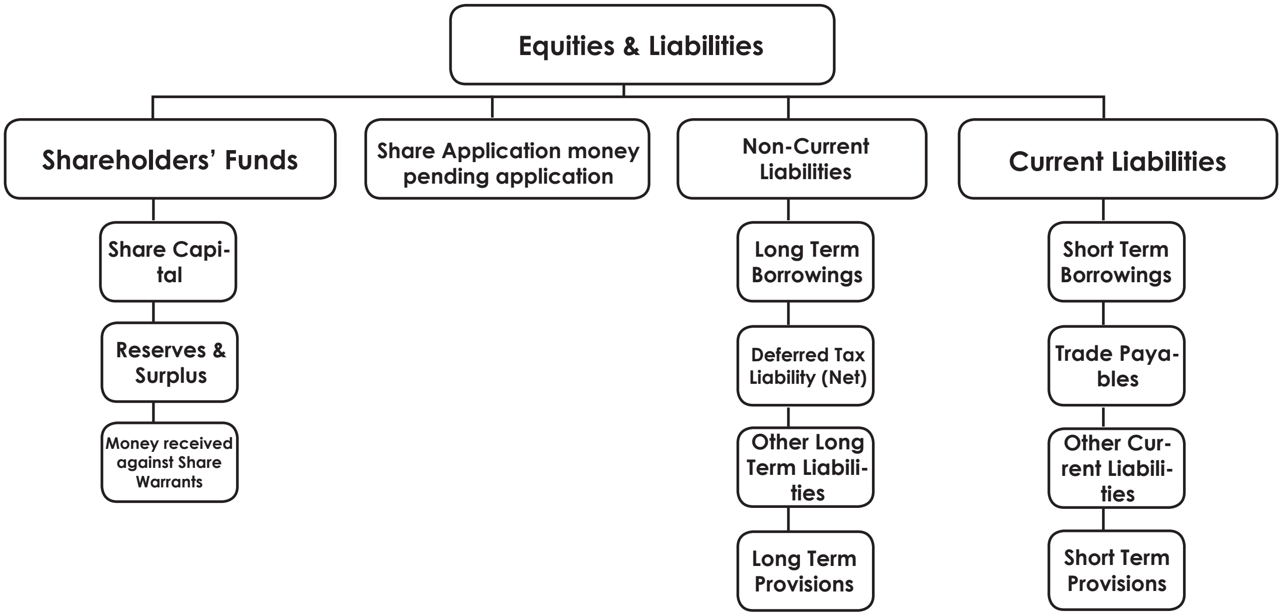
Date of enforcement of Schedule III : 01.04.2011



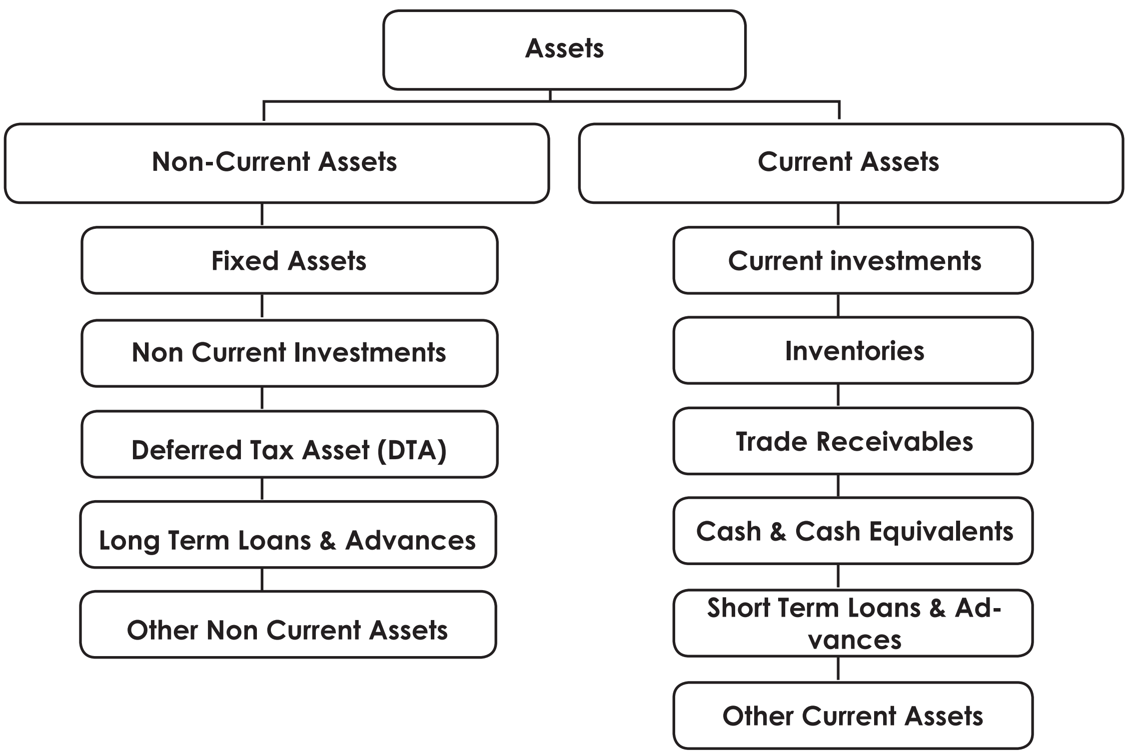
PART I – FORM OF BALANCE SHEET



Break-up of Equities & Liabilities



Break-up of Assets



PART I – FORM OF BALANCE SHEET

Name of the Company:………………………………………………..

Balance Sheet as at: …………………………………………………… (₹ in……)

	Particulars	Note	Figure as at the end of Current Reporting Period	Figures as at the end of the Previous Reporting Period
			₹	₹
I.	EQUITY AND LIABILITIES			
(1)	Shareholders' Funds			
	(a) Share Capital			
	(b) Reserves & Surplus			
	(c) Money Received against Share Warrants			
(2)	Share Application money pending allotment			
(3)	Non-Current Liabilities			
	(a) Long Term Borrowings			
	(b) DTL (Net)			
	(c) Other Long Term Liabilities			
	(d) Long Term Provisions			
(4)	Current Liabilities			
	(a) Short Term Borrowings			
	(b) Trade Payables			
	(c) Other Current Liabilities			
	(d) Short Term Provisions			
	Total			
II.	ASSETS			
(1)	Non-Current Assets			
	(a) Fixed Assets			
	(i) Tangible Assets			
	(ii) Intangible Assets			
	(iii) Capital WIP			
	(iv) Intangible Assets under Development			
	(b) Non-Current Investments			
	(c) DTA (Net)			
	(d) Long Term Loans & Advances			
	(e) Other Non-Current Assets			
(2)	Current Assets			
	(a) Current Investments			
	(b) Inventories			
	(c) Trade Receivables			
	(d) Cash & Cash Equivalents			
	(e) Short Term Loans & Advances			
	(f) Other Current Assets			
	Total			

For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards	
Notes to Balance Sheet	A Company shall disclose the following in the Notes to Accounts- Details provided

Disclosure Requirement: Schedules Forming Part of Financial Statements/Annual Report

(A) FOR "EQUITY AND LIABILITIES" ITEMS

(1) SHAREHOLDERS' FUNDS

(a) SHARE CAPITAL

Sch. III Disclosure Requirement	Points to be considered
General	• Sch III deals only with presentation and disclosure requirements • Accounting classification into Debt and Equity components is governed by the applicable Accounting Standard • Preference Shares will have to be classified as "Share Capital" and also includes such Preference Shares of which redemption is overdue
For each Class of Share Capital (different classes of Preference Shares to be treated separately):	
(a) Authorized Capital	It is the maximum number and face/par value, of each class of shares that a corporate entity may issue in accordance with its instrument of incorporation.
(b) Number of Shares Issued, Subscribed and Fully Paid, and Subscribed but not Fully Paid	• Subscribed Share Capital" is "that portion of the Issued Share Capital which has actually been subscribed by the public and subsequently allotted to the shareholders by the entity. This also includes any Bonus shares issued to the Shareholders • "Paid-up Share Capital" is "that part of the Subscribed Share Capital for which consideration is cash or otherwise has been received. This also includes Bonus Shares allotted and shares issued otherwise than for cash against purchase consideration, by the corporate entity." • If Shares are not fully called, then disclose the called up value per share
(c) Face/Par Value per Share	• Face/Par Value, as per Capital Clause in Memorandum of Association should be disclosed
(d) Reconciliation of No. of Shares	• For the Amount of Share Capital; • For comparative previous period; • Separate statements for both Equity and Preference Shares, which should again be sub-classified and represented for each class of Shares
(e) Rights, Preferences and Restrictions attaching to shares including restrictions on the distribution of Dividends and the Repayment of Capital	• For Equity Share Capital, such rights / preferences / restrictions may be with voting rights, or with differential voting rights as to dividend, voting or otherwise as per Companies (Issue of Share Capital with Differential Voting Rights) Rules, 2001. • For Preference Shares, the rights include dividend and / or capital related rights. Further, Preference Shares can be cumulative, non-cumulative, redeemable, convertible, non-convertible, etc. • All such Rights, Preferences and Restrictions attached to each class of Shares, terms of redemption, etc. should be disclosed separately.
(f) Shares held in the Company held by its Holding Company or its ultimate Holding Company including Shares held by or by Subsidiaries or Associates of the Holding Company or the ultimate Holding Company in aggregate	• Disclose number of Shares held by the entire chain of Subsidiaries and Associates starting from the Holding Company and ending right up to the Ultimate Holding Company • All such disclosures should be made separately representing for each class of Shares, (for both Equity and Preference Shares)

(g)	List of Shareholders holding more than 5% shares as on the Balance Sheet Date	• Date for computing the 5% limit should be taken as the Balance Sheet date. So, if during the year, any Shareholder held more than 5% Equity Shares but does not hold as much at the Balance Sheet date, disclosure is not required. • Companies should disclose the Shareholding for each class of Shares, both within Equity and Preference Shares. So, such % should be computed separately for each class of Shares. • This information should also be given for comparative previous period.
(h)	Shares Reserved for issue under Options and Contracts/ commitments for the sale of Shares/ Disinvestment, including the Terms and Amounts	• Shares under Options generally arise under Promoters or Collaboration Agreements, Loan Agreements or Debenture Deeds (including Convertible Debentures), agreement to convert Preference Shares into Equity Shares, ESOPs or Contracts for supply of Capital Goods, etc. • Disclosure is required for the Number of Shares, Amounts and Other Terms for Shares so reserved. Such options are in respect of Unissued Portion of Share Capital
(i)	For the period of 5 years immediately preceding the date as at which the Balance Sheet is prepared- • Aggregate Number & Class of Shares allotted as Fully Paid and Up Pursuant to Contract(s) without payment being received in Cash • Aggregate No. and Class of Shares allotted as fully Paid up by way of Bonus Shares • Aggregate Number & Class of Shares bought back	Disclose only if such event has occurred during a period of 5 years immediately preceding the Current Year Balance Sheet date • The aggregate number of shares allotted or bought back • If the company is in operation for a period of less than 5 years, then disclosure should cover all such earlier financial years Not to disclose the following allotments: • The following allotments are considered as Shares allotted for payment being received in cash, and hence should not be disclosed under this Clause – (a) If the subscription amount is adjusted against a bonafide debt payable in money at once by the Company, (b) Conversion of Loan into Shares in the event of default in repayment
(j)	Terms of any Securities Convertible into Equity / Preference Shares issued along with the earliest date of conversion in descending order starting from the farthest such date	• In case of Compulsorily Convertible Securities, where conversion is done in fixed tranches, all the dates of conversion have to be considered. • In case of Convertible Debentures/Bonds, etc. for the purpose of simplification, reference may also be made to the terms disclosed under the note on Long-Term Borrowings where these are required to be classified in the Balance Sheet, rather than disclosing the same against under this Clause.
(k)	Calls Unpaid (showing aggregate value of Calls Unpaid by Directors and Officers)	• Unpaid Amount towards Shares subscribed by the Subscribers of Memorandum of Association should be considered as 'Subscribed and paid-Up Capital' in the Balance Sheet and the Debts due from the Subscribers should be appropriately disclosed as an Asset in the B/ Sheet.
(l)	Forfeited Shares (amount originally paid up)	----

Example: Reporting Authorised, Issued, Subscribed, Called up and Paid up Capital including Forfeited Shares:

Authorised Capital: Equity Share 1,00,000 Shares @ ₹ 100 each = ₹ 1,00,00,000. Preference Share Capital: 15% Redeemable Preference Shares, 50,000 Shares @ ₹ 100 each = ₹ 50,00,000. 18%, Convertible Preference Shares, 30,000 shares @ ₹ 100 each = ₹ 30,00,000

Issued Capital: Equity Share 30,000 Shares @ ₹ 100 each, fully paid up = ₹ 30,00,000; 19,800 Equity Shares of ₹ 100 each, ₹ 80 called up and paid up = ₹ 15,84,000. Amount received on 200 shares forfeited for non-payment of allotment and first call of ₹ 30 and ₹ 40 each, final call was not made on those shares. Amount payable on application ₹ 10 per share. Preference Share Capital: 15% Redeemable Preference Shares, 10,000 Shares @ ₹ 100 each = ₹ 10,00,000. 18%, Convertible Preference Shares, 20,000 shares @ ₹ 100 each = ₹ 20,00,000

How will this shown in the Workings/Schedules, assuming first year of operation?

Solution:

Share Capital

A. Authorised Capital

Particulars		Current Year	Previous Year
(i)	Equity Share 1,00,000 Shares @ ₹ 100 each	1,00,00,000	
(ii)	15%, 50,000 Redeemable Preference Shares @ ₹ 100 each	50,00,000	
(iii)	18%, 30,000 Convertible Preference Shares @ ₹ 100 each	30,00,000	
Total		1,80,00,000	

B. Issued Capital

Particulars		Current Year	Previous Year
(i)	Equity Share 50,000 Shares @ ₹ 100 each	50,00,000	
(ii)	15%, 10,000 Redeemable Preference Shares @ ₹ 100 each	10,00,000	
(iii)	18%, 20,000 Convertible Preference Shares @ ₹ 100 each	20,00,000	
Total		80,00,000	

C. Subscribed, Called up and Paid up Capital

Particulars		Current Year	Previous Year
(i)	30,000 Equity Shares @ ₹ 100 each, fully paid up	30,00,000	
(ii)	19,800 Equity Shares @ ₹ 100 each, ₹ 80 called up and paid up	15,84,000	
(iii)	15%, 10,000 Redeemable Preference Shares @ ₹ 100 each	10,00,000	
(iv)	18%, 20,000 Convertible Preference Shares @ ₹ 100 each	20,00,000	
		75,84,000	
		75,84,000	
Add: Forfeited Shares (amount originally paid-up)		**2,000**	
Total for Balance Sheet		**75,86,000**	

D. Reconciliation of Number and Amount of Shares

(1) For Equity Shares

Particulars	**Current Year**		**Previous Year**	
	No. of Shares	**Amount (₹)**	**No. of Shares**	**Amount (₹)**
Opening Balance as on 01.04.2014	Nil	Nil	Nil	Nil
Add: Fresh Issue (including Bonus Shares, Right Shares, Split of Shares, Shares issued otherwise than for cash as a Purchase Consideration)	49,800	75,84,000	Nil	Nil
Sub Total	49,800	75,84,000	Nil	Nil
Less: Buy-back of Shares	Nil	Nil	Nil	Nil
Closing Balance as on 31.3.2015	49,800	75,84,000	Nil	Nil

(2) For Preference Shares

(a) For 15% Redeemable Preference Shares of ₹ 100 each

Particulars	**Current Year**		**Previous Year**	
	No. of Shares	**Amount (₹)**	**No. of Shares**	**Amount (₹)**
Opening Balance as on 01.04.2014	Nil	Nil	Nil	Nil
Add: Fresh Issue (including shares issued other-wise than for cash as a Purchase Consideration)	10,000	10,00,000	Nil	Nil
Sub Total	10,000	10,00,000	Nil	Nil
Less: Redemption of Shares	Nil	Nil	Nil	Nil
Closing Balance as on 31.3.2015	10,000	10,00,000	Nil	Nil

(b) For 18% Convertible Preference Shares of ₹ 100 each

Particulars	**Current Year**		**Previous Year**	
	No. of Shares	**Amount (₹)**	**No. of Shares**	**Amount (₹)**
Opening Balance as on 01.04.2014	Nil	Nil	Nil	Nil
Add: Fresh Issue	20,000	20,00,000	Nil	Nil
Sub Total	20,000	20,00,000	Nil	Nil
Less: Redemption/ Buy-back of Shares	Nil	Nil	Nil	Nil
Closing Balance as on 31.3.2015	20,000	20,00,000	Nil	Nil

(1) (b) RESERVES & SURPLUS

Sch. III Disclosure Requirement	**Points**
Reserves & Surplus shall be classified as – (a) Capital Reserves	• Capital Reserve is a Reserve of a Corporate Enterprise which is not available for distribution as Dividend. • Profit on Re-issue of Forfeited Shares is basically profit of a Capital Nature and, hence, it should be credited to Capital Reserve.
(b) Capital Redemption Reserve	Capital Redemption Reserve (CRR) is required to be created u/s 55 and 68 (for redemption of PSC and buyback of ESC), subject to conditions specified in the respective Sections.
(c) Securities Premium Reserve	Sch III uses the term "Securities Premium Reserve" but the Act uses the term "Securities Premium Account". Hence, the term used in the Act should be used.

(d) Debenture Redemption Reserve	Debenture redemption Reserve (DRR) is required to be created u/s 71, and maintained until such Debentures are redeemed. On redemption of the Debentures, the amounts no longer necessary to be retained in this Account should be transferred to the General Reserve.
(e) Revaluation Reserve	Revaluation Reserve is a Reserve created on the revaluation of Assets or Net Assets of an Enterprise represented by the surplus of the estimated Replacement Cost or estimated market values over the Book Values thereof.
(f) Share Options Outstanding Account	As per ICAI Guidance Note on ESOP, Share Options Outstanding should be shown as separate line item. Under Sch III, this line item should be shown separately under Reserves & Surplus.
(g) Other Reserves (specify the nature & purpose of each Reserve and the amount in respect thereof)	This includes any other Statutory Reserves, e.g. Tonnage Tax reserve to be created under the Income Tax Act, 1961.
(h) Surplus, i.e. balance in Statement of P&L disclosing allocations & appropriations such as Dividend, Bonus Shares and Transfer to/from Reserves etc. (Additions & Deductions since last Balance Sheet to be shown under each of specified heads)	• Appropriations to the Profit for the year (including carried forward balance) is to be presented under the main head 'Reserves and Surplus'. Under Sch III, the Statement of P&L will no longer reflect any appropriations, like Dividends transferred to Reserves, Bonus Shares, etc.

Notes:

1. **Fund:** A Reserve specifically represented by Earmarked Investments shall be termed as a 'Fund'.
2. **Profit and Loss Account (Dr.):** Debit balance Statement of P&L shall be shown as a Negative Figure under the head 'Surplus'. Similar, the balance of 'Reserves & Surplus', after adjusting Negative balance of Surplus, if any, shall be shown under the head 'Reserves & Surplus' even if the resulting figure is in the negative.

(1) (c) MONEY RECEIVED AGAINST SHARE WARRANTS

Sch. III Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	• In case of Listed Companies, Share warrants are issued to Promoters & others in terms of the Guidelines for Preferential Issues viz. SEBI (Issue of Capital and Disclosure Requirements), Guidelines, 2009. • Effectively, Share Warrants are amounts which would ultimately form part of the Shareholder's Funds. Since Shares are yet to be allotted against the same, these are not reflected as part of Share Capital, but as a separate line – item.

(2) SHARE APPLICATION MONEY PENDING ALLOTMENT

Sch. III Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	• Share Application Money not exceeding the Issued Capital and to the extent not refundable, is to be disclosed as a separate line item after "Share Holders Funds" and before "Non-Current Liabilities". • If the Company's Issued Capital is more than the Authorized Capital, and approval of increase in Authorized Capital is pending, the amount of Share Application Money received over and above the Authorized Capital should be shown under the head "Other Current Liabilities". • The amount shown as 'Share Application Money Pending Allotment' will not include Share Application Money to the extent refundable. For example, the amount in excess of Issued Capital, or where Minimum Subscription requirement is not met. Such amount will have to be shown separately under 'Other Current Liabilities'. • Calls Paid in Advance are to be shown under "Other Current Liabilities". The amount of interest which may accrue on such advance should also is to be reflected as a Liability.

(3) NON-CURRENT LIABILITIES

(3) (a) LONG TERM BORROWINGS

Sch. III Disclosure Requirement	Points
Long-Term Borrowings shall be classified as – (a) Bonds/Debentures,	-----
(b) Terms Loans – (i) from Banks, and (ii) from Other Parties,	Loans with repayment period beyond 36 months are usually known as "Term Loans". So, Cash Credit, Overdraft and Call Money Accounts/ Deposits are not covered by the expression "Term Loans".
(c) Deferred Payment Liabilities,	Deferred Payment Liabilities would include any Liability for which payment is to be made on deferred credit terms, e.g. Deferred Sales Tax Liability, Deferred Payment for Acquisition of fixed Assets, etc.
(d) Deposits,	Deposits classified under Borrowings would include Deposits accepted from Public and Inter – Corporate Deposits which are in the nature of Borrowings.
(e) Loans & Advances from Related Parties,	Loans and advances from related parties are required to be disclosed. Advances under this head should include those advances which are in the nature of loans.
(f) Long-Term Maturities of Finance Lease Obligations,	
(g) Other Loans & Advances (specify nature)	

Notes: **1. Security-wise Classification:** Borrowings shall further be sub-classified as Secured and Unsecured. Nature of Security shall be specified separately in each case.	• Nature of Security shall be specified separately in each case. A blanket disclosure of different securities covering all Loans classified under the same head such as "All Term Loans from Banks" will not suffice. • However, where one security is given for multiple Loans, the same may be clubbed together for disclosure purposes with adequate details of cross referencing. • Disclosure about the nature of security should also cover the type of asset given as security e.g. Inventories, Plant and Machinery, land and Building, etc. • When Promoters, other Shareholders or any third party have given any personal security for any borrowing, e.g. Shares or Other Assets held by them, disclosure should be made thereof, though such security does not result in the classification of such borrowing as secured.
2. Guarantees: where Loans have been guaranteed by Directors or Others, the aggregate amount of such Loans under each head shall be disclosed.	The word **"Others"** used in the phrase "Directors or Others" would mean any Person or Entity other than a Director, e.g. Related Parties, or any person associated with the Company in some manner.
3. Maturity Date-wise: Bonds / Debentures (along with Rate of Interest & particulars of Redemption or Conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest Redemption or Conversion Date, as the case may be.	• **Current** Maturities of all Long-Term Borrowings will be disclosed under "Other Current Liabilities" and not under Long-Term Borrowings and Short-Term Borrowings. • So, it is possible that the same Bonds/Debentures/ Term Loans may be bifurcated under both "Long-Term Borrowings" as well as under "Other Current Liabilities".
4. Installment Redemption: Where Bonds/Debentures are redeemable by Installments, the Date of Maturity for this purpose must be reckoned as the Date on which the First Installment becomes due.	------
5. Re-issue Powers: Particulars of any redeemed Bonds/ Debentures which the Company has power to reissue shall be disclosed.	------
6. Terms of Repayment: Repayment of Term Loans and Other Loans shall be stated.	Other Loans should be interpreted to mean all categories listed under the heading 'Long-Term Borrowings' as per Sch III. Disclosure of terms of repayment should be made preferably for each Loan unless the repayment terms of individual loans within a category are similar, in which case, they may be aggregated.

7. **Default:** Period and amount of continuing default as on the Balance Sheet date in repayment of Loans and Interest, shall be specified separately in each case.	The term "Continuing Default" is used w.r.t. Long Term Borrowings, whereas the term "Default" is used w.r.t. Short Term Borrowings. • As per Sch III, the period and amount of continuing default as on the Balance Sheet date in repayment or Term Loans and Interest shall be specified separately in each case. • Disclosures relating to default should be made for all items listed under the category of Borrowings such as Bonds/ Debentures, Deposits, Deferred Payment Liabilities, Finance Lease Obligations, etc. and not only to items classified as "Loans" such as Term Loans, Loans & Advances etc. • Defaults other than in respect of repayment of Loan and Interest, e.g. non-compliance with Debt Covenants, etc. need not be disclosed. • Any default that had occurred during the year and was **subsequently made good** before the end of the year need not be disclosed.

(3) (b) DEFERRED TAX LIABILITIES (Also Refer AS-22)

Sch. III Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet.	----

(3) (c) OTHER LONG TERM LIABILITIES

Sch. III Disclosure Requirement	Points
It shall be classified as – (a) Trade Payables	Sundry Creditors for Goods or Services, and Acceptances should be disclosed as part of Trade Payables. Disclosure Requirements under MSMED Act will also be required to be made in the annual Financial Statements
(b) Others	Amounts due under contractual obligations, e.g. payables in respect of statutory obligations like contribution to Provident Fund Purchase of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Payables, etc. should be classified as "Others" and each such item should be disclosed nature-wise.

(3) (d) LONG TERM PROVISIONS

Sch. III Disclosure Requirement	Points
It shall be classified as – (a) Provision for Employee Benefits	This should be classified into short-term and long-term portions, and the latter amount should be included here.
(b) Others (Specifying nature)	This would include items like Provisions for Warranties, etc.

(4) CURRENT LIABILITIES

(4) (a) SHORT TERM BORROWINGS

Sch. III Disclosure Requirement	Points
1. Short-Term Borrowings shall be classified as – • Loans Repayable on demand– (i) from Banks, & (ii) Other Parties, • Loans and Advances from Related Parties, • Deposits, • Others Loans and Advances (specify nature) **2. Security-wise Classification:** Borrowings shall further be sub-classified as Secured and Unsecured. Nature of security shall be specified separately in each case. **3. Guarantees:** Where Loans have been guaranteed by Directors or others, the aggregate amount of such Loans under each head shall be disclosed. **4. Default:** Period & amount of default as on B/Sheet Date in repayment of Loans and Interest shall be separately in each case.	• Short-Term Borrowings will include all Loans within a period of 12 months from the date of the loan, Loans payable on demand, etc. but will not include Current Maturity of Long-Term Borrowings (Which should be treated only as "Other Current Liabilities"). • In case of Short-Term Borrowings, all defaults (not continuing defaults as in the case of Long Term Borrowings) existing as at the date of the Balance Sheet should be disclosed (item-wise) • A 3-Year Loan taken for a business with an 4-year Operating Cycle will be categorized only as Short Term Borrowings, and not as Long Term Borrowings.

(4) (b) TRADE PAYABLES

As per Notification – G.S.R 679(E) (by Mimistry of Corporate Affairs dated 4th September, 2015):

In exercise of the powers conferred by sub-section (1) of section 467 of the Companies Act,2013 (18 of 2013), the Central Government hereby makes the following further alterations in Schedule III and the details relating to Micro, Small and Medium Enterprises shall be disclosed in the notes.

Sch. III Disclosure Requirement	Points
It shall be classified as – (A) Total outstanding dues of micro enterprises and small enterprises; and (B) Total outstanding dues of creditors other than micro enterprises and small enterprises."	• Refer to meaning of 'Trade Payable' given earlier. • **Liability for Capital Goods Purchases:** Amount due towards purchase disclosed under "Other Current Liabilities" with a suitable description. • **Liability under Contractual Obligations:** Liability towards Employees, Leases or other Contractual Liabilities should **not** be included under Trade Payables. Only "Commercial Dues" can be included under Trade Payables.

Note:

The following details relating to Micro, Small and Medium Enterprises shall be disclosed in the notes:

(a) The principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;

(b) The amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act,2006, along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;

(c) The amount of interest due and payable for the period of delay in making payment (which have been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act,2006;

(d) The amount of interest accrued and remaining unpaid at the end of each accounting year; and

(e) The amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the Micro, Small and Medium Enterprises Development Act,2006.

(f) Explanation – the terms 'appointed day', 'buyer', 'enterprise', 'micro enterprise', 'small enterprise' and 'supplier' shall have the same meaning assigned to those under (b),(d),(e),(h),(m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.

(4) (c) OTHER CURRENT LIABILITIES

Sch. III Disclosure Requirement	**Points**
It shall be classified as – (a) Current maturities of Long –Term Debt, (b) Current Maturities of Finance Lease Obligations, (c) Interest Accrued but not due on Borrowings, (d) Interest Accrued and due on Borrowings, (e) Income Received in Advance, (f) Unpaid Dividends, (g) Application Money received for allotment of Securities and due for Refund and Interest Accrued thereon (Refer Note below) (h) Unpaid Matured Deposits and Interest Accrued thereon, (i) Unpaid Matured Debentures and Interest Accrued thereon, (j) Other Payables (specify nature). **Note:** 1. Share Application Money includes Advances towards allotment of Share Capital. 2. Terms and Conditions including the Number of Shares proposed to be issued, the Amount of Premium, if any, and the period before which shares shall be allotted shall be disclosed. 3. It shall also be disclosed whether the Company has sufficient Authorized Capital to cover the Share Capital Amount resulting from Allotment of Shares out of such Share Application Money. 4. Further, the period for which the Share Application Money has been pending beyond the period for Allotment as mentioned in the document inviting application for shares along with the reason for such Share Application Money being pending shall be disclosed. 5. Share Application Money not exceeding the Issued Capital and to the extent not refundable shall be shown under the head 'Equity' and Share Application Money to the extent refundable, i.e. the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under '**Other Current Liabilities'.**	• The portion of Long Term Debts/ Lease Obligations, which is due for payments within 12 months of the reporting date is required to be classified under "Other Current Liabilities", while the balance amount should be classified under Long-Term Borrowings. • Trade Deposits and Security Deposits which are not in the nature of Borrowings should be classified separately under Other Non-Current / Current Liabilities. • **Other Payables** under this head may be in the nature of statutory dues such as Withholding Taxes, Service Tax, VAT, Excise Duty, etc. • **Current Year Classification as Current Liability and Previous Year Non-Current Liability:** Current/Non/Current Classification of Assets / Liabilities is determined a particular date, i.e. Balance Sheet date. So, if there is any change in the position at the end of the current year resulting in a different classification of Assets / Liabilities in the current year, it will **not** impact the classification made in the previous year.

(4) (d) SHORT TERM PROVISIONS

Schedule III Disclosure Requirement	Points
It shall be classified as – (a) Provision for Employee Benefits	This should be classified into short-term and long-term portions, and the former amount should be included here.
(b) Others (Specifying nature)	This includes Provision for Dividend, Provision for Taxation, Provision for Warranties, etc.

4 C. DISCLOSURE REQUIREMENTS FOR "ASSETS" ITEMS

(1) NON-CURRENT ASSETS

(1) (a) (i) TANGIBLE ASSETS (Also Refer AS – 6, 10)

Schedule III Disclosure Requirement	Points
1. **Classification shall be given as** –(a) Land, (b) Buildings, (c) Plant and Equipment, (d) Furniture & Fixtures, (e) Vehicles, (f) Office Equipment, (g) Others (Specify Nature).	AS-19 excludes Land Leases from its scope. **Leasehold Land** should be presented as a separate assets class under **Tangible Assets**. Also, Freehold Land should be presented as a separate asset class.
2. Assets under **Lease** shall be separately specified under each class of Asset.	• The term "under lease" should mean – (a) Assets given on Operating Lease in the case of Lessor, and (b) Assets held under Finance Lease in the case of Lessee. • Leasehold Improvements should continue to be shown as a separate asset class.
3. **Revaluation:** Where sums have been written off on a Reduction of Capital or Revaluation of Assets of where sums have been added on Revaluation of Assets, every Balance Sheet subsequent to date of such write-off, of addition shall show the Reduced or Increased figures as applicable and shall be way of a Note also show the amount of the Reduction or Increase as applicable together with the date thereof for the first 5 years subsequent to the dare of such Reduction or Increase.	• AS-10 requires disclosure of details such as Gross Book Value of Revalued Assets, Method adopted to compute revalued amounts, Nature of indices used, Year of appraisal, Involvement of External Valuer, etc. **as long as the concerned assets are held** by the Enterprise. [but only 5 years period is specified in Sch III] • AS-10 requirements will prevail. [**Note:** AS-26 does not permit revaluation of Intangible Assets.]

<table>
<tr><td>4. Reconciliation: A Reconciliation of the Gross and Net Carrying Amounts of each Class of Assets at the Beginning and End of the Reporting period showing Additions, Disposals, Acquisitions through Business Combinations and other Adjustments and the related Depreciation and Impairment Losses / Reversals shall be disclosed separately.</td><td>(a) Since reconciliation of Gross and Net Carrying Amounts of Fixed assets is required, the Depreciation / Amounts of fixed assets is required, the Depreciation / Amortization for each class of asset should be disclosed in terms of –
• Opening Accumulated Depreciation,
• Depreciation/Amortization for the year,
• Deductions/Other Adjustments, and
• Closing Accumulated Depreciation/Amortization
(b) Similar disclosures should also be made for Impairment, if any, as applicable.
(c) Business Combinations:
• Business Combination should be taken as an amalgamation or acquisition or any other mode of restructuring of a set of Assets and /or a group of Assets and Liabilities constituting a business.
• Acquisitions through ‘Business Combinations’ should be disclosed separately for each class of assets.
• Asset Disposals through Demergers, etc. any also be disclosed separately for each class of assets.
(d) Other Adjustments: This includes –
• Capitalization of FOREX Differences where such option has been exercised by the Company as per AS-11.
• Adjustments on a/c of Exchange Fluctuations for Fixed Assets in case of Non-Integral Operations (AS-11).
• Borrowing Costs capitalized as per AS-16.</td></tr>
</table>

(1) (a)(ii) INTANGIBLE ASSETS (Also Refer AS – 26)

Schedule III Disclosure Requirement	Points
Classification shall be given as – (a) Goodwill, (b) Brands / Trademarks, (c) Computer Software, (d) Mastheads and Publishing Titles, (e) Mining Rights, (f) Copyrights, and Patents and Other Intellectual Property Rights, Services and Operating Rights, (g) Recipes, Formulae, Models, Designs and Prototypes, (h) Licenses and Franchise, (i) Others (specify nature).	• Classification of Intangible Assets has been introduced under Sch III. • Intangible Assets under development should also be disclosed separately, if AS-26 criteria are met.

Note: Points 3 and 4 of Tangible Assets is also applicable for Intangible Assets.

(1) (a) (iii) CAPITAL WORK IN PROGRESS

Schedule III Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	**Capital Advances** should be included under Long-Term Loans and Advances and hence, cannot be included under Capital WIP.

(1) (a)(iv) INTANGIBLE ASSETS UNDER DEVELOPMENT

Schedule III Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	Intangible Assets under development should be disclosed under this head provided they can be recognized based on the criteria laid down in AS-26.

(1) (b) NON CURRENT INVESTMENTS (Also Refer AS – 13)

Schedule III Disclosure Requirement	Points
Non-Current Investments shall be classified as Trade Investments and Other Investments, and further classified as Investments in – (a) Property, (b) Equity Instruments, (c) Preference Shares (d) Government / Trust Securities, (e) Debentures or Bonds, (f) Mutual Funds, (g) Partnership Firms, and (h) Other Non-Current Investments (specify nature).	• If a Debenture is to be redeemed partly within 12 months and balance after 12 months, the amount to be redeemed within 12 months should be disclosed as current, and balance as Non-Current. • **"Trade Investment"** is normally understood as an Investment made by a Company in Shares or Debentures of another Company, to promote the trade or business of the first Company.
Notes: 1. Under each classification, details shall be given of Names of Bodies Corporate (indicating separately whether such bodies are – (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose Entities) in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (showing separately Investments which are partly-paid).	**(a) Controlled SPEs:** • Sch III requires separate disclosure of Investments in "Controlled Special Purpose Entities" in addition to Subsidiaries, Joint Venture, Associates, etc. • Since the expression "Controlled SPEs" is not defined in the Act/Sch. III/AS, **no disclosures** would be additionally required to be made under this caption. If and when such terminology is explained/ introduced in the applicable AS, the disclosure requirement would become applicable. **(b) Other Points:** "Nature and Extent" of Investment in each Body Corporate should be interpreted to mean the Number and Face Value of Share. Also, it is advisable to clearly disclose whether Investments are fully paid or partly paid. (item-wise)

2.	In regard to Investments in the capital of **Partnership Firms,** the Names of the Firms (with the names of all their Partners, Total Capital and the Shares of each Partner) shall be given.	**(a) LLP:** A LLP is a **Body Corporate,** and not a Partnership Firm as envisaged under the Partnership Act, 1932. Hence, disclosures pertaining to Investments, in Firms will **not** include LLPs. Investments in LLPs will be disclosed separately under "Other Investments". **(b) Change in Constitution:** In case of change in constitution of the Firm during the year, the names of the Other Partners should be disclosed based on the position existing as on the date of Company's B/s. **(c) Capital:** • The Total Capital of the Firm, to be disclosed, should be with reference to the Amount of Capital on the date of the Company's Balance Sheet. • If the Partnership Firm has separate accounts for Partner's Capital, Drawings or Current, Loans to or from Partners, etc. disclosure must be made with regard to the **Total of Capital Accounts** alone, since this is what constitutes the capital of the Partnership Firm. • Where, however, such Accounts have not been segregated, or where the Partnership Deed Provides that the Capital or each Partner is to be calculated by reference to the Net Amount at his credit after merging all the Accounts, the disclosure relating to the Partnership Capital must be made on the basis of the **total effect** of such accounts taken together. **(d) Share of each Partner:** Share of each Partner means share in the Profits of the Firm, rather than the share in the Capital. **(e) Different Reporting Dates:** If it is not practicable to draw up the Financial Statements of the Partnership upto such date and, are drawn upto different reporting dates, drawing analogy from AS-21 and AS-27, adjustments should be made for effects of significant transactions or other events that occur between those dates and the date of the Parent's Financial Statements. Also, the difference between reporting dates should not be more than 6 months. In such cases, the difference in reporting dates should be disclosed.

3.	Investments carried at other than at Cost should be separately stated specifying the basis for valuation thereof	**Basis of Valuation:** Disclosure for basis of valuation of Non-Current Investments may be either of – (a) Cost, or (b) Cost less Provision for other than temporary diminution, or (c) Lower of Cost and Fair Value.
4.	The following shall also be disclosed- (a) Aggregate amount of Quoted Investments and Market Value thereof, (b) Aggregate Amount of Unquoted Investments, (c) Aggregate Provision for Diminution in value of Investments.	it is recommended to disclose the amount of provision netted-off for each Long-Term Investment. However, the aggregate amount of provision made in respect of all Non-Current Investments should also be separately disclosed to comply with the specific disclosure requirement in Sch III.

(1) (c) DERERRED TAX ASSET (Also Refer AS – 22)

Schedule III Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet.	-----

(1) (d) LONG TERM LOANS AND ADVANCES

Schedule III Disclosure Requirement	Points
1. General Classification: Long Term Loans and Advances shall be classified as – (a) Capital Advances, (b) Security Deposits, (c) Loans and Advances to Related Parties (giving details thereof), (d) Other Loans and Advances (specify nature)	Capital Advances: • It should be specifically included under Long-Term Loans and Advances and hence, cannot be included under Capital Work-In-Progress. • Capital Advances are advances given for procurement of Fixed Assets which are Non-Current Assets. They are not realized back in cash, nut over a period, get converted into Fixed Assets. Assets. Hence, they are always Long Term Advances, irrespective of when the Fixed Assets are expected to be recd. **Other Loans and Advances** should include all other items in the nature of advances recoverable in cash or kind, e.g. Prepaid Expenses, Advance Tax, CENVAT Credit Receivable, VAT Credit Receivable, Service Tax Credit Receivable, etc. which are not expected to be realized within the next 12 months or operating cycle whichever is longer, from the Balance Sheet date.
2. Security-wise Classification: The above shall be separately sub-classified as – (a) Secured, considered Good (b) Unsecured, considered Good (c) Doubtful.	---

3. **Bad / Doubtful:** Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately.	---
4. **Directors, etc.:** Loans and Advances due by Directors or Other Officers of the Company or any of them either severally or jointly with any other persons or amounts due by Firms or Private Companies respectively in which any Director is a Partner of a Director of a Member should be separately stated.	The term **"Details"** of Loans and Advances of Related Parties would mean disclosure requirements contained in AS-18.

(1) (e) OTHER NON CURRENT ASSETS

Schedule III Disclosure Requirement	Points
1. **Other Non-Current Assets** shall be classified as – (a) Long-term Trade Receivables (including Trade Receivables on Deferred Credit Terms) (b) Others (specify nature) **2.** **Security-wise Classification:** Long-Term Receivables shall be separately sub-classified as – (a) Secured, considered Good (b) Unsecured, Considered Good (c) Doubtful. **3.** **Bad / Doubtful:** Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately. **4.** **Directors, etc.:** Debts due by Directors or Other Officers of the Company or any of them either severally or jointly with any other person or Debts due by Firms or Private Companies respectively in which any Director is a Partner or a Director or a Member should be separately stated.	• A Receivable shall be classified as 'Trade Receivable' if it is in respect of the amount due on account of good sold or services rendered in the normal course of business. • Dues in respect of Insurance Claims, Sale of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Receivables, etc. should be classified as **"Others"** and each such item should be disclosed nature-wise.

(2) CURRENT ASSETS

(2) (a) CURRENT INVESTMENTS **(Also Refer AS – 13)**

Schedule III Disclosure Requirement	Points
Current Investments shall be classified as – (a) Investments in Equity Instruments, (b) Investment in Preference Shares, (c) Investments in Government or Trust Securities, (d) Investments in Debentures or Bonds, (e) Investments in Mutual Funds, (f) Investments in Partnership Firms, (g) Other Investments (specify nature). **Notes:** 1. Under each classification, details shall be given of Names of Bodies Corporate [indicating separately whether such Bodies are – (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose Entities] in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (Showing Separately Investments which are party-paid). In regard to Investments in the Capital of Partnership Firms, the names of the Firms (with the names of all their Partners, Total Capital and the Shares of each Partner) shall be given. 2. The following shall also be disclosed: (a) Basis of Valuation of individual Investments, (b) Aggregate Amount of Quoted Investments and Market Value thereof, (c) Aggregate Amount of Unquoted Investments, (d) Aggregate Provision made for Diminution in Value of Investments.	Principles given for Non-current Investments will apply here, to the extent relevant. However, Trade vs Non-Trade Classification, is not required for Current Investments.

(2) (b) INVENTORIES **(Also Refer AS-2)**

Schedule III Disclosure Requirement	Points
Inventories shall be classified as – (a) Raw materials, (b) Work In Progress, (c) Finished Goods, (d) Stock-in-Trade (in respect of goods acquired for Trading), (e) Stores and Spares, (f) Loose Tools, (g) Others (specify nature) **Note:** Goods-in-Transit shall be disclosed under the relevant sub-head of Inventories. Mode of Valuation shall be stated.	• Goods in Transit should be included under relevant heads with suitable disclosure. • The heading "Finished Goods" should comprise of all Finished Goods other than those acquired for trading purposes. Those acquired for trading purposes are to be shown under "Stock in Trade".

(2) (c) TRADE RECEIVABLES

Schedule III Disclosure Requirement	Points
1. Aggregate amount of Trade Receivables outstanding for a period exceeding 6 months from the date they are due for payment should be separately stated. **2. Security-wise Details:** Trade Receivables shall be separately sub-classified as – (a) Secured, considered Good (b) Unsecured, considered Good (c) Doubtful. **3. Bad /Doubtful:** Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately. **4. Directors, etc:** Debts due by Directors or Other Officers of the Company or any of them either severally or jointly with any other person or debts due by Firms or Private Companies respectively in which any Director is a Partner or a Director or a Member should be separately stated.	• Sch III requires separate disclosure of "Trade Receivables O/s for a period exceeding 6 months **from the date they become due for payment",** only for the current portion of Trade Receivables. • Where no due date is specifically agreed upon, normal credit period allows by the Company should be taken into consideration for computing the due date, which may vary depending upon the Nature of Goods or Services sold and the Type of Customers, etc. • Amounts due under contractual obligations, e.g. dues in respect of Insurance Claims, Sale of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Receivables, etc, cannot be included within Trade Receivables, such Receivables should be classified as "Other Current Assets" and each such item should be disclosed nature – wise. • **Lean Period Activities:** Receivables arising out of sale of materials / rendering of services during a Company's lean period, should be included under "Trade Receivables", if such activity is in the normal course of business. If they are not part of "normal course of business", they are to be classified under "**Other Assets".**

(2) (d) CASH AND CASH EQUIVALENTS **(Also Refer AS – 3)**

Schedule III Disclosure Requirement	Points
Cash and Cash Equivalents shall be classified as – (a) Balances with Banks, (b) Cheques, Drafts on Hand, (c) Cash on Hand, (d) Other (Specify nature). Notes: • Earmarked Balances with Banks (e.g. for Unpaid Dividend) shall be separately stated. • Balances with Banks to the extent held as margin Money or Security against the Borrowings, Guarantees, Other Commitments shall be disclosed separately. • Repatriation restrictions, if any, in respect of Cash and Bank Balances shall be separately stated. • Bank Deposits with more than 12 months Maturity shall be disclosed separately.	• "Other Bank Balances" would comprise items like Balances with Banks to the extent of held as Margin Money or Security against Borrowings etc. and Bank Deposits with more than 3 months maturity. • Bank Deposits with more than 12 months maturity will also need to be separately disclosed under the above sub-head. • The Non-Current Portion of each of the above balances should be classified under the head "Other Non-Current Assets" with separate disclosure thereof.

(2) (e) SHORT TERM LOANS AND ADVANCES

Schedule III Disclosure Requirement	Points
1. General Classification: Short-Term Loans and Advances shall be classified as – (a) Loans and Advances to Related Parties (giving details thereof), (b) Others (specify nature). **2. Security-wise Classification:** The above shall also be sub-classified as- (a) Secured, considered Good, (b) Unsecured, considered Good, (c) Doubtful **3. Bad / Doubtful:** Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately. **4. Directors, etc.**: Loans & Advances due by Directors or Other Officers of the Company or any of them either severally or Jointly with any other person or amounts due by Firms or Private Companies respectively in which any Director is a Partner or a Director or a Member shall be separately stated.	Principles given for Long Term Loans and Advances will apply here, to the extent relevant.

(f) OTHER CURRENT ASSETS

Schedule III Disclosure Requirement	Points
• This is an all-inclusive heading, which incorporates Current Assets that do not fit into any other Asset Categories. • Nature of each item should be specified	• This is an **all-inclusive heading,** which incorporates Current Assets that do not fit into any other asset categories, e.g. Unbilled Revenue, Unamortized Premium on Forward Contracts, etc. • In case any amount classified under this category is doubtful, it is advisable that such doubtful amount as well as any provision made there against should be separately disclosed.

Special Point: UNAMORTISED PORTION OF SHARE ISSUE EXPENSES, etc.

1. Sch III does not contain any specifies disclosure requirement for the unamortized portion of expense items such as Share Issue Expenses, Ancillary Borrowing Costs and Discount or Premium relating to Borrowings.

2. As per AS-16, Ancillary Borrowing Costs and Discount or Premium relating to Borrowings could be amortized over the loan period. Further, share Issue Expenses, Discount on Shares, Ancillary Costs-Discount, Premium on Borrowing, etc. being special nature items, are excluded from the scope of AS-26 Intangible Assets.

3. Certain companies have taken a view that it is an acceptable practice to amortize these expenses over the period of benefit, i.e. normally 3 to 5 years.

4. **Conclusion:** Sch III does not deal with any accounting treatment of these items, and the same continues to be governed by the respective AS / best practices. So, a Company can disclose the Unamortized Portion of such expenses as "Unamortized Expenses", under the head "Other Current/ Non-Current Assets", depending on whether the amount will be amortized in the next 12 months or thereafter.

PART II FORM OF STATEMENT OF PROFIT AND LOSS

Name of the Company :………………………………………………….
Profit and Loss Statement for the year ended:……………………………………….. (₹ in ……..)

	Particulars	Note No.	Figures for the Current Reporting Period	Figures for the Previous Reporting Period
I	Revenue from Operations		XXX	XXX
II	Other Income		XXX	XXX
III	**Total Revenue (I+II)**		**XXX**	**XXX**
IV	**Expenses:**			
	Cost of Materials Consumed		XXX	XXX
	Purchases of Stock-In-Trade		XXX	XXX
	Changes in Inventories of Finished Goods / Work-in-progress and Stock-In-Trade		XXX	XXX
	Employee Benefits Expense			
	Finance Costs			
	Depreciation and Amortization Expense			
	Other Expenses			
	Total Expenses		**XXX**	**XXX**
V	Profit before Exceptional & Extraordinary Items and Tax (III – IV)		XXX	XXX
VI	Exceptional Items		XXX	XXX
VII	Profit before Extraordinary Items and IAX (V-VI)		XXX	XXX
VIII	Extraordinary Items		XXX	XXX
IX	Profit before Tax (VII-VIII)		XXX	XXX
X	Tax Expenses:			
	(1) Current Tax		XXX	XXX
	(2) Deferred Tax		XXX	XXX
XI	Profit /(Loss) for the period from Continuing Operations (IX – X)		XXX	XXX
XII	Profit /(Loss) from Discontinuing Operations		XXX	XXX
XIII	Tax Expense of Discontinuing Operations		XXX	XXX
XIV	Profit /(Loss) from Discontinuing Operations (After Tax) (XII-XIII)		XXX	XXX
XV	Profit / (Loss) for the period (XI + XIV)		XXX	XXX
XVI	Earnings per Equity Share:		XXX	XXX
	(1) Basic			
	(2) Diluted			

General Instructions for preparation of Statement of P&L

<table>
<tr><th>Item</th><th colspan="2">Description</th></tr>
<tr><td>1. Sec. 8 Companies</td><td colspan="2">The provisions of this Part shall apply to the Income and Expenditure Account referred to in Sec. 129 of the Act, in like manner as they apply to a Statement of Profit and Loss.</td></tr>
<tr><td>2. Revenue from Operations</td><td>For Company other than a Finance Company: Revenue from Operations shall disclose separately in the Notes, Revenue from –
(a) Sale of Products
(b) Sale of Services
(c) Other Operating Revenues
(d) Less: Excise Duty</td><td>For Finance Company: Revenue from Operations shall include Revenue from:
(a) Interest &
(b) Other Financial Services
Revenue under each of the above heads shall be disclosed separately by way of Notes to Accounts to the extent applicable.</td></tr>
<tr><td>3. Finance Costs</td><td colspan="2">Finance Costs shall be classified as –
(a) Interest Expenses,
(b) Other Borrowing Costs,
(c) Applicable Net Gain / Loss on Foreign Currency Transactions and Translation.</td></tr>
<tr><td>4. Other Income</td><td colspan="2">Other Income shall be classified as –
(a) Interest Income (in case of a Company other than a Finance Company),
(b) Dividend Income,
(c) Net Gain/Loss on Sale of Investments,
(d) Other Non-Operating Income (Net of Expenses directly attributable to such income).</td></tr>
<tr><td>5. Additional Information:</td><td colspan="2">A Company shall disclose by way of Notes, additional information regarding Aggregate Expenditure and Income on the following items referred below.</td></tr>
</table>

(i) Employee Benefits, Expense, Income Items, etc:

(a) **Employee Benefits Expense** [showing separately – (i) Salaries & Wages, (ii) Contribution to PF and Other Funds, (iii) Expense on ESOP and Employee Stock Purchase Plan (ESPP), (iv) Staff Welfare Expenses]

(b) Depreciation and Amortization Expenses,

(c) Any item of Income of Expenditure which exceeds 1% of Revenue from Operations or ₹ 1,00,000 whichever is **higher**,

(d) Interest Income,

(e) Interest Expense,

(f) Dividend Income,

(g) Net Gain / Loss on Sale of Investments,

(h) Adjustments to the Carrying Amount of Investments,

(i) Net Gain / Loss on Foreign Currency Transaction & Translation (other than considered as Finance Cost),

(j) Payments to the Auditor as – (a) Auditor, (b) For Taxation Matters, (c) For Company Law Matters, (d) For Management Services, (e) For other Services, (f) For Reimbursement of Expenses,

(k) Item of Exceptional and Extraordinary Nature,

(l) Prior Period Items.

(ii) Materials, Goods, Services, etc.

(a) In the case of **Manufacturing Companies –**

Raw Materials under broad heads.

Goods Purchased under broad heads.

(b) In the case of **Trading Companies**, Purchases in respect of goods Traded in by the Company under broad heads.

(c) In the case of **Companies rendering or supplying services**, Gross Income derived from Services Rendered or Supplied, under broad heads.

(d) In the case of a Company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if Purchases, Sales and Consumption of Raw Material and the Gross Income from Services rendered is shown under broad head.

(e) In the case of **Other Companies**, Gross Income derived under broad heads.

(iii) In the case of **all concerns having Works-in-Progress,** Works-in-Progress under broad heads**.**

(iv) Reserves – Creation & Utilisation:

(a) The aggregate, if materials, of any amounts set aside or proposed to be set aside, to Reserve, but not including Provisions made to meet any Specific Liability, Contingency or Commitment known to exist at the date as to which the Balance – Sheet is made up.

(b) The aggregate, if material, of any amounts withdrawn from such Reserves.

(v) Provision – Creation & Utilisation:

(a) The aggregate, if material, of the amounts set aside to Provisions made for meeting Specific Liabilities, Contingencies or Commitments.

(b) The aggregate, if material, of the amounts withdrawn from such provisions, as no longer required.

(vi) Expenses, etc: Expenditure incurred on each of the following items, separately for each item:

(a) Consumption of Stores and Spare Parts,

(b) Power and Fuel,

(c) Rent,

(d) Repairs to Buildings,

(e) Repairs to Machinery,

(f) Repairs to Machinery,

(g) Insurance,

(h) Rates and Taxes, excluding, Taxes on Income,

(i) Miscellaneous Expenses.

(vii) Subsidiaries Information:

(a) Dividends from Subsidiary Companies.

(b) Provisions for Losses of Subsidiary Companies.

(viii) FOREX Information: The P&L A/c shall also contain by way of a Note the following Information, namely –

(a) Value of Imports Calculated on **CIF basis** by the Company during the Financial Year in respect of – (I) Raw Materials, (II) Components and Spare Parts, (III) Capital Goods,

(b) Expenditure in Foreign Currency during the Financial Year on account of Royalty, Know-How, Professional and Consultation Fees, Interest, and Other Matters,

(c) Total Value if all **Imported** Raw Materials, Spare Parts and Components consumed during the Financial Year and the Total Value of all **Indigenous** Raw Materials, Spare Parts and Components similarly consumed and the Percentage of each to the Total Consumption,

(d) Amount **remitted** during the year in Foreign Currencies on account of **Dividends** with a specific mention of the total number of Non-Resident Shareholders, the Total Number of Shares held by them on which the Dividends were due and the year to which the Dividends related.

(e) Earnings in Foreign Exchange classified under the following heads, namely-

Export of Goods calculated on FOB Basis,

Royalty, Know-How, Professional & Consultation Fees,

Interest and Dividend,

Other Income, indicating the nature thereof.

Note: Broad heads shall be decided taking into account the concept of **Materiality** and **Presentation of True and Fair view** of Financial Statements**.**

Study Note - 2

ACCOUNTING FOR BUSINESS COMBINATIONS

This Study Note includes

2.1 Merger and Acquisitions
2.2 Accounting for Merger and Acquisitions
2.3 Demerger & Reverse Merger
2.4 Surrender of Shares and Buy Back of Shares
2.5 External Reconstruction
2.6 Special Purpose Vehicle

2.1 MERGER AND ACQUISITIONS

2.1.1 Introduction

In today's global business environment, companies may have to grow to survive, and one of the best ways to grow is by merging with another company or acquiring other companies. A merger occurs when one firm assumes all the assets and all the liabilities of another. The acquiring firm retains its identity, while the acquired firm ceases to exist.

The United Kingdom Financial Reporting Standard 6 defines the term 'merger' as: "Merger is a business combination which results in the creation of a new reporting entity formed from the combining parties, in which the shareholders come together in a substantially equal partnership for the mutual sharing of risks and benefits of the combined entity; and in which no party to the combination, in substance, obtains control over any other."

A majority vote of shareholders is generally required to approve a merger. A merger is just one type of acquisition. One company can acquire another in several other ways, including purchasing some or all of the company's assets or buying up its outstanding shares of stock.

In general, mergers and other types of acquisitions are performed in the hopes of realizing an economic gain. For such a transaction to be justified, the two firms involved must be worth more together than they were apart. Some of the potential advantages of mergers and acquisitions include achieving economies of scale, combining complementary resources, garnering tax advantages, and eliminating inefficiencies. Other reasons for considering growth through acquisitions include obtaining proprietary rights to products or services, increasing market power by purchasing competitors, shoring up weaknesses in key business areas, penetrating new geographic regions, or providing managers with new opportunities for career growth and advancement. Since mergers and acquisitions are so complex, however, it can be very difficult to evaluate the transaction, define the associated costs and benefits, and handle the resulting tax and legal issues.

2.1.2 What is Merger?

Merger or amalgamation contemplates joining two or more companies to form a new company, an altogether a new entity or absorbing of one or more companies by an existing company. The term "merger" and "amalgamation" are used synonymously.

$\boxed{\text{Co. A}} + \boxed{\text{Co. B}} - \boxed{\text{New Co. C}}$

Figure 1

Co. A and Co. B = Transferor/Amalgamating Company

New Co. C = Transferee/Amalgamated Company

$\boxed{\text{Co. A}}$ + $\boxed{\text{Co. B}}$ + $\boxed{\text{Co.C}}$ – $\boxed{\text{Existing Co.As}}$

Figure 2

Co. B and Co. C = Transferor/Amalgamating Company

Co. A = Transferee/Amalgamated Company

In other words, merger involves consolidation of business of Company A and Company B into a new Company C on a going concern basis as shown in Figure 1 above or transfer of business of Company B and Company C to Company A on a going concern basis as shown in Figure 2 above. The transaction involves arrangement with the shareholders.

The consideration for transfer of business may be discharged either through issue of shares (equity or preference) or other instruments of the transferee company or by cash.

2.1.3 Varieties of Mergers

From the perspective of business structures, there are a whole host of different mergers. Here are a few types, distinguished by the relationship between the two companies that are merging:

- Horizontal merger Two companies that are in direct competition in the same product lines and markets.
- Vertical merger A customer and company or a supplier and company. Think of a cone supplier to an ice cream maker.
- Market-extension merger: Two companies that sell the same products in different markets.
- Product-extension merger: Two companies selling different but related products in the same market.
- Conglomeration: Two companies that have no common business areas.

From the perspective of how the merge is financed, there are two types of mergers: purchase mergers and consolidation mergers. Each has certain implications for the companies involved and for investors:

o Purchase Mergers - As the name suggests, this kind of merger occurs when one company purchases another one. The purchase is made by cash or through the issue of some kind of debt instrument, and the sale is taxable.

Acquiring companies often prefer this type of merger because it can provide them with a tax benefit. Acquired assets can be ''written-up'' to the actual purchase price, and the difference between book value and purchase price of the assets can depreciate annually, reducing taxes payable by the acquiring company (we discuss this further in part four of this tutorial).

o Consolidation Mergers - With this merger, a brand new company is formed and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

2.1.4 Acquisitions

As you can see, an acquisition may be only slightly different from a merger. In fact, it may be different in name only. Like mergers, acquisitions are actions through which companies seek economies of scale, efficiencies, and enhanced market visibility. Unlike all mergers, all acquisitions involve one firm purchasing another – there is no exchanging of stock or consolidating as a new company. Acquisitions are often congenial, with all parties feeling satisfied with the deal. Other times, acquisitions are more hostile.

In an acquisition, as in some of the merger deals we discussed above, a company can buy another company with cash, with stock, or a combination of the two. Another possibility, which is common in smaller deals, is for one company to acquire all the assets of another company. Company X buys all of Company Y's assets for cash, which means that Company Y will have only cash (and debt, if they had debt before). Of course, Company Y becomes merely a shell and will eventually liquidate or enter another area of business.

Another type of acquisition is a reverse merger, a deal that enables a private company to get publicly-listed in a relatively short time period. A reverse merger occurs when a private company that has strong prospects and is eager to raise financing buys a publicly-listed shell company, usually one with no business and limited assets. The private company reverse merges into the public company, and together they become an entirely new public corporation with tradable shares.

Regardless of their category or structure, all mergers and acquisitions have one common goal: they are all meant to create synergy that makes the value of the combined companies greater than the sum of the two parts. The success of a merger or acquisition depends on how well this synergy is achieved.

2.1.5 Types of Acquisitions

In general, acquisitions can be horizontal, vertical, or conglomerate. A horizontal acquisition takes place between two firms in the same line of business. For example, one tool and die company might purchase another. In contrast, a vertical merger entails expanding forward or backward in the chain of distribution, toward the source of raw materials or toward the ultimate consumer. For example, an auto parts manufacturer might purchase a retail auto parts store. A conglomerate is formed through the combination of unrelated businesses.

Another type of combination of two companies is a consolidation. In a consolidation, an entirely new firm is created, and the two previous entities cease to exist. Consolidated financial statements are prepared under the assumption that two or more corporate entities are in actuality only one. The consolidated statements are prepared by combining the account balances of the individual firms after certain adjusting and eliminating entries are made.

Another way to acquire a firm is to buy the voting stock. This can be done by agreement of management or by tender offer. In a tender offer, the acquiring firm makes the offer to buy stock directly to the shareholders, thereby bypassing management. In contrast to a merger, a stock acquisition requires no stockholder voting. Shareholders wishing to keep their stock can simply do so. Also, a minority of shareholders may hold out in a tender offer.

A bidding firm can also buy another simply by purchasing all its assets. This involves a costly legal transfer of title and must be approved by the shareholders of the selling firm. A takeover is the transfer of control from one group to another. Normally, the acquiring firm (the bidder) makes an offer for the target firm. In a proxy contest, a group of dissident shareholders will seek to obtain enough votes to gain control of the board of directors.

2.1.6 Distinction Between Mergers and Acquisitions

Although they are often uttered in the same breath and used as though they were synonymous, the terms ''merger'' and "acquisition" mean slightly different things.

When a company takes over another one and clearly becomes the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist and the buyer "swallows" the business, and stock of the buyer continues to be traded.

In the pure sense of the term, a merger happens when two firms, often about the same size, agree to go forward as a new single company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals." Both companies' stocks are surrendered, and new company stock is issued in its place. For example, both Daimler-Benz and Chrysler ceased to exist when the two firms merged, and a new company, DaimlerChrysler, was created.

In practice, however, actual mergers of equals don't happen very often. Often, one company will buy another and, as part of the deal's terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it's technically an acquisition. Being bought out often carries negative connotations. By using the term "merger," dealmakers and top managers try to make the takeover more palatable.

A purchase deal will also be called a merger when both CEOs agree that joining together in business is in the best interests of both their companies. But when the deal is unfriendly–that is, when the target company does not want to be purchased–it is always regarded as an acquisition.

So, whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

Synergy is the magic force that allows for enhanced cost efficiencies of the new business. Synergy takes the form of revenue enhancement and cost savings. By merging, the companies hope to benefit from the following:

- Staff reductions – As every employee knows, mergers tend to mean job losses. Consider all the money saved from reducing the number of staff members from accounting, marketing and other departments. Job cuts will also include the former CEO, who typically leaves with a compensation package.
- Economies of scale yes, size matters. Whether it's purchasing stationery or a new corporate IT system, a bigger company placing the orders can save more on costs. Mergers also translate into improved purchasing power to buy equipment or office supplies – when placing larger orders, companies have a greater ability to negotiate price with their suppliers.
- Acquiring new technology – To stay competitive, companies need to stay on top of technological developments and their business applications. By buying a smaller company with unique technologies, a large company can keep or develop a competitive edge.
- Improved market reach and industry visibility – Companies buy companies to reach new markets and grow revenues and earnings. A merge may expand two companies' marketing and distribution, giving them new sales opportunities. A merger can also improve a company's standing in the investment community: bigger firms often have an easier time raising capital than smaller ones.

That said, achieving synergy is easier said than done – it is not automatically realized once two companies merge. Sure, there ought to be economies of scale when two businesses are combined, but sometimes it works in reverse. In many cases, one and one add up to less than two.

Sadly, synergy opportunities may exist only in the minds of the corporate leaders and the dealmakers. Where there is no value to be created, the CEO and investment bankers – who have much to gain from a successful M&A deal – will try to build up the image of enhanced value. The market, however, eventually sees through this and penalizes the company by assigning it a discounted share price. We talk more about why M&A may fail in a later section of this tutorial.

Conclusion & Resources

One size does not fit all. Many companies find that the best route forward is expanding ownership boundaries through mergers and acquisitions. For others, separating the public ownership of a subsidiary or business segment offers more advantages. At least in theory, mergers create synergies and economies of scale, expanding operations and cutting costs. Investors can take comfort in the idea that a merger will deliver enhanced market power.

By contrast, de-merged companies often enjoy improved operating performance thanks to redesigned management incentives. Additional capital can fund growth organically or through acquisition. Meanwhile, investors benefit from the improved information flow from de-merged companies.

M&A comes in all shapes and sizes, and investors need to consider the complex issues involved in M&A. The most beneficial form of equity structure involves a complete analysis of the costs and benefits associated with the deals.

2.2 ACCOUNTING FOR MERGERS AND ACQUISITIONS

The two principal accounting methods used in mergers and acquisitions are the pooling of interests method and the purchase method. The main difference between them is the value that the combined firm's balance sheet places on the assets of the acquired firm, as well as the depreciation allowances and charges against income following the merger.

The pooling of interests method assumes that the transaction is simply an exchange of equity securities. Therefore, the capital stock account of the target firm is eliminated, and the acquirer issues new stock to replace it. The two firms' assets and liabilities are combined at their historical book values as of the acquisition date. The end result of a pooling of interests transaction is that the total assets of the combined firm are equal to the sum of the assets of the individual firms. No goodwill is generated, and there are no charges against earnings. A tax-free acquisition would normally be reported as a pooling of interests.

Under the purchase method, assets and liabilities are shown on the merged firm's books at their market (not book) values as of the acquisition date. This method is based on the idea that the resulting values should reflect the market values established during the bargaining process. The total liabilities of the combined firm equal the sum of the two firms' individual liabilities. The equity of the acquiring firm is increased by the amount of the purchase price.

Accounting for the excess of cost over the aggregate of the fair market values of the identifiable net assets acquired applies only in purchase accounting. The excess is called goodwill, an asset which is charged against income and amortized over a period that cannot exceed 40 years. Although the amortization "expense" is deducted from reported income, it cannot be deducted for tax purposes.

Purchase accounting usually results in increased depreciation charges because the book value of most assets is usually less than fair value because of inflation. For tax purposes, however, depreciation does not increase because the tax basis of the assets remains the same. Since depreciation under pooling accounting is based on the old book values of the assets, accounting income is usually higher under the pooling method. The accounting treatment has no cash flow consequences. Thus, value should be unaffected by accounting procedure. However, some firms may dislike the purchase method because of the goodwill created. The reason for this is that goodwill is amortized over a period of years.

Accounting Standard (AS-14) as prescribed by the Institute of Chartered Accountants of India deals with accounting for amalgamation and treatment for resulting goodwill or reserves. AS-14 classifies amalgamation into two types, viz.:

Amalgamation in nature of merger; and

Amalgamation in nature of purchase.

Amalgamation in nature of merger is an amalgamation, which satisfies all the following conditions:

i. All the assets and liabilities of the transferor company become the assets and liabilities of the transferee company;

ii. Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than transferee company and its nominees) become equity shareholders of the transferee company after amalgamation;

iii. The consideration is to be discharged by way of issue of equity shares in the transferee company to the shareholders of the transferor company on the amalgamation;

iv. The business of the transferor company is to be carried on by the transferee company;

v. No adjustments are intended to be made to the book values of the assets and liabilities of the transferor company.

If any one or more of the aforesaid conditions are not satisfied then the amalgamation is in nature of purchase.

Amalgamation in the nature of merger is to be accounted as per the Pooling of Interest Method and in case of amalgamation in the nature of purchase accounting needs to be done as per the Purchase Method.

2.2.1 Methods of Accounting:

Pooling of Interest Method (In the nature of merger)

i. The assets, liabilities and reserves of the transferor company are to be recorded at their existing carrying amounts and in the same form as it was appearing in the books of the transferor company.

ii. The identity of the reserves of the transferor company is to be kept intact in the balance sheet of the transferee company.

iii. Difference between the amounts of share capital issued plus any other additional consideration paid by the transferee company and the amount of the share capital of the transferor company should be adjusted in Reserves.

Purchase Method:

i. The assets and the liabilities of the transferor company are to be recorded at their existing carrying amounts or, alternatively, the consideration should be allocated to individual assets and liabilities on the basis of fair values at the date of amalgamation while preparing the financial statements of the transferee company.

ii. The identity of the reserves of the transferor company other than the statutory reserves is not preserved. The identity of the statutory reserves is preserved in the same form and is recorded in the books of the transferee company by a corresponding debit to the amalgamation adjustment a/c.

iii. Excess or shortfall of consideration over the value of net assets acquired should be credited/ debited as capital reserve/goodwill, as the case may be.

iv. It is appropriate to amortize goodwill over a period of not exceeding 5 years unless a longer period is justified.

The accounting treatment as specified in AS-14 needs to be followed for accounting of reserves. In case the scheme of amalgamation sanctioned prescribes a separate treatment to be given to the reserves of the transferor company on amalgamation, it can be followed.

However the Institute of Chartered Accountants of India has issued a general clarification wherein the following disclosure is to be made in case the accounting treatment for reserves is different from that specified in AS-14:

i. Description of the accounting treatment given to reserves;

ii. Deviation in the Accounting Treatment and the reasons for following a treatment different from that prescribed in the AS-14;

iii. The financial effect, if any, arising due to such deviation is to be disclosed.

iv. Other Disclosure Requirements

a. General

- Names and general nature of business of the amalgamating companies
- Effective date of amalgamation for accounting purposes
- Method of accounting used to reflect the amalgamation and Exchange Ratio
- Particulars of the scheme sanctioned by the Court

b. If Pooling of Interest Method is used

- Description and number of shares issued, together with the percentage of each company's equity shares exchanged.
- The amount of any difference between the consideration and the value of net identifiable assets acquired and the treatment thereof.

c. If Purchase Method is used

- Consideration for the amalgamation and description of consideration paid/payable
- The amount of difference between the consideration and the value of net identifiable assets acquired and the treatment thereof including the period of amortization of any goodwill arising on amalgamation

entries in books of vendor company

1. Transfer to Realisation A/c.

Particulars		**Debit** ₹	**Credit** ₹
a. Assets taken over by purchasing Company at Book values.			
Realisation A/c	Dr.	XXX	
To Liquidator of A Ltd. A/c			XXX
b. Liabilities taken over by Purchasing Company at Balance Sheet value.			
Liabilities A/c	Dr.	XXX	
To Realisation A/c			XXX

2. Purchase Consideration

Purchase consideration represents consideration paid by transferee company to shareholders (equity and preference) in any form viz., cash, shares, debentures etc.

Particulars		Debit ₹	Credit ₹
a. Due Entry for consideration			
Transfer company A/c	Dr.	XXX	
To Realisation A/c			XXX
b. Receipt of Considertion			
Shares/Securities of transferee company A/c	Dr.	XXX	
Bank A/c	Dr.	XXX	
To Transferee company A/c			XXX

3. Sale of Assets not taken over (Assuming Profits)

Particulars		Debit ₹	Credit ₹
Bank A/c (Sale proceeds)	Dr.	XXX	
To Assets A/c (Book value)			XXX
To Realisation A/c (Profits)			XXX

4. Settlement of liabilities not taken over (Assuming at a discount)

Particulars		Debit ₹	Credit ₹
Liabilities A/c (book value)	Dr.	XXX	
To Bank A/c			XXX
To Realisation A/c (discount)			XXX

5. Realisation expenses

Particulars		Debit ₹	Credit ₹
a. Incurred by transferor company			
Realisation A/c	Dr.	XXX	
To Bank A/c			XXX
b. Incurred by transferee company			
No Entry			
c. Incurred by transferor company reimbursed by transferee company			
i. On incurring the expenses			
Transferee company A/c	Dr.	XXX	
To Bank			XXX
ii. On reimbursement			
Bank A/c	Dr.	XXX	
To Transferee company A/c			XXX

6. **Amount due to the euqity Share holders**

Particulars		Debit ₹	Credit ₹
a. Transfer of share capital and reserves to shareholders account			
Equity Share Capital A/c	Dr.	XXX	
Reserves A/c	Dr.	XXX	
To Shareholders A/c			XXX

7. **Settlement to Share holders by transfer of consideration received:**

Particulars		Debit ₹	Credit ₹
Shareholders A/c	Dr.	XXX	
To Shares/Securities of transferee company A/c			XXX
To Bank A/c			XXX

Entries in books of Transferee Company

(a) Three basic entries

For purchase consideration due		
Business Purchase a/c	Dr.	
To Liquidator of Vendor Company		
For assets and liabilities taken over		
Sundry Assets A/c	Dr.	
Goodwill A/c	Dr.	(Bal. fig.)
To Sundry Liabilities		
To Business Purchase A/c		
To Capital Reserve A/c (Bal. fig.)		
For discharge of purchase consideration		
Liquidator of Vendor Company A/c	Dr.	
To Equity Share Capital A/c		
To Securities Premium A/c		
To Debentures A/c		
To Preference Share Capital A/c		
To Cash A/c		

(b) For liquidation expenses paid by purchasing company

Goodwill/Capital Reserve A/c	Dr.
To Cash A/c	

(c) For cancellation of mutual owings

Creditor/Bills payable A/c	Dr.
To Debtors/Bills receivable A/c	

(d) For adjustment of unrealised profit

Goodwill/Capital reserve A/c	Dr.
To Stock A/c	

(e) For carry forward of statutory reserves

Amalgamation Adjustment A/c	Dr.
To Statutory Reserve A/c	

(f) If both capital reserve and goodwill appears in books

Capital Reserve A/c	Dr.
To Goodwill A/c	

2.2.2 How To Value An Acquisition

Valuing an acquisition is similar to valuing any investment. The analyst estimates the incremental cash flows, determines an appropriate risk-adjusted discount rate, and then computes the net present value (NPV). If firm A is acquiring firm B, for example, then the acquisition makes economic sense if the value of the combined firm is greater than the value of firm A plus the value of firm B. Synergy is said to exist when the cash flow of the combined firm is greater than the sum of the cash flows for the two firms as separate companies. The gain from the merger is the present value of this difference in cash flows.

2.2.3 Sources of Gains From Acquisitions

The gains from an acquisition may result from one or more of the following five categories: (1) revenue enhancement, (2) cost reductions, (3) lower taxes, (4) changing capital requirements, or (5) a lower cost of capital. Increased revenues may come from marketing gains, strategic benefits, and market power. Marketing gains arise from more effective advertising, economies of distribution, and a better mix of products. Strategic benefits represent opportunities to enter new lines of business. Finally, a merger may reduce competition, thereby increasing market power. Such mergers, of course, may run afoul of antitrust legislation.

A larger firm may be able to operate more efficiently than two smaller firms, thereby reducing costs. Horizontal mergers may generate economies of scale. This means that the average production cost will fall as production volume increases. A vertical merger may allow a firm to decrease costs by more closely coordinating production and distribution. Finally, economies may be achieved when firms have complementary resources — for example, when one firm has excess production capacity and another has insufficient capacity.

Tax gains in mergers may arise because of unused tax losses, unused debt capacity, surplus funds, and the write-up of depreciable assets. The tax losses of target corporations can be used to offset the acquiring corporation's future income. These tax losses can be used to offset income for a maximum of 15 years or until the tax loss is exhausted. Only tax losses for the previous three years can be used to offset future income.

Tax loss carry-forwards can motivate mergers and acquisitions. A company that has earned profits may find value in the tax losses of a target corporation that can be used to offset the income it plans to earn. A merger may not, however, be structured solely for tax purposes. In addition, the acquirer must continue to operate the pre-acquisition business of the company in a net loss position. The tax benefits may be less than their "face value," not only because of the time value of money, but also because the tax loss carry-forwards might expire without being fully utilized.

Tax advantages can also arise in an acquisition when a target firm carries assets on its books with basis, for tax purposes, below their market value. These assets could be more valuable, for tax purposes, if they were owned by another corporation that could increase their tax basis following the acquisition. The acquirer would then depreciate the assets based on the higher market values, in turn, gaining additional depreciation benefits.

Interest payments on debt are a tax-deductible expense, whereas dividend payments from equity ownership are not. The existence of a tax advantage for debt is an incentive to have greater use of debt, as opposed to equity, as the means of financing merger and acquisition transactions. Also, a firm that borrows much less than it could may be an acquisition target because of its unused debt capacity. While the use of financial leverage produces tax benefits, debt also increases the likelihood of financial distress in the event that the acquiring firm cannot meet its interest payments on the acquisition debt.

Finally, a firm with surplus funds may wish to acquire another firm. The reason is that distributing the money as a dividend or using it to repurchase shares will increase income taxes for shareholders. With an acquisition, no income taxes are paid by shareholders.

Acquiring firms may be able to more efficiently utilize working capital and fixed assets in the target firm, thereby reducing capital requirements and enhancing profitability. This is particularly true if the target firm has redundant assets that may be divested.

The cost of debt can often be reduced when two firms merge. The combined firm will generally have reduced variability in its cash flows. Therefore, there may be circumstances under which one or the other of the firms would have defaulted on its debt, but the combined firm will not. This makes the debt safer, and the cost of borrowing may decline as a result. This is termed the coinsurance effect.

Diversification is often cited as a benefit in mergers. Diversification by itself, however, does not create any value because stockholders can accomplish the same thing as the merger by buying stock in both firms.

2.2.4 Valuation Procedures

The procedure for valuing an acquisition candidate depends on the source of the estimated gains. Different sources of synergy have different risks. Tax gains can be estimated fairly accurately and should be discounted at the cost of debt. Cost reductions through operating efficiencies can also be determined with some confidence. Such savings should be discounted at a normal weighted average cost of capital. Gains from strategic benefits are difficult to estimate and are often highly uncertain. A discount rate greater than the overall cost of capital would thus be appropriate.

The net present value (NPV) of the acquisition is equal to the gains less the cost of the acquisition. The cost depends on whether cash or stock is used as payment. The cost of an acquisition when cash is used is just the amount paid. The cost of the merger when common stock is used as the consideration (the payment) is equal to the percentage of the new firm that is owned by the previous shareholders in the acquired firm multiplied by the value of the new firm. In a cash merger the benefits go entirely to the acquiring firm, whereas in a stock-for-stock exchange the benefits are shared by the acquiring and acquired firms.

Whether to use cash or stock depends on three considerations. First, if the acquiring firm's management believes that its stock is overvalued, then a stock acquisition may be cheaper. Second, a cash acquisition is usually taxable, which may result in a higher price. Third, the use of stock means that the acquired firm will share in any gains from merger; if the merger has a negative NPV, however, then the acquired firm will share in the loss.

In valuing acquisitions, the following factors should be kept in mind. First, market values must not be ignored. Thus, there is no need to estimate the value of a publicly traded firm as a separate entity. Second, only those cash flows that are incremental are relevant to the analysis. Third, the discount rate used should reflect the risk associated with the incremental cash flows. Therefore, the acquiring firm should not use its own cost of capital to value the cash flows of another firm. Finally, acquisition may involve significant investment banking fees and costs.

Mergers and acquisitions and corporate restructuring – or M&A for short – are a big part of the corporate finance world. Everyday, Wall Street investment bankers arrange M&A transactions that bring together separate companies to make larger ones. When they are not creating big companies from smaller ones, corporate finance deals do the reverse and break up companies through spinoffs, carve-outs, or tracking stocks.

Not surprisingly, these types of actions often make the news. Deals can be worth hundreds of millions or even billions of dollars, and they can dictate the fortunes of the companies involved for years to come. For CEOs, leading M&A can represent the pinnacle of their careers.

2.3 DEMERGER & REVERSE MERGER

Demerger

Definition:

The term "demerger" has been defined in the Income-tax Act, 1961. The definition of the term under the IT Act refers back to the provisions of sections 230 to 232 of the Companies Act, 2013, though an exception has been made in case of foreign companies. We know by now that the said sections 230 to 232 deal with a scheme of compromise or/and arrangement duly approved by the company or companies in question and further approved by the Tribunal.

The IT Act has made provisions removing certain tax disabilities, often referred to, inappropriately in our view, as tax incentives for demerger, to the companies 'involved in a demerger and to their shareholders. To avoid some of the disabilities under the Income-tax Act, it is essential that a demerger squarely falls within the definition of the term "demerger" under section 2(19AA) of the IT Act. Section 2(19AA) reads as follows:

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

(i) All the property of the undertaking, 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 therein 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 undertaking is on a going concern basis; (vii) The demerger is in accordance with the conditions, if any, notified under sub-section (5) of section 72A 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 undertaking 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 utilised solely fur the activities or operations of the undertaking; and

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

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

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

Notification No. S.O. 1159(E), dated December 26, 2000

In exercise of the powers conferred under Explanation 4 to clause (19AA) of section 2 of the Income-tax Act, 1961 the Central Government hereby specifies that where the split-up or the reconstructed authority or body, constituted or established under a Central, State or Provincial Act, is an entity engaged in the generation or transmission or distribution of electrical power, or in all of these activities, such splitting up or reconstruction shall be deemed to be a demerger if the following conditions are fulfilled, namely :-

(i) splitting up or reconstruction is effected through a notification in the Official Gazette by the. Central or the State Government; and

(ii) assets of the split-up or reconstructed authority or body, are transferred to one or more resulting companies on a going concern basis.

Other related definitions:

Definition of 'demerged company'

Section 2(19AAA) "demerged company" means the company whose undertaking 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 thereof] to which the undertaking 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.

Conditions for a demerger:

From the above it would be seen that a demerger for purposes of the Income-tax Act, has to fulfill the following conditions:

(a) the demerger must be a transfer by the transferor company to a transferee company of one ore more undertakings belonging to the transferor company;

(b) this transfer should be achieved pursuant to a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013;

(c) all the property and related liabilities of the undertaking transferred, immediately before the demerger, must become the property of the transferee company by virtue of the demerger, and not by virtue of sale or otherwise as a result of the acquisition of the property or assets of the transferor company or any undertaking thereof by the transferee company;

(d) the property and the liabilities transferred must be transferred at values appearing in the books of account of the transferor company immediately before the demerger. Revaluation of assets must be ignored;

(e) the consideration to be paid by the transferee company should be paid to the shareholders of the transferor company and not to the transferor company. Such payment must be in the form of the shares of the transferee company. The consideration should not be in cash or otherwise. Further such allotment to the shareholders of the transferor company must be in proportion to the shares held by them in the transferor company;

(f) the shareholders holding not less than three-fourths in value of the shares in the transferor company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) must become shareholders of the transferee company or companies by virtue of the demerger;

(g) the transfer of the undertaking is on a going concern basis; and

(h) the demerger must be in accordance with the conditions, if any, notified under sub-section (5) of section 72A by the Central Government in this behalf. As at now there is no -notification issued relating to demerger. Relating to amalgamation or merger a notification has already been issued in 1999.

Reverse merger

A **Reverse merger** - at times also referred to as a reverse takeover (RTO) - is a way by which a private company can become a public company and take advantage of the greater financing options available to public companies. The reverse merger is an alternative to the traditional IPO (Initial Public Offering) as a method for going public. Reverse takeovers have historically been used by businesses that wish to start trading in a very short time. However, recent SEC (Securities and Exchange Commission) regulations require that when doing a reverse merger information similar to an S-1 registration statement be filed.

A reverse merger is a complex method that a private company uses to become a publicly traded corporation. **Reverse mergers** happen when a public company that is no longer actively involved in business and has limited assets (that's why it's called a shell company or shell corporation) joins or merges, with a private company. The private company buys most of the outstanding shares of the shell company, gaining control and seating its own board of directors. The resulting merged business entity becomes a new operating company and may change its name to better reflect the newly merged company's business purpose.

A reverse merger refers to an arrangement where private company acquires a public company, usually a shell company, in order to acquire the status of a public company. Also known as a reverse takeover, it is an alternative to the traditional initial public offering (IPO) method of floating a public company. It is an easier way that allows private companies to change their type while avoiding the complex regulations and formalities associated with an IPO. Also, the degree of ownership and control of the private stakeholders increases in the public company. It also leads to combining of resources thereby giving greater liquidity to the private company.

Reverse take overs are one way for a company to go public. Companies interested in going public can go public without the use of a shell corporation. Our firm takes companies public directly. The going public process is attractive to businesses because after becoming a publicly traded company, the business can use its stock as currency to buy assets and other businesses. Many companies will use the stock of their public company to trade for advertising. Raising capital often becomes easier to accomplish as a public company because investors now have a clear exit strategy.

Reverse merging is the joining together of a public company and a private company. This can speed up the process to become a public company. It is still required by SEC (Securities and Exchange Commission) Form 8K to provide some of the information that would be in an SEC registration statement.

Many company directors and officers don't recognize there are other ways for a private company to become publicly traded, outside of doing a traditional IPO (Initial Public Offering) or a reverse merger.

As a strategy to go public it is not necessary to do a reverse merger. You can do a direct registration of your company. Many of the benefits bestowed upon public companies also apply to companies created through a direct registration, to include:

- The greater choice of financial opportunities available to public companies.
- An exit strategy for the company directors and founders.
- Investors are more compelled to invest in a company with a clear exit strategy.
- The ability to use the company stock as currency to acquire other businesses (M&A).

2.4 SURRENDER OF SHARES AND BUY BACK OF SHARES

Surrender of shares (alternative to capital reduction)

1. Shares surrendered:

Particulars		**Debit** ₹	**Credit** ₹
Share capital A/c	Dr.	xxx	
To, Share surrendered A/c			xxx

Note: Only fully paid share can be surrendered. The shares surrendered could be either equity shares or preference shares.

2. Reissue of Surrendered Shares:

Reissue of Surrendered Shares

For Discharge of Liability | For Cash

For Discharge of Liability

a. Transfer of shares surrendered in the name of creditors

Particulars		**Debit** ₹	**Credit** ₹
Share surrendered A/c	Dr.	xxx	
To, Share surrendered A/c			xxx

b. Cancellation of liability discharged pursuant to issue of above shares

Particulars		**Debit** ₹	**Credit** ₹
Liability A/c	Dr.	xxx	
To, Reconstruction A/c			xxx

For Cash

a. Transfer of shares surrendered in the name of Applicant

Particulars		**Debit** ₹	**Credit** ₹
Share surrendered A/c	Dr.	xxx	
To, Share capital A/c			xxx

b. Cash received from applicants represents entirely profit and hence transferred to Reconstruction

Particulars		**Debit** ₹	**Credit** ₹
Bank A/c	Dr.	xxx	
To, Reconstruction A/c			xxx

Note: The shares surrendered when reissued could be either:

(a) Shares of same class (original) OR

(b) Shares of a different class

3. Cancellation of Shares surrendered not reissued

Particulars		**Debit** ₹	**Credit** ₹
Share surrendered A/c	Dr.	xxx	
To, Reconstruction A/c			xxx

Accounting for Buy Back of shares

Caveat: This explanatory note is limited to the extent of explanation to quantitative restriction of buy back (Section 68 of the Companies Act, 2013) and accounting treatment. It is to be noted that there is no technical pronouncement of accounting for buy back.

Determination of quantum for buy back – Section 68

The maximum number of shares to be bought back is determined as the least of 'number of shares' arrived by performing the following tests:

1. Share outstanding test
2. Resource test
3. Debt Equity ratio test.

1. Share outstanding test:

(a) Ascertain the number of shares (Paid up share capital)

(b) 25% of the number of shares is eligible for buy back with the approval of share holders.

2. Resource test:

(a) Ascertain shareholders funds (Capital + Free reserves)

(b) Ascertain number of shares as follows

$$= \frac{\text{Share holders funds}}{\text{Buy back price}}$$

3. Debt Equity ratio test:

After buy back, the company has to maintain a debt equity ratio of 2:1

(a) Compute total borrowed funds

(b) Ascertain the minimum equity (shareholders funds)

(c) Ascertain present equity (share holders funds)

(d) Compute maximum possible dilution in equity in Step ii – Step iii

(e) Calculate the number of shares = $\frac{\text{Amount in Step d}}{\text{Buy back price}}$

Buy back:

On determination of quantum of buy back, the shares are bought from public at the buy back price. The shares bought back has to be cancelled within 7 days from the buy back. The amount paid in excess of the cost of the share will be debited to reserves after adjusting against securities premium, if any available. A transfer is to be made to capital redemption reserve equivalent to capital redeemed.

Particulars		**Debit** ₹	**Credit** ₹
a. On purchase of shares:			
Shares bought back A/c	Dr.	xxx	
To, Bank A/c			xxx
b. Cancellation of shares bought back			
Share Capital A/c	Dr.	xxx	
Reserves A/c	Dr.	xxx	
To, Shares bought back			xxx
[Being cancellation of shares bought on buy back]			
c. Transferring the reserves to the extent of capital is redeemed			
Reserves A/c	Dr.		
To, Capital redemption reserve A/c		xxx	
[Being transfer of reserves to capital redemption reserve to the extent capital is redeemed]			xxx

2.5 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 transferee 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 of 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 amalgamation in the nature of purchase; 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 whereas in amalgamation, there are at least two existing companies which amalgamate.

(ii) In external reconstruction, a new company is certainly formed whereas 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.

Scheme of 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, the reconstruction scheme must take into account the following:-

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

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

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

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

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

Steps:

(1) First of all the total amounts to be written off should be ascertained. This would mean totaling up the debit balance of the Profit and Loss account, all fictitious assets like goodwill, preliminary expenses, discount on shares or debentures, any fall in value of assets, any increase in liabilities and arrears of dividends on cumulative preference shares. If the value of any share can be legitimately increased the amount of loss would then be reduced accordingly. The other way to get at the same figure would be to add up the present value as a going concern, of all the assets and deduct there from the amount of liabilities and also the arrears of dividend on cumulative preference shares. What is left is "net assets". The share capital compared with net assets will show how much amount is to be written off.

(2) The question now arises has to who is to bear the loss. If the net assets are more than the preference share capital, it is obvious the whole of the loss will have to be borne by the equity shareholders. The nominal value of the equity shares should be reduced by a sufficient margin to cover the loss. If the net assets are not sufficient to cover the preference share capital (or if the net assets are just sufficient), the preference share holder will have to accept a sacrifice, although their sacrifice will be smaller than that of the equity share holders. (Equity share holders should not be completely wiped off). If the future earning power of the company permits, the dividend rate should be increased so that, in terms of rupees, the dividend remains unchanged. Thus if 10.5% preference share of ₹ 100 are converted into preference share of ₹ 75 each, rate of dividend should be raised to 14%, if possible. In both cases, then the dividend will be ₹ 10.5 per share.

(3) Payment of arrears of dividend (question arises only in case of cumulative preference shares) in cash immediately may present difficulties. In such a case a good method is to issue deposit certificates. This is preferable to issuing shares because (a) it will not upset the voting power and (b) the certificate can be redeemed as soon as opportunity arises. The rate of interest need not be heavy, but of course, it will depend on the future earning capacity of the company.

(4) Debenture holders and other creditors are affected by the reconstruction scheme only if the total assets in the company are insufficient to cover even the liabilities (although they are concerned is necessary to any scheme that may be formulated). In such an eventuality, the creditors (including debenture holders) will have to accept sacrifice unless they think that by sending the company into liquidation we will be able to realize substantial portion of their claims. The share holders, both preference and equity will have to accept a heavy reduction in the value of share but they cannot be expected to agree to complete wiping of the shares, in which case they will have no interest in keeping the company going. Generally, the sacrifice to be borne by the creditors will be as follows:

Preferential creditors (According to law)	Nil

Depending upon the value of the security Heaviest.

In short, the whole scheme should broadly depend upon the expected earning power and upon the position as it likely to obtain if the company is sent to liquidation.

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

(a) Creditors, specially bank overdraft and debenture holders, may continue whereas they may not if the company is formally liquidated 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. It should be remembered that in internal reconstruction fully paid up shares unless every shareholder gives his assent in writing. This may prove cumbersome. However, if shareholders are willing to accept partly paid shares in the new company, there is not much reason why they should refuse to buy new shares under a scheme of internal reconstruction.

Legal position as regards external reconstruction:

Sec 319 of the Companies Act permits the liquidator of a company to transfer the whole or any part of the company's business or property to another company and receive from the transferee company for distribution among the share holders of the company under liquidation. The liquidator must obtain the sanction of the company by a special resolution. Any sale of arrangement in pursuance of this section is binding on the members of the transferor company.

But a shareholder who has not voted for the special resolution may, within seven days of the resolution, serve a notice on the liquidator expressing his dissent and requiring the liquidator either, (a) to abstain from carrying the resolution into effect, or (b) to purchase his interest at a price to be determined by agreement or by arbitration.

Illustrations :

I. Computation and Discharge of Purchase Consideration

Illustration 1.

The Oil Shell Ltd. was incorporated on 1st April 2015 for the purpose of acquiring P Ltd., Q. Ltd., and R Ltd.

The Balance sheet of these companies as on 31st March 2015 are as follows :

(₹)

Particulars	P Ltd.	Q Ltd.	R Ltd.
Assets			
Tangible Fixed assets - at cost less depreciation	50,00,000	40,00,000	30,00,000
Goodwill		6,00,000	
Other assets	20,00,000	28,00,000	8,50,000
Total	**70,00,000**	**74,00,000**	**38,50,000**
Liabilities			
Issued Equity Share Capital (shares of ₹ 10 each)	40,00,000	50,00,000	25,00,000
Profit and Loss A/c	15,00,000	11,00,000	6,00,000
10% Debentures	7,00,000		4,00,000
Sundry Creditors	8,00,000	13,00,000	3,50,000
Total	**70,00,000**	**74,00,000**	**38,50,000**

Average annual profits before debentures interest (April 2014 to March 2015 inclusive)	9,00,000	12,00,000	5,00,000
Professional valuation of tangible assets on 31st March 2015	62,00,000	48,00,000	36,00,000

1. The directors in their negotiations agreed that : (i) the recorded goodwill of Q Ltd. is valueless ; (ii) the "Other assets" of P Ltd. are worth ₹ 3,00,000; (iii) the valuation of 31st March 2015 in respect of tangible Fixed assets should be accepted. (iv) these adjustments are to be made by the individual companyt before the completion of the acquitition.
2. The acquisition agreement provided for the issue of 12% unsecured Debentures to the value of the net assets of companies P Ltd. Q Ltd and R Ltd., and for the issuance of ₹ 100 nominal value equity shares for the capitalized average profit of each acquired company in excess of net assets contributed. The capitalisation rate is established at 10%.

You are required to:

i. Compute Purchase consideration.

ii. Dicscharge of Purchase consideration.

Solution :

Computation of Purchase Consideration

WN # 1 : ***Consideration in the form of 12% Debentures***

Particulars	P Ltd.		Q Ltd.		R Ltd.	
	₹	₹	₹	₹	₹	₹
a. Asset						
i. Tangilbe Fixed assets (as valuation)	62,00,000		48,00,000		36,00,000	
ii. Other Assets (as per directors negotiation)	3,00,000	65,00,000	28,00,000	76,00,000	8,50,000	44,50,000
b. Liabilities						
i. Sundry Creditors	8,00,000		13,00,000		3,50,000	
ii. 10% Debentures	7,00,000	(15,00,000)	—	(13,00,000)	4,00,000	(7,50,000)
c. NET ASSETS (a-b)		50,00,000		63,00,000		37,00,000
d. 12% Debentures to be issued.		50,00,000		63,00,000		37,00,000

WN # 2 : ***Consideration in the form of Equity Shares***

Particulars	P Ltd. ₹	Q Ltd. ₹	R Ltd. ₹
a. Average annual profit before debenture interest (given)	9,00,000	12,00,000	5,00,000
b. Debenture interest (on 10% Debentures)	70,000	—	40,000
c. Profit after debentures interest (a-b)	8,30,000	12,00,000	4,60,000
d. Capitalisation rate	10%	10%	10%
e. Capitalised average profit (c/d)	83,00,000	1,20,00,000	46,00,000
f. Net Assets takeover (WN # 1(c))	50,00,000	63,00,000	37,00,000
g. Excess of capitalised average profit over net assets take over (e-f)	33,00,000	57,00,000	9,00,000

WN # 3 : Summary of Purchase Consideration

Particulars	P Ltd. ₹	Q Ltd. ₹	R Ltd. ₹
a. 12% Debentures of Oil Shell Ltd. each @ ₹ 100/- [WN # 1(d)]	50,00,000	63,00,000	37,00,000
b. Equity shares of ₹ 100 each of Oil Shell Ltd. [WN # 2(g)]	33,00,000	57,00,000	9,00,000
c. Total Consideration	**83,00,000**	**1,20,00,000**	**46,00,000**

Illustration - 2

Zee Ltd. agreed to absorb Gulf Ltd. on 31st March, 2015, whose Summarised Balance sheet stood as follows :

Liabilities	₹	***Assets***	₹
Share capital 80,000 shares of ₹ 100 each fully paid Reserves and surplus General Reserve Secured Loan Unsecured Loan Current Liabilities and Provisions Sundry creditors	 80,00,000 10,00,000 — — 10,00,000	Fixed assets Investments Current assets Loans and Advances Stock in trade Sundry Debtors	70,00,000 10,00,000 20,00,000
	1,00,00,000		**1,00,00,000**

Note : Assumed that secured and unsecured loan is of less that 12 months, hence to be treated as short term borrowings (ignoring interest)

The consideration was agreed to be paid as follows :

a. A payment in cash of ₹ 50 per share in Gulf Ltd. and

b. The issue of shares of ₹ 100 each in Zee Ltd., on the basis of 2 Equity Shars (valued at ₹ 150) and one 10% cumulative preference share (valued at ₹ 100) for every five shares held in Gulf Ltd.

It was agreed that Zee Ltd. will pay in cash for fractional shares equivalent at agreed value of shares in Gulf Ltd. i.e. ₹ 650 for five shares of ₹ 500 paid.

The whole of the Share capital consists of shareholdings in exact multiple of five except the following holding.

Bharati	116	
Sonu	76	
Hitesh	72	
Jagat	28	
Other individuals	8	(eight members holding one share each)
	300	

Prepare a statement showing the purchase consideration receivable by above shareholders in shares and cash.

Solution :

WN # 1 : *Statement of consideration paid for fraction shares*

Particulars	Bharti	Sonu	Hitesh	Jagat	Others	Total
a. Holding of shares	116	76	72	28	8	300
b. Non-exchangeable shares (Payable in Cash)	1	1	2	3	8	15
c. Exchangeable Shares [(a) - (b)]	115	75	70	25	—	285
d. Above shares						
i. in Equity shares (2:5)	46	30	28	10	—	114
ii. in Preference shares (1:5)	23	15	14	5	—	57

WN # 2 : Number of shares to be issued

a. Exchangeable shares :

= Total shares – Non Exchangeable shares

= 80,000 – 15 = 79,985

b. Equity shares to be issued :

$= \frac{79,985}{5} \times 2 = 31,994$ Shares (i.e. 2 shares for every 5 shares)

c. Preference shares to be issued

$= \frac{79,985}{5} \times 1 = 15,997$ Shares (i.e. 1 shares for every 5 shares)

WN # 3 : ***Cash to be paid***

	Particulars	₹
a.	79,985 shares @ ₹ 50 each	39,99,250
b.	Consideration for non-exchangeable $[15\times100]\times\frac{650}{500}$ (i.e. ₹ 650 for five shares of ₹ 500 paid)	1,950
c.	Total	40,01,200

Statement of Purchase Consideration :

Particulars	₹	₹
a. In Shares :		
i. 31,994 Equity shares @ ₹ 150 each	47,99,100	
ii. 15,997 Preference shares @ ₹ 100 each	15,99,700	63,98,800
b. In Cash (WN # 3)		40,01,200
c. Total (a+b)		1,04,00,000

Illustration - 3

The summarized Balance Sheets of P Ltd. and R Ltd. for the year ended 31.3.2015 are as under :

	P Ltd. ₹	**R Ltd.** ₹		**P Ltd.** ₹	**R Ltd.** ₹
Equity Share capital (in shares of ₹ 100 each)	24,00,000	12,00,000	Fixed Assets	55,00,000	27,00,000
8% Preference Share capital (in share of ₹ 100 each)	8,00,000	—	Current Assets	25,00,000	23,00,000
10% Preference Share capital (in shares of ₹ 100 each)	—	4,00,000			
Reserves	30,00,000	24,00,000			
Current liabilities	18,00,000	10,00,000			
	80,00,000	**50,00,000**		**80,00,000**	**50,00,000**

1. The following information is provided :

	P Ltd. ₹	R Ltd. ₹
(a) Profit before tax	10,64,000	4,80,000
(b) Taxation	4,00,000	2,00,000
(c) Preference dividend	64,000	40,000
(d) Equity dividend	2,88,000	1,92,000

2. The Equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.

3. P. Ltd. proposes to absorb R Ltd. as on 31.3.2015. The terms of absorption are as under :

   a. Preference shareholders of R Ltd. will receive 8% preference shares of P. Ltd. sufficient to increase the income of preference shareholders of R Ltd. by 10%

   b. The equity shareholders of R Ltd. will receive equity shares of P Ltd. on the following basis :

      i. The equity shares of R Ltd. will be valued by applying to the earnings per share of R Ltd. 75% of price earnings ratio of P Ltd. based on the results of 2014-2015 of both the companies.

      ii. The market price of equity shares of P Ltd. is ₹ 400 per share.

      iii. The number of shares to be issued to the equity shareholders of R Ltd. will be based on the above market value.

      iv. In addition to equity shares, 8% preference share of P Ltd. will be issued to the equity shareholders of R Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2014-2015.

4. The assets and liabilities of R Ltd. as on 31.3.2015 are revalued by professional valuer as under :

	Increased by ₹	***Decreased by*** ₹
Fixed assets	1,60,000	—
Current assets	—	2,00,000
Current liabilities		40,000

5. For the next two years, no increase in the rate of equity dividend is expected.

   You are required to :

   i) Calculate purchase consideration.

   ii) Give the Balance Sheet as on 31.3.2015 after absorption.

Note : Journal entires are not required.

Solution :

I. Purchase Consideration

A. Preference Shareholders

8% preference shares of P Ltd. sufficient to increase income by 10%.

Particulars	₹
Current income from Preference shares of R Ltd. (₹ 4,00,000 × 10%)	40,000
Add : 10% increase	4,000
Income from Preference Shares of P Ltd.	44,000
Value of 8% Preference Shares of R Ltd. to be issued [44,000×100/8]	**5,50,000**

B. Equity Shareholders

i. Consideration by way of Equity shares

Valuation of shares of P Ltd.

(12,000 shares × ₹ 240 [WN # 3]

$\boxed{\text{₹ 28,80,000}}$

Share Capital
[7,200 shares* ×₹ 100]
₹ 7,20,000

Share Premium
[7,200 shares* × ₹ 300]
₹ 21,60,000

* No. of shares to be issued = ₹ 28,80,000 ÷ ₹ 400

= 7,200 Shares

ii. Consideration by way of Preference Shares

Particulars	₹
i. Current equity dividend from R Ltd.	1,92,000
ii. Expected Equity dividend from P Ltd. $\left(\frac{\text{₹ } 2,88,000}{\text{₹ } 24,00,000} \times \text{₹ } 7,20,000\right)$	86,400
iii. Loss in income	1,05,600
iv. Value of 8% Preference Shares to be issued (1,05,600 ÷ 8%)	**13,20,000**

C. Total Purchase Consideration

[5,50,000 + 28,80,000 + 13,20,000] ₹ 47,50,000

WN # 1 : *Computation of EPS*

(₹)

Particulars	***P Ltd.***	***R Ltd***
Profit before tax (PBT)	10,64,000	4,80,000
Less : Tax (given)	(4,00,000)	(2,00,000)
Profit after tax (PAT)	6,64,000	2,80,000
Less : Preference dividend	(64,000)	(40,000)
Profit available to equity shareholders	6,00,000	2,40,000
Earnings per share (Profit for Equity Shareholders ÷ No of Shares)	25	20

WN # 2 : P/E ratio of R Ltd.

P/E ratio = $\frac{\text{Market Price}}{\text{EPS}} = \frac{400}{25}$ = ₹ 16

75% of P/E ratio = (16×0.75) = ₹ 12

WN # 3 : Value per share of P Ltd.

= EPS × P/E ratio

= ₹ 20 × ₹ 12

= ₹ 240

WN # 4 : *Adjustment with Reserves*

Total Purchase Consideration paid to R Ltd.	47,50,000
Less : Share Capital of R Ltd.	16,00,000
(Equity + Preference) (₹ 12,00,000 + ₹ 4,00,000)	
To be adjusted with Reserves	31,50,000

∴ Reserves = 30,00,000 + 24,00,000 – 31,50,000 = 22,50,000

Name of the Company: P Ltd.					
Balance Sheet as at 31st March, 2015					
Ref No.		**Particulars**	**Note No.**	**After absorption**	**Befor absorption**
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	57,90,000	
		(b) Reserves and surplus	2	44,10,000	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a)Other current liabilities	3	27,60,000	
		Total		1,29,60,000	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	83,60,000	
	2	**Current assets**			
		(a) Other current assets	5	46,00,000	
		Total		1,29,60,000	

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

(₹)

Note 1. Share Capital	After absorption	Before absorption
Equity Share Capital (share of ₹100 each)(24,000+7,200 Eq. Shares) 8% Preference Share capital (in share of ₹100 each) (8,000+5,500+13,200 = 26,700 shares)	31,20,000 26,70,000	
Total	57,90,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	After absorption		Before absorption	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	24,000	24,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	7,200	7,20,000	NIL	NIL
	31,200	31,20,000	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	31,200	31,20,000	NIL	NIL

FOR 8% PREFERENCE SHARE :-	After absorption		Before absorption	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	8,000	8,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	18,700	18,70,000	NIL	NIL
	26,700	26,70,000	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	26,700	26,70,000	NIL	NIL

Note 2. Reserves and Surplus	After absorption	Before absorption
Reserves	22,50,000	
Securities Premium	21,60,000	
Total	44,10,000	

Note 3. Other Current Liabilities	After absorption	Before absorption
Current Liabilities (18,00,000+10,00,000-40,000)	27,60,000	
Total	27,60,000	

Note 4. Tangible Assets	After absorption	Before absorption
Fixed Assets	55,00,000	
Add: R Ltd.(27,00,000+1,60,000)	28,60,000	
Total	83,60,000	

(It is assumed that all fixed assets are tangible fixed assets)

Note 5. Other Current assets	After absorption	Before absorption
Current Liabilities (25,00,000+23,00,000-2,00,000)	46,00,000	
Total	46,00,000	

II Basics of Amalgamation and Absorption

Illustration 4.

A Ltd. and B Ltd. amalgamated on and from 31st March, 2015. A new Company C Ltd. was formed to take over the businesses of the existing companies.

Balance Sheet as on 31.03.2015 (Extract)

₹ in '000

Liabilities	*A Ltd.*	*B Ltd.*	*Assets*	*A Ltd.*	*B Ltd.*
Equity Shares of ₹ 100 each	60,000	70,000	Sundry Fixed Assets	85,000	75,000
General reserve	15,000	20,000	Investments	10,500	5,500
Profit and Loss A/c	10,000	5,000	Stock	12,500	27,500
Investment allowance			Debtors	18,000	40,000
Reserve	5,000	1,000	Cash and Bank	4,500	4,000
Export profit reserve	500	1,000			
12% Debentures	30,000	40,000			
Sundry creditors	10,000	15,000			
	1,30,500	**1,52,000**		**1,30,500**	**1,52,000**

C Ltd. issued requisite number of equity shares to discharge the claims of the equity shareholders of the transferor companies; The total shares issued as consideration is to be aggregate of paid up capital of A Ltd. and B Ltd.

Compute the Purchase Consideration and mode of discharge thereof and draft the Balance Sheet of C Ltd. after amalgamation on the following assumptions.

a. Amalgamation in the nature of MERGER

b. Amalgamation in the nature of PURCHASE

Solution:

i. Amalgamation in the nature of MERGER

- Nature of Amalgamation → MERGER
- Method of Accounting → POOLING OF INTEREST METHOD

ii. Computation of Purchase Consideration

(₹ in '000)

Particulars	A Ltd.		B Ltd.	
A. Assets				
i. Sundry Fixed assets	85,000		75,000	
ii. Investments	10,500		5,500	
iii. Stock	12,500		27,500	
iv. Debtors	18,000		40,000	
v. Cash and Bank	4,500		4,000	
		1,30,500		1,52,000
B. Liabilities				
i. 12% Debentures	30,000		40,000	
ii. Sundry creditors	10,000		5,000	
		(40,000)		(55,000)
C. NET ASSETS taken over [A-B]		**90,500**		**97,000**

Journal Entries in the Books of C Ltd. (in the case of Amalgamation in the nature of Merger)

Purchase consideration for amalgamation in the nature of merger.

Total consideration payable = Aggregate of paid-up capital of A Ltd. and B Ltd.
= ₹ 60,000 + ₹ 70,000
= ₹ 1,30,000

Total net assets taken over = ₹ 90,500 + ₹ 97,000
= ₹ 1,87,500

The total consideration payable to A Ltd. and B Ltd. is apportioned based on the net assets of the companies.

A Ltd. : $₹\ 1{,}30{,}000 \times \frac{90{,}500}{1{,}87{,}500} = ₹\ 62{,}750$

B Ltd. : $₹\ 1{,}30{,}000 \times \frac{97{,}000}{1{,}87{,}500} = ₹\ 67{,}250$

(₹ in '000)

Particulars		Debit	Credit
I. Take over a A Ltd:	Dr.	62,750	62,750
a. For Business Purchase			
Business Purchase A/c			
b. For Assets and Liabilities taken over:			
i. Purchase consideration paid - 62,750			
ii. Less: Paid up Share capital - 60,000			
iii. Excess consideration paid - 2,750			
As per AS-14 consideration will be adjusted against for reserves of A Ltd.			
The General reserves of A Ltd. to be incorporated = ₹ 15,000 - ₹ 2,750 = ₹ 12,250			
Sundry Fixed Assets A/c	Dr.	85,000	
Investments A/c	Dr.	10,500	
Stock A/c	Dr.	12,500	
Debtors A/c	Dr.	18,000	
Cash and Bank A/c	Dr.	4,500	
To General Reserve A/c			12,250
To Profit and Loss A/c			10,000
To Investment Allowance Reserve A/c			5,000
To Export Profit Reserve A/c			500
To 12% Debentures A/c			30,000
To Sundry creditors A/c			10,000
To Business Purchase A/c			62,700
c. For Discharge of Purchase Consideration :			
Liquidator of A Ltd. A/c	Dr.	62,750	
To Equity Share Capital A/c			62,750

Particulars		Debit	Credit
II. Take over a B Ltd:			
a. For Business Purchase			
Business Purchase A/c	Dr.	62,750	
To Liquidator of B Ltd. A/c			62,750
b. For Assets and Liabilities taken over:			
i. Purchase consideration paid - 62,750			
ii. Less: Paid up Share capital - 60,000			
iii. Excess consideration paid - 2,750			
The above short payment is to be credited to "Capital Reserve A/c" as per ICAI - Expert Advisory Committee Opinion on AS-14			
Sundry Fixed Assets A/c	Dr.	75,000	
Investments A/c	Dr.	5,500	
Stock A/c	Dr.	27,500	
Debtors A/c	Dr.	40,000	
Cash and Bank A/c	Dr.	4,000	
To General Reserve A/c			20,000
To Profit and Loss A/c			5,000
To Investment Allowance Reserve A/c			1,000
To Export Profit Reserve A/c			1,000
To 12% Debentures A/c			40,000
To Sundry creditors A/c			15,000
To Business Purchase A/c			67,250
To Capital Reserve A/c			2,750
c. For Discharge of Purchase Consideration :			
Liquidator of A Ltd. A/c	Dr.	67,250	
To Equity Share Capital A/c			67,250

Name of the Company: C Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**After Amalgamation**	**Before Amalgamation**
				(₹ in '000)	**(₹ in '000)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	1,30,000	
		(b) Reserves and surplus	2	57,500	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	70,000	
	4	**Current Liabilities**			
		(a) Trade payables	4	25,000	
		Total		2,82,500	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	1,60,000	
		(b) Non-current investments	6	16,000	
	2	**Current assets**			
		(a) Inventories	7	40,000	
		(b) Trade receivables	8	58,000	
		(c) Cash and cash equivalents	9	8,500	
		Total		2,82,500	

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

(₹ in '000)

Note 1. Share Capital	**After Amalgamation**	**Before Amalgamation**
Equity Share Capital (share of ₹100 each)(60,000+70,000)	1,30,000	
Total	1,30,000	

RECONCILATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**After Amalgamation**		**Before Amalgamation**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on			NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	13,000	1,30,000	NIL	NIL
	13000	13000	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	13000	13000	NIL	NIL

Note 2. Reserves and Surplus	After Amalgamation	Before Amalgamation
Capital Reserves	2,750	
Gerneral Reserves (12,250+20,000)	32,250	
Profit and Loss A/C (10,000+5,000)	15,000	
Investment Allowance Reserve (5,000+1,000)	6,000	
Export Profit Reserve (500+1,000)	1,500	
Total	57,500	

Note 3. Long-term borrowings	After Amalgamation	Before Amalgamation
12% Debentures(30,000+40,000)	70,000	
Total	70,000	

Note 4. Trade payables	After Amalgamation	Before Amalgamation
Sundry Creditors (10,000+15,000)	25,000	
Total	25,000	

Note 5. Tangible Assets	After Amalgamation	Before Amalgamation
Sundry Fixed assets (85,000+75,000)	1,60,000	
Total	1,60,000	

Note 6. Non current Investments	After Amalgamation	Before Amalgamation
Investments (10,500+5,500)	16,000	
Total	16,000	

Note 7. Inventories	After Amalgamation	Before Amalgamation
Stock (12,500+27,500)	40,000	
Total	40,000	

Note 8. Trade Receivables	After Amalgamation	Before Amalgamation
Debtors (18,000+40,000)	58,000	
Total	58,000	

Note 9. Cash and Cash equivalents	After Amalgamation	Before Amalgamation
Cash and Bank	8,500	
Total	8,500	

Journal Entries in the Books of C Ltd. (in the case of Amalgamation in the nature of Purchase)

In the case of Amalgamation in the nature of purchase consideration will be paid on the bais of "Net Assets" and hence the purchase consideration is for A - ₹ 90,500 and for B - ₹ 97,000.

Particulars		Debit	Credit
I. Take over a A Ltd:			
a. For Business Purchase			
Business Purchase A/c	Dr.	90,500	
To Liquidator of B Ltd. A/c			90,500
b. For Assets and Liabilities taken over:			
Sundry Fixed Assets A/c	Dr.	85,000	
Investments A/c	Dr.	10,500	
Stock A/c	Dr.	12,500	
Debtors A/c	Dr.	18,000	
Cash and Bank A/c	Dr.	4,500	
To Business Purchase A/c			90,500
To 12% Debentures A/c			30,000
To Sundry Creditors A/c			10,000
c. For Discharge of Purchase Consideration :			
Liquidator of A Ltd. A/c	Dr.	90,500	
To Equity Share Capital A/c			90,500
II. Take over a B Ltd:			
a. For Business Purchase			
Business Purchase A/c	Dr.	97,000	
To Liquidator of B Ltd. A/c			97,000
b. For Assets and Liabilities taken over:			
Sundry Fixed Assets A/c	Dr.	75,000	
Investments A/c	Dr.	5,500	
Stock A/c	Dr.	27,500	
Debtors A/c	Dr.	40,000	
Cash and Bank A/c	Dr.	4,000	
To Business Purchase A/c			97,000
To 12% Debentures A/c			40,000
To Sundry Creditors A/c			15,000
c. For Discharge of Purchase Consideration :			
Liquidator of A Ltd. A/c	Dr.	97,000	
To Equity Share Capital A/c			97,000

Note: Assumed that new debetures were issued in exchange of the old debentures.

Amalgamation Adjustment A/c	Dr.	7,500	
To Statutory Reserve A/c			7,500

Note: The "Amalgamation Adjustment A/c" should be disclosed as a part of "Miscellaneous Expenditure" to the extent not written off or other similar category in the Balance Sheet of the TRANSFEREE Company.

Name of the Company: C Ltd.					
Balance Sheet as at 01.04.2015					
Ref No.		**Particulars**	**Note No.**	**As at 1st April, 2015**	**As at 31st March, 2015**
				(₹ in '000)	**(₹ in '000)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	1,87,500	
		(b) Reserves and surplus	2	7,500	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	70,000	
	4	**Current Liabilities**			
		(a) Trade payables	4	25,000	
		Total		2,90,000	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	1,60,000	
		(b) Non-current investments	6	16,000	
		(c) Other non-current assets	7	7,500	
	2	**Current assets**			
		(a) Inventories	8	40,000	
		(b) Trade receivables	9	58,000	
		(c) Cash and cash equivalents	10	8,500	
		Total		2,90,000	

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

(₹ in '000)

Note 1. Share Capital	**As at 1st April, 2015**	**As at 31st March, 2015**
Equity Share Capital (share of ₹100 each)(90,500+97,000)	1,87,500	
Total	1,87,500	

RECONCILATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 1st April, 2015**		**As at 31st March, 2015**	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.15			NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	18,750	187,500	NIL	NIL
	18750	1,87,500	NIL	NIL
Less: Buy Back of shares	-		-	-
	18750	1,87,500	NIL	NIL

Note 2. Reserves and Surplus	As at 1st April, 2015	As at 31st March, 2015
Investment Allowance Reserve (5,000+1,000)	6,000	
Export Profit Reserve (500+1,000)	1,500	
Total	7,500	

Note 3. Long-term borrowings	As at 1st April, 2015	As at 31st March, 2015
12% Debentures(30,000+40,000)	70,000	
Total	70,000	

Note 4. Trade payables	As at 1st April, 2015	As at 31st March, 2015
Sundry Creditors (10,000+15,000)	25,000	
Total	25,000	

Note 5. Tangible Assets	As at 1st April, 2015	As at 31st March, 2015
Sundry Fixed assets (85,000+75,000)	1,60,000	
Total	1,60,000	

Note 6. Non current Investments	As at 1st April, 2015	As at 31st March, 2015
Investments (10,500+5,500)	16,000	
Total	16,000	

Note 7. Other noncurrent assets	As at 1st April, 2015	As at 31st March, 2015
Amalgamation adjustment A/c	7,500	
Total	7,500	
Note 8. Inventories	**As at 1st April, 2015**	**As at 31st March, 2015**
Stock (12,500+27,500)	40,000	
Total	40,000	

Note 9.Trade Receivables	As at 1st April, 2015	As at 31st March, 2015
Debtors (18,000+40,000)	58,000	
Total	58,000	

Note 10. Cash and Cash equivalents	As at 1st April, 2015	As at 31st March, 2015
Cash and Bank	8,500	
Total	8,500	

Illustration 5.

A Ltd. and B Ltd. were amalgamation on and from 31st March, 2015. A new company X Ltd. was formed to take over the business of the existing companies. The summarised Balance sheet of A Ltd and B Ltd as on 31st March, 2015 are given below:

(₹ in Lakhs)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share capital:			Fixed assets:		
Equity Shares of ₹ 100/- each	850	725	Land and Building	460	275
			Plant and Machinery	325	210
10% Preference Share of			Investments	75	50
₹ 100 each	320	175	Current Asset and		
Reserves and surplus:			Loans and Advances:		
Revaluation Reserve	125	80	Stock	325	269
General reserve	240	160	Sundry Debtors	305	270
Investment Allowance	50	30	Bills receivable	25	—
Reserve			Cash and Bank	385	251
Profit and Loss Account	75	52			
Secured Loans:					
13% Debentures (₹100 each)	50	28			
Unsecured Loan:					
Public Deposits	25	—			
Current liabilities and					
Provision:					
Sundry creditors	145	75			
Bills Payable	20	—			
	1,900	**1,325**		**1,900**	**1,325**

Other Information:

i. 13% debentures of A Ltd and B Ltd are discharged by X Ltd. by issuing such number of its 15% debentures of ₹ 100 each so as to maintain the same amount to interest.

ii. Preference shareholders of the two companies are issued equivalent number of 15% preference shares of X Ltd. at a price of ₹ 125 per share (face value ₹ 100)

iii. X Ltd. will issue 4 equity shares for each equity share of A Ltd. and 3 equity shares for each equity share of B Ltd. The shares are to be issued @ ₹ 35 each, having a face value of ₹10 per share.

iv. Investment allowance reserve is to be maintained for two more years.

Prepare the Balance sheet of X Ltd. as on 31st March, 2015 after the amalgamation.

Note : Unsecured Loans in assumed to be of less than 12 months hence treated on short term borrowings ignoring interest.

Solution:

Method 1: Amalgamation in the Nature of Merger

WN # 1 : ***Calculation of Purchase Consideration***

	Particulars	***A Ltd.***	***B Ltd.***
a.	Equity Shares:		
	i. No. of Shares outstanding	8.50	7.25
	ii. Exchange Ratio	4:1	3:1
	iii. No. of Shares to be issued	34	21.75
	iv. Issue price per share (₹)	35	35
	v. Purchase Consideration	1,190	761.25
	• Share capital	340	217.50
	• Securities Premium	850	543.75
b.	Preference Shares:		
	i. No. of Shares outstanding	3.2	1.75
	ii. Exchange Ratio	1:1	1:1
	iii. No. of Shares to be issued	3.2	1.75
	iv. Issue price per share (₹)	125	125
	v. Purchase Consideration	400	218.75
	• Share capital	320	175.00
	• Securities Premium	80	43.75
c.	Total Considertion {a(iv) + b(iv)}	1,590	980.00
			₹ 2,570 Lakhs

WN # 2 : ***Computation of Debenture to be issued***

Particulars	***A Ltd.***	***B Ltd.***
a. Value of 13% Debentures takes over	50,00,000	28,00,000
b. 13% Interest on above value	6,50,000	3,64,000
c. 15% Debentures to be issued to keep same interest amount	43,33,333.33 $\left[6,50,000 \times \frac{100}{15}\right]$	24,26,666.66 $\left[3,64,000 \times \frac{100}{15}\right]$
d. Total amont of debenture issued		₹ 67,60,000

Note: Normally fractions of Debentures is settled in Cash.

Ref No.		Particulars	Note No.	As at 31st March, 2015
Name of the Company: X Ltd. (after amalgamation)				
Balance Sheet as at 31.03.2015				
				(₹ in lakhs)
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	1,052.50
		(b) Reserves and surplus	2	1,839.90
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	67.60
	4	**Current Liabilities**		
		(a) Short-term borrowings	4	25.00
		(b) Trade payables	5	220.00
		(c) Other current liabilities	6	20.00
		Total		**3,225.00**
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	7	1,270.00
		(b) Non-current investments	8	125.00
	2	**Current assets**		
		(a) Inventories	9	594.00
		(b) Trade receivables	10	575.00
		(c) Cash and cash equivalents	11	636.00
		(d) Other current assets	12	25.00
		Total		**3,225.00**

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

Note 1. Share Capital Authorised Issued and subscribed Capital	**As at 31st March, 2015**
Equity Share share of ₹100 each(340+217.5)[out of the above all the shares were issued for consideration other than cash]	557.50
15% Preference Share of ₹100 each (320+175) [out of the above all the shares were issued for consideration other than cash]	495.00
Total	1,052.50

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	As at 31st March, 2015	
	Nos	Amount (₹)
Opening Balance as on 01.04.14		
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash) (34+21.75)	55.75	557.50
	55.75	557.50
Less: Buy Back of shares	-	-
	55.75	557.50

RECONCILATION OF SHARE CAPITAL

FOR 15% PREFERENCE SHARE :-	As at 31st March, 2015	
	Nos	Amount (₹)
Opening Balance as on 01.04.14	-	-
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash) (3.2+1.75)	4.95	495
	4.95	495
Less: Buy Back of shares	-	-
	4.95	495

Note 2. Reserves and Surplus	As at 31st March, 2015
Securities Premium (850+543.75+80+43.75)	1,517.50
Profit and Loss A/c (WN # 3)	37.40
Revaluation Reserve	205.00
Investment Allowance Reserve	80.00
Total	1,839.90

Note 3. Long-term borrowings	As at 31st March, 2015
15% Debentures(₹100 each)(WN#2)	67.60
Total	67.60

Note 4. Short-term borrowings	As at 31st March, 2015
Unsecured Loan:	
Public Deposits	25.00
Total	25.00

Note 5. Trade payables	As at 31st March, 2015
Sundry Creditors	220.00
Total	220.00

Note 6. Other Current Liabilities	As at 31st March, 2015
Particulars	Amount (₹)
Bills Payable	20.00
Total	20.00

Note 7. Tangible Assets	As at 31st March, 2015
Land and Biuldings(460+275) Plant and Machinery(325+210)	735.00 535.00
Total	1270.00

Note 8. Non current Investments	As at 31st March, 2015
Investment (75+50)	125.00
Total	125.00

Note 9. Inventories	As at 31st March, 2015
Stock (325+269)	594.00
Total	594.00

Note 10. Trade Receivables	As at 31st March, 2015
Sundry Debtors(305+270)	575.00
Total	575.00

Note 11. Cash and Cash Equivalents	As at 31st March, 2015
Cash and Bank(385+215)	636.00
Total	636.00

Note 12. Other Current assets	As at 31st March, 2015
Bills Receivable	25.00
Total	25.00

WN # 3: ***Calculation of reserves to be incorporated in Balance Sheet.*** (₹ in Lakhs)

Particulars	*A Ltd.*	*B Ltd.*
a. Aggregated Purchase Consideration		2,570
b. Aggregate paid-up capial		
i. Equity Share capital	1,575	
ii. Preference Share capital	495	2,070
c. Excess		500
d. The above excess to be adjusted against :		
i. General reserves	400	
ii. P and L Account	100	500
e. Balance of Reserves available		
i. Profit and Loss A/c	27	
ii. Investment allowance reserve	80	
iii. Revaluation reserve	205	312
f. Settlement to debenture holders		
i. Debenure capital of transferee companies	78.00	
ii. Less : Amount of X Ltd.'s debenture issued	(67.60)	
iii. Profit to be credited to Profit and Loss A/c		10.40
g. Balance of reserves to be incorporated		
i. P and L Account		37.40
ii. Investment allowance reserve		80.00
iii. Revaluation reserve		205.00

Method 2: Amalgamation in the Nature of Purchase

Name of the Company: X Ltd. (after amalgamation)

Balance Sheet as at 31.03.2015

Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**
				(₹ in Lakhs)
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	1,052.50
		(b) Reserves and surplus	2	1,919.90
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	67.60
	4	**Current Liabilities**		
		(a) Short-term borrowings	4	25.00
		(b) Trade payables	5	220.00
		(c) Other current liabilities	6	20.00
		Total		3,305.00
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	7	1,270.00
		(b) Non-current investments	8	125.00

		(c) Other non-current assets	9	80.00
	2	**Current assets**		
		(a) Inventories	10	594.00
		(b) Trade receivables	11	575.00
		(c) Cash and cash equivalents	12	636.00
		(d) Other current assets	13	25.00
		Total		3,305.00

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

(₹ in Lakhs)

Note 1. Share Capital **Authorised Issued and subscribed Capital**	**As at 31st March, 2015**
Equity Share share of ₹100 each(340+217.5)[out of the above all the shares were issued for consideration other than cash]	557.50
15% Preference Share of ₹100 each (320+175) [out of the above all the shares were issued for consideration other than cash]	495.00
Total	1,052.50

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.14 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash) (34+21.75)	55.75	557.50
	55.75	557.50
Less: Buy Back of shares	-	-
	55.75	557.50

FOR 15% PREFERENCE SHARE :-	**As at 31st March, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.14 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash) (3.2 + 1.75)	4.95	495.00
	4.95	495.00
Less: Buy Back of shares	-	-
	4.95	495 .00

Note 2. Reserve & Surplus	As at 31st March, 2015
Secirotіes Premium (WN#1)	1517.50
Capital Reserve (312 + 10.40)	322.40
Investment allowance	80.00
Total	1919.90

Note 3. Long-term borrowings	As at 31st March, 2015
15% Debentures(₹100 each)(WN#2)	67.60
Total	67.60

Note 4. Short-term borrowings	As at 31st March, 2015
Unsecured Loan: Public Deposits	25.00
Total	25.00

Note 5. Trade payables	As at 31st March, 2015
Sundry Creditors	220.00
Total	220.00

Note 6. Other Current Liabilities	As at 31st March, 2015
Bills Payable	20.00
Total	20.00

Note 7. Tangible Assets	As at 31st March, 2015
Land and Biuldings(460+275) Plant and Machinery(325+210)	735.00 535.00
Total	1270.00

Note 8. Non current Investments	As at 31st March, 2015
Investment (75+50)	125.00
Total	125.00

Note 9. Other non current Assets	As at 31st March, 2015
Amalgamation Adjustment A/c	80.00
Total	80.00

Note 10. Inventories	As at 31st March, 2015
Stock (325+269)	594.00
Total	594.00

Note 11. Trade Receivables	As at 31st March, 2015
Sundry Debtors(305+270)	575.00
Total	575.00

12. Cash and Cash Equivalents	As at 31st March, 2015
Cash and Bank(385+215)	636.00
Total	636.00

13. Other Current assets	As at 31st March, 2015
Bills Receivable	25.00
Total	25.00

Illustration 6.

A Limited and B Limited were amalgamated on and from 31st March, 2015. A new company D Limited was formed to takeover the business of the existing companies. The summarised Balance Sheet of A Limited and B Limited (before merger) as on 31st March, 2015 are given below:

(₹ in Lakhs)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share capital:			Fixed assets	1,200	1,000
Equity Shares of	1,000	800	Current assets,		
₹100 each			Loans and Advances	880	565
15% Preference Share	400	300			
Capital of ₹ 100 each					
Reserve and Surplus:					
Revaluation Reserve	100	80			
General Reserve	200	150			
P & L Account	80	60			
Secured Loan:					
12% Debentures of					
₹ 100 each	96	80			
Current Liabilities					
and Provisions	204	95			
	2,080	**1,565**		**2,080**	**1,565**

Other Information :

1. 12% Debenture holders of A Ltd. and B Ltd. are discharged by D Limited by issuing adequate number of 16% Debentures of ₹ 100 each to ensure that they continue to receive the same amount of interest.
2. Preference shareholders of A Ltd. and B Ltd. have received same number of 15% Preference share of ₹ 100 each of D Limited.
3. D Ltd. has issued 1.5 equity shares for each equity share of A Ltd. and 1 equity share each equity share of B Ltd. The face value of shares issued by D Ltd. is ₹ 100 each.

Required:

Prepare the Balance sheet of D Ltd. as on 31st March, 2015 after the amalgamation has been carried out using pooling of interest method.

Solution:

WN # 1 : *Calculation of purchase consideration:*

	Purchase consideration	***A Ltd.***	***B Ltd.***
i.	No. of equity shares	10,00,000	8,00,000
	Exchange Ratio	1:1.5	1:1
	No. of equity shares to be issued	15,00,000	8,00,000
	Equity Shares capital	₹ 1,500 Lakhs	₹ 800 Lakhs
ii.	No. of preference shares	4,00,000	3,00,000
	Exchange Ratio	1:1	1:1
	No. of preference share to be issued	4,00,000	3,00,000
	Preference Share Capital	₹ 400 Lakhs	₹ 300 Lakhs

Journal Entries in the books of D Ltd.

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest

Particulars		A Ltd.		B Ltd.	
		Debit ₹	Credit ₹	Debit ₹	Credit ₹
a. For Business Purchase					
Business Purchase A/c	Dr.	1,900		1,100	
To Liquidator of Selling Co. A/c			1,900		1,100
b. Incorporation of Assets and Liabilities taken over:					
Fixed Assets A/c	Dr.	1,200		1,000	
Current Assets A/c	Dr.	880		565	
Profit and Loss A/c	Dr.	220			
To Current Liabilities A/c			204		95
To 12% Debentures A/c			96		80
To Revaluation Reserve A/c	WN # 2		100		80
To General Reserve A/c			—		150
To Profit and Loss A/c			—		60
To Business Purchase A/c			1,900		1,100
c. Discharge of Purchase Consideration					
Liquidator of Selling Co. A/c	Dr.	1,900		1,100	
To Equity Share Capital A/c			1,500		800
To Preference Share Capital A/c			400		300
d. Discharge of Debentures:					
12% Debentures A/c	Dr.	96		80	
To 16% Debentures A/c			72		60
To Profit & Loss A/c (WN # 3)			24		20

WN # 2 : *Reserves to be incorporated on the Amalgamation:*

(₹ in Lakhs)

	Particulars		*A Ltd.* ₹	*B Ltd.* ₹
(i)	Purchase consideration payable		1,900	1,100
(ii)	Total paid up Share capital			
	(a) Equity Share capital	1,000		
	(b) Preference Share capital	400	1,400	1,100
(iii)	Excess purchase consideration		500	Nil
(iv)	Adjustment against reserves of transferee company:			
	(a) General reserve		(200)	
	(b) Profit & Loss A/c Balance		(80)	
	(c) Profit & Loss A/c debit balance		(220)	
(v)	Reserves of transferor company to be incorporated			
	(a) Revaluation Reserve		100	80
	(b) General Reserve		—	150
	(c) Profit & Loss A/c		—	60

WN # 3 : *Settlement of Debentures:*

(in Lakhs)

	Particulars	*A Ltd.* ₹	*B Ltd.* ₹
(i)	Value of 12% Debentures	96	80
(ii)	Interest Payable	11.52	9.6
(iii)	16% Debentures to be issued	72	60
	$\frac{11.52}{16} \times 100$ $\frac{9.6}{16} \times 100$		
(iv)	Amount to be credited to Profit & Loss A/c (i)-(iii)	24	20

Name of the Company: D Ltd.				
Balance Sheet as at 31.03.2015				
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**
				(₹ in lakhs)
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	3,000
		(b) Reserves and surplus	2	214
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	132
	4	**Current Liabilities**		
		(a) Other current liabilities	4	299
		(b) Short-term provisions		
		Total		3,645
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	5	2,200
	2	**Current assets**		
		(a) Short-term loans and advances	6	1,445
		Total		3,645

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

(₹ in Lakhs)

Note 1. Share Capital	**As at 31st March, 2015**
Equity Share share of ₹ 100 each	2,300
15% Preference Share of ₹ 100 each	700
Total	3,000

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.14 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	23	2,300.00
	23	2,300.00
Less: Buy Back of shares		-
	23	2,300.00

RECONCILATION OF SHARE CAPITAL		
FOR PREFERENCE SHARE :-	**As at 31st March, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.14 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	7	700.00
	7	700.00
Less: Buy Back of shares		-
	7	700.00

Note 2. Reserves and Surplus	**As at 31st March, 2015**
General Reserve	150
Profit and Loss A/c (60+24+20 – 220)	(116)
Revaluation Reserve	180
Total	214

Note 3. Long-term borrowings	**As at 31st March, 2015**
16% Debentures(₹100 each)(72+60)	132
Total	132

Note 4. Other Current Liabilities	**As at 31st March, 2015**
Current Liabilities and Provisions (2004+95)	299
Total	299

Note 5. Tangible Assets	**As at 31st March, 2015**
Fixed assets (1,200+1,000)	2,200
Total	2,200

Note 6. Short-term Loans and Advances	**As at 31st March, 2015**
Current assets, Loans and Advances (880+565)	1,445
Total	1,445

Illustration 7.

D Ltd. and F Ltd. were amalgamated on and from 1st April, 2015. A new Company P Ltd. was formed to takeover the business of the existing companies. The Balance Sheets of D Ltd. and F Ltd. as on 31st March, 2015 are given below: (₹)

Liabilities	D Ltd.	F Ltd.	Assets	D Ltd.	F Ltd.
Share capital			**Fixed assets:**		
Equity Shar of ₹ 10 each	85,000	72,500	Land and Building	79,500	43,300
9% Preference	32,000	17,500	Investments	7,500	5,000
Shares of ₹ 10 each			**Current assets:**		
Reserve and Surplus:			Stock	32,500	26,900
Revaluation Reserve	12,500	8,000	Debtors	30,500	27,000
General Reserve	24,000	16,000	Bills Receivable	2,500	—
Export Profit Reserve	7,500	3,000	Cash and Bank	30,000	25,100
Secured Loan:					
13% Debentures of	5,000	2,800			
₹ 100 each					
Current liabilities					
and Provisions					
Bills Payable	2,000	–			
Sundry creditors	14,500	7,500			
	1,82,500	**1,27,300**		**1,82,500**	**1,27,300**

Other informations:

1. 13% Debenture holders of D Ltd. and F Ltd. are discharged by P Ltd. by 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 of 12% Preference Shares of P Ltd. at a price of ₹ 12.50 per share (face value ₹10).
3. P Ltd. will issue 2 equity shares for each equity share of D Ltd. and 2 equity shares for each equity share of F Ltd. at ₹ 15 per share having a face value ₹ 10.
4. Export Profit Reserve is to be maintained for two more years.

Prepare Journal Entries and prepare the Balance Sheet of P Ltd. after the amalgamation is carried out using under Merger Method.

Solution:

WN # 1 : ***Calculation of Purchase Consideration***

Particulars	***D Ltd.*** ₹	**F Ltd.** ₹
a. In Preference shares:		
i. No. of Preference shares outstanding	3,200	1,750
ii. Exchange ratio	1:1	1:1
iii. No. of shares to be issued	3,200	1,750
iv. Issue Price	₹ 12.5	₹ 12.5
v. Value of Shares to be issued	₹ 40,000	₹ 21,875
b. In Equity shares:		
i. No. of Equity shares outstanding	8,500	7,250
ii. Exchange ratio	2:1	2:1
iii. No. of shares to be issued	17,000	14,500
iv. Issue Price	₹ 15	₹ 15
v. Value of Shares to be issued	₹ 2,55,000	₹ 2,17,500
c. Total Purchase Consideration (a+b)	**₹ 2,95,000**	**₹ 2,39,375**

In the books of P Ltd.

1. Amalgamation of D Ltd.

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest

(₹)

Particulars			***Debit***	***Credit***
a. For Busines Purchase				
Business Purchase A/c		Dr.	2,95,000	
To Liquidator of D Ltd.				2,95,000
b. Incorporated of assets and liabilities				
Consideration	2,95,000			
Less: Paid up share capital	(1,17,000)			
Amount to be adjusted against reserves	1,78,000			
Less : General reserve	(24,000)			
Profit and Loss balance (Dr.)	1,54,000			
Land and Building A/c		Dr.	79,500	
Investments A/c		Dr.	7,500	

	Stock A/c	Dr.	32,500	
	Debtors A/c	Dr.	30,500	
	Bill Receivable A/c	Dr.	2,500	
	Profit and Loss A/c	Dr.	1,54,000	
	Cash and bank A/c	Dr.	30,000	
	To Revaluation Reserve A/c			12,500
	To Bills Payable A/c			2,000
	To Sundry Creditors A/c			14,500
	To Debenture A/c			5,000
	To Business Purchase A/c			2,95,000
	To Export Profit Reserve A/c			7,500
c.	For Discharge of Consideration			
	Liquidator of D Ltd. A/c	Dr.	2,95,000	
	To Equity Share Capital A/c			1,70,000
	To Preference Share Capital A/c			32,000
	To Securities Premium A/c			93,000

*Note: Securities Premium includes both Equity & Preference shares Premium

II. Amalgamation of F Ltd.

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest

Particulars				**Debit** ₹	**Credit** ₹
a.	For Business Purchase:				
	Business Purchase A/c		Dr.	2,39,375	
	To Liquidator of F Ltd.				2,39,375
b.	For of Assets and Liabilities taken over:				
	Amount of Reserves to be incorporated.				
	Consideration	2,39,375			
	Less: Paid up Share capital	(90,000)			
	Amount to be adjusted against Reserves	1,49,375			
	Less : General Reserve	(16,000)			
	Profit and Loss Balance (Dr.)	1,33,375			

	Land and Building A/c	Dr.	43,300	
	Investments A/c	Dr.	5,000	
	Stock A/c	Dr.	26,900	
	Debtors A/c	Dr.	27,000	
	Cash and Bank A/c	Dr.	25,100	
	Profit and Loss A/c	Dr.	1,33,375	
	To Revaluation Reserve A/c			8,000
	To Export Profit Reserve A/c			3,000
	To 13% Debentures A/c			2,800
	To Sundry Creditors A/c			7,500
	To Business Purchase A/c			2,39,375
c.	For Discharge of consideration			
	Liquidator of F Ltd. A/c	Dr.	2,39,375	
	To Equity Share Capital A/c			1,45,000
	To Preference Share Capital A/c			17,500
	To Securities Premium A/c			76,875

III. Others: (₹)

Particulars		***Debit***	***Credit***
For Discharge of Debenture Liability			
13% Debenture A/c	Dr.	7,800	
To 15% Debentures A/c			6,760
To Profit and Loss A/c			1,040

WN # 2 : Discharge of Debentures :

					₹
a.	13% Debenture Outstanding	=	5,000 + 2,800	=	7,800
b.	Interest Payable	=	650 + 364	=	1,014
c.	15% Debenture to be issued	=	4,333 + 2,427	=	6,760

$$\frac{650}{15\%} + \frac{364}{15\%}$$

d.	Amount to be credited to profit and loss account [(a)-(c)]	=	667 + 373		1,040

Note:

In "Amalgamation in the nature of Merger" all the assets and liabilities are to be taken at Book values. Change in the rate of interest will amount to violation of the above condition i.e. it is in the nature of purchase. But as the problem specifically require to solve "in the nature of merger", the problem is solved accordingly.

Name of the Company: P Ltd.				
Balance Sheet as at 01.04.2015				
Ref No.		**Particulars**	**Note No.**	**As at 1st April, 2015**
				₹
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	3,64,500
		(b) Reserves and surplus	2	(85,460)
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	6,760
	4	**Current Liabilities**		
		(a) Trade payables	4	22,000
		(b) Other current liabilities	5	2,000
		Total		3,09,800
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	6	1,22,800
		(b) Non-current investments		12,500
	2	**Current assets**		
		(a) Inventories		59,400
		(b) Trade receivables	7	57,500
		(c) Cash and cash equivalents	8	55,100
		(d) Other current assets	9	2,500
		Total		3,09,800

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

(₹)

Note 1. Share Capital	**As at 1st April, 2015**
Equity Shares of ₹10 each	315,000
9% Preference Shares of ₹10 each	49,500
Total	3,64,500

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 1st April, 2015**	
	Nos	**Amount** (₹)
Opening Balance as on 01.04.14 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	31,500	3,15,000
	31,500	3,15,000
Less: Buy Back of shares	-	-
	31,500	3,15,000

FOR 9% PREFERENCE SHARE :-	As at 1st April, 2015	
	Nos	Amount (₹)
Opening Balance as on 01.04.14 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	4,950	49,500
	4,950	49,500
Less: Buy Back of shares	-	-
	4,950	49,500

Note 2. Reserves and Surplus	As at 1st April, 2015
Securities Premium (85,000+72,500+8,000+4,375)	169,875
Revaluation Reserve	20,500
Export Profit Reserve (20,000+30,000)	10,500
Profit and Loss A/c (1,54,000+1,33,375-1,040)	(2,86,335)
Total	-85,460

Note 3. Long-term borrowings	As at 1st April, 2015
15% Debentures of ₹100 each	6,760
Total	6,760

Note 4. Trade Payables	As at 1st April, 2015
Sundry Creditors	22,000
Total	22,000

Note 5. Other Current Liabilities	As at 1st April, 2015
Bills Payables	2,000
Total	2,000

Note 6. Tangible Assets	As at 1st April, 2015
Land and Buildings	1,22,800
Total	1,22,800

Note 7. Trade Receivables	As at 1st April, 2015
Debtors	57,500
Total	57,500

Note 8. Cash and Cash Equivalents	As at 1st April, 2015
Cash and Bank	55,100
Total	55,100

Note 9. Other Current Assets	As at 1st April, 2015
Bills Receivable	2,500
Total	2,500

Illustration 8.

Given below Extract Balance Sheets of Ram Ltd and Rahim Ltd. as on 31.3.2015. Rahim Ltd. was merged with Ram Ltd. with effect from 31.03.2015.

Balance Sheets as on 31.3.2015 (Before merger)

(₹)

Liabilities	Ram Ltd.	Rahim Ltd.	Assets	Ram Ltd.	Rahim Ltd.
Share Capital :			Sundry Fixed Assets (Tangible)	9,50,000	4,00,000
Equity Shares of			Investments (Non-	2,00,000	50,000
₹ 10 each	7,00,000	2,50,000	trade)		
General Reserve	3,50,000	1,20,000	Stock	1,20,000	50,000
Profit and Loss A/c	2,10,000	65,000	Debtors	75,000	80,000
Export Profit Reserve	70,000	40,000	Advance Tax	80,000	20,000
12% Debentures	1,00,000	1,00,000	Cash and Bank	2,75,000	1,30,000
Sundry Creditors	40,000	45,000	balances		
Provision for Taxation	1,00,000	60,000	Preliminary Expenses	10,000	—
Proposed Dividend	1,40,000	50,000			
	17,10,000	**7,30,000**		**17,10,000**	**7,30,000**

Ram Ltd. would issue 12% Debentures to discharge the claims of the debenture holders of Rahim Ltd. at par. Non-trade investments of Ram Ltd. fetched @ 25% while those of Rahim Ltd. fetched @ 18%. Profit (pre-tax) by Ram Ltd and Rahim Ltd. during 2012-13, 2013-14 and 2014-15 and were as follows :

Year	Ram Ltd.	Rahim Ltd.
	₹	₹
2012-13	5,00,000	1,50,000
2013-14	6,50,000	2,10,000
2014-15	5,75,000	1,80,000

Goodwill may be calculated on the basis of capitalisation method taking 20% as the pretax normal rate of return. Purchase consideration is discharged by Ram Ltd. on the basis of intrinsic value per share. Both companies decided to cancel the proposed dividend.

Required Balance Sheet of Ram Ltd. after merger.

Solution:

WN # 1: Purchase Consideration:

(i)	Shares outstanding in Rahim Ltd.	25,000
(ii)	Intrinsic Value per Share of Rahim Ltd. [WN # 2]	₹ 36.20
(iii)	Value of Shares (a×b)	₹ 9,05,000
(iv)	Intrinsic value per share of Ram Ltd. [WN # 2]	₹ 40.40
(v)	No. of shares to be issued by Ram Ltd.	

₹ 9,05,000 / ₹ 40.40 = 22,400.99

Shares	Cash for fractions
22400	0.99 × 40.40 = 40

(vi) Purchase consideration

(a) 22400 shares @ 40.40

Capital [₹ 10 / Share]	2,24,000	
Premium [₹ 30.40 / Share]	6,80,960	= 9,04,960
(b) Cash for fractional shares		= 40
(c) Total purchase consideration payable		= 9,05,000

WH # 2 : *Intrinsic Value per share :*

(₹)

	Ram Ltd.		Rahim Ltd.	
(i) **Assets**				
(a) Goodwill	13,65,000		3,80,000	
(b) Sundry Fixed assets	9,50,000		4,00,000	
(c) Investments	2,00,000		50,000	
(d) Stock	1,20,000		50,000	
(e) Debtors	75,000		80,000	
(f) Advance Tax	80,000		20,000	
(g) Cash and Bank Balance	2,75,000	30,65,000	1,30,000	11,10,000
(ii) **Liabilities**				
(a) 12% Debentures	1,00,000		1,00,000	
(b) Sundry creditors	40,000		45,000	
(c) Provision for tax	1,00,000	(2,40,000)	60,000	(2,05,000)
(iii) Net Assets (i-ii)		28,25,000		9,05,000
(iv) No. of Outstanding Shares		70,000		25,000
(v) Intrinsic Value per share (iii)/(iv)		**40.40**		**36.20**

W # 3 : *Valuation of Goodwill*

A. Capital Employed (₹)

	Ram Ltd.		***Rahim Ltd.***	
(i) Assets :				
(a) Sundry Fixed assets	9,50,000		4,00,000	
(b) Investment (Non-trade)	-		-	
(c) Stock	1,20,000		50,000	
(d) Debtors	75,000		80,000	
(e) Advance tax	80,000		20,000	
(f) Cash and Bank balance	2,75,000	15,00,000	1,30,000	6,80,000
(ii) Liabilities:				
(a) 12% Debentures	1,00,000		1,00,000	
(b) Sundry creditors	40,000		45,000	
(c) Provision for tax	1,00,000	2,40,000	60,000	2,05,000
(iii) Capital Employed : (i) - (ii)		**12,60,000**		**4,75,000**

B. Average Pre-tax Profit :

	Particulars	***Ram Ltd.***	***Rahim Ltd.***
(i)	2012-13	5,00,000	1,50,000
(ii)	2013-14	6,50,000	2,10,000
(iii)	2014-15	5,75,000	1,80,000
(iv)	Total (a+b+c)	17,25,000	5,40,000
(v)	Simple Average [(iv)/3]	5,75,000	1,80,000
(vi)	Less: Non-trading income	(50,000)	(9,000)
(vii)	**Average pre-tax profit**	**5,25,000**	**1,71,000**

C. Computation of Goodwill :

	Particulars	***Ram Ltd.*** ₹	***Rahim Ltd.*** ₹
a.	Capitalised value of average profits $\frac{5,25,000}{0.20}; \frac{1,71,000}{0.20}$	26,25,000	8,55,000
b.	Capital Employed	12,60,000	4,75,000
c.	**Goodwill (a-b)**	**13,65,000**	**3,80,000**

Journal Entries - Books of Ram Ltd.

- Nature of Amalgamation – PURCHASE
- Method of Accounting – PURCHASE METHOD

(₹)

Particulars			***Debit***	***Credit***
a.	For Business Purchase :			
	Business Purchase A/c	Dr.	9,05,000	
	To Liquidator of Rahim Ltd. A/c			9,05,000
b.	For Assets and Liabilities taken over			
	Goodwill A/c	Dr.	3,80,000	
	Fixed Assets A/c	Dr.	4,00,000	
	Investments A/c	Dr.	50,000	
	Stock A/c	Dr.	50,000	
	Debtors A/c	Dr.	80,000	
	Advance tax A/c	Dr.	20,000	
	Cash and Bank A/c	Dr.	1,30,000	
	To 12% Debenture holders A/c			1,00,000
	To Creditors A/c			45,000
	To Provision for Taxation A/c			60,000
	To Business Purchase A/c			9,05,000
c.	For Discharge of Purchase Consideration:			
	Liquidator of Rahim Ltd.	Dr.	9,05,000	
	To Equity Share capital A/c			2,24,000
	To Securities premium A/c			6,80,960
	To Cash A/c			40
d.	Contra Entry			
	Amalgamation Adjustment A/c	Dr.	40,000	
	To Export Profit Reserve A/c			40,000

Name of the Company: Ram Ltd.					
Balance Sheet as at 31.03.2015 (After Merger)					
Ref No.		**Particulars**	**Note No.**	**After Merger**	**Before Merger**
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	9,24,000	
		(b) Reserves and surplus	2	14,90,960	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	2,00,000	
	4	**Current Liabilities**			
		(a) Trade payables	4	85,000	
		(b) Short-term provisions	5	1,60,000	
		Total		28,59,960	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	13,50,000	
		(ii) Intangible assets	7	3,80,000	
		(b) Non-current investments	8	2,50,000	
		(c) Long-term loans and advances	9	1,00,000	
		(d) Other non-current assets	10	40,000	
	2	**Current assets**			
		(a) Inventories	11	1,70,000	
		(b) Trade receivables	12	1,55,000	
		(c) Cash and cash equivalents	13	4,04,960	
		(d) Other current assets	14	10,000	
		Total		28,59,960	

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

₹

Note 1. Share Capital	**After Merger**	**Before Merger**
Authorised, Issued, Subscribed and Paid up Share Capital 92,400 Equity Shares of ₹10 each (of which 22,400 shares were issued for consideration other than cash)	9,24,000	
Total	9,24,000	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	After Merger		Before Merger	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	70,000	7,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	22,400	2,24,000	NIL	NIL
	92,400	9,24,000	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	92,400	9,24,000	NIL	NIL

Note 2. Reserves and Surplus		After Merger	Before Merger
Securities Premium		6,80,960	
General Reserve		3,50,000	
Profit and Loss A/c	₹ 2,10,000		
Add: Proposed Dividend Cancelled	₹ 1,40,000	3,50,000	
Export Profit reserve (70,000+40,000)		1,10,000	
Total		14,90,960	

Note 3. Long-term borrowings	After Merger	Before Merger
12% Debentures of ₹ 100 each (1,00,000+1,00,000)	2,00,000	
Total	2,00,000	

Note 4. Trade Payables	After Merger	Before Merger
Sundry Creditors	85,000	
Total	85,000	
Note 5. Short term Provisions	**After Merger**	**Before Merger**
Provision for Tax (1,00,000 + 60,000)	1,60,000	
Total	1,60,000	

Note 6. Tangible Assets	After Merger	Before Merger
Sundry Fixed assets(9,50,000+4,00,000)	13,50,000	
Total	13,50,000	

Note 7. Intangible assets	After Merger	Before Merger
Goodwill	3,80,000	
Total	3,80,000	

Note 8. Noncurrent Investments	After Merger	Before Merger
Investment	2,50,000	
Total	2,50,000	

Note 9. Long-term Loans and advances	After Merger	Before Merger
Advance Tax	1,00,000	
Total	1,00,000	

Note 10.Other Noncurrent assets	After Merger	Before Merger
Amalgamation Adjustment A/c	40,000	
Total	40,000	

Note 11. Inventories	After Merger	Before Merger
Stock (1,20,000+50,000)	1,70,000	
Total	1,70,000	

Note 12. Trade receivables	After Merger	Before Merger
Debtors (75,000+80,000)	1,55,000	
Total	1,55,000	

Note 13. Cash and Cash Equivalents	After Merger	Before Merger
Cash and Bank balance (2,75,000 + 1,30,000-40)	4,04,960	
Total	4,04,960	

Note 14. Other Current Assets	After Merger	Before Merger
Preliminary Expenses	10,000	
Total	10,000	

Illustration 9.

The following are the Extracted Balance sheets of Fat Ltd. and Thin Ltd. for the year ending on 31st March, 2015.

(₹ in Crores)

	Fat Ltd.	Thin Ltd.
Equity Share capital. @ ₹ 10 each	50	40
Preference Share capital - in 12% preference shares of ₹ 100 each	–	60
Reserves and surplus	200	150
	250	250
Loan - Secured	100	100
Total	**350**	**350**
Fixed assets (at cost less depreciation) - Tangible	150	150
Current assets less Current liabilities	200	200
Total	**350**	**350**

Note : Secured Loan to repayable with in 12 months.

The present worth of Fixed assets of Fat Ltd. is ₹ 200 crores and that of Thin Ltd. is ₹ 429 crores. Goodwill of Fat Ltd. is ₹ 40 crores and of Thin Ltd. is 75 crores.

Thin Ltd. absorbs Fat Ltd. by issuing equity shares at par in such a way that intrinsic networth is maintained.

Goodwill account is not to appear in the books. Fixed assets are to appear at old figures.

(a) Show the Balance Sheet after absorption.

(b) Draft a statement of valuation of shares on intrinsic value basis and prove the accuracy of your workings.

Solution:

Part-I: ***Purchase consideration***

WN # 1 : Intrinsic Value of Equity Shares

(₹ in Crores)

Particulars			***Fat Ltd.***	***Thin Ltd.***
a)	**Assets :**			
	i.	Goodwill	40	75
	ii.	Fixed assets	200	429
	iii.	Current asset less Current liabilities	200	200
			440	704
b)	**Liabilities**			
	i.	Secured Loans	(100)	(100)
	ii.	12% Preference Share capital	-	(60)
c)	Net Assets attributable to Equity shareholders		340	544
d)	Number of Shares (in Crores)		5	4
e)	Value per share of ₹ 10 each		₹ 68	₹ 136

WN # 2 : ***Determination of Exchange Ratio and the number of shares to be issued***

Exchange Ratio is based on intrinsic value per share of the companies

		Fat Ltd.	:	Thin Ltd.
i.	Intrinsic value	₹ 68	:	₹ 136
ii.	Exchange ratio	1	:	2

1 share of Thin Ltd. for 2 shares of Fat Ltd.

Therefore, Number of shares to be issued = Number of shares of Fat Ltd. × %

= 5 crores × 50% (i.e. ratio is 1:2 =50%)

= 2.5 crores

Journal Entries in the books of Thin Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

(₹ in Crores)

Particulars		*Debit* ₹	*Credit* ₹
1. For Business Purchase			
Business Purchase A/c	Dr.	25	
To Liquidator of Fat Ltd.			25
2. For assets and liabilities taken over :			
Fixed Assets A/c	Dr.	150	
Net Current Assets A/c	Dr.	200	
To Secured Loans A/c			100
To Capital Reserve A/c			225
To Business Purchase A/c			25
3. For Discahrge of Purchase Consideration :			
Liquidator of Fat Ltd. A/c	Dr.	25	
To Equity Share Capital A/c			25

Name of the Company: Thin Ltd. (After absorption)

Balance Sheet as at 31.03.2015

Ref No.		Particulars	Note No.	After absorption (₹ in Crore)	Before absorption (₹ in Crore)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	125	
		(b) Reserves and surplus	2	375	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	200	
	4	**Current Liabilities**		Nil	
		Total		700	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	300	
	2	**Current assets**			
		(a) Other current assets	5	400	
		Total		700	

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

(₹ in Crore)

Note 1. Share Capital	**After absorption**	**Before absorption**
Authorised, issued, subcribed and paid up 6.5 crore equity shares of ₹10 each (of the above shares 2.5 crores equity shares are allotted as fully paid up for consideration other than cash)	65	
12% Preference Share capital (60 lakhs shares of ₹100 each)	60	
Total	125	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	After absorption		Before absorption	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	4	40.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares , Right shares, split shares, shares issued other than cash)	2.5	25.00	NIL	NIL
	6.5	65.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	6.5	65.00	NIL	NIL

FOR 12% PREFERENCE SHARE :-	After absorption		Before absorption	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	6	60	NIL	NIL
Add: Fresh Issue (Incld Bonus shares , Right shares, split shares, shares issued other than cash)		-	NIL	NIL
	6	60	NIL	NIL
Less: Buy Back of shares	-		-	-
	6	60	NIL	NIL

Note 2. Reserves and Surplus	After absorption	Before absorption
Capital Reserve	225	
Other Reserve	150	
Total	375	

Note 3. Short-term borrowings	After absorption	Before absorption
Secured Loan (100+100)	200	
Total	200	

Note 4. Tangible assets	After absorption	Before absorption
Fixed Assets (150+150)	300	
Total	300	

Note 5. Other Current Assets	After absorption	Before absorption
Current Assets less Current Liabilities (200+200)	400	
Total	400	

* Secured loan is repayable with in 12 months.

WN 3 : *Statement to prove the accuracy of workings.*

		(₹ in Crores)
(i)	Equity Share capital (after absorption)	65
	Add: Reserves Surplus (after absorption)	375
	Add: Unrecorded value of goodwill (40+75)	115
	Add: Unrecorded incremental value of Fixed assets (50+279)	329
	Value of the Business	884
(ii)	Number of Equity shares (4 + 2.5)	6.5 Crores
(iii)	Intrinsic value of an equity share (884/6.5)	₹ 136

Ilustration 10.

A Ltd. agreed to take over B Ltd. as on 1st October, 2015. No Balance Sheet of B Ltd. was prepared on that date.

Summarised Balance Sheets of A Ltd. and B Ltd. as at 31st March, 2015 were as follows :

	A Ltd. ₹	***B Ltd.*** ₹		***A Ltd.*** ₹	***B Ltd.*** ₹
Share capital:	15, 00,000	10,00,000	Fixed Assets (Tangible)	12,50,000	8,75,000
In equity shares of ₹ 10 each fully paid up			Current Assets:		
			Stock	2,37,500	1,87,500
Reserves and surplus:			Debtors	3,90,000	2,56,000
Reserve			Bank	2,93,750	1,50,000
Profit and Loss	4,15,000	2,56,000	Miscellaneous		
Creditors	1,87,000	1,50,000	Expenditure		
	93,750	75,000	Preliminary		
			Expenses	25,000	12,500
	21,96,250	**14,81,000**		**21,96,250**	**14,81,000**

Additional information available:

(i) For the six months period from 1st April, 2015, A Ltd. made a profit of ₹ 4,20,000 after writing off depreciation at 10% per annum on its Fixed assets.

(ii) 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.

(iii) Both the companies paid on 1st August, 2015 equity dividends of 15%. Tax at 10% on such payments was also paid by each of them.

(iv) Goodwill of B Ltd. was valued at ₹ 1,20,000, on the date of take-over, stock of B, subject to an abnormal item of ₹ 7,500 to be fully written off, would be appreciated by 25% (or purpose of take-over).

(v) A Ltd. to issue to B's shareholders fully paid equity share of ₹10 each, on the basis of the comparative intrinsic value of the shares on the take-over date.

Draft the Balance sheet of A Ltd. after absorption of B Ltd.

Solution :

• Nature of Amalgamation - Purchase Method

• Method of Accounting - Purchase Method

Part - 1 Purchase consideration

WN # 1 : ***Balance sheet of A Ltd. and B Ltd. as on 1st October 2012 [Before absorption]***

Name of the Company: A Ltd. and B Ltd.							
Balance Sheet as at 1st October, 2015							
				A Ltd.		**B Ltd.**	
Ref No.	**Particulars**		**Note No.**	**As at 1st October, 2015**	**As at 31st March, 2015**	**As at 1st October, 2015**	**As at 31st March, 2015**
				₹	₹	₹	₹
	I	**Equity and Liabilities**					
	1	**Shareholders' funds**					
		(a) Share capital	1	15,00,000		10,00,000	
		(b) Reserves and surplus	2	7,75,000		4,45,000	
	2	**Share application money pending allotment**		Nil			
	3	**Non-current liabilities**		Nil			
	4	**Current Liabilities**					
		(a) Trade payables	3	93,750		75,000	
		Total (1+2+3+4)		23,68,750		15,20,000	
	II	**Assets**					
	1	**Non-current assets**					
		(a) Fixed assets					
		(i) Tangible assets	4	11,87,500		8,31,250	
	2	**Current assets**					
		(a) inventories	5	2,37,500		1,87,500	
		(b) trade receivables	6	3,90,000		2,93,750	
		(c) Cash and cash equivalents	7	5,28,750		2,32,750	
		(d) Other current assets	8	25,000		12,500	
		Total (1+2)		23,68,750		15,20,000	

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

(₹)

Particulars		A Ltd.	B Ltd.
WN # 1(a)	Fixed assets :		
	As on 1.4.15	12,50,000	12,50,000
	Less: Depreciation for 6 months [1-4-15 to 30-9-15]	62,500	43,750
	Balance carried to balance sheet	11,87,500	8,31,250
WN # 1(b)	Bank Balance :	2,93,750	1,50,000
	As on 31.3.15	4,20,000	2,04,000
	Add : Net profit after depreciation	62,500	43,750
	Add : Depreciation	7,76,250	3,97,750
	Less : Dividend @ 15%	(2,25,000)	(1,50,000)
	Less : Dividend tax @ 10%	(22,500)	(15,000)
	Balance carried to balance sheet	**5,28,750**	**2,32,750**
WN # 1(c)	Profit and Loss A/c.		
	Balance as on 31.3.15	1,87,500	1,50,000
	Add : Profit after depreciation for 6 months	4,20,000	2,04,000
		6,07,500	3,54,000
		(2,25,000)	(1,50,000)
	Dividend	(22,500)	(15,000)
	Dividend tax	**3,60,000**	**1,89,000**
WN # 1(d)	Stock and debtors :		
	It is assumed that in the absence of any other information, the amount of stock and debtors as on 1st October 2015 and 1st April 2015 is same.		

WN # 2 : Intrinsic value per share :

(₹)

			A Ltd.	*B Ltd.*
A.	Assets :			
	(i)	Goodwill	–	1,20,000
	(ii)	Fixed assets	11,87,500	8,31,250
	(iii)	Stock [1,87,500 – 7,500] × 1.25	2,37,500	2,25,500
	(iv)	Debtors	3,90,000	2,56,000
	(v)	Bank	5,28,750	2,32,750
			23,43,750	**16,65,000**
B.	Liabilities			
	Creditors		(93,750)	(75,000)
C.	Net asset (A - B)		22,50,000	15,90,000
D.	Number of shares		1,50,000	1,00,000
E.	Intrinsic value per share (C ÷ D)		**15**	**15.90**

WN # 3 : Purchase consideration.

a.	No. of shares of B Ltd.		1,00,000
b.	Value of shares of B Ltd. (1,00,000 × 15.525)	=	₹ 15,90,000
c.	Intrinsic value per share of A Ltd.		₹ 15
d.	No. of share to be issued by A Ltd. to B Ltd.	=	1,03,500

$\frac{15,52,500}{15}$

∴ Purchase consideration = ₹

Share capital	Securities premium
₹ 10,35,000	₹ 5,17,500
(1,03,500 x ₹ 10)	(1,03,500 x ₹ 5)

Name of the Company: A Ltd.				
Balance Sheet as at 01.10.2015 (after absorption of B Ltd.)				
Ref No.		**Particulars**	**Note No.**	**As at 1st October, 2015**
				₹
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	25,35,000
		(b) Reserves and surplus	2	12,93,200
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		Nil
	4	**Current Liabilities**		
		(a) Trade payables	3	1,68,750
		Total (1+2+3+4)		39,96,250
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	4	20,18,750
		(ii) Intangible assets	5	1,20,000
	2	**Current assets**		
		(a) Inventories	6	4,25,000
		(b) Trade receivables	7	6,46,000
		(c) Cash and cash equivalents	8	7,61,500
		(d) Other current assets	9	25,000
		Total (1+2)		39,96,250

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

(₹)

Note 1. Share Capital	As at 1st October, 2015
Authorised, Issued, Subscribed (1,50,000+1,06,000) 2,56,000 Equity Shares of ₹10 each fully paid [1,03,500 shares alloted for consideration other than cash]	2,56,000
Total	2,56,000

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	As at 1st October, 2015	
	Nos	Amount (₹)
Opening Balance as on 01.04.15	1,50,000	15,00,000
Add: Fresh Issue (Incld Bonus shares , Right shares, split shares, shares issued other than cash)	1,06,000	1,06,000
	2,56,000	2,56,000
Less: Buy Back of shares	-	-
	2,56,000	2,56,000

Note 2. Reserves and Surplus	As at 1st October, 2015
Securities Premium	5,30,000
Reserves	4,15,000
Profit and Loss a/c	3,60,000
Total	13,05,000

Note 3. Trade Payables	As at 1st October, 2015
Creditors (93,750 + 75,000)	1,68,750
Total	1,68,750

Note 4. Tangible Assets	As at 1st October, 2015
Fixed Assets	20,18,750
Total	20,18,750

Note 5. Inangible Assets	As at 1st October, 2015
Goodwill	1,20,000
Total	1,20,000

Note 6. Inventories	As at 1st October, 2015
Stock (2,37,500 + 2,25,000)	4,62,000
Total	4,62,000

Note 7. Trade Receivables	As at 1st October, 2015
Particulars	Amount (₹)
Debtors	6,46,000
Total	6,46,000

Note 8. Cash and Cash Equivalents	As at 1st October, 2015
Particulars	Amount (₹)
Bank Balance	7,61,500
Total	7,61,500

Note 9.Other Current assets	As at 1st October, 2015
Particulars	Amount (₹)
Preliminary Expenses	25,000
Total	25,000

Illustration 11.

S and M had been carrying on business independently, agree to amalgamate and form a company N Ltd. with an authorised Share capital of ₹ 2,00,000 divided into 40,000 equity shares of ₹ 5 each.

On 31st March, 2015, the respective extract Balance Sheets of S and M were as follows: (₹)

Particulars	***S*** ₹	***M*** ₹
Fixed Assets	3,17,500	1,82,500
Current Assets	1,63,500	83,875
	4,81,000	**2,66,375**
Less : Current liabilities	2,98,500	90,125
	1,82,500	**1,76,250**

Additional Information :

Revalued figures of Fixed and Current assets were as follows : (₹)

Particulars	**S**	**M**
Fixed Assets	6,55,000	2,95,000
Current Assets	1,49,750	78,875

The debtors and creditors include ₹ 21,675 owed by S to M.

The purchase consideration is satisfied by issue of the following shares and debentures:

(i) 30,000 equity shares of N Ltd. to S and M in the proportion to the profitability of their respective business based on the average net profit during the last three years which were as follows:

Particulars	***S***	***M***
2011-12 Profit	2,24,788	1,36,950
2012-13 (Loss) / Profit	(1,250)	1,71,050
2013-14 Profit	1,88,962	1,79,500

(ii) 15% debentures in N Ltd. at par to provide an income equivalent to 10% return on capital employed in their respective business as on 31st March, 2015 after revaluation of assets.

You are required to :

1. Compute the amount of debentures and shares to be issued to S and M.
2. A Balance sheet of N Ltd. showing the position immediately after amalgamation.

Solution :

Part I : Calculation of shares to be issued and No. of debentures to be issued :

WN # 1 : ***Calculation of average profit for the past 3 years.***

$$S = \frac{2,24,788 - 1,250 + 1,88,962}{3} = ₹\ 1,37,500/-$$

$$M = \frac{1,36,950 + 1,71,050 + 1,79,500}{3} = ₹\ 1,62,500/-$$

WN # 2 : *Determination of shares to be distributed to each company*

Distribution : 30,000 Equity Shares of N Ltd. are to be distributed between the S Ltd. and M Ltd. in their profitability ratio. i.e. 1375 : 1625

Shares to be Issued to S Ltd. $= \frac{1,375}{3,000} \times 30,000 = 13,750$ Shares.

Shares to be Issued to M Ltd. $= \frac{1,625}{3,000} \times 30,000 = 16,250$ Shares.

WN # 2 : *Calculation of the number of debentures to be issued :*

i. Calculation of 10% return of capital employed :- (at revalued figures)

Particulars		**S**	**M**
a.	Fixed Assets	6,55,000	2,95,000
b.	Current Assets	1,49,750	78,875
		8,04,750	3,73,875
c.	Current liabilities	(2,98,500)	(90,125)
d.	Capital employed	5,06,250	2,83,750
e.	Return on capital employed @ 10%	50,625	28,375
f.	Number of 15% debenture to be issued in order to get same return of ₹ 50,625 and ₹ 28,375 respectively. $\left(\frac{50,625}{15\%}, \frac{28,375}{15\%}\right)$	3,37,500	1,89,167

WN # 3 : ***Calculation of Purchase consideration and Goodwill or Capital reserve from the amalgamation:***

(₹)

Particulars	**S**	**M**	**Total**
I. Purchase Consideration:			
a. Value of Equity Shares (WN # 1) (13,750 x 5; 16,250 x 5)	68,750	81,250	1,50,000
b. 15% Debentures (WN # 2)	3,37,500	1,89,200	5,26,700
c. *Total*	**4,06,250**	**2,70,450**	**6,76,700**
II. Net Assets taken over:			
a. Fixed assets (Revalued Figures)	6,55,000	2,95,000	9,50,000
b. Add: Current assets (*78,875 - 21,675 Inter Co. Owings)	1,49,750	57,200*	2,06,950
c. Less: Current liabilities (**2,98,500 - 21,675 Inter Co. Owings)	(2,76,825)**	(90,125)	(3,66,950)
d. **Total (a+b+c)**	**5,27,925**	**2,62,075**	**7,90,000**
III. Goodwill / (Capital reserve) (I - II)	(1,21,675)	8,375	(1,13,300)

Name of the Company: N Ltd.				
Balance Sheet as at 31.03.2015				
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**
				₹
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	1,50,000
		(b) Reserves and surplus	2	1,13,300
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	5,26,700
	4	**Current Liabilities**		
		(a) Other current liabilities		3,66,950
		Total (1+2+3+4)		11,56,950
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	4	9,50,000
	2	**Current assets**		
		(a) Other current assets		2,06,950
		Total (1+2)		11,56,950

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

(₹)

1. Share Capital	As at 31st March, 2015
Authorised Capital: Equity Shares of ₹5 each	2,00,000
Issued Capital 30,000 shares of ₹ 5 each [All the above shares were issued to for a consideration other than cash]	1,50,000
Total	1,50,000

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	As at 31st March, 2015	
	Nos	Amount (₹)
Opening Balance as on 01.04.14	—	—
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	30,000	1,50,000
	30,000	1,50,000
Less: Buy Back of shares	-	-
	30,000	1,50,000

2. Reserves and Surplus	As at 31st March, 2015
Capital Reserve (WN # 3)	1,13,300
Total	1,13,300

3. Long-term borrings	As at 31st March, 2015
Secured Loans 15% Debentures (W N # 2)	5,26,700
Total	5,26,700

4. Tangible Assets	As at 31st March, 2015
Fixed assets	9,50,000
Total	9,50,000

Illustration 12.

On 1st April, 2014 Hero Ltd. was incorporated with an authorised capital of ₹ 1,000 lakhs. It issued to its promoters equity capital of ₹ 50 lakhs which was paid for in full. On that day it purchased the running business of Vijay Ltd. for ₹ 200 lakhs and allotted at par equity capital of ₹ 200 lakhs in discharge of the consideration. The net assets taken over from Vijay Ltd. were valued as follows : Fixed assets ₹ 150 lakhs, inventory ₹ 10 lakhs, customers' dues ₹ 70 lakhs and Creditors ₹ 30 lakhs.

Hero Ltd. carried on business and the following information is furnished to you:

a. Summary of cash/bank transactions for year ended 31 st March, 2015.

		(₹ in Lakhs)
Equity capital raised :		
Promotors (as shown above)	50	
Others	250	300
Collections from customers		4,000
Sale proceeds of Fixed assets (cost ₹18 crores)		20
Less :		4,320
Payment to suppliers	2,000	
Payment for employees	700	
Payment for expenses	500	3,200
Investments in Upkar Ltd.		100
Payments to suppliers of Fixed assets :		
Instalment due	600	
Interest	50	3,200
Tax payment		270
Dividend		50
Closing cash/bank balance		50

b. On 31st March, 2015 Hero Ltd.'s assets and liabilities were.

	₹ in Lakhs
Inventory at cost	15
Customers' dues	400
Prepaid expenses	10
Advances to suppliers	40
Amounts due to suppliers of goods	260
Amounts due to suppliers of Fixed assets	750
Outstanding expenses	30

c. Depreciation for the year under :

i. Companies Act, 2013 — ₹ 180 Lakhs

ii. Income tax Act, 1961 — ₹ 200 Lakhs

d. Provide for tax at 35% of "total income". There are no disallowables for the purpose of income taxation, provision for tax is to be rounded off.

i. Revenue statement for the year ended 31st March, 2015 and

ii. Balance Sheet as on 31st March, 2015 from the above information.

Solution:

WN # 1 : *Computation of purchase consideration*

	₹ in Lakhs
Fixed Assets	150
Inventory	10
Customer's Dues	70
Less: Creditors	(30)
Purchase consideration	**200**

IN THE BOOKS OF HERO LTD.

- Nature of Amalgamation - Purchase Method
- Method of Accounting - Purchase Method

(₹ in Lakhs)

	Particulars		*Debit*	*Credit*
1.	**For Business Purchase :**			
	Business Purchase A/c	Dr.	200	
	To Liquidator of Vijay Ltd. A/c			200
2.	**Incorporation of assets and liabilities taken over :**			
	Fixed Assets A/c	Dr.	150	
	Inventory A/c	Dr.	10	
	Customer's dues A/c	Dr.	70	
	To Creditors A/c			30
	To Business Purchase A/c			200
	Note : There is no goodwill or Capital reserve arising.			
3.	**Discharge of Consideration :**			
	Liquidator of Vijay Ltd. A/c	Dr.	200	
	To Equity Share Capital A/c			200

Debtors / Customers Account

Dr. Cr.

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To Business Purchase	70	By Bank	4,000
To Sales [balance c/d]	4,330	By Balance c/d	400
	4,400		**4,400**

Suppliers Account

Dr. Cr.

Particulars	**Amount (₹)**	**Particulars**	**Amount (₹)**
To Bank *	1,960	By Business Purchase	30
To Balance c/d	260	By Purchase [balance c/d]	2,190
	2,220		**2,220**

Payment to suppliers	
Amount	2,000
Less: Advances	40
	1,960

₹ in lakhs

Dr. **Fixed assets Accounts (Suppliers)** Cr.

Particulars	***Amount***	***Particulars***	***Amount***
To Bank A/c	650	By Fixed assets A/c (Bal. fig.)	1,350
To Balance c/d	750	By Interest A/c	50
	1,400		**1,400**

₹ in lakhs

Dr. **Fixed assets Account** Cr.

Particulars	***Amount***	***Particulars***	***Amount***
To Business Purchase A/c	150	By Bank A/c	20
To Profit and Loss A/c	2	By Balance c/d	1,482
To Suppliers A/c	1,350		
	1,502		**1,502**

₹ in lakhs

Dr. **Expenses Account** Cr.

Particulars	***Amount***	***Particulars***	***Amount***
To Bank A/c	500	By Profit and Loss a/c	520
To Outstanding expenses A/c	30	(Balancing Figure)	
		By Balance c/d (prepaid)	10
	530		**530**

Revenue Statement for the year ended 31.3.15

₹ in Lakhs

Particulars	***Amount***	***Amount***
a) Sales		4,330
b) Less: Expenditure		
Stock taken over	10	
Add: Purchases	2,190	
	2,200	
Less : Closing Stock	15	
Inventory consumed	2,185	
Expenses	520	
Employee Cost	700	(3,405)
Profit before Interest depreciation and Tax		925
Less: Interest		(50)
Profit before depreciation and Tax		875
Less: Depreciation as per Companies Act, 2013		(180)
		695
Add: Profit on sale of Fixed assets		2
Profit before tax		697
Less: Provision for tax *		236.25
Profit After Tax		460.75
Less: Dividend		(50)
Balance Carried forward to Balance Sheet.		**410.75**

* Calculation of Tax provision

Particulars	***₹ in lakhs***
Profit before Tax.	697
Less: Profit and Loss on sale of Fixed assets	(2)
Add: Depreciation as per Companies Act	180
Less: Depreciation as per IT Account	(200)
Adjusted Profit before tax	675
Less: Tax @ 35%	236.25
	438.75

Name of the Company: Hero Ltd.				
Balance Sheet as at 31.03.2015				
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**
				(₹ in lakhs)
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	500.00
		(b) Reserves and surplus	2	410.75
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Other Long term liabilities	3	750.00
	4	**Current Liabilities**		
		(a) Trade payables	4	260.00
		(b)Other current liabilities	5	30.00
		(c) Short-term provisions	6	236.25
		Total		2,187.00
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	7	1,302.00
		(b) Non-current investments	8	100.00
		(c) Long-term loans and advances	9	270.00
	2	**Current assets**		
		(a) Inventories		15.00
		(b) Trade receivables	10	400.00
		(c) Cash and cash equivalents	11	50.00
		(d) Short-term loans and advances	12	40.00
		(e) Other current assets	13	10.00
		Total		2,187.00

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

(Note: Amount due to supplier of Fixed Assets assumed to be for more than 12 months, hence treated as long term borrowings. (Without interest).

(₹ in Lakhs)

Note 1. Share Capital	31.03.15
Authorised Capital:Equity Shares of ₹5 each	1,000
Issued,subscribed and fully paid up capital Existing 300+ Issued 200 (of the above, shares worth ₹200 crores were issued for a consideration other than cash)	500.00
Total	500.00

RECONCILATION OF SHARE CAPITAL		
FOR EQUITY SHARE :-	**As at 31st March, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.14		300.00
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)		200.00
		500.00
Less: Buy Back of shares		-
		500.00

Note 2. Reserves and Surplus	31.03.15
Profit and loss A/c	410.75
Total	410.75

Note 3. Other Long-term Liabilities	31.03.15
Amount due to suppliers of fixed assets	750
Total	750

Note 4. Trade Payables	31.03.15
Creditors	260
Total	260

Note 5. Other Current Liabilities	31.03.15
Outstanding expenses	30
Total	30

Note 6. Short Term Provisions	31.03.15
Provision for tax	236.25
Total	236.25

Note 7. Tangible assets	31.03.15
Fixed assets less: depreciation (1,482 – 180)	1,302
Total	1,302

Note 8. Non Current Investments	31.03.15
Investment in Upkar Ltd.	100
Total	100

Note 9. Long term Loans and Advances	31.03.15
Advance Tax	270
Total	270

Note 10. Trade receivables	31.03.15
Dcustomers Due	400
Total	400

Note 11. Cash and cash equivalents	31.03.15
Cash and Bank	50
Total	50
Note 12. Short term loans and advances	31.03.15
Advance to suppliers	40
Total	40

Note 13. Other Current assets	31.03.15
Prepaid expenses	10
Total	10

Illustration 13.

AX Ltd. and BX Ltd. decided to amalgamate their business with a view to a public share issue. A holding company, MX Ltd. is to be incorporated on 1st August 2015 with an authorised capital of ₹ 60,00,000 in ₹ 10 ordinary shares. The company will acquire the entire ordinary Share capital of AX Ltd. and BX Ltd. in exchange for an issue of its own shares.

The consideration for the acquisition is to be ascertained by multiplying the estimated profits available to the ordinary shareholders by agreed price earnings ratio. The following relevant figures are given :

	AX Ltd. ₹	*BX Ltd.* ₹
Issued Share capital		
Ordinary shares of ₹ 10 each	30,00,000	12,00,000
6% Cumulative Preference shares of ₹ 100 each	–	10,00,000
5% Debentures, redeemable in 2016-17		8,00,000
Estimated annual maintainable profits, before deduction of debenture interest and taxation	6,00,000	2,40,000
Price / Earning Ratio	15	10

The shares in the holding company are to be issued to members of the subsidiaries on 1st September 2015, at a premium of ₹ 2.50 per share and thereafter these shares will be marketable on the Stock Exchange.

It is anticipated that the merger will achieve significant economics but will necessitate additional working capital. Accordingly, it is planned that on 31st March, 2016, MX Ltd. will make a further issue of 60,000 ordinary shares the public for cash at the premium of ₹ 3.75 a share. These shares will not rank for dividends until 31st March, 2016.

In the period ended 31st March, 2016, bank overdraft facilities will provide funds for the payment of MX Ltd. of preliminary expenses estimated at ₹ 50,000 and management etc. expenses estimated at ₹ 6,000.

It is further assumed that interim dividends on ordinary shares, relating to the period from 1st June to 31st March, 2016 will be paid on 31st March, 2016 by MX Ltd. at 3.5% by AX Ltd. at 5% and by BX Ltd. at 2%.

You are required to project, as on 31st March, 2016 for MX Ltd., the Balance Sheet as it would appear immediately after fully subscribed share issue for the period ending 31st March, 2016.

Assume the rate of corporation tax to be 40% you can make any other assumption you consider relevant.

Solution :

WN # 1 : *Computation of Purchase Consideration*

		AX Ltd.		***BX Ltd.***
		₹		₹
a.	Earnings before Interest and Tax (EBIT)	6,00,000		2,40,000
b.	Less: Interest	–		(40,000)
c.	Earnings before tax (EBT)	6,00,000		2,00,000
d.	Less: Tax @ 40%	(2,40,000)		(80,000)
e.	Earnings after tax (EAT or PAT)	3,60,000		1,20,000
f.	Less: Preference Dividend	–		(60,000)
g.	Profit for Equity Shareholders	3,60,000		60,000
h.	P/E Ratio	15		10
i.	Total Consideration (Profit × P/E ratio)	54,00,000		6,00,000
j.	Share capital (432000 × 10)	43,20,000	48000 × 10	4,80,000
k.	Share Premium (432000 × 2.5)	10,80,000	48000 × 2.5	1,20,000

Projected Profit and Loss Account for the period ending on 31st March, 2016

			₹
a.	Dividend Received from Subsidiaries		
	AX Ltd.	30,00,000 × 5%	1,50,000
	BX Ltd.	12,00,000 × 2%	24,000
			1,74,000
b.	Less: Management Expense		(6,000)
	Less: Dividend @ 3.5% on 48,00,000		1,68,000
	(43,20,000 ÷ 4,80,000)		(1,68,000)
c.	Projected profit		Nil

WN # 2 :

Bank Account

Dr. ***Cr.***

Particulars	₹	**Particulars**	₹
To Shares issued	8,25,000	By Preliminary expenses	50,000
(60,000 @ 13.75)		By Management expenses	6,000
To Dividend Received - AX Ltd.	1,50,000	By Dividend paid	1,68,000
- BX Ltd.	24,000	By Balance c/d	7,75,000
	9,99,000		**9,99,000**

Name of the Company: MX Ltd.				
Balance Sheet as at 31.03.2016				
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2016**
				₹
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	54,00,000
		(b) Reserves and surplus	2	13,75,000
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		Nil
	4	**Current Liabilities**		Nil
		Total		67,75,000
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		Nil
		(b) Non-current investments	3	60,00,000
	2	**Current assets**		
		(a) Short-term loans and advances	4	7,75,000
		Total		67,75,000

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

(₹)

Note 1. Share Capital		As at 31st March, 2016
Authorized 6,00,000 Equity Share of ₹10 Each		60,00,000
Issued, Subscribed and fully paid Equity Share of ₹ 10 each		54,00,000
Total		54,00,000

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2016**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.15 Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	5,40,000	54,00,000
	5,40,000	54,00,000
Less: Buy Back of shares	-	-
	5,40,000	54,00,000

Note 2. Reserves and Surplus	**As at 31st March, 2016**
Share Premium	
AX Ltd.	10,80,000
BX Ltd.	1,20,000
Others(60,000×3.75)	2,25,000
Total	14,25,000
Less: Preliminary Expenses	50,000
Total	13,75,000

Note 3. Non-current Investments	**As at 31st March, 2016**
Investments: Subsidiaries Shares at Cost	60,00,000
Total	60,00,000

Note 4.Cash and Cash Equivalents	**As at 31st March, 2016**
Bank	7,75,000
Total	7,75,000

Note: The preliminary expenses are to be written off against Securities Premium A/c.

III. Purchasing Company holding shares in Selling Company

Illustration 14.

It has been decided that P Ltd. will absorb the entire undertaking of S Ltd. and T Ltd. as on 1.4.2015. The outside shareholders in the latter companies are to be issued equity shares in P Ltd. on the basis of an agreed issue price of ₹200 per share. For this purpose, the interests of such shareholders are to be determined according to the intrinsic values of the shares of the respective companies. N Ltd. is a subsidiary of T Ltd. and is also to be merged into P Ltd. appropriately.

The summarised Balance Sheets of the companies as at 31.3.2015, stood as under :

(₹ Lakhs)

	P	**S**	**T**	**N**
Sources of Funds:				
Share capital				
Equity shares ₹ 100 each	1,500	1,000	800	400
Reserves	2,000	540	702	400
Loans	1,600	900	1,000	700
Total	**5,100**	**2,440**	**2,502**	**1,500**

(₹ Lakhs)

	P	S	T	N
Application of Funds :				
Land	200	100	50	10
Buildings	500	400	100	200
Machinery	1,500	800	500	500
Other Fixed Assets	400	100	200	50
Investments				
4 lakhs shares of S	500			
2 lakhs shares of T	300			
4 lakhs shares of N	-	-	400	
Others	100	-	-	
Net Current Assets	1,600	1,040	1,252	740
Total	**5,100**	**2,440**	**2,502**	**1,500**

Note : Loans assumed to be of less than 12 months hence treated as short term borrowing (ignoring interest)

For the purpose of the scheme, it is agreed to give effect to the following value appreciations of the assets of the companies to be absorbed.

Land	-	100%
Buildings	-	50%
Machinery	-	20%

In order to obtain the consent of the creditors of T Ltd., it becomes necessary to accept a claim of ₹20 lakhs hitherto classified as contingent. 60% of the claim is accepted by T Ltd. and the balance is to be settled by P Ltd.

You are required to :

i. Compute the number of shares to be issued by P Ltd. to eligible outsiders

ii. Show journal entries.

iii. Draft the Balance sheet of P Ltd. after the absorption.

Solution :

Part 1. *Calculation of Purchase consideration.*

WN # 1 : *Calculation of Intrinsic value of shares.*

(₹ in Lakhs)

		S	T	N
a.	Land (↑100%)	200	100	20
b.	Building (↑50%)	600	150	300
c.	Machinery (↑20%)	960	600	600
d.	Others Fixed Assets	100	200	50
e.	Net current Asset	1040	1252	740
f.	Investment in N Ltd. (100% subsidiary company)	—	1010	—
	[4 Lakhs shares × ₹ 252.50]	2900	3312	1710
g.	Loans	(900)	(1000)	(700)
h.	Contingent loan (60% of 20)	—	(12)	—
i.	Value of Net Assets	2,000	2,300	10100
j.	No. of shares Outstanding	10	8	4
k.	Intrinsic value per share (i/j)	200	287.50	252.50

WN # 2 : Purchase consideration

(₹ in Lakhs)

	Particulars	*S*	*T*
a.	No. of shares outstanding	10	8
b.	Less: Already held by P Ltd.	(4)	(2)
c.	No. of shares held by outsiders	6	6
d.	Value payable at intrinsic value [WN # 2(c)xWN # 1 (k)]	₹ 1,200	₹ 1,725
e.	No. of shares to be issued at value of ₹ 200	6	8.625
f.	Payment to be made for T Ltd. is : Shares	–	8
	Cash (for fractional shares)		0.625 x 200
			= ₹ 125/-

Part II - In the books of purchasing Co. P Ltd.

A. Take over of S Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

₹ in Lakhs

	Particulars		Debit	Credit
a.	For Purchase Consideration Due :			
	Business Purchase A/c (6×200)	Dr.	1,200	
	To Liquidator of S Ltd's. A/c			1,200
b.	For Assets and liabilities takeover :			
	Land A/c	Dr.	200	
	Building A/c	Dr.	600	
	Machinery A/c	Dr.	960	
	Other Fixed Assets A/c	Dr.	100	
	Net Current Assets A/c	Dr.	1040	
	To Capital Reserve A/c (balancing figure)			300
	To Loans A/c			900
	To Business purchase A/c			1,200
	To Investments in S Ltd			500
c.	Discharge of consideration			
	Liquidator of S Ltd. A/c	Dr.	1,200	
	To Equity Share Capital A/c (6 x 100)			600
	To Securities Premium A/c (6 x 100)			600

B. Take over of T Ltd.

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

(₹ in Lakhs)

	Particulars		Debit	Credit
a.	For Purchase Consideration Due :			
	Business Purchase A/c	Dr.	1,725	
	To Liquidator of T Ltd. A/c			1,725
b.	For takeover of assets and liabilities:			
	Land A/c	Dr.	120	
	Building A/c	Dr.	450	
	Machinery A/c	Dr.	1200	
	Other Fixed Assets A/c	Dr.	250	
	Net Current Assets A/c	Dr.	1992	
	To Capital Reserve A/c (balancing figure)			267
	To Loans A/c			1712
	To Contingent loan payable A/c			8
	To Business purchase A/c			1725
	To Investments in T Ltd. A/c			300
c.	Settlement of contingent liability:			
	Contingent liability payable A/c	Dr.	8	
	To Net current asset (cash)			8

d. For discharge of consideration:

Liquidator of T Ltd. A/c	Dr.	1,725	
To Equity Share Capital A/c (8 × 100)			800
To Securities Premium A/c (8 × 100)			800
To Cash A/c			125

Name of the Company: P Ltd.					
Balance Sheet as at 1.04.2015					
Ref No.		**Particulars**	**Note No.**	**As at 1st April, 2015**	**As at 31st March, 2015**
				(₹ in Lakhs)	**(₹ in Lakhs)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	2,900	
		(b) Reserves and surplus	2	3,967	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Short-term borrowings	3	4,212	
		Total		11,079	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	6,480	
		(b) Non-current investments		100	
	2	**Current assets**			
		(a) Other current assets	5	4,499	
		Total		11,079	

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

(₹ in Lakhs)

Note 1. Share Capital	**As at 1st April, 2015**	**As at 31st March, 2015**
Authorized, Issued subscribed and fully paid up equity shares of ₹10 each [Out of the above 6 lakhs shares to S Ltd. And 8 lakhs shares to T Ltd. Were issued for consideration other than cash]	2,900	
Total	2,900	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st April, 2015**		**As at 31st March, 2015**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.15	15	1,500.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	14	1,400.00	NIL	NIL
	29	2,900.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	29	2,900.00	NIL	NIL

2. Reserves and Surplus		**As at 1st April, 2015**	**As at 31st March, 2015**
Capital Reserve (300+267)	567		
Securities Premium(600+800)	1,400		
Other Reserves	2,000	3,967	
Total		3,967	

3. Short-term Loans	**As at 1st April, 2015**	**As at 31st March, 2015**
Loans(1600+900+1012+700)	4,212	
Total	4212	

4. Tangible Assets	**As at 1st April, 2015**	**As at 31st March, 2015**
Land(200+200+100+20)	520	
Buildings(500+600+150+300)	1,550	
Machinery(1500+960+600+600)	3,660	
Other Fixed assets(400+100+200+50)	750	
Total	6,480	

5. Other Current Assets	**As at 1st April, 2015**	**As at 31st March, 2015**
Net Current assets(1,600+1,040+1,252+740+740-8-125)	4,499	
Total	4,499	

Note : Loan are assurred to be of less than 12 months Hence, Short term (ignoring interest)

Illustration 15.

The summarised Balance Sheets of Sweet Ltd. and Salt Ltd. as on 31.03.15 were as follows:

Balance Sheet as on 31.03.15

Liabilities	**Sweet Ltd. (₹)**	**Salt Ltd. (₹)**	**Assets**	**Sweet Ltd. (₹)**	**Salt Ltd. (₹)**
Equity Share capital (₹ 100)	8,00,000	3,00,000	Building	2,00,000	1,00,000
			Machinery	5,00,000	3,00,000
10% Preference Share capital (₹ 100)	-	2,00,000	Furniture	1,00,000	60,000
			Investment:		
			600 shares of Small Ltd.	60,000	—
General Reserve	3,00,000	1,00,000	Stock	1,50,000	1,90,000
Profit and Loss A/c	2,00,000	1,00,000	Debtors	3,50,000	2,50,000
Creditors	2,00,000	3,00,000	Cash and Bank	90,000	70,000
			Preliminary Expenses	50,000	30,000
	15,00,000	**10,00,000**		**15,00,000**	**10,00,000**

Sweet Ltd. has taken over the entire undertaking of Salt Ltd. on 30.09.15, on which date, the position of Current assets except cash and bank balances and Current liabilities were as follows:

	Sweet Ltd (₹)	Salt 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 30.09.15 after charging depreciation as 5% on building, 15% on machinery and 10% on furniture, are:

Sweet Ltd. ₹ 1,02,500

Salt Ltd. ₹ 54,000

On 30.08.15 both companies have declared 15% dividend for 2014-15.

Goodwill of Salt Ltd. has been valued at ₹ 50,000 and other Fixed assets at 10% above Sweet their book values on 31.03.15. Preference shares of Salt Ltd. are to be allotted 10%. Preference Shares of Sweet Ltd. and Equity shareholders of Salt Ltd. are to receive requisite number of equity shares of Sweet Ltd. valued at ₹ 150 per share on satisfaction of their claims.

Show the Balance Sheet as of 30.09.15 assuming absorption is through by that date.

Solution:

Name of the Company: Sweet Ltd. and Salt Ltd.							
Balance Sheet as on September 30, 2015							
				Sweet Ltd.		**Salt Ltd.**	
Ref No.	**Particulars**		**Note No.**	**As at 31st Sept., 2015**	**As at 31st March, 2015**	**As at 31st Sept., 2015**	**As at 31st March, 2015**
				₹	₹	₹	₹
	I.	**Equity and Liabilities**					
	1	**Shareholders' funds**					
		(a) Share capital	1	8,00,000		5,00,000	
		(b) Reserves and surplus	2	4,91,500		2,09,000	
	2	**Share application money pending allotment**		Nil			
	3	**Non-current liabilities**		Nil			
	4	**Current Liabilities**					
		(a) Trade payables	3	1,80,000		2,10,000	
		Total (1+2+3+4)		14,71,500		9,19,000	
	II.	**Assets**					
	1	**Non-current assets**					
		(a) Fixed assets					
		(i) Tangible assets	4	7,05,000		4,04,000	
		(b) Non-current investments	5	60,000			
	2	**Current assets**					
		(a) inventories	6	1,20,000		1,50,000	
		(b) trade receivables	7	3,80,000		2,50,000	
		(c) Cash and cash equivalents	8	1,56,500		85,000	
		(d) Other current assets	9	50,000		30,000	
		Total (1+2)		14,71,500		9,19,000	

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

	Sweet Ltd.		**Salt Ltd.**	
Note 1. Share Capital	**30.09.2015**	**31.03.2015**	**30.09.2015**	**31.03.2015**
Authorised, Issued, Subscribed and fully paid up				
Equity Shares of ₹ 100 each	8,00,000		3,00,000	
2,000, 10% Prefrence Share Capital of ₹ 100 each			2,00,000	
Total	8,00,000		5,00,000	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE:-	**Sweet Ltd.**				**Salt Ltd.**			
	30.09.2015		**31.03.2015**		**30.09.2015**		**31.03.2015**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**	**Nos**	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.11	8,000	8,00,000	NIL		3,000	3,00,000		NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)			NIL					NIL
			NIL					NIL
Less: Buy Back of shares	-	-	-					-
	8,000		NIL		3,000	3,00,000		NIL

FOR 10% PREFERENCE SHARE:-	**Sweet Ltd.**				**Salt Ltd.**			
	30.09.2015		**31.03.2015**		**30.09.2015**		**31.03.2015**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**	**Nos**	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.15	NIL	NIL	NIL		2,000	2,00,000		NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)			NIL					NIL
		NIL	NIL					NIL
Less: Buy Back of shares	-	-	-					-
			NIL		3,000	3,00,000		NIL

	Sweet Ltd.		**Salt Ltd.**	
Note 2. Reserves and Surplus	**30.09.15**	**31.03.15**	**30.09.15**	**31.03.15**
General Reserve	3,00,000		1,00,000	
Profit and Loss A/c	1,91,500		1,09,000	
Total	4,91,500		2,09,000	

Note 3. Trade Payables	**30.09.15**	**31.03.15**	**30.09.15**	**31.03.15**
Creditors	1,80,000		2,10,000	
Total	1,80,000		2,10,000	

Note 4. Tangible Assets	**30.09.15**	**31.03.15**	**30.09.15**	**31.03.15**
Building	1,90,000		95,000	
Machinery	4,25,000		2,55,000	
Furniture	90,000		54,000	
Total	7,05,000		4,04,000	

Note 5. Non Current Investment	**30.09.15**	**31.03.15**	**30.09.15**	**31.03.15**
Investment	60,000		-	
Total	60,000		-	

Note 6. Inventories	30.09.15	31.03.15	30.09.15	31.03.15
Stock	1,20,000		1,50,000	
Total	1,20,000		1,50,000	

Note 7. Trade Receivables	30.09.15	31.03.15	30.09.15	31.03.15
Debtors	3,80,000		2,50,000	
Total	3,80,000		2,50,000	

Note 8. Cash and Cash Equivalents	30.09.15	31.03.15	30.09.15	31.03.15
Bank Balance	1,56,500		85,000	
Total	1,56,500		85,000	

Note 9. Other Current assets	30.09.15	31.03.15	30.09.15	31.03.15
Preliminary Expenses	50,000		30,000	
Total	50,000		30,000	

*** Calculation of Profit & Loss Account Balances**

(₹)

Particulars	Sweet Ltd.	Salt Ltd.
Opening balance	2,00,000	1,00,000
Add.Profit for half year	1,02,500	54,000
Less: Equity dividend	(1,20,000)	(45,000)
Add: Dividend income on 600 Equity Shares	9,000	–
Total	**1,91,500**	**1,09,000**

Assumptions:

(a) Preference dividend has already been paid

(b) Half year profit given is "Trading Profit" and does not include dividend income.

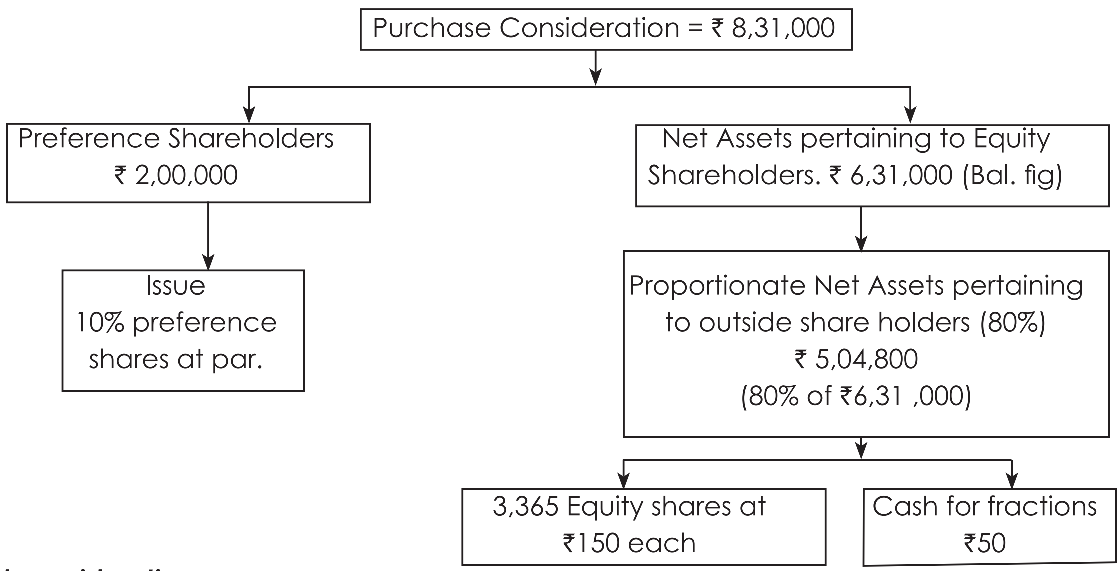
(c) The entire dividend income is post-acquisition (ie. investment has been acquired prior to 1.4.15)

Part II

Purchase Consideration - Net Assets Method

Particulars	*Amount* ₹	*Amount* ₹
Goodwill	50,000	
Building	1,10,000	
Machinery	3,30,000	
Furniture	66,000	
Stock	1,50,000	
Debtors	2,50,000	
Cash	85,000	10,41,000
Less: Creditors		(2,10,000)
Purchase Consideration		8,31,000

Analysis of Purchase Consideration:



Total consideration summary :

	Particulars	***Amount*** ₹
i)	Preference Share capital at par	2,00,000
ii)	3,365 Equity shares @ ₹ 150 per share	5,04,750
iii)	Cash	50
	Total	**7,04,800**

Part - III : ***In the books of Sweet Ltd.***

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

Journal entries (₹)

	Particulars		*Debit*	*Credit*
a.	For Purchase Consideration Due :			
	Business Purchase A/c	Dr.	7,04,800	
	To Liquidator of Salt Ltd.			7,04,800
2.	For Assets of Libilties taken over :			
	Building A/c	Dr.	1,10,000	
	Machinery A/c	Dr.	3,30,000	
	Furniture A/c	Dr.	66,000	
	Stock A/c	Dr.	1,50,000	
	Debtors A/c	Dr.	2,50,000	
	Cash A/c	Dr.	85,000	
	To Creditors A/c			2,10,000
	To Business Purchase A/c			7,04,800
	To Investment in Salt Ltd. A/c			60,000
	To Capital Reserve A/c			16,200
3.	Discharge of Purchase Consideration			
	Liquidator of Salt Ltd. A/c	Dr.	7,04,800	
	To 10% Preference Share Capital A/c			2,00,000
	To Equity Share Capital A/c			3,36,500
	To Securities Premium A/c			1,68,250
	To Bank/Cash A/c			50

Name of the Company: Sweet Ltd. (After absorption)					
Balance Sheet as at 30.09.2015					
Ref No.	**Particulars**		**Note No.**	**After**	**Before**
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	13,36,500	
		(b) Reserves and surplus	2	6,75,950	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Trade payables	3	3,90,000	
		Total		24,02,450	

Ref No.		Particulars	Note No.	After	Before
				₹	₹
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	12,11,000	
	2	**Current assets**			
		(a) Inventories	5	2,70,000	
		(b) Trade receivables	6	6,30,000	
		(c) Cash and cash equivalents	7	2,41,450	
		(d) Other current assets	8	50,000	
		Total		24,02,450	

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

Note 1. Share Capital	**After**	**Before**
Authorised, Issued, Subscribed & Paid up :-		
113650 Equity shares of ₹10 each [Out of which 33650 shares are allotted for consideration other than cash]	11,36,500	
10% Preference Share Capital of ₹100 each (The above shares are alloted for consideration other than cash)	2,00,000	
Total	13,36,500	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE :-		**After**		**Before**
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.15	80,000	800,000.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	33,650.00	336,500.00	NIL	NIL
	113650	11,36,500	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	113650	11,36,500	NIL	NIL

FOR 10% PREFERENCE SHARE :-		**After**		**Before**
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.15	2,000	2,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)			NIL	NIL
			NIL	NIL
Less: Buy Back of shares			-	-
	2,000	2,00,000	NIL	NIL

Note 2. Reserves and Surplus	After	Before
Capital Reserve Securities Premium General Reserve Profit and Loss A/c	16,200 1,68,250 3,00,000 1,91,500	
Total	6,75,950	

Note 3. Trade Payables	After	Before
Particulars	Amount (₹)	Amount (₹)
Creditors	3,90,000	
Total	3,90,000	

Note 4. Tangible Assets		After	Before
Building	2,00,000		
Less: Depreciation	10,000		
	1,90,000		
Add: Taken Over	1,10,000	3,00,000	
Machinery	5,00,000		
Less: Depreciation	75,000		
Add: Taken Over	3,30,000	7,55,000	
Furniture	1,00,000		
Less: Depreciation	10,000		
Add: Taken Over	66,000	1,56,000	
		12,11,000	

Note 5. Inventories	After	Before
Stock	2,70,000	
Total	2,70,000	

Note 6. Trade Receivables	After	Before
Debtors	6,30,000	
Total	6,30,000	

Note 7. Cash & Cash Equivalent	After	Before
Cash & Bank	241450	
Total	241450	

Note 8. Other Current assets	After	Before
Preliminary Expenses	50,000	
Total	50,000	

Ilustration 16.

The draft Balance Sheets of S Ltd. and H Ltd. as on 31.3.15 were as follows.

(₹ in Lakhs)

Liabilities	*S Ltd.*	*H Ltd.*
Equity Share capital	80	25
Reserves and surplus	400	75
10% 25,000 Debentures of ₹ 100 each	–	25
Other Liabilities	120	–
	600	**125**

Assets				
Fixed assets at cost	200		75	
Less: Depreciation	100	100	50	25
Investments in H Ltd.				
2 Lakhs Equity shares of ₹ 10 each at cost	32			
10% 25,000 debentures of ₹ 100 each at cost	24	56		
Current assets	800		300	
Less: Current liabilities	(356)	444	(200)	100
		600		**125**

In a scheme of absorption duly approved by the Court, the assets of 'H' Ltd. were taken over at an agreed value of ₹ 130 lakhs. The liabilities were taken over at par. Outside shareholders of 'H' Ltd. were allotted equity shares in S Ltd. at a premium of ₹ 90 per share in satisfaction of other claims in 'H' Ltd. for purposes of recording in the books of 'S' Ltd. Fixed assets taken over from 'H' Ltd. were revalued at ₹ 40 lakhs.

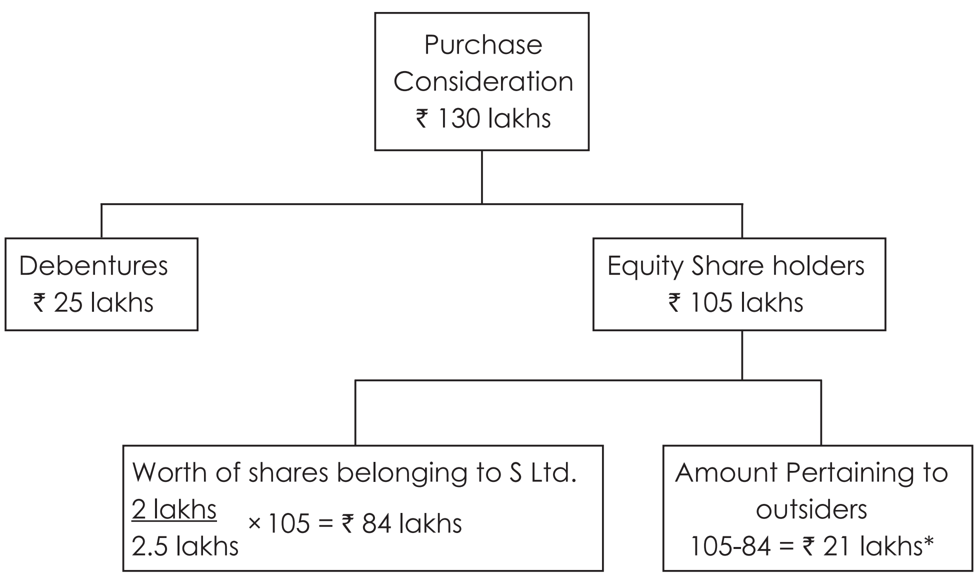
The scheme was put through on 1st April, 2015.

a. Journal Entries in the books of 'S' Ltd.

b. Show the balance of 'S' Ltd. after absorption of 'H' Ltd.

Solution :

WN # 1 : ***Purchase consideration of shares to be issued***



'Number of shares to be issued to outside shareholders @ 10/ each at a premium of ₹ 90/- $= \frac{₹\ 21,00,000}{100}$

= 21,000 Shares.

(a) Part - II Journals in Books of S Ltd.

- Nature of Amlagamation- Purchase Method
- Method of Accounting - Purchase Method

(₹ in Lakhs)

	Particulars		***Debit***	***Credit***
i.	For Purchase Consideration Due :			
	Business Purchase A/c	Dr.	21	
	To Liquidator for H Ltd." A/c			21
	(Being the purchase consideration payable to liquidator of H Ltd. for business purchase)			
ii.	For assets and liabilities taken over:			
	Fixed Assets A/c	Dr.	40	
	Current Assets A/c	Dr.	300	
	To Current Liabilities A/c			200
	To Liability for 10% Debentures A/c			25
	To Business Purchase A/c			21
	To Investment in H Ltd. A/c			32
	To Capital Reserve (balancing figure)			62
	(Being the assets and liabilities taken over from H Ltd)			
iii.	Discharge of purchase consideration:			
	Liquidator of H Ltd. A/c	Dr.	21	
	To Equity Share Capital A/c			2.10
	To Securities Premium A/c			18.90
	(Being the allotment of 21 lakhs equity shares of ₹ 10 each to outside shareholders of H Ltd. at a premium of ₹90 per share.)			
iv.	Cancellation of Liability of Debentures:			
	10% Debenetures A/c	Dr.	25	
	To Investments in Debentures A/c			24
	To Capital Reserve A/c			1
	(Being the cancellation of debentures of H Ltd.)			

(b)

Name of the Company: S Ltd.					
Balance Sheet as at 01.04.2015					
Ref No.	Particulars		Note No.	As at 1st April, 2015	As at 31st March, 2015
				(₹ in lakhs)	(₹ in lakhs)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	82.10	
		(b) Reserves and surplus	2	481.90	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Other current liabilities	3	676	
		Total		1,240	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	140	
	2	**Current assets**			
		(a) Other current assets	5	1,100	
		Total		1,240	

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

(₹ in Lakhs)

Note 1. Share Capital	**As at 1st April, 2015**	**As at 31st March, 2015**
Authorised, Issued, Subscribed & paid up 8.21 lakhs Equity Shares of ₹ 10 each [of the above shares, 21,000 Equity shares are allotted as fully paid up for consideration other than cash]	82.10	
Total	82.10	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE :-		**As at 1st April 2015**		**As at 31st March 2015**
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.15	8	80.00	NIL	NIL
Add: Fresh Issue (Incld, Bonus shares, Right shares, split shares, shares issued other than cash)	0.21	2.10	NIL	NIL
	8.21	82.10	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	8.21	82.10	NIL	NIL

Note: It has been assumed that Current assets have been taken over by S Ltd. at their book value.

Note 2. Reserves and Surplus	As at 1st April, 2015	As at 31st March, 2015
Reserves Capital Reserve Securities Premium	400.00 63.00 18.90	
Total	481.90	

Note 3. Other Current Liabilities	As at 1st April, 2015	As at 31st March, 2015
Other Liabilities Current Liabilities (356+200)	120.00 556.00	
Total	676.00	

Note 4. Tangible assets	As at 1st April, 2015	As at 31st March, 2015
Particulars	Amount (₹)	Amount (₹)
Fixed asset (100+40)	140.00	
Total	140.00	

Note 5. Other Current Assets	As at 1st April, 2015	As at 31st March, 2015
Current Assets (800+300)	1,100.00	
Total	1100.00	

Note : It has been assumed that Current assets have been taken over by S Ltd. as their book value.

Illustration 17.

The draft Balance Sheets of S Ltd. and P Ltd. as on 31.03.15 are as under:

(₹ in Lakhs)

Liabilities	***S***	***P***	***Assets***	***S***	***P***
Equity Shares of ₹ 100 each	25.00	50.00	Fixed Assets	110.00	50.00
Reserves	131.00	29.25	Investments	16.25	25.00
12% Debentures	11.00	5.50	Current Assets	40.25	3.25
Creditors	8.00	2.75	Miscellaneous Expenditure	8.50	9.25
	175.00	**87.50**		**175.00**	**87.50**

Investments of S Ltd. represents 12,500 shares of P Ltd. investments of P Ltd. are considered worth ₹ 30 lakhs.

P Ltd. is taken over by S Ltd. on the basis of the intrinsic value of shares in their respective books of accounts.

Prepare a statement showing the number of shares to be allotted by S Ltd. to P Ltd. and the balance sheet of S Ltd. after absorpotion of P Ltd.

Solution :

Part. I : Purchase consideration

WN # 1 Net Assets

(₹ in Lakhs)

			S Ltd.	P Ltd.
A.	Assets			
	i)	Fixed Assets	110.00	50.00
	ii)	Investments	18.75*	30.00
	iii)	Current Assets	40.25	3.25
			169.00	83.25
B.	Liabilities			
	i)	12% Debentures	11.00	5.50
	ii)	Creditors	8.00	2.75
			19.00	7.75
C.	Net Assets [A-B]		150.00	75

* Investments of 'S' Ltd = 12,500 × ₹ 150 [WN # 2]
= ₹ 18.75 Lakhs.

WN # 2 : Intrinsic Value

	S Ltd.	P. Ltd.
Net assets	150.00 Lakhs	75.00 Lakhs
No. of equity shares	25,000	50,000
Intrinsic value	₹ 600	₹ 150.00

WN # 3 : *Purchase consideration (No. of shares alloted)*

No. of equity shares outstanding in P Ltd	50,000
Less: Already held by S Ltd.	12,500
No. of equity shares of outsiders	37,500
Intrinsic value of P Ltd.	₹ 150
Purchase consideration (37,5000 × 150)	56,25,000
Instrinsic value per share of S Ltd.	₹ 600
No. of shares to be allotted	56,25,000/600
	9,375 shares

Equity Share Capital = 9,375 × 100 = 9,37,500

Securities Premium = 9,375 × 500 = 46,87,500

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

- Nature of Amalgamation - Purchase
- Method of Accounting - Purchase

(₹)

	Particulars		*Debit*	*Credit*
1.	For Purchase Consideration Due :			
	Business Purchase A/c	Dr.	56,25,000	
	To Liquidator of P Ltd. A/c			56,25,000
2.	For assets and liabilities taken over :			
	Fixed Assets A/c	Dr.	50,00,000	
	Investments A/c	Dr.	30,00,000	
	Current Assets A/c	Dr.	3,25,000	
	To 12% Debentures A/c			5,50,000
	To Creditors A/c			2,75,000
	To Business Purchase A/c			56,25,000
	To Investment in shares of P Ltd. A/c			16,25,000
	To Capital Reserve (Balancing Figure)			2,50,000
3.	Discharge of purchase consideration :			
	Liquidator of P Ltd. A/c	Dr.	56,25,000	
	To Share Capital A/c			9,37,500
	To Securities Premium A/c			46,87,500

Name of the Company: S Ltd.

Balance Sheet as at 31.03.2015

Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				(₹ in Lakhs)	(₹ in Lakhs)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	34.378	
		(b) Reserves and surplus	2	180.375	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	16.50	
	4	**Current Liabilities**			
		(a) Trade payables	4	10.75	
		Total (1+2+3+4)		242.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	160.00	
		(b) Non-current investments	6	30.00	
	2	**Current assets**			
		(a) Other current assets	7	52.00	
		Total (1+2)		242.00	

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

(₹ in Lakhs)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorised, Issued, Subscribed & Paid up :- 34,375 equity shares of ₹100 each [of the above shares 9,375 equity shares are allotted as fully paid up for consideration other than cash]	34.38	
Total	34.38	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	0.25	25.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	0.09	9.38	NIL	NIL
	0.3438	34.38	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	0.3438	34.38	NIL	NIL

Note 2. Reserves and Surplus	**31.03.15**	**31.03.14**
Reserves	131.00	
Capital Reserve	2.50	
Securities Premium	46.875	
Total		180.375

Note 3. Longterm borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Secured Loan		
12% Debentue	16.50	
Total	16.50	

Note 4. Trade Payable	**As at 31st March, 2015**	**As at 31st March, 2014**
Creditors	10.75	
Total	10.75	

Note 5. Tangible assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Fixed Assets (110+50)	160.00	
Total	160.00	

Note 6. Non Current investments	**As at 31st March, 2015**	**As at 31st March, 2014**
Investments	30.00	
Total	30.00	

7. Other Current assets	As at 31st March, 2015	As at 31st March, 2014
Current assets Miscellaneous expenditure	43.50 8.50	
Total	52.00	

IV. Selling Company holding shares in Purchasing Company

Illustration 18.

Following are the extract Balance sheets of two companies, B Ltd. and D Ltd. as at March 31, 2015.

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

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

Solution:

Part I: In the Books of D Ltd.

Particulars		***Debit*** ₹	***Credit*** ₹
1. Realisation A/c	Dr.	3,50,000	
To Sundry Assets A/c			3,50,000
[Being the assets taken over by B Ltd. transferred to Realisation A/c]			
2. Creditors A/c	Dr.	95,000	
To Realisation A/c			95,000
[Being Creditors taken over by B Ltd. transferred Realisation A/c]			
3. B Ltd. A/c	Dr.	2,12,500	
To Realisation A/c			2,12,500
[Being purchase consideration (WN # 2) receivable]			
4. Shares in B Ltd. A/c	Dr.	2,12,500	
To B Ltd. A/c			2,12,500
[Being discharge of purchase consideration]			
5. Shareholders A/c	Dr.	42,500	
To Realisation A/c			42,500
[Being realisation loss transferred to Shareholder A/c]			

6.	Share Capital A/c	Dr.	3,00,000	
	Reserves A/c	Dr.	55,000	
	To Shareholders A/c			3,55,000
	[Being Share capital and Reserves transferred to Shareholders A/c]			
7.	Shareholders A/c	Dr.	3,12,500	
	To Shares in B Ltd.			3,12,500
	[Being the settlement to shareholders for the amount due]			

Calculation of Purchase consideration - Net Assets Method

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

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

WN # 2: ***Purchase Consideration***

	Particulars	Amount (₹)
a)	No. of shares of D Ltd.	30,000
b)	Value of shares @ ₹ 12.50	₹ 3,75,000
c)	No. of shares issuable based on intrinsic value of ₹ 12 (3,75,000 ÷ 12)	31,250
d)	No. of shares held by D Ltd.	(10,000)
e)	Net shares to be issued	21,250
f)	Total consideration at par (21,250 x ₹ 10)	₹ 2,12,500

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

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest

	Particulars		Debit (₹)	Credit (₹)
1.	For Purchase Consideration Due:			
	Business Purchase A/c	Dr.	2,12,500	
	To Liquidator of D Ltd.'s A/c			2,12,500
2.	a. For of assets and liabilities taken over			
	i. Aggregate consideration to share holders of Selling Company			
	* Shares already held by D Ltd.	1,00,000		
	* Shares now issued	2,12,500		

ii. Paid up capital of D Ltd. 3,12,500			
(3,00,000)			
iii. Excess 12,500			
iv. Above excess to be adjusted against reserves of D Ltd. 12,500			
v. Balance of reserves to be incorporated (55,000 - 12,500) 42,500			
b. Assets A/c	Dr.	3,50,000	
To Creditors A/c			95,000
To Reserves A/c			42,500
To Business Purchase A/c			2,12,500
3. Discharge of Purchase consideration			
Liquidator of D Ltd.'s A/c	Dr.	2,12,500	
To Equity Share Capital A/c			2,12,500
4. Others			
a. Cancellation of Inter company owings			
Creditors A/c	Dr.	20,000	
To Sundry Assets A/c			20,000
b. Adjusted of Stock Reserve			
Reserve A/c	Dr.	5,000	
To Stock Reserve			5,000

Name of the Company: B Ltd.

Balance Sheet as at 31.03.2015 (After absorption)

Ref No.		Particulars	Note No.	After	Before
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	7,12,500	
		(b) Reserves and surplus	2	1,37,500	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Trade payables	3	2,25,000	
		Total		10,75,000	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	10,75,000	
	2	**Current assets**		Nil	
		Total		10,75,000	

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

(₹)

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

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	After		Before	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.01.14	50000	5,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	21,250	2,12,500	NIL	NIL
	71,250	7,12,500	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	71,250	7,12,500	NIL	NIL

Note 2. Reserves and Surplus	After	Before
Reserve(1,00,000+42,500-5,000)	1,37,500	
Total	1,37,500	
Note 3.Trade Payables	**After**	**Before**
Creditors	2,25,000	
Total	2,25,000	

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

V. Cross Holding

Illustration 19.

The following draft Balance sheets of A Ltd. and B Ltd. as at 31st March, 2015 are given to you:

	A Ltd. ₹	*B Ltd.* ₹
Liabilities:		
Equity Share capital		
of ₹10 each	15,00,000	5,00,000
General Reserve	2,00,000	1,00,000
Profit and Loss Account	1,60,000	10,000
10% Debentures	—	3,00,000
Current liabilities	2,00,000	90,000
	20,60,000	**10,00,000**

Assets:		
Fixed Assets	10,00,000	50,000
Sundry Debtors	2,90,000	1,50,000
Stock	4,80,000	2,10,000
10,000 shares in B Ltd.	1,50,000	—
30,000 shares in A Ltd.	—	5,00,000
Cash at bank	1,40,000	90,000
	20,60,000	**10,00,000**

B Ltd. traded raw material which were required by A Ltd. for manufacture of its products. Stock of A Ltd. includes ₹ 1,00,000 for purchases made from B Ltd. on which the company (B Ltd.) made a profit of 12% on selling price. A Ltd. owed ₹ 25,000 to B Ltd. in this respect. It was decided that A Ltd. should absorb B Ltd. on the basis of the intrinsic value of the shares of the two companies. Before absorption, A Ltd. declared a dividend of 10%. A Ltd. also decided to revalue the shares in B Ltd. before recording entries relating to the absorption.

Show the journal entries, which A Ltd. must pass to record the acquisition and prepare its balance sheet immediately thereafter. All workings should from part of your answer.

Solution :

Part I - Purchase consideration - Net Asset Method.

WN #1: *Net assets excluding inter company investment at the time of Amalgamation*

(₹)

Particulars	***A***	***B***
Fixed Assets	10,00,000	50,000
Sundry Debtors	2,90,000	1,50,000
Stock	4,80,000	2,10,000
Cash	1,40,000	90,000
Dividend Receivable		30,000
Less:		
10% Debentures	—	(3,00,000)
Current liabilities	(2,00,000)	(90,000)
Proposed Dividend	(1,50,000)	
	15,60,000	**1,40,000**

WN # 2 : *Intrinsic value of investment*

A	=	15,60,000 + 0.2 B
B	=	1,40,000 + 0.2 A
A	=	15,60,000 + 0.2 (1,40,000 + 0.2A)
A	=	15,60,000 + 28,000 + 0.04A
0.96A	=	15,88,000
A	=	16,54,166.67
B	=	1,40,000 + 0.2 (16,54,166.67)
	=	4,70,833.32

Summary : (₹)

Particulars	*A Ltd.*	*B Ltd.*
a) Net Assets (₹)	16,54,167	4,70,833
b) No. of shares outstanding	1,50,000	50,000
c) Intrinsic value per share	₹ 11	₹ 9.4

WN # 3: Purchase consideration

Total no. of B Ltd.'s shares outstanding	50,000
Less: No. of shares held by A Ltd	10,000
Shares held by outsiders	40,000
Value of the above shares (40,000 × ₹ 9.40)	₹ 3,76,000
Number of shares issuable at intrinsic value (3,76,000÷11)	34,182
Less: Number of shares already held by B Ltd.	30,000
Number of shares to be issued	4,182
Purchase consideration (4,182 x 11)	₹ 46,002

In Shares	In Cash
₹ 46,000	₹ 2

Part II - In the books of Selling Company - B Ltd.

Section A: Pre-Amalgamation Event (₹)

Particulars		*Debit*	*Credit*
i. Dividend Receivable			
Dividend Receivable A/c	Dr.	30,000	
To Profit and Loss A/c			30,000

Note : Revised Profit and Loss A/c balance = ₹ 10,000 + 30,000

= ₹ 40,000

Section B** : **Entries relating to Amalgamation

Realisation Account

Dr. **Cr.**

Particulars	*Amount* (₹)	*Particulars*	*Amount* (₹)
To Fixed Assets	50,000	By Debentures	3,00,000
To Debtors	1,50,000	By Creditors	90,000
To Stock	2,10,000	By A Ltd.'s A/c (Purchasing Co.)	46,002
To Cash	90,000	By Share capital (Head as Investment)	1,00,000
To Dividend Receivable	30,000		
To Profit transferred to share holders	6,002		
	5,36,002		**5,36,002**

Particulars		***Debit*** ₹	***Credit*** ₹
1. Transfer to Realisation Account			
a. Transfer of Assets			
Realisation A/c	Dr.	5,30,000	
To Fixed Assets A/c			50,000
To Debtors A/c			1,50,000
To Stock A/c			2,10,000
To Cash A/c			90,000
To Dividend Receivable A/c			30,000
(Being assets taken over by transferred to Realisation A/c)			
b. Transfer of Liabilities			
10% Debentures A/c	Dr.	3,00,000	
Creditors A/c	Dr.	90,000	
To Realisation A/c			3,90,000
(Being liabilities taken over by A Ltd. transferred to Realisation A/c)			
2a. **Purchase consideration due:**			
A Ltd A/c	Dr.	46,002	
To Realisation A/c			46,002
b. Receipt of Purchase Consideration :			
Cash A/c	Dr.	2	
Equity shares of A Ltd A/c	Dr.	46,000	
To A Ltd A/c			46,002
3. Cancellation of paid up capital to the extent of A Ltd's Interest (Purchasing Co.) :			
Share Capital A/c	Dr.	1,00,000	
To Realisation A/c			1,00,000
4. a. Amount due to outside shareholders : Transfer of remaining Share capital and all reserves			
Share Capital A/c	Dr.	4,00,000	
General Reserve A/c	Dr.	1,00,000	
Profit & Loss A/c	Dr.	40,000	
To Shareholders A/c			5,40,000
b. Transfer of profit on realisation to shareholders :			
Realisation A/c	Dr.	6,002	
To Shareholders A/c			6,002
5. Settlement of amount to outsiders (5,40,000 + 6,002) :			
Shareholders A/c	Dr.	5,46,002	
To Equity shares of A Ltd. (5,00,000 + 46,000)			5,46,000
To Cash A/c			2

PART III - In the books of A Ltd (Purchasing co.)

Section A - Pre Amalgamation Events. (₹)

Particulars		**Debit**	**Credit**
1. Proposed dividend :			
Profit & Loss A/c	Dr.	1,50,000	
To Proposed Dividend A/c			1,50,000
2. Revaluation of Investments			
Profit and Loss A/c	Dr.	56,000	
To Investments A/c [1,50,000 - (10,000 × 9.4)]			56,000

Section B - Amalgamation events

- Nature of Amalgamation : Merger
- Method of Accounting : Pooling of Interest

(₹)

Particulars					**Debit**	**Credit**
3. For Purchase Consideration Due :-						
Business Purchase A/c				Dr.	46,002	
To Liquidator of B Ltd.'s A/c						46,002
4. For assets and liabilities taken over :						
a. Aggregate investment - Consideration Paid						
i. Investment of A Ltd. in B		94,000				
ii. Paid to outsiders.						
I. Now issued	46,002					
II. Already held by A Ltd. in B Ltd.	<u>5,00,000</u>	<u>5,46,002</u>				
		6,40,002				
III. Less: Paid up capital		<u>(5,00,000)</u>				
IV. Excess		<u>1,40,002</u>				
b. Above excess to be adjusted against						
i. General reserve of B Ltd.			1,00,000			
ii. P & L A/c of B Ltd.			<u>40,000</u>			
c. Balance of B Ltd reserve to be incorporated			1,40,000			
i. General reserve (1,00,000 – 1,00,000)			Nil			
ii. Profit and Loss A/c (40,000 – 40,000)			Nil			
Fixed Assets A/c				Dr.	50,000	
Sundry Debtors A/c				Dr.	1,50,000	
Stock A/c				Dr.	2,10,000	
Cash at Bank A/c (90,000 + 2)				Dr.	90,002	
Dividend Receivable A/c				Dr.	30,000	
To Debentures A/c						3,00,000
To Creditors A/c						90,000

To Business Purchase A/c			46,002
To Investments in B Ltd A/c			94,000
5. Discharge of Purchase Consideration:			
Liquidator of B Ltd A/c	Dr.	46,002	
To Equity Share Capital A/c			41,818
To Securities Premium A/c			4,182
To cash A/c			2
6. Others			
a. Cancellation of inter company dividends.			
Proposed Dividend A/c	Dr.	30,000	
To Dividend Receivable A/c			30,000
b. Cancellation of inter company owings.			
Creditors A/c	Dr.	25,000	
To Debtors A/c			25,000
c. Creation of Stock Reserve			
Profit & Loss A/c	Dr.	12,000	
To Stock Reserve A/c			12,000

Name of the Company: A Ltd.

Balance Sheet as at 31.03.2015 (After absorption)

Ref No.		Particulars	Note No.	After	Before
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	15,41,820	
		(b) Reserves and surplus	2	1,46,182	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	3,00,000	
	4	**Current Liabilities**			
		(a) Other current liabilities	4	2,65,000	
		(b) Short-term provisions	5	1,20,000	
		Total		23,73,002	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	10,50,000	
	2	**Current assets**			
		(a) Inventories	7	6,78,000	
		(b) Trade receivables	8	4,15,000	
		(c) Cash and cash equivalents	9	2,30,002	
		Total		23,73,002	

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

(₹)

Note 1. Share Capital	**After**	**Before**
Authorised, Issued,and paid up Capital of ₹ 100 each (out of which 4182 shares were issued for consideration other than cash)	15,41,820	
Total	15,41,820	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**After**		**Before**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	1,50,000	15,00,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	4,182	41,820	NIL	NIL
	1,54,182	15,41,820	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	1,54,182	15,41,820	NIL	NIL

Note 2. Reserves and Surplus	**After**	**Before**
Securities Premium	4,182	
General Reserve	2,00,000	
Profit and Loss A/c	(58,000)	
Total	1,46,182	

Note 3. Long Term borrowing	**After**	**Before**
100% Debentures	3,00,000	
Total	3,00,000	

Note 4. Other Current Liabilities	**After**	**Before**
Current Liabilities	2,65,000	
Total	2,65,000	

Note 5. Short-term provision	**After**	**Before**
Proposed Dividend	1,20,000	
Total	1,20,000	

Note 6. Tangible	**After**	**Before**
Fixed Assets (1000000 + 50,000)	10,50,000	
Total	10,50,000	

Note 7. Inventories	After	Before
Stock (480 + 210) 6,90,000	6,78,000	
Less : Reserves 12,000		
Total	6,78,000	

Note 8. Trade	After	Before
Particulars	Amount (₹)	Amount (₹)
Debtors (290+150)	4,15,000	
Total	4,15,000	

Note 9. Cash and Cash Equivalent	After	Before
Particulars	Amount (₹)	Amount (₹)
Cash at Bank	2,30,002	
Total	2,30,002	

Illustration 20.

The following are the draft Balance Sheets of A Ltd. and B Ltd. as on 31st March 2015.

Liabiltiies	***A Ltd.*** ₹	***B Ltd.*** ₹	***Assets***	***A Ltd.*** ₹	***B Ltd.*** ₹
Share capital			**Fixed Assets**	7,00,000	2,50,000
Equity shares of ₹ 10 each	6,00,000	3,00,000	**Investment:**		
10% Preference shares of ₹ 10 each	2,00,000	1,00,000	6,000 shares of B Ltd.	80,000	-
			5,000 shares of A Ltd.	-	80,000
Reserves and surplus	3,00,000	2,00,000	**Current Assets:**		
			Stock	2,40,000	3,20,000
Secured loans:			Debtors	3,60,000	1,90,000
12% Debentures	2,00,000	1,50,000	Bills receivable	60,000	20,000
Current liabilities			Cash at bank	1,10,000	40,000
Sundry creditors	2,20,000	1,25,000			
Bills payable	30,000	25,000			
	15,50,000	**9,00,000**		**15,50,000**	**9,00,000**

Fixed assets of both the companies are to be revalued at 15% above book value. Stock-in-trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, A Ltd. will absorb B Ltd. on the following terms.

i. 8 Equity shares of ₹ 10 each will be issued by A Ltd. at par against 6 shares of B Ltd.

ii. 10% Preference Shareholders of B Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in A Ltd.

iii. 12% Debentureholders of B Ltd. are to be paid at 8% premium by 12% Debentues in A Ltd. issued at a discount of 10%.

iv. ₹ 30,000 is to be paid by A Ltd. to B Ltd. for Liquidation expenses. Sundry creditors of B Ltd. include ₹ 10,000 due to A Ltd.

Prepare :

(a) Absorption entries in the books of A Ltd.

(b) Statement of consideration payable by A Ltd.

Solution:

Part - I *Purchase consideration payable by A Ltd.*

A. *Equity share holders:*

No of equity shares of B Ltd.	30,000
Less:- Held by A Ltd.	6,000
No. of equity shares held by outsiders	24,000
Exchange ratio	8:6
No. of equity shares to be issued by A Ltd. (24,000 × 8/6)	32,000
Less: Already held by B Ltd. in A Ltd.	(5,000)
No. of equity shares to be issued now	27,000
Value of shares to be issued 27,000 × 10 =	₹ 2,70,000

B. *Preference share holders:*

Preference Share capital of B Ltd.	1,00,000
Payable at discount of 10% [100,000 - (10% of 100,000)]	90,000
10% Preference shares to be issued at par by A Ltd. to B Ltd.	₹ 90,000

C. *Purchase consideration (A+B)* ₹ 3,60,000

Part II - Absorption entries in the books of A Ltd.

A. Pre - Amalagamation Events :-

	Particulars		*Debit*	*Credit*
1.	Revaluation of Fixed assets			
	Fixed Assets A/c	Dr.	1,05,000	
	To Revaluation Reserve A/c			1,05,000
2.	Dividend received from B Ltd. on 600 shares			
	Bank A/c	Dr.	6,000	
	To Reserves and Surplus			6,000
3.	Dividend on equity Share capital @ 10%			
	i. Due entry			
	Reserves and Surplus	Dr.	60,000	
	To Proposed Dividend A/c			60,000
	ii. Payment entry			
	Proposed Dividend A/c	Dr.	60,000	
	To Bank A/c			60,000

B. ***Amalgamation Events***

Nature of Amalgamation - Purchase

Method of Accounting - Purchase (₹)

Particulars		***Debit***	***Credit***
1. For Purchase Consideration Due:			
Business purchase A/c	Dr.	3,60,000	
To Liquidator of B Ltd.			3,60,000
2. For assets and liabilities taken over			
Fixed Assets (115% of 2,50,000)	Dr.	2,87,500	
Stock A/c (95% of 3,20,000)	Dr.	3,04,000	
Debtors A/c (1,90,000 × 95%)	Dr.	1,80,500	
Bills Receivable A/c	Dr.	20,000	
Bank A/c *	Dr.	15,000	
To 12% Debentures of B Ltd A/c			1,62,000
To Sundry creditors A/c			1,25,000
To Bills payable A/c			25,000
To Business Purchase A/c			3,60,000
To Investment in B Ltd. A/c			80,000
To Capital Reserve A/c (Balancing Figure)			55,000
3. For Discharge of Purchase consideration			
Liquidator of B Ltd A/c	Dr.	3,60,000	
To Equity Share Capital A/c			2,70,000
To 10% Preference Share Capital A/c			90,000
4. Liquidation expenses incurred by B Ltd, later reimbursed by A Ltd.			
Capital Reserve A/c	Dr.	30,000	
To Bank A/c			30,000
5. Discharge to debenture holders of B Ltd.			
12% Debenture Holders A/c	Dr.	1,62,000	
Discount on Issue of debentures A/c	Dr.	18,000	
To 12% Debentures A/c.			1,80,000
6. Cancellation of inter company owings			
Sundry Creditors A/c	Dr.	10,000	
To Sundry Debtors A/c			10,000

* Bank Balance of B Ltd.	
Balance as per Balance Sheet	40,000
Add : Dividend Received from A Ltd (10% on 50,000)	5,000
Less : Dividend paid on Share capital (10% on 3,00,000)	[30,000]
	15,000
# 12% Debentures of B Ltd.	1,50,000
Payable at 8% premium 1,50,000 × 108% = 1,62,000	

VI. Chain Holding

Illustration 21.

The following are the summarized Balance Sheet of A Ltd. and B Ltd.

(₹)

Liabilities	*A Ltd.*	*B Ltd.*	*Assets*	*A Ltd.*	*B Ltd.*
Equity Share Capital A/c	32,000	28,000	Sundry assets	42,000	33,000
Profit and Loss A/c	5,000	—	Shares in B Ltd.	20,000	—
Creditors	15,000	6,000	Profit and Loss A/c	—	1,000
Loan - C Ltd.	10,000	—			
	62,000	**34,000**		**62,000**	**34,000**

Note : Loan from C Ltd. assumed to be of less that 12 months, hence treated as short terms borrowings (ignoring interest)

The whole of the shares of A Ltd. are held by C Ltd. and the entire Share capital of B Ltd. is held by A Ltd.

A new company Z Ltd. is formed to acquire the sundry assets and liabilities of A Ltd. and B Ltd. For the purpose, the sundry assets of A Ltd. are revalued at ₹ 30,000 and those of B Ltd. at ₹ 20,000.

Show the journal entries and prepare necessary ledgers A/c to close the books of A Ltd. and B Ltd.

Solution:

In the Books of A Ltd.

(₹)

	Particulars		*Debit*	*Credit*
1.	Realisation A/c	Dr.	62,000	
	To Sundry Assets A/c			42,000
	To Investment in B Ltd. A/c			20,000
	[Being sundry assets and shares in B Ltd. transferred to Realisation A/c on sale of business of A Ltd.]			
2.	Creditors A/c	Dr.	15,000	
	Loan (C Ltd.) A/c	Dr.	10,000	
	To Realisation A/c			25,000
	[Sundry creditors and loans transferred to Realisation A/c on sale of business to Z Ltd.]			
3.	Z Ltd. A/c	Dr.	5,000	
	To Realisation A/c			5,000
	[Amount of purchase consideration receivable from Z Ltd.]			
4.	Shares in Z Ltd. A/c	Dr.	5,000	
	To Z Ltd. A/c			5,000
	[Amount of purchase consideration received as shares of B Ltd.]			
5.	Shares in Z Ltd. A/c	Dr.	14,000	
	To Realisation A/c			14,000
	[Amount of shares in Z Ltd. received against investment in Z Ltd.]			
6.	Shareholders (C Ltd.) A/c	Dr.	18,000	
	To Realisation A/c			18,000
	[Loss on realisation transferred to Shareholders A/c]			

7. Equity Share Capital A/c	Dr.	32,000	
Profit and Loss A/c	Dr.	5,000	
To Realisation A/c			37,000
[Balance of Share capital and Profit and Loss A/c transfer to Share holder A/c]			
8. Shareholders (C Ltd.) A/c	Dr.	19,000	
To Shares in Z Ltd. A/c			19,000
[Amount payable to shareholders discharged by issue of shares in Z Ltd. (14,000÷5,000)]			

In the Books of B Ltd.

Particulars		***Debit***	***Credit***
1. Realisation A/c	Dr.	33,000	
To Sundry Assets A/c			33,000
[Being Sundry Assets and Shares in B Ltd. transferred to Realisation account on sale of business to Z Ltd.]			
2. Creditors A/c	Dr.	6,000	
To Realisation A/c			6,000
[Sundry Creditor is transferred to Realisation A/c on sale of Business to Z Ltd.]			
3. Z Ltd. A/c	Dr.	14,000	
To Realisation A/c			14,000
[Amount of purchase consideration receivable from Z Ltd. on transfer sundry assets, creditor and Loan vide agreement dated.....]			
4. Equity Share Capital A/c	Dr.	28,000	
To Shareholders (A Ltd.) A/c			28,000
[Being amount of Share capital transferred to Shareholder A/c]			
5. Shareholders A/c	Dr.	14,000	
To Realisation A/c			13,000
To Profit and Loss A/c			1,000
[Loss on realisation and Profit and Loss A/c debit balance transferred to Share holders A/c]			
6. Shares in Z Ltd. A/c	Dr.	14,000	
To Z Ltd. A/c			14,000
[Amount of purchase consideration received in shares of Z Ltd.]			
7. Shareholders (A Ltd.) A/c	Dr.	14,000	
To Shares in Z Ltd.			14,000
[Amount payable to shareholders discharged by issue of shares in Z Ltd.]			

WN # 1 : *Calculation of Purchase Consideration (Net Assets Method)* (₹)

Particulars	***A Ltd.***	***B Ltd.***
Value of net assets	30,000	20,000
Creditors	(15,000)	(6,000)
Loans from C Ltd.	(10,000)	—
Purchase Consideration	**5,000**	**14,000**

In the Books of B Ltd. :

Realisation Account

Dr. Cr.

Particulars	***Amount (₹)***	***Particulars***	***Amount (₹)***
To Sundry Assets	33,000	By Creditors A/c	6,000
		By A Ltd. (Purchase Consideration)	14,000
		By Shareholders (A Ltd.) A/c (Loss on Realisation)	13,000
	33,000		**33,000**

Shareholders (A Ltd.) Account

Dr. Cr.

Particulars	***Amount (₹)***	***Particulars***	***Amount (₹)***
To Realisation A/c	13,000	By Share Capital A/c	28,000
To Profit and Loss A/c	1,000		
To Shares in Z Ltd. A/c	14,000		
	28,000		**28,000**

In the Books of A Ltd. :

Realisation Account

Dr. Cr.

Particulars	***Amount (₹)***	***Particulars***	***Amount (₹)***
To Sundry Assets	42,000	By Creditors A/c	15,000
To Investments in B Ltd.	20,000	By Loan (Z Ltd.)	10,000
		By A Ltd. (Purchase consideration)	5,000
		By Shares in A Ltd.	14,000
		By Shareholders A/c (Loss on Realisation)	18,000
	62,000		**62,000**

Sundry Shareholders (A Ltd.) Account

Dr. Cr.

Particulars	***Amount (₹)***	***Particulars***	***Amount (₹)***
To Realisation A/c	18,000	By Share capital A/c	32,000
To Shares in Z Ltd. (14,000 from B Ltd. 5,000 from Z Ltd.)	19,000	By Profit and Loss A/c	5,000
	37,000		**37,000**

VII. Internal Reconstruction

Illustration 22.

The draft Balance Sheet of X Ltd. as on 31st March, 2015 before reconstruction is:

Liabilities	₹	***Assets***	₹
12,000 7% Preference	6,00,000	Building at cost	
shares of ₹ 50 each		Less: Depreciation	4,00,000
7,500 Equity shares of ₹ 100 each	7,50,000	Plant at cost	
		Less: Depreciation	2,68,000
		Trade Marks and Goodwill	
(Note : Preference dividend is		at Cost	3,18,000
in arrear for five years)		Stock	4,00,000
Loan	5,73,000	Debtors	3,28,000
Sundry creditors	2,07,000	Preliminary expenses	11,000
Other liabilities	35,000	Profit and Loss A/c	4,40,000
Total	**21,65,000**	**Total**	**21,65,000**

Note: Loan is assumed to be of less than 12 months, hence treated as short term borrowings (ignoring interest)

The Company is now earning profits short of working capital and a scheme of reconstruction has been approved by both classes of shareholders. A summary of the scheme is as follows:

a. The Equity Shareholders have agreed that their ₹ 100 shares should be reduced to ₹ 5 by cancellation of ₹ 95 per share. They have also agreed to subscribe in each for the six new Equity Shares of ₹ 5 each for two Equity Share held.

b. The Preference Shareholders have agreed to cancel the arrears of dividends and to accept for each ₹50 share, 4 new 5 per cent Preference Shares of ₹10 each, plus 3 new Equity Shares of ₹ 5 each, all credited as fully paid.

c. Lenders to the Company of ₹ 1,50,000 have agreed to convert their loan into share and for this purpose they will be allotted 12,000 new preference shares of ₹10 each and 6,000 new equity share of ₹ 5 each.

d. The Directors have agreed to subscribe in cash for 20,000, new Equity Shares of ₹ 5 each in addition to any shares to be subscribed by them under (a) above.

e. Of the cash received by the issue of new shares, ₹ 2,00,000 is to be used to reduce the loan due by the Company.

f. The equity Share capital cancelled is to be applied:

   i. to write off the preliminary expenses;

   ii. to write off the debit balance in the Profit and Loss A/c ; and

   iii. to write off ₹ 35,000 from the value of Plant.

Any balance remaining is to be used to write down the value of Trade Marks and Goodwill.

Show by journal entries how the financial books are affected by the scheme and prepare the balance sheet of company after reconstruction. The nominal capital as reduced is to be increased to the old figures of ₹ 6,50,000 for Preference capital and ₹ 7,50,000 for Equity capital.

Solution :

(₹)

Particulars		*Debit*	*Credit*
1. Reduction of Equity capital			
Equity Share capital A/c (Face Value ₹ 100)	Dr.	7,50,000	
To Equity Share capital (Face value ₹ 5) A/c			37,500
To Reconstruction A/c			7,12,500
2. Right issue : (7,500 × 3 = 22,500 Shares)			
(a) Bank A/c	Dr.	1,12,500	
To Equity Share Application A/c			1,12,500
(b) Equity Share Application A/c	Dr.	1,12,500	
To Equity Share Capital A/c			1,12,500
3. Cancellation of arrears of preference dividend			
NO ENTRY (as it was not provided in the Books of Accounts)			
Note :			
(a) On cancellation, it ceases to be a contingent liability and hence no further disclosure			
(b) Preference shareholders have to forego voting rights presently enjoyed at par with equity share holders			
4. Conversion of preference shares			
7% Preference Share Capital A/c	Dr.	6,00,000	
Reconstruction A/c (balancing figure)	Dr.	60,000	
To 5% Preference Share Capital (12,000×4×10)			4,80,000
To Equity Share Capital (12,000 × 3 × 5)			1,80,000
5. Conversion of Loan			
Loan A/c	Dr.	1,50,000	
To 5% Preference Share Capital A/c			1,20,000
To Equity Share Capital A/c			30,000
6. Subscription by directors:			
(a) Bank A/c	Dr.	1,00,000	
To Equity Share Application A/c			1,00,000
(b) Equity Share Application A/c	Dr.	1,00,000	
To Equity Share Capital A/c			1,00,000

Particulars		Debit	Credit
7. Repayment of loan			
Loan A/c	Dr.	2,00,000	
To Bank			2,00,000
8. Utilisation of reconstruction surplus			
Reconstruction A/c	Dr.	6,52,500	
To Preliminary Expenses A/c			11,000
To Profit and Loss A/c			4,40,000
To Plant A/c			35,000
To Trademark and Goodwill A/c			1,66,500

Reconstruction Account

Dr. **Cr.**

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Preference shareholders	60,000	By Equity Share capital (FV ₹ 50)	7,12,500
To Preliminary expenses	11,000		
To Profit and Loss A/c	4,40,000		
To Plant A/c	35,000		
To Trademark and Goodwill	1,66,500		
	7,12,500		7,12,500

Bank Account

Dr. **Cr.**

Particulars	*Amount (₹)*	*Particulars*	*Amount (₹)*
To Equity share application A/c	1,12,500	By Loan A/c	2,00,000
To Equity share application A/c	1,00,000	By Balance c/d	12, 500
	2,12,500		2,12,500

Name of the Company: X Ltd.					
Balance Sheet as at 31st March, 2015 (and Reduced)					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				(₹)	(₹)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	10,60,000	
		(b) Reserves and surplus	2	-	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Short-term borrowings	3	2,23,000	
		(b) Trade payables	4	2,07,000	
		(c) Other current liabilities	5	35,000	
		Total		15,25,000	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	6,33,000	
		(ii) Intangible assets	7	1,51,500	
	2	**Current assets**			
		(a) inventories	8	4,00,000	
		(b) trade receivables	9	3,28,000	
		(c) Cash and cash equivalents	10	12,500	
		(d) Short-term loans and advances	11	-	
		Total		15,25,000	

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

(₹)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authosired Share Capital		
60,000 5% Preference Shares of ₹ 10 each	6,00,000	
1,50,000 Equity shares of ₹ 5 each	7,50,000	
	13,50,000	
Issued, subscribed and paid-up		
92,000 Equity shares of ₹ 5 each	4,60,000	
60,000 5% Preference Shares of ₹ 10 each	6,00,000	
Total	10,60,000	

FOR EQUITY SHARE :-	As at 31st March, 2015		As at 31st March, 2014	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	7500	37,500.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	84,500.00	422,500.00	NIL	NIL
	92000	460,000.00	NIL	NIL
Less: Buy Back of shares	-		-	-
	92000	460,000.00	NIL	NIL

FOR 5% PREFERENCE SHARE :-	As at 31st March, 2015		As at 31st March, 2014	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	60000	600,000.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	-	-	NIL	NIL
	60000	600,000.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	60000	600,000.00	NIL	NIL

Note 2. Reserves and Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
Profit and Loss A/c	(4,40,000)	
Less: Written off	4,40,000	
Total	0.00	

Note 3. Short term borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Loan	5,73,000	
Less: Reduced	3,50,000	
Total	2,23,000	

Note 4. Trade Payables	**As at 31st March, 2015**	**As at 31st March, 2014**
Sundry Creditors	2,07,000	
Total	2,07,000	

Note 5. Other Current Liabilities	**As at 31st March, 2015**	**As at 31st March, 2014**
Other Liabilities	35,000	
Total	35,000	

Note 6. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Building at cost Less Depreciation Plant at Cost Less Depreciation (2,68,000-35,000)	4,00,000 2,33,000	
Net Block	6,33,000	

Note 7. Intangible assets	As at 31st March, 2015	As at 31st March, 2014
Trade Mark at Goodwill at cost Less: Reduction	3,18,000 1,66,500	
Total	1,51,500	

8. Inventories	As at 31st March, 2015	As at 31st March, 2014
Inventories	4,00,000	
Total	4,00,000	

9. Trade receivables	As at 31st March, 2015	As at 31st March, 2014
Debtors	3,28,000	
Total	3,28,000	

10. Cash & Cash Equivalents	As at 31st March, 2015	As at 31st March, 2014
Bank	12,500	
Total	12500	

11. Other Current Assets	As at 31st March, 2015	As at 31st March, 2014
Preliminary Expenses Less: Reduced	11,000 11,000	
Total	NIL	

Note: Loan is assumed to be of less than 12 months. Hence, treated as short term borrowings.

Illustration 23.

M Ltd. is in the hands of a Receiver for debenture holders who holds a charge on all assets except uncalled capital. The following statement shows the position as regards creditors as on 31st March, 2015 :

Liabilities	₹	*Assets*	₹
Share capital	3,60,000	Property, Machinery	
in shares of ₹60 each		and Plant etc. (Cost	
₹ 30 paid up	-	₹ 3,90,000)	
First Debentures	3,00,000	estimated at	1,50,000
Second Debentures	6,00,000	Cash in hand	2,10,000
Unsecured Creditors	4,50,000	Investment	4,20,000
		Uncalled Capital	1,80,000
		Deficiency	7,50,000
	17,10,000		**17,10,000**

A holds the First Debentures for ₹ 3,00,000 and Second Debentures for ₹ 3,00,000. He is also an unsecured creditor for ₹ 90,000. B holds Second Debentures for ₹ 3,00,000 and is an unsecured creditor for ₹ 60,000.

The following scheme of reconstruction is proposed:-

1. A is to cancel ₹ 2,10,000 of the total debt owing to him, to advance ₹ 30,000 in cash and to take First Debentures (in cancellation of those already issued to him) for ₹ 5,10,000 in satisfaction of all his claims.
2. B is to accept ₹ 90,000 in cash in satisfaction of all claims by him.
3. Unsecured creditors (other than A and B) are to accept four shares of ₹ 7.50 each, fully paid in satisfaction of 75% of every ₹ 60 of their claim. The balance of 25% is to be postponed and to be payable at the end of three years from the date of Court's approval of the scheme. The nominal Share capital is to be increased accordingly.
4. Uncalled capital is to be called up in full and ₹ 52.50 per share cancelled, thus taking the shares of ₹ 7.50 each.

   Assuming that the scheme is duly approved by all parties interested and by the Court, give necessary journal entries and the Balance Sheet of the Company after the scheme has been carried into effect.

Solution :

WN # 1 : ***Calculation of P & L Debit Balance at the time of Reconstruction***

Liabilities	₹	*Assets*	₹
Share capital	1,80,000	Fixed assets	3,90,000
1st Debenture	3,00,000	(Book value)	
2nd Debenture	6,00,000	Cash	2,70,000
Unsecured creditors	4,50,000	Profit and Loss A/c (Bal. fig.)	8,70,000
	15,30,000		**15,30,000**

Particulars		Debit ₹	Credit ₹
1. Restructuring of A's liability:			
a. Ascertainment of amount due			
1st DebenturesA/c	Dr.	3,00,000	
2nd Debentures A/c	Dr.	3,00,000	
Unsecured Creditors A/c	Dr.	90,000	
To A's A/c			6,90,000
b. Waiver			
A's A/c	Dr.	2,10,000	
To Reconstruction A/c			2,10,000
c. Cash brought in			
Bank A/c	Dr.	30,000	
To A's A/c			30,000
d. Conversion of liability			
A's A/c	Dr.	5,10,000	
To 1st Debentures A/c			5,10,000
2. Restructuring of B's liability:			
2nd Debentures A/c	Dr.	3,00,000	
Unsecured creditors A/c	Dr.	60,000	
To Bank A/c			90,000
To Reconstruction A/c			2,70,000
3. Restructuring of other unsecured creditors*			
(4,50,000 - 90,000 - 60,000 = 3,00,000)			
Unsecured Creditors A/c	Dr.	3,00,000	
To Equity Share capital A/c			1,50,000
To Loan (Unsecured) A/c			75,000
To Reconstruction A/c			75,000
4. Share capital			
a. Call money due:			
Share call A/c	Dr.	1.80,000	
To Share capital A/c			1,80,000
b. Share Call Money Received :			
Bank A/c	Dr.	1,80,000	
To Share call A/c			1,80,000
c. Capital Reduction :			
Equity Share Capital A/c (Face value ₹ 60)	Dr.	3,60,000	
To Equity Share capital (Face value ₹7.50)			45,000
To Reconstruction A/c			3,15,000
5. Utilisation of reconstruction surplus			
Reconstruction A/c	Dr.	8,70,000	
To Profit and Loss A/c			8,70,000

a.	Scheme of settlement unit of liability is	60
b.	75% share (60 x .75)	45
	i. 4 Equity shares @ ₹ 7.5	30
	ii. Waiver	15
c.	25% share (60 x .25)	15
	[Can be carried forward as unsecured loan]	
	Note : Liability is settled in the Ratio of 30:15:15 (i.e. 2:1:1)	

Balance Sheet (and Reduced)

Liabilities	₹	***Assets***	₹
Share capital	1,95,000	Fixed assets	3,90,000
Debentures	5,10,000	Cash	3,90,000
Unsecured Loans	75,000		
	7,80,000		**7,80,000**

Dr. ***Reconstruction Account*** Cr.

Particulars	₹	***Particulars***	₹
To Profit and Loss A/c	8,70,000	By A's A/c	2,10,000
		By B's A/c	2,70,000
		By Unsecured creditors	75,000
		By Equity Share Capital	3,15,000
	8,70,000		**8,70,000**

Dr. ***Cash/Bank Account*** Cr.

Particulars	₹	***Particulars***	₹
To Balance b/d	2,70,000	By B's A/c	90,000
To A's A/c	30,000	By Balance c/d	3,90,000
To Share call A/c	1,80,000		
	4,80,000		**4,80,000**

Illustration 24.

The following was the drafted Balance Sheet of Bhushan Developers Ltd., as on 31st March 2015:

Liabilities		₹	***Assets***	₹
Authorised capital :			Goodwill	10,000
20,000 Equity Shares of			Land and buildings	20,500
₹10 each		2,00,000	Machinery	50,850
Issued, subscribed and			Stock	10,275
paid up capital			Book debts	15,000
12,000 Shares of			Cash at bank	1,500
₹10 each	1,20,000		Profit and Loss A/c :	
Less: Calls in arrear			Balance as per last	
(₹ 3 per share				

Liabilities		₹	*Assets*		₹
			Balance Sheet	22,000	
on 3,000 shares)	(9,000)		Less: Profit for the year	(1,200)	20,800
		1,11,000			
Sundry creditors		15,425			
Provision for taxation		4,000	Preliminary expenses		1,500
		1,30,425			**1,30,425**

The directors have had a valuation made of the machinery and find it overvalued by .. ₹ 10,000. It is proposed to write down this asset to its true value and to extinguish the deficiency in the Profit and loss account and to write off goodwill and preliminary expenses, by the adoption of the following course :

1. Forfeit the shares on which the call is outstanding.
2. Reduce the paid up capital by ₹ 3 per share.
3. Reissue the forfeited shares at ₹ 5 per share.
4. Utilise the provision for taxes, if necessary.

The shares on which the calls were in arrear were duly forfeited and reissued on payment of ₹ 5 per share. You are requested to draft the journal entries necessary and the Balance sheet of the Company after carrying out the terms of the scheme as set above.

Solution :

	Particulars		*Debit* ₹	*Credit* ₹
1.	Forfeiture of 3,000 shares :			
	Equity Share Capital A/c	Dr.	30,000	
	To Calls in arrears A/c			9,000
	To Share forfeiture A/c			21,000
2.	Reduction of capital			
	Equity Share capital (Face value - ₹ 10)	Dr.	90,000	
	To Equity Share capital (Face value ₹ 7) A/c			63,000
	To Reconstruction A/c			27,000
3.	Re-issue of forfeiture shares :			
	Bank A/c	Dr.	15,000	
	Shares Forfeiture A/c	Dr.	6,000	
	To Equity Share Capital A/c			21,000
4.	Transfer of unutlised balance in share forfeiture A/c to Capital Reserve			
	Shares Forfeiture A/c	Dr.	15,000	
	To Capital Reserve			15,000
5.	Utilisation of Reconstruction A/c			
	Reconstruction A/c	Dr.	27,000	
	Capital Reserve A/c	Dr.	15,000	
	Provision for Tax A/c (Balancing Figure)	Dr.	300	
	To Profit and Loss A/c			20,800
	To Preliminary Expenses A/c			1,500
	To Machinery A/c			10,000
	To Goodwill A/c			10,000

Name of the Company: Bhushan Developers Ltd.					
Balance Sheet as at 31st March, 2015 (and Reduced)					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	84,000	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Short-term borrowings	2	15,425	
		(b) Short-term provisions	3	3,700	
		Total		1,03,125	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	61,350	
	2	**Current assets**			
		(a) inventories	5	10,275	
		(b) trade receivables	6	15,000	
		(c) Cash and cash equivalents	7	16,500	
		Total		1,03,125	

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

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
A. Authosired Capital Authorised Capital : 20,000 Equity Shares of ₹ 10 each	2,00,000	
	2,00,000	
B. Issued, subscribed and paid-up Capital Issued, Subscirbed and paid-up capital 12,000 Shares of ₹ 7 each	84,000	
Total	84,000	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	12000	37,500.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	-	-	NIL	NIL
	12000	84,000.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	12000	84,000.00	NIL	NIL

Note 2. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors	15,425	
Total	15,425	

Note 3. Short term Provisions	As at 31st March, 2015	As at 31st March, 2014
Provision for taxation	4,000	
Less: Reduction	(300)	
Total	3,700	

Note 4. Tangible Assets		As at 31st March, 2015	As at 31st March, 2014
Land and Buildings		20,500	
Machinery	50,850		
Less: Reduced	10,000	40,850	
Total		61,350	

Note 5. Inventories	As at 31st March, 2015	As at 31st March, 2014
Inventories	10,275	
Total	10,275	

Note 6. Trade Receivables	As at 31st March, 2015	As at 31st March, 2014
Book Debts	15,000	
Total	15,000	

Note 7. Cash and Cash Equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash in Hand	16,500	
Total	16,500	

VIII. Reverse Merger

Illustration 25.

The following are the Extracted Balance sheets of AB Ltd. and XY Ltd. as on 31.03.2015.

(₹ '000)

Liabilities	***AB Ltd.*** ₹	***XY Ltd.*** ₹	***Assets***	***AB Ltd.*** ₹	***XY Ltd.*** ₹
Share capital:			Fixed assets		
Equity Shares of ` 100	2,000	1,000	(net of depreciation)	2,700	850
each fully paid up			Investments	700	–
Reserves and surplus	800	–	Sundry Debtors	400	150
10% Debentures	500	–	Cash and Bank	250	–
Loan from Financial			Profit and Loss A/c	–	800
Institutions	250	400			
Bank Overdraft	–	100			
Sundry creditors	300	300			
Proposed Dividend	200	–			
Total	**4,050**	**1,800**	**Total**	**4,050**	**1,800**

Note: Loan from financial institution is assumed to be of more than 12 months (ignoring interest) hence treated as long term borrowings.

It was decided that XY Ltd. will acquire the business of AB Ltd. for enjoying the benefit of carry forward of business loss. After acquisition, XY Ltd. will be renamed as Z Ltd. The following scheme has been approved for the merger.

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

ii. Financial institutions agreed to waive 15% of the loan of XY Ltd.

iii. Shareholders of AB Ltd. will be given one new share of XY Ltd. in exchange of every share held in AB Ltd.

iv. AB Ltd. will cancel 20% holdings of XY Ltd. Investments were held at ₹ 250 thousands.

v. After merger, the proposed dividend of AB Ltd. will be paid to the shareholders of AB Ltd.

vi. Authorised Capital of XY Ltd. will be raised accordingly to carry out the scheme.

vii. Sundry creditors of XY Ltd. includes payables to AB Ltd. ₹ 1,00,000.

Pass the necessary entries to implement the scheme in the books of AB Ltd. and XY Ltd. and prepare a Balance Sheet of Z Ltd.

Solution:

Part - I Purchase consideration

WN # 1: *Shareholding of AB Ltd. in XY Ltd.*

Particulars		*Amount ₹*
a.	Original Share capital of XY Ltd. [10,000 equity shares of ₹ 100 each]	10,00,000
b.	Share capital of XY Ltd. after reduction [10,000 equity shares of ₹ 10 each]	1,00,000
c.	Share capital of XY Ltd. after reconsolidation [1000 equity shares of ₹ 100 each]	1,00,000
d.	Holding of AB Ltd in XY Ltd.	20%
e.	Value of holding of AB Ltd in XY Ltd. [200 equity shares of ₹ 100 each]	20,000

WN # 2 : *Purchase consideration*

a.	No. of equity shares of AB Ltd. (20,00,000 ÷ 100)	20,000
b.	Exchange ratio	1:1
c.	No. of equity shares to be given by XY Ltd. to AB Ltd.	20,000
d.	Less : No. of Equity shares held by AB Ltd. in XY Ltd.	200
e.	No. of shares now to be given	19,800
f.	Purchase consideration (19,800 equity shares of ₹ 100 each)	19,80,000

Part - II : Journal entries in the books of AB Ltd.

(₹ '000)

Particulars		*Debit*	*Credit*
1. a. Transfer to realisation account of all Assets taken over except investment held by selling company in purchasing company			
Realisation A/c	Dr.	3,800	
To Fixed assets A/c			2,700
To Investments [700 - 250] A/c			450
To Sundry Debtors A/c			400
To Cash and Bank A/c			250
b. Transfer to realisation account of all liabilities taken over			
10% Debentures A/c	Dr.	500	
Loan from financial institations A/c	Dr.	250	
Sundry Creditors A/c	Dr.	300	
Proposed Dividend A/c	Dr.	200	
To Realisation A/c			1250
2. Purchase consideration			
a. Due entry			
XY Ltd. A/c	Dr.	1,980	
To Realisation A/c			1,980

Particulars		Debit	Credit
b. Receipt			
Shares in XY Ltd. A/c	Dr.	1,980	
To XY Ltd. A/c			1,980
3. Transfer of realisation loss to share holders			
Equity shareholders A/ c	Dr.	570	
To Realisation A/c			570
4. Transfer of Share capital and Reserves and surplus to equity share holders			
Share capital A/c	Dr.	2,000	
Reserves and surplus A/c	Dr.	800	
To Equity shareholders			2,800
5. Settlement to share holders by transfer of purchase consideration now received and shares already held by AB Ltd. in XY Ltd.			
Equity shareholders A/c	Dr.	2,230	
To Equity shares of XY Ltd.			2,230

Part. III. Journal entries in the books of XY Ltd.

(₹ '000)

Particulars		Debit	Credit
1. Reduction of Share capital			
Equity Share Capital (₹ 100) A/c	Dr.	1,000	
To Equity Share Capital (₹ 10) A/c			100
To Reconstruction A/c			900
2. Consolidation of equity shares of ₹10 each to ₹ 100 each			
Equity Share Capital (₹ 10) A/c	Dr.	100	
To Equity Share Capital (₹ 100) A/c			100
3. Waiver of loan by financial institution			
Loan from financial institution A/c	Dr.	60	
To Reconstruction A/c			60
4. Write off the debit balance of Profit and Loss A/c by utilising Reconstruction A/c and balance of Reconstruction A/c transferred to Capital reserve			
Reconstruction A/c	Dr.	960	
To Profit and Loss A/c			800
To Capital Reserve A/c			160

***Entries relating to Amalgamation* :**

- Nature of Amalgamation - Merger
- Method of Accounting - Pooling of Interest Method

(₹ '000)

Particulars				*Debit*	*Credit*
1. For Purchase Consideration Due					
Business Purchase A/c			Dr.	1,980	
To Liquidator of AB Ltd. A/c					1,980
2. For assets and liabilities taken over					
Purchase consideration now paid				1,980	
Shares already held by AB Ltd.		250			
Total consideration		2,230			
Less: Paid-up Share capital of AB Ltd.		2,000			
Excess Purchase Consideration Paid		230			
This excess is to be adjusted against reserves of AB Ltd.					
Reserves of AB Ltd.	800				
Less: Excess as above	<u>230</u>				
Balance to be incorporated	<u>570</u>				
Fxed assets (net of depreciation) A/c			Dr.	2,700	
Investment A/c			Dr.	450	
Sundry Debtors A/c			Dr.	400	
Cash and Bank A/c			Dr.	250	
To Reserves and Surplus A/c					570
To Debentures A/c					500
To Loan from financial institutions A/c					250
To Sundry Creditors A/c					300
To Proposed Dividend A/c					200
To Business Purchase A/c					1,980
3. Discharge of purchase consideration					
Liquidator of AB Ltd. A/c			Dr.	1,980	
To Equity Share capital of XY Ltd. A/c					1,980
4. Payment of proposed divided to shareholders of AB Ltd.					
Proposed Dividend A/c			Dr.	200	
To Bank A/c					200
5. Cancellation of inter company owings					
Sundry Creditors A/c			Dr.	100	
To Sundry Debtors A/c					100

Name of the Company: Z Ltd.					
Balance Sheet as at 31st March, 2015 (and Reduced)					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				(₹ in '000)	**(₹ in '000)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	2,080.00	
		(b) Reserves and surplus	2	730.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	1,090.00	
	4	**Current Liabilities**			
		(a) Trade payables	4	500.00	
		(b) Other current liabilities	5	50.00	
		Total		4,450.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	3,550.00	
		(b) Non-current investments	7	450.00	
	2	**Current assets**			
		(a) trade receivables	8	450.00	
		Total		4450.00	

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

(₹ '000)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
A. Authosired, Issued, Subscribed and paid up:- Equity Shares of ₹ 100 each issued and Fully paid up (1,980+20+80)	2,080	
Total	2,080	

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
<u>Opening Balance as on 01.04.11</u>	20.8	2,080.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares , Right shares, split shares, shares issued other than cash)	-	-	NIL	NIL
	20.8	2,080.00	NIL	NIL
Less: Buy Back of shares	-		-	-
	20.8	2,080.00	NIL	NIL

Note 2. Reserves and Surplus	As at 31st March, 2015	As at 31st March, 2014
General Reserve Capital Reserve	160 570	
Total	730	

Note 3. Long Term Borrowings	As at 31st March, 2015	As at 31st March, 2014
100% debentures Loan from Financial Institution	500 590	
Total	1090	

Note 4. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Creditors (600-100)	500	
Total	500	

Note 5. Other Current Liabilities	As at 31st March, 2015	As at 31st March, 2014
Bank Overdraft (200+100-250)	50	
Total	50	

Note 6. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed Assets net of depreciation (2,700+850)	3,550	
Total	3,550	

Note 7. Non-Current Investments	As at 31st March, 2015	As at 31st March, 2014
Investments (700-250)	450	
Total	450	

Note 8. Trade Receivables	As at 31st March, 2015	As at 31st March, 2014
Sundry Debtors (400+150-100)	450	
Total	450	

IX. External Reconstruction

Illustration 26.

A Ltd. is engaged in the manufacture of D and N. It has two wholly owned subsidiaries. B Ltd. and C Ltd. which have never traded. The draft financial statement of parent company shows:

Extracted Balance Sheet as on 31st March, 2015

Liabilities	₹	***Assets***	₹
Share Capital	40,000	Fixed Assets	21,400
Reserves and surplus	48,800	Investment in B Ltd.	10,000
Secured loan	12,000	Investment in C Ltd.	10,000
Sundry creditors	90,000	Current assets	
Owing to subsidiaries	20,000	Stock and Work-in-progress	43,400
Proposed dividend	4,000	Sundry debtors	9,360
		Cash at bank	36,400
	2,14,800		**2,14,800**

Note: Secured loan and owing to subsidiary is assumed to be not less than 12 months, hence treated as long term borrowings (ignoring interest).

Profit and Loss Account for the year ended 31st March, 2015

	₹
Net Profit	37,200
Less: Dividend Paid	4,000
Transfer to Reserve	33,200

The two managing directors Mr. Kali and Mr. Prem who own 40% and 60% respectively of the Share capital of A Ltd. will become individually concerned with B Ltd. and C Ltd. respectively in order to allow them to develop their own interests.

They have agreed to a scheme of reconstruction whereby the respective trade and assets apart from cash at bank and liabilities will be transferred to the two subsidiaries. The resulting inter-company debts will be waived and A Ltd. will be placed into liquidation. The liquidator will retain ₹ 5,200 of the cash at bank to meet the costs of liquidation and reorganisation and pay dividend. He will distribute the remaining cash at bank and shares in two subsidiaries to A Ltd's shareholders Mr. Kali and Mr. Prem.

As far as his cash distribution pool permits, each director will then purchase, at net assets value, those shares in his own company distributed by the liquidator to his former colleague. It has been agreed that B Ltd. will receive a first tranch of the assets of A Ltd. comprising stock and work in progress of ₹ 15,000. C Ltd. will take over the liability for the Secured Loan. The remainder of the net assets will be transferred to the subsidiary companies in the ratio of 75% to B Ltd. and 25% of C Ltd. with the group freehold property, included in the Fixed assets at ₹ 15,000 being revalued at the open market value of ₹ 42,000 and being transferred to C Ltd.as a part of its share.

You are required to :

a. Produce the proforma balance sheets of the two former subsidiary immediately after reorganisation.

b. Calculate the final share holdings in each of the two companies.

Solution:

Purchase Consideration:

Particulars	*B Ltd.* ₹	*C Ltd.* ₹
Stock in trade	15,000	—
Secured Loan	—	(12,000)
Remaining Net Assets in the Ratio of 75:25 (WN#1)	60,300*	20,100*
	75,300	**8,100**
Total Purchase Consideration	**₹ 83,400**	

WN # 1 : Net Asset Value:

Particulars		₹	₹
a.	Fixed Asset:	15,000	
	Add: Increase due to Revaluation	27,000	
	Others (21,400 – 15,000)	6,400	48,400
b.	Stock and Work-in-progress	43,400	
	Less: Separately taken by B Ltd.	15,000	28,400
c.	Sundry Debtors		93,600
d.	Total Assets (a+b+c)		1,70,400
e.	Sundry Creditors		(90,000)
f.	Net Assets		80,400
g.	B Ltd. Share (75% of Net Assets)		60,300
h.	A Ltd. Share (25% of Net Assets)		20,100

Shareholders Account

Dr. **Cr.**

	Kali (40%)	**Prem (60%)**		**Kali (40%)**	**Prem (60%)**
To Cash	12,480@	18,720@	By Share capital	16,000	24,000
To B Ltd.	33,360		By Reserve	19,520	29,280
To C Ltd.		50,040	By Realisation (Profit)	10,320#	15,480#
	45,840	**68,760**		**45,840**	**68,760**

Cash **(₹)**

Particulars	*Amount*
Opening balance	36,400
Retained by liquidator	(5,200)
Closing balance	31,200
Kalii's share [40% of (c)]	12,480
Prem's share [60% of (c)]	18,720

Realisation Profit

Particulars	*Amount*
Dividend	4,000
Revaluation on Fixed assets (42,000 – 15,000)	27,000
Liquidation expenses:	(5,200)
Net realisation profit	25,800
Kali [40% of (d)]	10,320
Prem [60% of (d)]	15,480

WN # 2 : Statement showing Goodwill* or *Capital Reserves

	Particulars	*B Ltd.* (₹)	*C Ltd.* (₹)
a.	Purchase Consideration	75,300	8,100
b.	Less: Net Assets as at the date of acquisition		
	representedby :	10,000	10,000
	- Share capital		
c.	Goodwill		**1,900**
d.	Capital Reserves	**65,300**	

Proforma Balance Sheet of B Ltd. as on 31st March, 2015.

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Share Capital	10,000	Fixed Assets	6,400
Reserves and Surplus	65,300	Current Assets:	
Current liabilities		Stocks and Work-in-Progress	43,400
Creditors	68,100	Debtors	93,600
	1,43,400		**1,43,400**

Proforma Balance Sheet of C Ltd. as on 31st March, 2015.

Liabilities	*Amount* ₹	*Assets*	*Amount* ₹
Share Capital	10,000	Fixed assets	42,000
Secured Loan	12,000	Goodwill	1,900
Current liabilities	21,900		
	43,900		**43,900**

X. Surrender of Shares

Illustration 27.

The business of P Ltd. was being carried on continuously at losses. The following are the extracts from the Balance Sheet of the Comapny as on 31st March, 2015.

Balance Sheet as on 31st March, 2015

Liabilities	***Amount*** ₹	***Assets***	***Amount*** ₹
Authorised, Issed and		Goodwill	50,000
Subscribed Capital :		Plant	3,00,000
30,000 Equity Shares of ₹ 10		Loose Tools	10,000
each fully paid	3,00,000	Debtors	2,50,000
2,000 8% Cumulative Pref.		Stock	1,50,000
Shares of ₹ 100 each fully paid	2,00,000	Cash	10,000
Securities Premium	90,000	Bank	35,000
Unsecured Loan(From Director)	50,000	Preliminary Expenses	5,000
Sundry creditors	3,00,000	Profit & Loss Account	2,00,000
Outstanding Expenses	70,000		
(including Directors'			
remuneration ₹ 20,000)			
	10,10,000		**10,10,000**

Note : 1) Dividends on Cumulative Preference Shares are in arrears for 3 years.

2) Unsecured loans (from director) is assumed to be of less than 12 months hence, treated as short term borrowings. (ignoring interest)

The following scheme of reconstruction has been agreed upon and duly approved by the Court.

1. Equity shares to be converted into 1,50,000 shares of ₹ 2 each.
2. Equity shareholders to surrender to the Company 90 per cent of their holding.
3. Preference shareholders agree to forego their right to arrears to dividends inconsideration of which 8 percent Preference Shares are. to be converted into 9 per cent Preference Shares.
4. Sundry creditors agree to reduce their claim by one fifth in consideration of their getting shares of ₹ 35,000 out of the surrendered equity shares.
5. Directors agree to forego the amounts due on account of unsecured loan and Director's remuneration.
6. Surrendered shares not otherwise utilised to be cancelled.
7. Assets to be reduced as under :

Goodwill by	₹ 50,000
Plant by	₹ 40,000
Tools by	₹ 8,000
Sundry Debtors by	₹ 15,000
Stock by	₹ 20,000

8. Any surplus after meeting the losses should be utili sed in writing down the value of the plant further.
9. Expenses of reconstruction amounted to ₹ 10,000.
10. Further 50,000 Equity shares were issued to the existing members for increasing the working capital. The issue was fully subscribed and paid-up.

A member holding 100 equity shares opposed the scheme and his shares were taken over by the Director on payment of ₹ 1,000 as fixed by the Court.

You are required to pass the journal entries for giving effect to the above arrangement and also to draw up the resultant Balance Sheet of the Company.

Solution:

Particulars		***Debit*** ₹	***Credit*** ₹
a. Sub Division of Shares			
Equity Share Capital (₹ 10 each) A/c	Dr.	3,00,000	
To Equity Share Capital (₹ 2 each) A/c			3,00,000
b. Surrender of Shares			
Equity Share Capital (₹ 2) A/c	Dr.	2,70,000	
To Shares Surrendered A/c			2,70,000
c. Conversion of Preference Share Capital			
8% Cumulative Preference Share Capital A/c	Dr.	2,00,000	
To 9% Cumulative Preference Share Capital A/c			2,00,000
d. Surrendered shares issued to creditors			
under reconstruction scheme			
Shares Surrendered A/c	Dr.	35,000	
To Equity Share Capital A/c			35,000
e. Expenses Paid			
Expenses A/c	Dr.	10,000	
To Bank A/c			10,000
f. Cancellation of unissued surrendered shares			
Shares Surrendered A/c	Dr.	2,35,000	
To Capital Reduction A/c			2,35,000
g. Amount sacrificed by Directors			
Unsecured Loan A/c	Dr.	50,000	
Sundry Creditors A/c	Dr.	60,000	
Outstanding Expenses A/c	Dr.	20,000	
To Capital Reduction A/c			1,30,000
h. Assets Written off			
Capital Reduction A/c	Dr.	3,65,000	
To Goodwill A/c			50,000
To Loose tools A/c			8,000
To Sundry debtors A/c			15,000

Particulars		*Debit* ₹	*Credit* ₹
To Stock - in - trade A/c			20,000
To Profit and Loss A/c			2,00,000
To Preliminary expenses A/c			5,000
To Expenses A/c			10,000
To Plant A/c			57,000
i. Issue of Shares			
Applications received			
Bank A/c	Dr.	1,00,000	
To Share Application A/c			1,00,000
Allotment of Shares			
Share Application A/c	Dr.	1,00,000	
To Share Capital A/c			1,00,000
(Being 50000 equity shares of ₹ 2 each			
issued as fully paid as per Board's Resolution dated...)			

Note 1 : a. Cancellation of Preference dividend need not be journalised; on cancellation it cease to be contingent liability and hence no further disclosure.

b. Preference shareholders have to forego policy rights presently enjoyed at par with Equity Shareholders.

Note 2 : The transfer of 100 shares by the dissentient shareholders to the director concerned need not be journalised.

Note 3 : It has been assumed that the share premium account is to be kept infact since the scheme is silent about it.

Name of the Company: P Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				₹	₹
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	3,65,000	
		(b) Reserves and surplus	2	90,000	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Trade payables	3	2,40,000	
		(b)Other current liabilities	4	50,000	
		Total		7,45,000	
	II.	**Assets**			
	1	**Non-current assets**			

		(a) Fixed assets			
		(i) Tangible assets	5	2,43,000	
	2	**Current assets**			
		(a) Inventories	6	1,32,000	
		(b) Trade receivables	7	2,35,000	
		(c) Cash and cash equivalents	8	1,35,000	
		Total		7,45,000	

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

		(₹)
Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Particulars	**Amount (₹)**	**Amount (₹)**
Authorised : 1,50,000 equity shares of ₹ 12 each fully paid up	3,00,000	
2,000 8% cumulative preferrence shares of ₹ 100 each	2,00,000	
	5,00,000	
Issued, Subscribed and Paidup Subscribed Capital : 82,500Equity shares of ₹ 2 each fully paid up (of the above 17,500 shares have been issued other than cash under the scheme of reconstruction)	1,65,000	
2,000 9 % Cumulative Pref. Shares of ₹ 100 each fully paid up	2,00,000	
Total	3,65,000	

RECONCILIATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	82,500	165,000,000	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)			NIL	NIL
	82,500	165,000,000	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	82,500	165,000,000	NIL	NIL

Note 2. Reserves and Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
Securities Premium	90,000	
Total	90,000	

Note 3. Trade Payables	**As at 31st March, 2015**	**As at 31st March, 2014**
Sundry creditors	2,40,000	
Total	2,40,000	

Note 4.Other Current Liabilities	As at 31st March, 2015	As at 31st March, 2014
Outstanding Expenses	50,000	
Total	50,000	

Note 5. Tangible assets		As at 31st March, 2015	As at 31st March, 2014
Plant	₹ 3,00,000		
less: Amount written off under the sceme of reconstruction	₹57,000	2,43,000	
Total		2,43,000	

Note 6. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock-in trade	1,30,000	
Loose tools	2,000	
Total	1,32,000	

Note 7. Trade receivables	As at 31st March, 2015	As at 31st March, 2014
Debtors	2,35,000	
Total	2,35,000	

8. Cash and Cash Equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at Bank	1,25,000	
Cash in Hand	10,000	
Total	1,35,000	

XI. Demerger

Illustration 28.

The following is the Balance Sheet of P Ltd.

Liabilities		₹
Equity Share Capital		2,00,000
Reserves and Surplus		4,00,000
Secured Loan		2,00,000
Unsecured Loans		6,00,000
		14,00,000
Assets	₹	₹
Fixed Assets		7,00,000
Investments		4,00,000
(Market Value ₹ 9,00,000)		
Current Assets	4,00,000	
Less: Current liabilities	(1,00,000)	3,00,000
		14,00,000

The company consists of three divisions. The scheme was agreed upon, according to which a new company B Ltd. is to be formed. It will takeover investmen.ts at ₹ 9,00,000 and unsecured loans at balance sheet value. It is to allot equity shares of ₹ 10 each at par to the shareholders of P Ltd. in satisfaction of the amount due under the arrangement. The scheme was duly approved by the High Court. Pass journal entries in the books of P Ltd.

Solution:

In the Books of P Ltd.

Particulars		***Debit*** ₹	***Credit*** ₹
1. B Ltd. A/c	Dr.	9,00,000	
To Investments A/c			4,00,000
To Shareholders A/c			5,00,000
[Being investments transferred at agreed value of ₹ 9,00,000]			
2. Unsecured Loans A/c	Dr.	6,00,000	
To B Ltd. A/c			6,00,000
[Being unsecured loan taken over by B Ltd.]			
3. Shareholders A/c	Dr.	3,00,000	
To B Ltd. A/c			3,00,000
[Being allotment by B Ltd. of 30,000 Equity shares of ₹ 10 each to shareholders of the company]			
4. Shareholders A/c	Dr.	2,00,000	
To Capital Reserve			2,00,000
[Being balance in Shareholders A/c transferred to Capital Reserve]			

Illustration 29.

Lazy Ltd. and Yummy Ltd. are two companies. On 31st March, 2015 their Balance Sheets were as under :

(₹ in Crores)

		Lazy Ltd.		***Yummy Ltd.***
Sources of funds				
Share capital				
Authroised :		500		500
Issued : Equity shares of ₹ 100				
each fully paid up		300		200
Reserves and surplus.				
Capital reserves	40		20	
Revenue reserves	700		425	
Surplus	10	750	5	450
Owners' funds		1,050		650
Loan		250		350
Total		**1,300**		**1,000**

Funds' employed in :

Fixed assets (Tangible) :				
Cost	1,000		700	
Less : Depreciation	(400)	600	(300)	400
Net Current assets :				
Current assets	2,000		1,500	
Less : Current liabilities	(1,300)	700	(900)	600
		1,300		**1,000**

Lazy Ltd. has 2 divisions - very profitable division A and loss making division B. Yummy Ltd. similarly has 2 divisions-very profitable .division B and loss making division A.

The two companies decided to reorganise. Necessary approval's from creditors and members and sanction by High Court have been obtained to the following scheme.

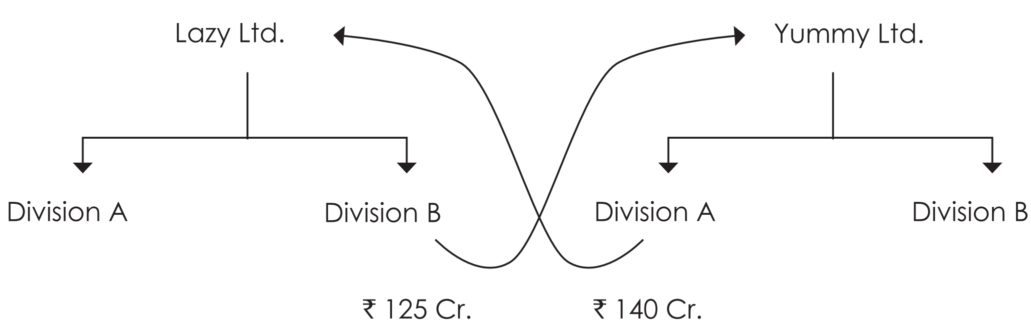
1. Division B of Lazy Ltd. which has Fixed assets costing ₹ 400 crores (written down value ₹ 160 crores). Current assets ₹ 900 crores, Current liabilities ₹ 750 crores and loan funds of ₹ 200 crores is to be transferred at ₹ 125 crores to Yummy Ltd.
2. Division A of Yummy Ltd. which has Fixed assets costing ₹ 500 crores (depreciation ₹ 200 crores), Current assets ₹ 800 crores Current liabilities ₹ 700 crores and loan funds ₹ 250 crores is to be transferred at ₹ 140 crores to Lazy Ltd.
3. The difference in the two consideration is to be treated as loan carrying interest at 15% per annum.
4. The directors of each of the companies revalued the Fixed assets taken over as follows :
   i. Division A of Yummy Ltd. taken over: ₹ 325 crores.
   ii. Division B of Lazy Ltd. taken over: ₹ 200 crores.

All the other assets and liabilities are recorded at the Balance sheet values.

a. The directors of both the companies ask you to prepare the Balance sheets after reconstruction (showing the corresponding figures before reconstruction).

b. Mr. Pravin, who owns 5,000 equity shares of Lazy Ltd. and 3,000 equity shares of Yummy Ltd. wants to know whether he has gained or lost in terms of net asset value of equity shares on the above recognisation.

Solution :



Books of Lazy Ltd.

A. Transfer of Division B

(₹ in Crores)

Particulars		***Debit***	***Credit***
i. Due Entry :			
Yummy Ltd A/c	Dr.	125	
Current liabilities A/c	Dr.	750	
Loan Funds A/c	Dr.	200	
Provision for Depreciation A/c (400-160)	Dr.	240	
To Fixed Assets A/c			400
To Current Assets A/c			900
To Capital Reserve A/c			15
ii. Receipt of consideration - Not Applicable			

B. Take over of division A of Yummy Ltd.

Particulars		***Debit***	***Credit***
i. Due Entry :			
Business Purchase A/c	Dr.	140	
To Yummy Ltd. A/c			140
ii. Incorporation of Assets and Liabilities taken over :			
Fixed assets A/c	Dr.	325	
Current assets A/c	Dr.	800	
To Current liabilities A/c			700
To Loan A/c			250
To Business Purchase A/c			140
To Capital Reserve A/c			35
iii. Discharge of consideration - Not Applicable			

Name of the Company: Lazy Ltd.

Balance Sheet as at 31.03.2015

Ref No.		**Particulars**	**Note No.**	**@ As at 31st March, 2015**	****As at 31st March, 2014**
				(₹ in Crore)	**(₹ in Crore)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	300.00	300.00
		(b) Reserves and surplus	2	800.00	750.00
	2	**Share application money pending allotment**		**Nil**	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	300.00	250.00
	4	**Current Liabilities**			
		(a) Short-term borrowings	4	15.00	
		(b)Other current liabilities	5	1,250.00	13,00.00
		Total		2,665.00	2600.00

Ref No.		Particulars	Note No.	As at 31st March, 2015	As at 31st March, 2014
				(₹ in Crore)	(₹ in Crore)
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	765.00	600.00
	2	**Current assets**			
		(a) Other current assets	7	1900.00	2000.00
		Total		2665.00	2600.00

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

@ After Reconstruction ** Before Reconstruction

Note : Assume short term borrowings is less than 12 months & ignoring interest

(₹ in Crore)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Autohrised Equity Share Capital @ ₹ 100/- each	500.00	500.00
Issued, subscribed and fully paid Equity Share of ₹ 100/- each	300.00	300.00
Total	300.00	300.00

RECONCILATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	3	300.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)			NIL	NIL
	3	300.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	3	300.00	NIL	NIL

Note 2. Reserves and Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
Capital reserve (40+15+35)	90.00	40.00
Revenue Reserve	700.00	700.00
Surplus	10.00	10.00
Total	800.00	750.00
Note 3. Long Term Borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Existing	250	250.00
less: Inter company Transfer	200.00	
	50.00	250.00
Add: value at which takenover	250.00	
Total	300.00	250.00

Note 4. Short Term Borrowings	As at 31st March, 2015	As at 31st March, 2014
15% loan -Yummy ltd.	15.00	
Total	15.00	

Note 5. Other Current Liabalities	As at 31st March, 2015	As at 31st March, 2014
Existing	1300.00	1300.00
less: Inter company Transfer	750.00	
	550.00	1300.00
Add: value at which takenover	700.00	
Total	1250.00	1300.00

Note 6. Tangible assets	As at 31st March, 2015		As at 31st March, 2014	
	Cost Price	Prov. for Dep.	Cost Price	Prov. for Dep.
Existing	1000.00	400.00	1000.00	400.00
less: Inter company Transfer	400.00	240.00		-
	600.00	160.00	1000.00	400.00
Add: value at which takenover	325.00			-
	925.00	160.00	1000.00	400.00
Less : Depreciation	160.00	160.00	400	400.00
Total	765.00	-	600	-

Note 7. Other Current Asset	As at 31st March, 2015	As at 31st March, 2014
Existing	2000.00	2000.00
less: Inter company Transfer	900.00	
	1100.00	2000.00
Add: value at which takenover	800.00	
Total	1900.00	2000.00

Part - II Books of Yummy Ltd.

A. Transfer of Division A to Lazy Ltd.

(₹ in Crores)

Particulars			*Debit*	*Credit*
1.	For Purchase Consideration Due:			
	Lazy Ltd. A/c	Dr.	140	
	Current liabilities A/c	Dr.	700	
	Loan A/c	Dr.	250	
	Provision for Depreciation A/c	Dr.	200	
	Capital reserve A/c [balancing figure]	Dr.	10	
	To Fixed Assets A/c			500
	To Current Assets A/c			800
ii.	Receipt of consideration - Not applicable			

B. Take over of division B of Lazy Ltd.

(₹ in Crores)

Particulars			***Debit***	***Credit***
1.	For Purchase Consideration Due:			
	Business purchase A/c	Dr.	125	
	To Lazy Ltd. A/c			125
ii.	Incorporation of assets and liabilities taken over :			
	Fixed Assets A/c	Dr.	200	
	Currnt Assets A/c	Dr.	900	
	To Current liabilities A/c			750
	To Loan A/c			200
	To Business Purchase A/c			125
	To Capital Reserve A/c			25
iii.	Discharge of consideration - Not Applicable			

Name of the Company: Yummy Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**@ As at 31st March, 2015**	*** As at 31st March, 2014**
				(₹ in Crore)	**(₹ in Crore)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	200.00	200.00
		(b) Reserves and surplus	2	465.00	450.00
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	300.00	350.00
	4	**Current Liabilities**			
		(a) Other current liabilities	4	950.00	900.00
		Total		1915.00	1900.00
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	300.00	400.00
	2	**Current assets**			
		(a) Short-term loans and advances	6	15.00	
		(b) Other current assets	7	1600.00	1500.00
		Total		1915.00	1900.00

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

Note: Assume it is short term loans and advance (ignoring interest)

@After Reconstruction *Before Reconstruction

(₹ in Crore)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Autohrised Equity Share Capital @ ₹ 100/- each	200.00	200.00
Issued, subscribed and fully paid Equity Share of ₹ 100/- each	200.00	200.00
Total	200.00	200.00

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	2	200.00	2	200.00
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)			NIL	NIL
	2	200.00	2	200.00
Less: Buy Back of shares	-	-	-	-
	2	200.00	2	200.00

Note 2. Reserves and Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
Capital reserve(20+25-10)	35.00	20.00
Revenue Reserve	425.00	425.00
Surplus	5.00	5.00
Total	465.00	450.00

Note 3. Long Term Borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Existing	350	350.00
less: Inter company Transfer	250.00	-
	100.00	350.00
Add: value at which takenover	200.00	-
Total	300.00	350.00

Note 4. Other Current Liabalities	**As at 31st March, 2015**	**As at 31st March, 2014**
Existing	900.00	900.00
less: Inter company Transfer	700.00	-
	200.00	900.00
Add: value at which takenover	750.00	-
Total	950.00	900.00

Note 5. Tangible assets	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Cost Price	**Prov. for Dep.**	**Cost Price**	**Prov. for Dep.**
Existing	700.00	300.00	700.00	300.00
less: Inter company Transfer	500.00	200.00	-	-
	200.00	100.0	700.00	300.00
Add: value at which takenover	200.00	-	-	-
	400.00	100.00	700.00	300.00
Less : Depreciation	100.00	100.00	300.00	300.00
Total	300.00	-	400.00	-

Note 6. Short term loans and advances	**As at 31st March, 2015**	**As at 31st March, 2014**
15% loan	15.00	-
Total	15.00	-

Note 7. Other Current Asset	**As at 31st March, 2015**	**As at 31st March, 2014**
Existing	1500.00	1500.00
less: Inter company Transfer	800.00	-
	700.00	1500.00
Add: value at which takenover	900.00	-
Total	1600.00	1500.00

Evaluation of Mr. Pravin's Investment

(₹ **in Crore**)

		Lazy Ltd.		*Yummy Ltd*	
		Before Reconstruction	After Reconstruction	Before Reconstruction	After Reconstruction
a.	Total assets (₹ Corers)	1300	1415	1000	965
b.	Outside liabilities (₹ Corers)	250	315	350	300
c.	Net Assets (₹ Corers)	1050	1100	650	665
d.	Number of shares (in Corers) Outstanding	3	3	2	2
e.	Intrinsic Value (₹ Per Share) [c/d]	350	367	325	332.50
f.	Number of shares held	5,000	5,000	3,000	3,000
g.	Value of shares held (₹)	17.5 Lakhs	18.35 Lakhs	9.75 Lakhs	9.975 Lakhs
h.	Increase in value (₹)	85,000		22,500	
i.	***Total increase in value due to demerger***		₹ ***1,07,500***		

Illustration 30.

The following is the Balance sheet of Diverse Ltd. having an authorised capital of ₹ 1,000 Cr. as on 31st March, 2015:

(₹ in Crores)

	₹	₹
Sources of funds :		
Shareholders' funds		
Share capital		
Equity shares of ₹ 1 0 each fully paid in cash	250	
Reserves and surplus (Revenue)	750	1,000
Loan funds		
Secured against : (a) Fixed assets ₹ 300 Cr.(L.T.)		
(b) Working capital ₹ 100 Cr.(S.T.)	400	
Unsecured	600	1,000
		2,000
Employment of funds		
Fixed Assets		
Gross block	800	
Less: Depreciation	200	600
Investment at cost (Market value ₹ 1 ,000 Cr.)		400
Net Current assets :		
Current assets	3,000	
Less: Current liabilities	(2,000)	1,000
		2,000

Capital commitments: ₹ 700 crores.

The company consists of 2 divisions.

i. Established division whose gross block was ₹ 200 crores and net block was ₹ 30 crores; Current assets were ₹ 1, 500 crores and working capital was ₹ 1,200 crores; the entire amount being financed by shareholders' funds.

ii. New project division to which the remaining Fixed assets, Current assets and Current liabilities related.

The following scheme of reconstruction was agreed upon.

a. Two new companies Sunrise Ltd. and Khajana Ltd. are to be formed. The authorised capital of Sunrise Ltd. is to be ₹ 1,000 crores. The authorised capital of Khajana Ltd. is to be ₹ 500 crores.

b. Khajana Ltd. is to take over investments at ₹ 800 crores and unsecured loans at balance sheet value. It is to allot equity share of ₹ 10 each at par to the members of Diverse Ltd. in satisfaction of the amount due under the arrangement.

c. Sunrise Ltd. is to take over the Fixed assets and net working capital of the new project division along with the secured loans and obligation for capital commitments for which Diverse Ltd. is to continue to stand guarantee at book values. It is to allot one crore equity shares of ₹ 10 each as consideration to Diverse Ltd. Sunrise Ltd. . made an issue of unsecured convertible debentures of ₹ 500 crores carrying interest at 15% per annum and having a right to convert into equity shares of ₹ 10 each at par on 31.3.2017. This issue was made to the members of Sunrise Ltd. as a right who grabbed the opportunity and subscribed in full.

d. Diverse Ltd. is to guarantee all liabilities transferred to the 2 companies.

e. Diverse Ltd. is to make a bonus issued of equity shares in the ratio of one equity share for every equity share held by making use of the Revenue reserves. .

Assume that the above scheme was duly approved by the Honourable High Court and that there are no other transactions. Ignore taxation.

You are asked to :

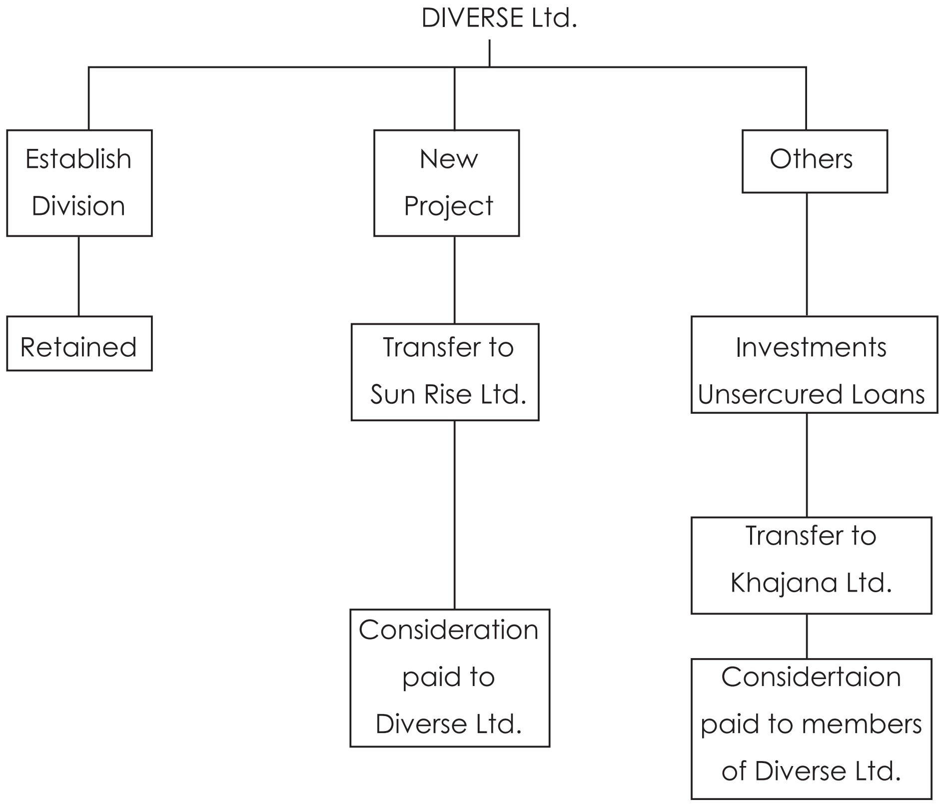
i. Pass journal entries in the books of Diverse Ltd., and

ii. Prepare the balance sheets of the three companies giving all the information required by the Companies Act, 2013 in the manner so required to the extent of available information.

Solution :

Part. I Basic Information

WN # 1 : ***Scheme of Reorganisation***



WN # 2 : ***Assets and Liabilities - Division Wise***

(₹ in Crores)

	Particulars	*Established Division*	*New Project Division*	*Others*
a.	Fixed Assets :			
	i) Gross Block	200	600	-
	ii) Accumulated depreciation	(170)	(30)	-
	iii) Net block	30	570	-
b.	Investments	-	-	400
c.	Net Current Assets			
	i) Current Assets	1500	1500	-
	ii) Current liabilities	(300)	(1700)	-
	iii) Net Current Assets	1200	(200)	-
d.	Secured loans	-	400	-
e.	Unsecured loans	-	-	600

WN # 3 : ***Purcahse considerations.***

A. For transfer to Khajana Ltd. - Net Assets Method.

(₹ in Crores)

	Particulars	*Amount*
(i)	Investments	800
(ii)	Unsecured loans	(600)
(iii)	Net assets	200

Share of Khajana Ltd. issued to members of Diverse Ltd.

B. For transfer to Sunrise Ltd. - Payment Method $\boxed{\text{10 Crores}}$

1 crores shares of ₹ 10 each

Issued to Diverse Ltd.

Part -II

Books of Khajana Ltd.

(₹ in Crores)

Particulars		*Debit*	*Credit*
i. For Purchase Consideration Due:			
Business Purchase A/c	Dr.	200	
To Shareholders of Diverse Ltd.			200
ii. For Assets and Liabiltiies taken over			
Investment A/c	Dr.	800	
To Unsecured Loans			600
To Business Purchase			200
iii. For Discharge of purchase consideration			
Shareholders of Diverse Ltd. A/c	Dr.	200	
To Equity Share capital A/c			200

Name of the Company: Khajana Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				₹ in crore	**₹ in crore**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	200.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	2	600.00	
	4	**Current Liabilities**		Nil	
		Total		800.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(b) Non-current investments	3	800.00	
	2	**Current assets**		Nil	
		Total		800.00	

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

(₹ in Crores)

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorised Capital : 50 crore equity share @ ₹ 10 each	500.00	
Issued, subscribed and paid up Equity Share of ₹ 10 each fully paid (the above shares are issued for consideration other than cash)	200.00	-
Total	200.00	-

RECONCILIATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	-	-	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	20.00	200.00	NIL	NIL
	20.00	200.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	20.00	200.00	NIL	NIL

Note 2. Long Term Borrowings	As at 31st March, 2015	As at 31st March, 2014
Unsecured Loan	600.00	
Total	600.00	

Note 3. Non Current Investments	As at 31st March, 2015	As at 31st March, 2014
Investment at cost (Quoted investment with market value of ₹ 1000 Cr.)	800.00	
Total	800.00	

Part III : ***Books of Sunrise Ltd***.

(₹ in Crores)

Particulars		***Debit***	***Credit***
II. For Purchase Consideration Due:			
Business purchase A/ c	Dr.	10	
To Diverse Ltd.			10
b. For assets and Liabilities taken over			
Good will A/c (Balancing Figure)	Dr.	40	
Fixed Asset A/ c	Dr.	570	
Current Assets A/c	Dr.	1500	
To Current liabilities A/c			1700
To Business Purchase A/c			10
To Secured loan A/c			400

c.	For Discharge of purchase consideration			
	Diverse Ltd. A/c	Dr.	10	
	To Equity Share capital			10
d.	For Issue of unsecured convertible debentures			
	i. Bank A/c	Dr.	500	
	To Debenture Application A/c			500
	ii. Debenture Application A/c	Dr.	500	
	To 15% Debenture A/c			500

Name of the Company: Sunrise Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				(₹ **in Crore**)	(₹ **in Crore**)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	10.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	2	900.00	
	4	**Current Liabilities**			
		(a) Other current liabilities	3	1700.00	
		Total		2610.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	570.00	
		(ii) Intangible assets	5	40.00	
	2	**Current assets**			
		(a) Cash and cash equivalents	6	500.00	
		(b) Other current assets	7	1500.00	
		Total		2610.00	

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

(₹ in Crore)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorised capital : 100 crore equity share @ ₹ 10 each	1000	
Issued, subscribed and paid up Equity share of ₹ 10 each (The above consideration other than cash. The entire capital is held by diverse limited)	10.00	
Total	10.00	

RECONCILIATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	-	-	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	1	10.00	NIL	NIL
	1	10.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	1	10.00	NIL	NIL

Note 2. Long Term Borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Debanture	500.00	
Secured Loan	400.00	
Total	900.00	

Note 3. Other Current Liabilities	**As at 31st March, 2015**	**As at 31st March, 2014**
Current Liabilities and provision	1700.00	
Total	1700.00	

Note 4. Tangible assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Other fixed assets	570.00	-
Total	570.00	-

Note 5. Intangible assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Goodwill	40.00	-
Total	40.00	-

Note 6. Cash and cash equivalent	**As at 31st March, 2015**	**As at 31st March, 2014**
Bank	500.00	-
Total	500.00	-

Note 7. Other Current assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Other Current assets	1500.00	-
Total	1500.00	-

Note : 1. Capital commitments: ₹ 700 crores.

2. Secured Loans and Current liabilities guaranteed by M/s. Diverse Ltd.

Part - IV ***Books of Diverse Ltd.***

(₹ in Crores)

	Particulars		**Debit**	**Credit**
1.	Transfer to Khajana Ltd.			
i.	For Purchase Consideration Due:			
	Khajana Ltd. A/c	Dr.	200	
	Unsecured Loans A/c	Dr.	600	
	To Investments A/c			400
	To Capital reserve A/c			400
ii.	Cancellation of balance in Khajana Ltd. not receivable, since consideration is paid directly to members :			
	Capital Reserve A/c	Dr.	200	
	To Khajana Ltd.			200
2.	Transfer to Sunrise Ltd :			
i.	For purchase consideration Due:			
	Sunrise Ltd A/c	Dr.	10	
	Current liabilities A/c	Dr.	1700	
	Secured Loan A/c	Dr.	400	
	Provision for depreciation A/c	Dr.	30	
	To Fixed Asset A/c			600
	To Current Assets A/c			1500
	To Capital Reserve A/c			40

	Particulars		**Debit**	**Credit**
ii.	Receipt of consideration			
	Equity shares of Sunrise Ltd.	Dr.	10	
	To Sunrise Ltd.			10
iii.	Others			
	a. Subscripiton to unsecured convertible debenture of Sunrise Ltd.			
	Investments in Debenture of Sunrise Ltd. A/c	Dr.	500	
	To Bank			500
	b. Bonus issue			
	i. Revenue Reserves A/c	Dr.	250	
	To Bonus to Shareholders A/c			250
	ii. Bonus to Share holders A/c	Dr.	250	
	To Equity Share capital A/c			250

Name of the Company: Diverse Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				(₹ in Crore)	**(₹ in Crore)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	500.00	
		(b) Reserves and surplus	2	740.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Other current liabilities	3	300.00	
		Total		1540.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	30.00	
		(b) Non-current investments	5	510.00	
	2	**Current assets**			
		(a) Other current assets	6	1000.00	
		Total		1540.00	

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

(₹ in Crore)

1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorised, Issued, subscirbed and fully paid up :- Equity share capital of ₹ 10 each fully paid (out of each 25 crores Equity share on issued for consideration other than cash)	500.00	
Total	500.00	

RECONCILATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	-	-	NIL	NIL
Add: Bonus issue	25	250.00	NIL	NIL
	25	250.00	NIL	NIL
Add: Share issued other than cash	25	250.00	NIL	NIL
	50	500.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	50	500.00	NIL	NIL

Note 2. Reserve and Surplus	As at 31st March, 2015	As at 31st March, 2014
Capital Reserve	240.00	
Revenue Reserve	750.00	
Less: Bonus Issue	(250.00)	
Total	740.00	

Note 3. Other Current Liabalities	As at 31st March, 2015	As at 31st March, 2014
Current Liabilities and provision	300.00	
Total	300.00	

Note 4. Tangible assets	As at 31st March, 2015	As at 31st March, 2014
Other fixed assets	30.00	-
Total	30.00	-

Note 5. Non current Investments	As at 31st March, 2015	As at 31st March, 2014
share of sunrise	10.00	-
Debentures of sunrise	500.00	
Total	510.00	-

Note 6. Other Current assets	As at 31st March, 2015	As at 31st March, 2014
Other Current assets	1000.00	-
Total	1000.00	-

Capital committment by Sunrise Ltd. ₹ 700 Crores, Guarantees given in respect of liabilities transferred to Sunrise Ltd, and Khajana Ltd. amounting to ₹ 2100 Crores and ₹ 600 Crores respectively.

Illustration 31.

The draft Balance Sheet of Z Ltd. as at 31st March, 2015 is given below. In it, the respective shares of the company's two divisions namely "S" Division and "W" Division in the various assets and liabilities have also been shown.

(All amounts in Crores of Rupees)

	S Division	*W Division*	*Total*
Fixed assets (Tangible) :			
Cost	875	249	
Less : Depreciation	360	81	
Written-down value	515	168	683
Investments			97
Net Current assets :			
Current assets	445	585	
Less: Current liabilities	(270)	(93)	
	175	492	667
			1,447

Financed by :		
Loan funds	15	417
Own funds		
Equity Share capital : Shares of ₹ 10 each		345
Reserves and surplus		685
		1,447

Loan funds included, inter alia, bank Loans of ₹ 15 crore specifically taken for W Division and Debentures of the paid up value of ₹ 125 crore redeemable at any time between 1st October, 2014 and 30th September, 2015.

On 1st April, 2015 the company sold all of its investments for ₹ 102 crore and redeemed all the debentures at par, the cash transactions being recorded in the Bank Account pertaining to S Division.

Then a new company named Y Ltd. was incorporated with an authorized capital of ₹ 900 crore divided into shares of ₹ 10 each. All the assets and liabilities pertaining to W Division were transferred to the newly formed company; Y Ltd, allotting to Z Ltd's shareholders its two fully paid equity shares of ₹ 10 each at par for every fully paid equity share of ₹ 10 each held in Z Ltd. as discharge of consideration for the division taken over.

Y Ltd. recorded in its books the Fixed assets at ₹ 218 crore and all other assets and liabilities at the same values at which they appeared in the books of Z Ltd.

You are required to :

i. Show the journal entries in the books of Z Ltd.
ii. Prepare Z Ltd's Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Schedules in both cases need not be prepared).
iii. Calculate the intrinsic value of one share of Z Ltd. immediately before the demerger and immediately after the demerger; and
iv. Calculate the gain, if any, per share to the shareholders of Z Ltd. arising out of the demerger.

Solution :

Journal entries in the books of Z Ltd.

(**₹ in Crore**)

Particulars			***Debit***	***Credit***
a.	Bank A/c	Dr.	102	
	To Investments A/c			97
	To Profit & Loss A/c			5
	[Being sale of investments and profit realised thereon]			
b.	Debenture A/c	Dr.	125	
	To Bank A/c			125
	[Being redemption of debentures at par]			
c.	Bank Loan A/c	Dr.	15	
	Current liabilities A/c	Dr.	93	
	Provision for Depreciation A/c	Dr.	81	
	Reserves and Surplus A/c	Dr.	645	
	To Fixed Assets A/c			249
	To Current Assets A/c			585
	[Being assets and liabilities of W Division transferred to Y Ltd.]			

Name of the Company: Z Ltd.					
Balance Sheet as at 01.04.2015					
Ref No.		**Particulars**	**Note No.**	**As at 1st April, 2015**	**As at 31st March, 2015**
				(₹ in Crore)	**(₹ in Crore)**
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	345.00	
		(b) Reserves and surplus	2	45.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	277.00	
	4	**Current Liabilities**			
		(a) Other current liabilities	4	270.00	
		Total		937.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	515	
	2	**Current assets**			
		(a) Other current assets	6	422.00	
		Total		937.00	

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

(₹ in Crore)

Note 1. Share Capital	**As at 1st April, 2015**	**As at 1st March, 2015**
Authorised, Issued, subscribed and paid up Equity share of ₹ 10 Each	345	
Total	345.00	

RECONCILIATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 1st April, 2015**		**As at 31st March, 2015**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	34.5	345	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	-	-	NIL	NIL
	34.5	345.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	34.5	345.00	NIL	NIL

Note 2. Reserve and Surplus	As at 1st April, 2015	As at 31st March, 2015
Revenue Reserve	45.00	
Total	45.00	

Note 3. Long Term Borrowings	As at 1st April, 2015	As at 31st March, 2015
Loan Fund	277.00	
Total	277.00	

Note 4. Other Current liabalities	As at 1st April, 2015	As at 31st March, 2015
Current liabilities (Pertaining to S Division)	270.00	-
Total	270.00	-

Note 5. Tangible Assets	As at 1st April, 2015	As at 31st March, 2015
Fix Asssets	875.00	-
Less :Prov. for Dep.	360	
Total	515.00	-

Note 6. Other Current assets	As at 1st April, 2015	As at 31st March, 2015
Current assets (division S)	422.00	-
Total	422.00	-

WN # 1: ***Revenue Reserves***

Particulars	**₹ *in Crores***
Balance as 31.03.2015	685
Add : Profit on sale of investment	5
Less: Loss on demerger	(645)
Balance as on 01.04.2015	45

WN # 2 : ***Loan Funds***

Particulars	**₹ *in Crores***
Balance as 31.03.2015	417
Less: Bank Loan transferred to Y Ltd.	(15)
Less: Debentures redeemed	(125)
Balance as on 01.04.2015	277

WN # 3: ***Current Assets***

Particulars	***₹ in Crores***
Balance as 31.03.2015	445
Add: Cash received on sale of investments	102
Less: Cash paid on redemption of debentures	(125)
Balance as on 01.04.2015	422

Name of the Company: Y Ltd.				
Balance Sheet as at 01.04.2015				
Ref No.		**Particulars**	**Note No.**	**As at 01st April, 2015**
				(₹ in Crore)
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	690.00
		(b) Reserves and surplus	2	5.00
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	15.00
	4	**Current Liabilities**		
		(a) Other current liabilities	4	93.00
		Total		803.00
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	5	218.00
	2	**Current assets**		
		(a) Other current assets	6	585.00
		Total		803.00

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

(₹ in Crore)

Note 1. Share Capital	**As at 1st April, 2015**
Authorised capital : 90 crores Equity Share of ₹ 10 each	900.00
Issued, Subscribed and paid up Equity share of ₹ 10 each (The above share were issued for a consideration other than cash.)	690.00
Total	690.00

RECONCILIATION OF SHARE CAPITAL		
FOR EQUITY SHARE :-	**As at 1st April, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 01.04.15	-	-
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	69	690.00
	69	690.00
Less: Buy Back of shares	-	-
Total	69	690.00

Note 2. Reserve and Surplus	**As at 1st April, 2015**
Capital Reserve	5.00
Total	5.00

Note 3. Long Term Borrowings	**As at 1st April, 2015**
Bank Loan	15.00
Total	15.00

Note 4. Other Current liabalities	**As at 1st April, 2015**
Current liabilities & provision	93.00
Total	93.00

Note 5. Tangible Assets	**As at 1st April, 2015**
Other Fixed Assets	218.00
Total	218.00

(It is assumed that all other Fixed Asset are Tangible Fixed Assets)

Note 6. Other Current assets	**As at 1st April, 2015**
Other Current assets	585.00
Total	585.00

WN # 4 : *Capital Reserves*

	Particulars		**₹ *in Crores***
i.	Purchase consideration		690
ii.	Less: Net Assets taken Over		
	Assets taken over (218 + 585)	803	
	Less: Liabilities taken over (93+15)	(108)	(695)
iii.	*Capital reserves* [(i) - (ii)]		5

Calculation of Intrinsic value per share before and after demerger **₹ in Crores**

Particulars	***Before Demerger***	***After Demerger***
Fixed Assets	683	515
Net Current Assets (WN # 5)	644	152
Total assets	1,327	667
Less : Loan funds (WN # 6)	(292)	(277)
Net asset value	1,035	390
Number of shares	34.5	34.5
Intrinsic value per share [(v)+(vi)]	**₹ 30**	***₹ 11.30***

WN # 5 : *Current Assets* **₹ in Crores**

Particulars	***Before Demerger***	***After Demerger***
Balance as per balance sheet	667	175
Less : Cash paid on redemption of debentures	(125)	(125)
Add : Cash received on sale of investments	102	102
	644	**152**

WN # 6 : *Loan Funds* **₹ in Crores**

Particulars	***Before Demerger***	***After Demerger***
Balance as per balance sheet	417	417
Less : Redemption of debentures	(125)	(125)
Less : Transfer of loan funds to Y Ltd.	-	(15)
	292	**277**

IV. ***Gain per share to the shareholders of Z Ltd. arising out of the demerger :***

For every share in Z Ltd, the shareholders will hold 2 shares in Y Ltd. also.

		₹
I.	**After demerger**	
	i. Value of one share in Z Ltd.	11.30
	ii. Value of two share in Y Ltd. (₹ 10 x 2)	20.00
	iii. Total Value after merger for each share	31.30
II.	**Before demerger**	
	i. Value of one share in Z Ltd. before merger	30.00
III.	**Gain per share**	**1.30**

XII. Sales of Division

Illustration 32.

X Ltd. has 2 divisions A and B.

Division A has been making constant profits while Division B has been invariably suffering losses. On 31st March, 2015 the divisionwise summarised Balance Sheet was :

(₹ Crores)

		A	B	Total
Fixed Assets cost (Tangible)		250	500	750
Depreciation		225	400	625
	(i)	25	100	125
Current Assets :		200	500	700
Less : Current liabilities		25	400	425
	(ii)	175	100	275
	(i) + (ii)	200	200	400
Financed by :				
Loan		—	300	300
Capital : Equity ₹ 10 each		25	_	25
Surplus		175	(100)	75
		200	200	400

Division B along with its assets and liabilities was sold for ₹ 25 crores to Y Ltd. a new company, who allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share to the memebers of B Ltd. in full settlement of the consideration in proportion to their shareholding in the company.

Asssuming that there are no other transactions, you are asked to :

i. Pass journal entries in the books of X Ltd.

ii. Prepare the Balance Sheet of X Ltd. after the entires in (i).

iii. Prepare the Balance Sheet of Y Ltd.

Solution :

Part I - Books of A Ltd :

Basic Information :

X Ltd.

Division A	Division B
Profit Making	Loss Making
Retained by X Ltd	Assets and Liabilites transferred to Y Ltd for consideration of ₹ 25 Crores.

I. ***Journal Entries***

(₹ Crores)

Particulars		***Debit***	***Credit***
i. Sale of Assets and Liabilities to Y Ltd.			
Y Ltd A/c	Dr.	25	
Loan A/c	Dr.	300	
Current liabilities A/c	Dr.	400	
Provision for depreciation A/c	Dr.	400	
To Fixed Assets A/c			500

To Current Assets A/c			500
To Capital Reserve A/c (bal fig)			125
ii. Receipt of consideration from B Ltd.			
Equity shares in Y Ltd.	Dr.	25	
To Y Ltd. A/c		25	

II.

Name of the Company: X Ltd.					
Balance Sheet as at 31.03.2015					
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
				(₹ **in Crore**)	(₹ **in Crore**)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	25.00	
		(b) Reserves and surplus	2	200.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Other current liabilities	3	25.00	
		Total		250.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	25.00	
		(b) Non-current investments	5	25.00	
	2	**Current assets**			
		(a) Other current assets	6	200.00	
		Total		250.00	

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

Note :

Division 'B' was sold to M/s. Y Ltd. The consideration received for the transfer was equity shares of Y Ltd. of ₹ 10 each fully paid, issued at a premium of ₹ 15.

Total value of consideration = 1 Crore shares × (₹ 10 + ₹ 15)

= 1 Crore × ₹ 25

= ₹ 25 Crores

(₹ in Crore)

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorised, Issued, Subscribed and paid up:- 2.5 crores Equity share of ₹ 10 each	- 25.00	
Total	25.00	

RECONCILATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	As at 31st March, 2015		As at 31st March, 2014	
	Nos	Amount (₹)	Nos	Amount (₹)
Opening Balance as on 01.04.14	-	-	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	2.50	25.00	NIL	NIL
	2.50	25.00	NIL	NIL
Less: Buy Back of shares	-	-	-	-
	2.50	25.00	NIL	NIL

Note 2. Reserve and Surplus	As at 31st March, 2015	As at 31st March, 2014
Capital Reserve	125.00	
Profit & loss(existing)	75.00	
Total	200.00	

Note 3. Other Current liabalities	As at 31st March, 2015	As at 31st March, 2014
Current liabilities	25.00	-
Total	25.00	-

Note 4. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed Assets	250.00	-
Less : Provision for Depreciation	225.00	
Total	25.00	-

(It is assumed that all Fixed Asset are Tangible Fixed Assets)

Note 5. Non Current Investment	As at 31st March, 2015	As at 31st March, 2014
Investment in Equity Share of Y Ltd. (Face value of ₹ 10 subscribed at a Premium of ₹ 15 each)	25.00	-
Total	25.00	-

Note 6. Other Current Assets	As at 31st March, 2015	As at 31st March, 2014
Current Assets	200.00	-
Total	200.00	-

Part II - In the books of Y Ltd.
Journal Entries

(₹ in Crore)

	Particulars		Debit	Credit
a.	For Business purchase			
	Business Purchase A/c	Dr.	25	
	To X Ltd A/c			25
b.	Assets and liabilities taken over			
	Fixed Assets A/c	Dr.	100	
	Current Assets A/c	Dr.	500	
	Goodwill A/c (Balancing Figure)	Dr.	125	
	To Loan A/c			300
	To Current liabilities A/c			400
	To Business Purchase A/c			25
c.	Discharge of liability			
	X Ltd A/c	Dr.	25	
	To Equity Share capital A/c			10
	To Securities premium A/c			15

Name of the Company: Y Ltd.				
Balance Sheet as at 31.03.2015				
Ref No.		**Particulars**	**Note No.**	**As at 31st March, 2015**
				₹ in Crore
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	10.00
		(b) Reserves and surplus	2	15.00
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		
		(a) Long-term borrowings	3	300.00
	4	**Current Liabilities**		
		(a) Other current liabilities	4	400.00
		Total		725.00
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	5	100.00
		(ii) Intangible assets	6	125.00
	2	**Current assets**		
		(a) Other current assets	7	500.00
		Total		725.00

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

	(₹ in Crore)
Note 1. Share Capital	**As at 31st March, 2015**
Authorised, Issued, Subscribed and fully paid up :-	-
1 crore Equity share of ₹ 10 Each	10.00
Total	10.00

RECONCILATION OF SHARE CAPITAL		
FOR EQUITY SHARE :-	**As at 31st March, 2015**	
	Nos	**Amount (₹)**
Opening Balance as on 31.03.15	-	-
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	1	10.00
	1	10.00
Less: Buy Back of shares	-	-
	1	10.00

Note 2. Reserve and Surplus	**As at 31st March, 2015**
Securities Premium	15.00
Total	15.00

Note 3. Long Term borrowing	**As at 31st March, 2015**
Loan Fund	300.00
Total	300.00

Note 4. Other Current Liablities	**As at 31st March, 2015**
Current Liablities and Provision	400.00
Total	400.00

Note 5. Tangible Assets	**As at 31st March, 2015**
Other Fixed Assets	100.00
Total	100.00

Note 6. Intangible Assets	**As at 31st March, 2015**
Goodwill	125.00
Total	125.00

Note 7. Other Current Assets	**As at 31st March, 2015**
Other Current Assets	500.00
Total	500.00

Note:

(a) Goodwill due to business purchase should be amortized over a period of 5 years.

(b) Fixed assets:

Gross Block	500
Less: Accumulated Depn.	400
Net Blcok	100

XIII. Impact of Reconstruction over Wealth of Investor and Company

Illustration 33.

AB Ltd has 2 divisions - A and B. The draft Balance Sheet as at 31, March, 2015 was as under:

(₹ *in Crores*)

		A		B		Total
Fixed assets						
Cost		600		300		900
Depreciation		500		100		600
W.D.V.		100		200		300
Net Current Assets						
Current Assets	400		300		700	
Less: Current Liabilities	100	300	100	200	200	500
Total		**400**		**400**		**800**
Financed by:						
Loans		—		100		100
(Secured by a charge on Fixed assets)		—		100		100
Own funds:						
Equity capital						50
(Fully paid up ₹ 10 shares)						
Reserves and surplus						650
						700
Total		**400**		**400**		**800**

It is decided to form a new company B Ltd., to take over the assets and liabilities of B division.

According B. Ltd. was incorporated to take over at balance sheet figures, the assets and liabilities of that division. B Ltd. is to allot 5 crores equity shars of ₹ 10 each in the company to the members of AB Ltd., in full settlement of the consideration. The members of AB Ltd. are therefore to become members of B 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 AB Ltd. and B. Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st April, 2015, 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".

Solution:

Part I: In the Books of M/s. AB Ltd.

(₹ in Crores)

	Particulars		Debit	Credit
i.	Transfer of assets and liabilities of Division B to B Ltd.			
	(a) For Purchase Consideration Due:			
	A Ltd. A/c	Dr.	50	
	Loan funds A/c	Dr.	100	
	Curent liabilities A/c	Dr.	100	
	Povision for depreciation A/c	Dr.	100	
	Profit and Loss A/c (balancing figure)	Dr.	250	
	To Fixed Assets A/c			300
	To Current Assets A/c			300
ii.	Cancellation of balance in A Ltd. not receivable since consideration is paid to members of AB Ltd. in full			
	Reserves A/c	Dr.	50	
	To A Ltd.			50

Part II: In the Books of B Ltd.

(₹ in crores)

	Particulars		Debit ₹	Credit ₹
i.	For Purchase Consideration Due:			
	Business Purchase A/c	Dr.	50	
	To Shareholders of AB Ltd. A/c			
ii.	Assets and liabilities taken over			
	Fixed Assets A/c	Dr.	200	
	Current Assets A/c	Dr.	300	
	To Loan A/c			100
	To Current liabilities A/c			100
	To Capital Reserve (balancing figure)			250
	To Business Purchase A/c			50
iii.	Discharge of purchase consideration			
	Shareholders of AB Ltd.	Dr.	50	
	To Equity Share capital A/c			50

Part III : Balance Sheet of two companies after reorganisation.

Name of the Company: Y Ltd.							
Balance Sheet as at 01.04.2015							
				Before AB Ltd.		**After B Ltd.**	
Ref No.		**Particulars**	**Note No.**	**As at 1st April, 2015**	**As at 31st March, 2015**	**As at 1st April, 2015**	**As at 31st March, 2015**
				(₹ **in Crore**)	(₹ **in Crore**)	(₹ **in Crore**)	(₹ **in Crore**)
	I.	**Equity and Liabilities**					
	1	**Shareholders' funds**					
		(a) Share capital	1	50.00	50.00	50.00	-
		(b) Reserves and surplus	2	350.00	650.00	250.00	-
	2	**Share application money pending allotment**		Nil	Nil	Nil	-
	3	**Non-current liabilities**					
		(a) Long-term borrowings	3	-	100.00	100.00	-
	4	**Current Liabilities**		Nil	Nil	Nil	-
		Total		400.00	800.00	400.00	-
	II.	**Assets**					
	1	**Non-current assets**					
		(a) Fixed assets					
		(i) Tangible assets	4	100.00	300.00	200.00	-
	2	**Current assets**					
		(a) Other current assets	5	300.00	500.00	200.00	-
		Total		400.00	800.00	400.00	

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

(₹ in Crores)

Note 1. Share Capital	**01.04.2015**		**31.03.2015**
	Before AB Ltd.	**After B Ltd.**	**Before AB**
Authorised, Issued, Subscribed and paid up	-	-	-
Equity Share of ₹ 10 each fully paid	50.00	50.00	50.00
Total	50.00	50.00	50.00

Note 2. Reserve and Surplus	**01.04.2015**				**31.03.2015**	
	Before AB Ltd.		**After B Ltd.**		**Before AB**	
Capital Reserve	-			250.00	-	
Revenue Reserve		650.00	-		650.00	650.00
Less : Trf to B Ltd.	250.00					
Less : Cancel due frm B Ltd.	50.00					
		300.00				
Total		350.00	-	250.00		650.00

Note 3. Long Term Borrowings	**01.04.2015**		**31.03.2015**
	Before AB Ltd.	**After B Ltd.**	**Before AB**
Loan Funds	-	100.00	100.00
Total	-	100.00	100.00

Note 4. Tangible Assets	01.04.2015				31.03.2015	
	Before AB Ltd.		After B Ltd.		Before AB	
Fixed Assets	600.00	-	300.00	-	900.00	-
Less : Provision for Depreciation	500.00	-	100.00	-	600.00	-
Total	100.00	-	200.00	-	300.00	-

Note 5. Other Current Assets	01.04.2015		31.03.2015
	Before AB Ltd.	After B Ltd.	Before AB
Current Asset (Net)	300.00	200.00	500.00
Total	300.00	200.00	500.00

(₹ in Crores)

	A	*B*	*AB*
Value of total assets	800	400	400
Less: Loan funds	(100)	—	(100)
Net assets	700	400	300
Net assets belonging to Equity share holders after December		700	

Conclusion:

The impact on share holders wealth after reorganisation is Nil.

XIV. Buy back of shares:

Illustration 34.

K Ltd. furnishes you with the following Balance Sheet as at 31st March, 2015:

(₹ in Crores)

Sources of Funds		
Share capital :		
Authorised		100
Issued:		
12% redeemable preference shares of ₹ 100 each fully paid	75	
Equity shares of ₹ 10 each fully paid	25	100
Reserves and surplus		
Capital Reserve	15	
Securities Premium	25	
Revenue Reserves	260	300
		400
Funds employed in:		
Fixed assets (Tangible) : cost	100	
Less: Provision for depreciation	100	nil
Investments at cost (Market value ₹ 400 Cr.)		100
Current assets	340	
Less: Current liabilities	40	300
		400

The company redeemed preference shares on 1st April, 2015. It also bought back 50 lakh equity shares of ₹ 10 each at ₹ 50 share. The payments for the above were made out of the huge bank balances, which appeared as a part of Current assets.

You are asked to :

i. Pass journal entries to record the above

ii. Prepare Balance Sheet

iii. Value equity share on net asset basis.

Solution:

Part I - Journal entries in the books of K Ltd.

(₹ **in Crore**)

Particulars		***Debit***	***Credit***
a. Redemption of Preference Shares on 1st April 2015			
i. Due Entry			
12% Preference Share capital A/c	Dr.	75	
To Preference Share Hodlers A/c			75
ii. Payment Entry			
Preference Shareholders A/c	Dr.	75	
To Bank A/c			75
b. Shares bought back			
i. On buy back			
Shares bought back A/c	Dr.	25	
To Bank A/c			25
(50 lakhs shares × ₹ 50 per share)			
ii. On Cancellation			
Equity Share capital A/c (50 Lakhs × ₹ 10)	Dr.	5	
Securities premium A/c (50 Lakhs × ₹ 40)	Dr.	20	
To Shares bought back A/c			25
iii. Transfer to Capital Redemption Reserve			
Revenue reserve A/c	Dr.	80	
To Capital Redemption Reserve A/c			80
(Being creation of capital redemption reserve to the extent of the face value of preference shares redeemed and equity shares bought back)			

Part-II: Balance Sheet of K Ltd after reconstruction:

Name of the Company: K Ltd.					
Balance Sheet as at 01.04.2015					
Ref No.		**Particulars**	**Note No.**	**As at 1st April, 2015**	**As at 31st March, 20115**
				(₹ **in Crore**)	(₹ **in Crore**)
	I.	**Equity and Liabilities**			
	1	**Shareholders' funds**			
		(a) Share capital	1	20.00	
		(b) Reserves and surplus	2	280.00	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Other current liabilities	3	40.00	
		Total		340.00	
	II.	**Assets**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(b) Non-current investments	4	100.00	
	2	**Current assets**			
		(a) Other current assets	5	240.00	
		Total		340.00	

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

(₹ in Crore)

Note 1. Share Capital	**As at 1st April, 2015**	**As at 31st March, 2015**
Authorised, Issued, Subscribed and paid up :- 200 lakh Equity Share of ₹ 10 each fully paid	- 20.00	
12% Redeemable pref share @ ₹ 10 each	-	
Total	20.00	

RECONCILIATION OF SHARE CAPITAL				
FOR EQUITY SHARE :-	**As at 1st April, 2015**		**As at 31st March, 2015**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	2.5	25.00	NIL	NIL
Add: Fresh Issue (Incld Bonus shares, Right shares, split shares, shares issued other than cash)	-	-	NIL	NIL
	2.5	25.00	NIL	NIL
Less: Buy Back of shares	0.50	5.00	-	-
	2.00	20.00	NIL	NIL

RECONCILIATION OF SHARE CAPITAL				
12% Redeemable Preference Share	**As at 1st April, 2015**		**As at 31st March, 2015**	
	Nos	**Amount (₹)**	**Nos**	**Amount (₹)**
Opening Balance as on 01.04.14	0.75	75.00	NIL	NIL
Add: Fresh Issue	-	-	NIL	NIL
	0.75	75.00	NIL	NIL
Less: Redemption of Shares	0.75	75.00	-	-
	-	-	NIL	NIL

Note 2. Reserve and Surplus	As at 1st April, 2015	As at 31st March, 2015
Capital Reserve	15.00	
Capital Redemption Reserve	80.00	
Share Premium (25-20)	5.00	
Revenue Reserve (260-80)	180.00	
Total	280.00	

Note 3. Other Current Liablities	As at 1st April, 2015	As at 31st March, 2015
Current Liablities	40.00	-
Total	40.00	-

Note 4. Non Current Investment	As at 1st April, 2015	As at 31st March, 2015
Investment at cost (Market value of Investment ₹ 400 crores)	100.00	-
Total	100.00	-

Note 5. Other Current Assets	As at 1st April, 2015	As at 31st March, 2015
Current Assets	240.00	-
Total	240.00	-

Part - III - Net Asset Value of Equity Shares

(₹ in Crores)

Particulars	*Amount*	*Amount*
a. i. Fixed assets	Nil	
ii. Investments (at market value)	400	
iii. Current assets	240	640
b. Less: Current liabilities		(40)
Net assets available for equity share holders		600
c. No. of equity shares outstanding (in lakhs)		2
d. Value per equity share of ₹ 10 each = (600÷2)		₹ 300

XV. Conversion:

Illustration 35.

X Co. Ltd. was incorporated on 1st July, 2014 to take over the business of Mr. A as and from 1st April, 2014, Mr. A's Balance Sheet, as at that date, was as under :

Liabilities	₹	***Assets***	₹
Trade creditors	36,000	Building	80,000
Capital	1,94,000	Furniture and Fittings	10,000
		Debtors	90,000
		Stock	30,000
		Bank	20,000
	2,30,000		**2,30,000**

Debtors and Bank balance are to be retained by the vendor and creditors are to be paid off by him. Realisation of debtors will be made by the company on a commission of 5% on cash collected. The company is to issue A with 10,000 equity shares of ₹ 10 each, ₹ 8 per share paid up and cash of ₹ 5,000.

The company issued to the public for cash 20,000 equity shares of ₹ 10 each on which by 31st March, 2012, ₹ 8 per share was called and paid up except in the case of 1,000 shares on which the 3rd call of ₹ 2 per share had not been realised. In the case of 2,000 shares, the entire face value of the shares has been realised. The share issue was underwritten for 2% commission, payable in shares fully paid up.

In addition to the balances arising out of the above, the following balances were shown by the books of account of X Co. Ltd. on 31st March, 2015.

	₹
Discount (including ₹ 1,000 allowed on vendor's debtors)	6,000
Preliminary Expenses	10,000
Director's Fees	12,000
Salaries	48,000
Debtors (including vendor's debtors)	1,60,000
Creditors	48,000
Purchases	3,20,000
Sales	4,60,000

Stock on 31st March, 2015 was ₹ 52,000. Depreciation at 10% on Furniture and Fittings and at 5% on building is to be provided. Collections from debtors belonging to the vendor were ₹ 60,000 in the period.

Prepare the Trading and Profit and Loss account for the period ended 31 st March, 2015 of X Co. Ltd. and its Balance Sheet as at that date.

Solution:

Part I: Calculation of purchase consideration.

	Particulars	₹
a.	Consideration paid in the form of cash	56,000
b.	Consideration paid in the form of equity shares of X Co. Ltd 10,000 Shares of ₹ 10 each, ₹ 8 paid up	80,000
c.	Total consideration	1,36,000

Part II : *In the Books of Mr. A.*

Realisation Account

Dr. Cr.

Particulars	₹	**Particulars**	₹
To Building	80,000	By X Co. Ltd (Purchase consideration)	1,36,000
To Furniture	10,000		
To Stock	30,000		
To Profit on Realisation	16,000		
	1,36,000		**1,36,000**

Journal Entries

Particulars		***Debit*** ₹	***Credit*** ₹
a. For Purchase Consideration Due:			
X Co. Ltd. A/c	Dr.	1,36,000	
To Realisation A/c			1,36,000
b. Receipt entry			
Equity shares in X Ltd. A/c	Dr.	80,000	
Cash / Bank A/c	Dr.	56,000	
To X Co. Ltd. A/c			1,36,000
c. Other receipts from X Ltd - Debtors collection			
i. Recovery of debtors.			
X Co. Ltd. (Vendor Drs)	Dr.	90,000	
To Debtors A/c			90,000
ii. Receipt of cash and commission paid.			
Discount on Debtors A/c	Dr.	1,000	
Commission to X Co. Ltd A/c	Dr.	3,000	
Cash/Bank A/c	Dr.	57,000	
To X Co. Ltd A/c			61,000
[Since the debtors are held by Mr. A, the discount given to debtors are to be borne by Mr. A.			
Commission = Cash collected × 5%= 60,000 × 5%= 3,000			
∴ Balance in vendor debtors A/c (90,000–61,000=29,000)			
d. Settlement to creditors			
Creditors A/c	Dr.	36,000	
To Bank A/c			36,000
[Since creditors are also held by Mr. A. and not taken over by X Co. Ltd.]			

Cash / Bank Account

Dr. Cr.

Particulars	₹	**Particulars**	₹
To balance b/d	20,000	By Creditors	36,000
To X. Co. (Purchase Consideration)	56,000	By balance c/d	97,000
To X Co. (Debtors Collection)	57,000		
	1,33,000		1,33,000
To Bal b/d	97,000		

Balance sheet of Mr. A as at 1 st April 2014

Liabilities	₹	**Assets**	₹
Capital	1,94,000	Investment in equity shares of X Co. Ltd (₹ 8 paid)	80,000
Add : Realisation Profit	16,000		
Less : Discount to debtors	(1,000)	Vendor Debtors (X Ltd.)	29,000
Less : Commission Paid.	(3,000)		
	2,06,000		**2,06,000**

Part III - In the books of X Co. Ltd.

Particulars			***Debit***	***Credit***
a.	Take over business of Mr. A			
i.	For Purchase Consideration Due:			
	Business Purchase A/c	Dr.	1,36,000	
	To Mr. A			1,36,000
ii.	For Assets taken over			
	Goodwill A/c (balancing figure)	Dr.	16,000	
	Building A/c	Dr.	80,000	
	Furniture and fixture A/c	Dr.	10,000	
	Stock A/c	Dr.	30,000	
	To Business Purchase A/c			1,36,000
iii.	Discharge of Purchase Consideration			
	Mr. A A/c	Dr.	1,36,000	
	To Equity Share capital A/c			80,000
	To Bank / Cash A/c			56,000
b.	Public Issue of shares			
i.	Bank A/c	Dr.	1,36,000	
	To Equity shares capital A/c			1,36,000
	[Being ₹ 8 per share received on 17,000 shares (20,000 - 1,000 - 2,000)]			
ii.	Bank A/c	Dr.	6,000	
	Calls in Arrears A/c	Dr.	2,000	
	To Equity Share capital A/c			8,000
	[Being receipt of ₹ 6 - on 1000 shares. ₹ 2 on 3rd call had not been realised]			
iii.	Bank A/c	Dr.	20,000	
	To Equity Share capital A/c			16,000
	To Calls in advance A/c			4,000
	[Being on 2,000 shares, the entire amount of Share capital received. ₹ 2 per share not called up transferred to calls in advance A/c)			
	Underwriting commission A/c]	Dr.	4,000	
	To Equity Share capital A/c			4,000
	[Being 2% on the face value of the public issue paid as underwriting commission. Commission discharged as fully paid equity shares. 20,000 shares × ₹ 10 each = 2,00,000 2% × 2,00,000 = 4,000]			

Debtors Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Sales		By Discount (6,000 - 1,000)	5,000
(Assuming fully credit)	4,60,000	By Cash received (balancing figure)	3,24,000
		By Balance c/d (1,60,000 - 29,000)*	1,31,000
	4,60,000		**4,60,000**

Vendor Debtors Taken over:

Particulars		₹
i.	Particulars Debtors taken over from Mr. A	90,000
ii.	Less : Discount given	(1,000)
iii.	Less : Cash collected	(60,000)
iv.	Balance in vendor debtors	29,000

Creditors Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Cash (Balancing figure)	2,72,000	By Purchases (assuming fully on credit)	3,20,000
To Balance c/d	48,0000		
	3,20,000		3,20,000

Cash / Bank Account

Dr. Cr.

Particulars	₹	Particulars	₹
To Realisation from debtors	3,24,000	By Purchase consideration to Mr.A	56,000
To Receipt from vendor debtors	60,000	By Remittance of vendor Debtors collection (60000 – 3000)	57,000
To Equity Share capital (1,36,000 + 6,000 + 20,000)	1,62,000	By Payment to creditors	2,72,000
		By Preliminary expenses	10,000
		By Directors fees	12,000
		By Salaries	48,000
		By Balance c/d (balancing figure)	91,000
	5,46,000		**5,46,000**

Computation of Goodwill on acquisition

Particulars	₹	₹
Purchase Consideration		
- in shares of ₹ 10 each	80,000	
- in cash	56,000	1,36,000
Less : Assets taken over:		
- Building	80,000	
- Furniture and Fittings	10,000	
- Stock	30,000	1,20,000
Goodwill		16,000

Trading Account of X Co. Ltd. for the year ended 31st March, 2015

Dr. **Cr.**

Particulars	**₹**	**Particulars**	**₹**
To Opening Stock	30,000	By Sales	4,60,000
To Purchase	3,20,000	By Closing Stock	52,000
To Gross profit c/d	1,62,000		
	5,12,000		**5,12,000**

Profit and Loss Account of X Co. Ltd. for period from 1st July 2014 to 31st March 2015.

Dr. **Cr.**

Particulars	**1.4.14 to 30.06.14**	**1.7.14 to 31.3.15**	**Particulars**	**1.4.14 to 30.6.14**	**1.7.14 to 31.3.15**
To Discount	-	5,000	By Gross profit	40,500	1,21,500
To Directors fees	.	12,000	By Commission	.	3,000
To Salaries	-	48,000	Received		
To Depreciation	1,250	3,750			
To Capital Reserve	39,250	-			
To P & L A/c	-	55,750			
	40,500	**1,24,500**		**40,500**	**1,24,500**

Note :

a. Entire salary and discount pertains to post incorporation period.

b. Depreciation :

i. Pre-incorporation:

Building : 80,000 × 5% × = 1,000

Furniture : $10{,}000 \times 10\% \times \frac{3}{2}$ = $\underline{250}$ 1,250

ii. Post-incorporation :

Building: 80,000 × 5% × 9/12 = 3,000

Furniture: 10,000 × 10% × 9/12 = $\underline{750}$ 3,750

* Profit during 1.4.14 to 30.6.14 reduces the cost of Acquisition and hence transferred to Capital reserve.

Name of the Company: X Co. Ltd.				
Balance Sheet as at 31.03.2015				
Ref No.		Particulars	Note No.	As at 31st March, 2015
				₹
	I.	**Equity and Liabilities**		
	1	**Shareholders' funds**		
		(a) Share capital	1	242,000.00
		(b) Reserves and surplus	2	79,000.00
	2	**Share application money pending allotment**		Nil
	3	**Non-current liabilities**		Nil
	4	**Current Liabilities**		
		(a) Other current liabilities	3	48,000.00
		(b) Short-term provisions	4	4,000.00
		Total		3,73,000.00
	II.	**Assets**		
	1	**Non-current assets**		
		(a) Fixed assets		
		(i) Tangible assets	5	85,000.00
	2	**Current assets**		
		(a) Inventories	6	52,000.00
		(b) Trade receivables	7	131,000.00
		(c) Cash and cash equivalents	8	91,000.00
		(d) Other current assets		14,000.00
		Total		3,73,000.00

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

***Note:** Since both Capital Reserve and goodwill arise out of the business acquisition, they can be netted off against each other.

(₹)

Note 1. Share Capital	As at 31st March, 2015
30,000 equity shares @ ₹ 8 each	240,000.00
Less : Calls in arrear (1000 @ ₹2)	2,000.00
	238,000.00
(Out of the above shares 10,000 shares were issued to Mr. A for consideration other than cash)	
Add: 400 shares of @ ₹ 10 each	4,000.00
(to be issued to underwriter for consideration other than cash)	
Total	242,000.00

RECONCILATION OF SHARE CAPITAL		
FOR EQUITY SHARE :-	As at 31st March, 2015	
	No.	Amount
30,000 shares @ ₹8 each	30,000	240,000.00
Add: 400 shares @ ₹ 10 each (issued to underwrite other than cash)	400	4,000.00
	30,400	244,000.00
Less: Calls in Arrear	1,000	2,000.00
	29,400	242,000.00

Note 2. Reserve and Surplus	As at 31st March, 2015
Capital Reserve	-
Pre incorporation profit	39,250.00
Less: Goodwill for business purchase	16,000.00
	23,250.00
Profit & Loss	55,750.00
Total	79,000.00

Note 3. Trade Payable	As at 31st March, 2015
Sundry creditors	48,000.00
Total	48,000.00

Note 4. Other Current Liabilities	As at 31st March, 2015
Calls in advance	4,000.00
Total	4,000.00

Note 5. Tangible Assets		As at 31st March, 2015
Building	80,000.00	
Less: Depreciation @ 5%	4,000.00	76,000.00
Furniture	10,000.00	
Less: depreciation @ 10%	1,000.00	9,000.00
Total		85,000.00

Note 6. Inventories	As at 31st March, 2015
Stock	52,000.00
Total	52,000.00

Note 7. Trade Receivable	As at 31st March, 2015
Sundry debtors	131,000.00
Tota;	131,000.00

Note 8. Cash and cash equivalent	As at 31st March, 2015
Cash	91,000.00
Total	91,000.00

Note 9. Other Current assets	As at 31st March, 2015
Misc. Expenses	
Preliminary Exp	10,000.00
Underwriting commission	4,000.00
Total	14,000.00

PROBLEMS ON "NOTES TO ACCOUNTS - RELEVANCE RELATED TO PUBLISHED FINANCIAL STATEMENTS"

Illustration 36.

The following information has been extracted from the books of account of Hero Ltd. as at 31st March, 2015: (₹ '000)

	Dr.	Cr.
Administration Expenses	480	
Cash at Bank and on Hand	228	
Cash Received on Sale of Fittings		10
Long Term Loan		70
Investments	200	
Depreciation on Fixtures, Fittings, Tools and Equipment		
(1st April, 2014)		260
Distribution Costs	102	
Factory Closure Costs	60	
Fixtures, Fittings, Tools and Equipment at Cost	680	
Profit & Loss Account (at 1st April, 2014)		80
Purchase of Equipment	120	
Purchases of Goods for Resale	1710	
Sales (net of Excise Duty)		3,000
Share Capital (1,00,000 shares of @ ₹10 each fully paid)		1,000
Stock (at 1st April, 2014)	140	
Trade Creditors		80
Trade Debtors	780	
	4,500	4,500

Additional Information:

(1) The stock at 31st March, 2015 (valued at the lower of cost or net realizable value) was estimated to be worth ₹ 2,00,000.

(2) Fixtures, fittings, tools and equipment all related to administration. Depreciation is charged at a rate of 20% per annum on cost. A full year's depreciation is charged in the year of acquisition, but no depreciation is charged in the year of disposal.

(3) During the year to 31st March, 2015, the Company purchased equipment of ₹ 1,20,000. It also sold some fittings (which had originally cost ₹ 60,000) for ₹ 10,000 and for which depreciation of ₹ 30,000 had been set aside.

(4) The average Income tax for the Company is 50%. Factory closure cost is to be presumed as an allowable expenditure for Income tax purpose.

(5) The company proposes to pay a dividend of 20% per Equity Share.

Prepare Hero Ltd.'s Profit and Loss Account for the year to 31st March, 2015 and Balance Sheet as at that date in accordance with the Companies Act, 2013 in the Vertical Form along with the Notes on Accounts containing only the significant accounting policies.

Solution:

Name of he Company : Hero Ltd.
Balance Sheet as at 31st March, 2015

(₹ In '000)

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	1,000	
		(b) Reserves and surplus	2	150	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	70	
	4	**Current Liabilities**			
		(a) Other current liabilities	4	80	
		(b) Short-term provisions	5	470	
		Total (1+2+3+4)		1,770	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	362	
		(b) Non-current investments	7	200	
	2	**Current assets**			
		(a) inventories	8	200	
		(b) trade receivables	9	780	
		(c) Cash and cash equivalents	10	228	
		Total (1+2)		1,770	

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

		Note No.		As at 31st March, 2015	As at 31st March, 2014
I	REVENUE FROM OPERATION	11		3,000	
	Less: Excise duty				
				3,000	
II	OTHER INCOME				
III	TOTAL REVENUE(I+II)			3000	
IV	EXPENSES:				
	(a) Purchase of products for sale		1,710		
	(b) changes in inventories of finished goods, work-in-progress and products for sale (140-160)		(60)		

	(c) Depreciation and amortization expenses		148		
	(d) Other expenses	12	602		
	TOTAL EXPENSES			2,400	
V	PROFIT BEFORE EXCEPTIONAL AND EXTRAORDINARY ITEMS AND TAX (III-IV)			600	
VI	EXCEPTIONAL ITEMS			Nil	
VII	PROFIT BEFORE EXTRAORDINARY ITEMS AND TAX (V-VI)			600	
VIII	EXTRAORDINARY ITEMS			60	
IX	PROFIT BEFORE TAX FRON CONTINUING OPERATIONS (VII-VIII)			540	
X	Tax expenses:				
	(1) Current Tax			270	
	(2) deferred tax			-	
XI	PROFIT AFTER TAX FOR THE YEAR FROM CONTINUING OPERATION(IX-X)			270	
XII	Profit (loss) from discontinuing operations				
XIII	Tax expenses from discontinuing operations				
XIV	Profit(loss) from discontinuing operations (after tax)(XII-XIII)			Nil	
XV	PROFIT (LOSS) FOR THE PERIOD (XI+XIV)			270	
	Balance brought forward from previous year				
	Profit available for appropriation			80	
				350	
	Appropriation:				
	Proposed dividend		200		
	Transfer to General Reserve		30	230	
	Balance carried forward			120	
XVI	Earning per equity share:				
	(1) Basic				
	(2) Diluted				

(₹ In '000)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorized, Issued, Subscribed and paid-up Share capital:-		
1,00,000 Equity share of ₹10 each	1,000	
Total	1,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11 (Figure in '000)	100	1,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	100	1,000		
Less: Buy Back of share				
Total	100	1,000		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
General Reserve	30	
Profit and loss A/c	120	
Total	150	

Note 3. Long term borrowings	As at 31st March, 2015	As at 31st March, 2014
Long term loan	70	
Total	70	

Note 4. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors	80	
Total	80	

Note 5. Short- term provisions	As at 31st March, 2015	As at 31st March, 2014
Proposed dividend (20% on ₹10,00,000)	200	
Provision for Taxation	270	
Total	470	

Note 6. Tangible Assets		As at 31st March, 2015	As at 31st March, 2014
Fixtures, Fittings, Tools and equipment at cost- Opening	680		
Add: Additions	120		
Less: Sale/ disposed	(30)		
Less: Depreciation (260+148)	(408)	362	
Total		362	

Note 7. Non Current Investments	As at 31st March, 2015	As at 31st March, 2014
Investments	200	
Total	200	

Note 8. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock	200	
Total	200	

Note 9.Trade Receivables	As at 31st March, 2015	As at 31st March, 2014
Trade Debtors (more than six months considered good) –	780	
Total	780	

Note 10. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at Bank and on hand	228	
Total	228	

Note 11. Revenue from operation	As at 31st March, 2015	As at 31st March, 2014
Sales (net of Excise Duty)	3,000	
Total	3,000	

Note 12. Other Expenses	As at 31st March, 2015	As at 31st March, 2014
Administrative Expenses	480	
Distribution Expenses	102	
Loss on sale of Fixed Assets	20	
Total	602	

Notes on Accounts for the year ended 31st March, 2015

Significant Accounting Policies:

(a) Basis for preparation of financial statements: The financial statements have been prepared under the historical cost convention, in accordance with the generally accepted accounting principles and the provisions of the companies Act, 2013 as adopted consistently by the company.

(b) Depreciation: Depreciation on fixed assets is provided using the straight-line method, based on the period of five years. Depreciation on additions is provided for the full year but no depreciation is provided on assets sold in the year of their disposal.

(c) Investments: Investments are valued at lower of cost or net realizable value.

(d) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.

Working Notes:

			(₹ in thousands)
(1)	Fixtures, Fittings, Tools and Equipment		
	Gross Block		
	As on 1.4.2014	680	
	Add: Additions during the year	120	
		800	
	Less: Deductions during the year	60	
	As on 31.3.2015		740
	Depreciation		
	As on 1.4.2014	260	
	For the year (20% on 740)	148	
		408	
	Less: Deduction during the year	30	
	As on 31.3.2015		378
	Net block as on 31.3.2015		362
(2)	Provision for taxation		
	Profit as per profit and loss account		540
	Add back: Loss on sale of asset (short term capital loss)	20	
	Depreciation	148	
			168
			708
	Less: Depreciation under Income-tax Act		168
			540
	Provision for tax @ 50%		270

It has been assumed that depreciation calculated under Income-tax Act amounts to ₹1,68,000)

(3)	Provisions		
	(a)	Provision for taxation	270
	(b)	Proposed dividend (20% on ₹10,00,000)	200
			470

(4) In balance sheet, Reserves and Surplus represent general reserve ₹ 30,000 and profit and loss account ₹1,20,000.

NOTES:

(1) The rate of interest on long term loan is not given in the question. Reasonable assumption may be made regarding the rate of interest and accordingly it may be accounted for.

(2) As per Companies (Transfer of Profits to Reserve) Rules, the amount to be transferred to the reserves shall not be less than 7.5% of the current profits since proposed dividend exceeds 15% but does not exceed 20% of the paid up capital. In this answer, it has been assumed that ₹30,000 have been transferred to General Reserve. The students may transfer any amount based on a suitable percentage not less than 7.5%.

(3) In the absence of details regarding factory closure costs, there costs are treated as extraordinary items in the above solution assuming that the factory is permanently closed. However, the factory may close for a short span of time on account of strikes, lockouts etc. and such type of factory closure costs should be treated as loss from ordinary activities. In that case also, a separate disclosure regarding the factory closure costs will be required as per para 12 of AS 5 (Revised) 'Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.'

Illustration 37.

The following balances are extracted from the books of Supreme Ltd., a real estate company, on 31st March, 2015:

(₹ '000)

	Dr.	***Cr.***
Particulars	**Amount**	**Amount**
Sales		13,800
Purchases of materials	6,090	
Share capital fully paid		500
Land purchased in the year as stock	365	
Leasehold premises	210	
Creditors		2,315
Debtors	3,675	
Directors' salaries	195	
Wages	555	
Work in progress on 01.04.2014	1,050	
Sub-contractors' cost	4,470	
Equipment, Fixtures and Fittings at cost on 01.04.2014	1,320	
Stock on 01.04.2014	295	
Profit and Loss Account, Credit Balance on 01.04.2014		640
Secured Loan		560
Bank Overdraft		525
Interest on Loan and Overdraft	110	
Depreciation on Equipment on 01.04.2014		820
Administration Expenses	735	
Office Salaries	90	
	19,160	19,160

You also obtain the following information:

(a) On 31st March, 2015, stock on hand including the land acquired during the year, is valued at ₹7,10,000. Work in progress at that date is valued at ₹ 7,00,000.

(b) On 1st October, 2014 the company moved to new premises. The premises are on a 12 years lease and the lease premium paid amounted to ₹ 2,10,000. The company used sub-contract labour of ₹ 2,00,000 and materials at cost of ₹ 1,90,000 in the refurbishment of the premises. These are to be considered as part of the cost of leasehold premises.

(c) A review of the debtors reveals specific doubtful debts of ₹1,75,000 and the directors wish to provide for these together with a general provision based on 2% of the balance.

(d) Depreciation on equipment, fixtures and fittings is provided at 15% on the written down value.

(e) Supreme Ltd. sued Shallow Ltd. for supplying defective materials which has been written off as valueless. The Directors are confident that Shallow Ltd. will agree for a settlement of ₹ 2,50,000.

(f) The directors propose a dividend of 25%.

(g) ₹ 1,00,000 is to be provided as audit fee.

(h) The company will provide 10% of the pre-tax profit as bonus to employees in the accounts before charging the bonus.

(i) Income tax to be provided at 50% of the profits.

You are required:

(i) to prepare the company's financial statements for the year ended 31st March, 2015 as near as possible to proper form of company final accounts; and

(ii) to prepare a set of Notes to accounts including significant accounting policies.

Notes: Workings should form part of your answer.

Previous year figures can be ignored.

Figures are to be rounded off to nearest thousands.

Solution:

Name of the company : Supreme Ltd.

Balance Sheet as at 31st March, 2015

(₹ In '000)

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	500	
		(b) Reserves and surplus	2	945	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Long-term borrowings	3	560	
	4	**Current Liabilities**			
		(a) Trade payables	4	2,315	
		(b) Other current liabilities	5	625	
		(c) Short-term provisions	6	895	
		Total (1+2+3+4)		5840	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	7	1,000	
	2	**Current assets**			
		(a) inventories	8	1,410	
		(b) trade receivables	9	3,430	
		Total (1+2)		5840	

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

		Note No.		As at 31st March, 2015	As at 31st March, 2014
I	REVENUE FROM OPERATION	11		13,800	
	Less: Excise duty			Nil	
				13,800	
II	OTHER INCOME			Nil	
III	TOTAL REVENUE(I+II)			13,800	
IV	EXPENSES:				
	(a) Cost of material consumed	12	11,025		
	(b) Employees cost/ benefits expenses	13	405		
	(c) Finance cost		110		
	(d) Depreciation and amortization expenses		100		
	(e) Other expenses	14	1,080		
	TOTAL EXPENSES			12,720	
V	PROFIT BEFORE EXCEPTIONAL AND EXTRAORDINARY ITEMS AND TAX (III-IV)			1,080	
VI	EXCEPTIONAL ITEMS			Nil	
VII	PROFIT BEFORE EXTRAORDINARY ITEMS AND TAX (V-VI)			1,080	
VIII	EXTRAORDINARY ITEMS			Nil	
IX	PROFIT BEFORE TAX FRON CONTINUING OPERATIONS (VII-VIII)			1,080	
X	Tax expenses:				
	(1) Current Tax			650	
XI	PROFIT AFTER TAX FOR THE YEAR FROM CONTINUING OPERATION(IX-X)			430	
XII	Profit (loss) from discontinuing operations				
XIII	Tax expenses from discontinuing operations				
XIV	Profit(loss) from discontinuing operations (after tax)(XII-XIII)				
XV	PROFIT (LOSS) FOR THE PERIOD (XI+XIV)			430	
	Balance brought forward from previous year			640	
	Profit available for appropriation			1,070	
	Appropriation:				
	Proposed dividend		125		
	Transfer to General Reserve		45	170	
	Balance carried forward			900	
XVI	Earning per equity share:				
	(1) Basic				
	(2) Diluted				

(₹ In '000)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorized, Issued, Subscribed and paid-up Share capital:-		
50,000 Equity share of ₹10 each	500	
Total	500	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos.	**Amount (₹)**	**Nos.**	**Amount (₹)**
Opening Balance as on 01.04.14 (Figure in '000)	50	500		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	50	500		
Less: Buy Back of share				
Total	50	500		

Note 2. Reserve & Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
General Reserve	45	
Profit and loss A/c	900	
Total	945	

Note 3. Long term borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Secured Loan	560	
Total	560	

Note 4. Short-term borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Bank Overdraft	525	
Total	525	

Note 5. Trade Payables	**As at 31st March, 2015**	**As at 31st March, 2014**
Sundry Creditors	2,315	
Total	2,315	

Note 6. Other Current Liabilities	**As at 31st March, 2015**	**As at 31st March, 2014**
Audit fees	100	
Total	100	

Note 7. Short- term provisions	As at 31st March, 2015	As at 31st March, 2014
Proposed dividend	125	
Provision for Taxation	650	
Provision for bonus	120	
Total	895	

Note 8. Tangible Assets		As at 31st March, 2015	As at 31st March, 2014
Equipment, Fixtures & Fittings at cost- Opening	1,320		
Less: Depriciation	895	425	
Leasehold premises (210+200+190)	600		
Less: Witten off	25	575	
Total		1,000	

Note 9. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock – Finished stock	710	
Work in progress	700	
Total	1410	

Note 10.Trade Receivables	As at 31st March, 2015	As at 31st March, 2014
Trade Debtors (more than six months)	3,675	
Less: Provision for doubtful debts	245	
Total	3,430	

Note 11. Revenue from operation	As at 31st March, 2015	As at 31st March, 2014
Sales (net of Excise Duty)	13,800	
Total	13,800	

Note 12. Cost of materials Consumed		As at 31st March, 2015	As at 31st March, 2014
Manufacturing expenses- Opening Stock (FG)	295		
Opening WIP	1,050	1,345	
Purchase of materials (6,090-190)		5,900	
Purchase of land as stock		365	
Wages		555	
Sub-contract Cost (4,470-200)		4,270	
Less: Closing Stock- Finished goods	710		
Work in progress	700	(1,410)	
Total		11,025	

Note 13. Employees benefit expenses	As at 31st March, 2015	As at 31st March, 2014
Salary- office staff (90+195)	285	
Bonus	120	
Total	405	

Note 14. Other Expenses	As at 31st March, 2015	As at 31st March, 2014
Administrative Expenses	735	
Provision for doubtful debts	245	
Auditors remunerations	100	
Total	1,080	

Note 15. Auditors Remuneration	As at 31st March, 2015	As at 31st March, 2014
Audit fees (Excluding service Tax)	100	
Total	100	

Notes on Accounts for the year ended 31st March, 2015

1. **Accounting Policies:** The Accounts have been prepared primarily on the historical cost convention. The significant accounting policies followed by the Company are stated below:
   (a) Fixed Assets: Fixed assets are shown at cost less depreciation. Cost comprises the purchase price and other attributable expenses.
   (b) Depreciation on Fixed Assets: Depreciation on equipment, fixtures and fittings has been provided on written down value method at 15% per annum. Lease-hold premises improvements are being amortised over the lease period.
   (c) Inventories: Inventories are valued at the lower of historical cost or the net realizable value.
2. **Other Matters:**
   (a) The cost of leasehold premises includes the cost of refurbishment to the extent of ₹ 3,90,000 (Materials ₹ 1,90,000 + Labour ₹ 2,00,000).
   (b) Shallow Ltd. has been sued for supplying defective materials. Settlement of ₹ 2,50,000 is hopeful however it has not been recognized in the accounts as it represents contingent gain.

(₹ in thousands)

(1) Manufacturing Expenses		
Stocks at Commencement:		
Opening Stock	295	
Opening Work-in-progress	1,050	
		1,345
Purchases of Materials (6,090 – 190)		5,900
Purchase of Land		365
Wages		555
Sub-contractors' cost (4,470 – 200)		4,270
		12,435
Less: Stocks at close:		
Closing Stock	710	
Closing Work-in-progress	700	
		1,410

			11,025
(2)	Administration Expenses		735
	Office Salaries		90
	Directors' Salaries		195
	Provision for Doubtful Debts [175 + 2% of (3675 – 175)]		245
	Audit Fees		100
	Bonus (See Working Note 3)		120
			1,485
(3)	Bonus		
	Sales		13,800
	Less: Manufacturing Expenses	11,025	
	Other Expenses (excluding bonus)	1,365	
	Depreciation	100	
	Interest	110	
			12,600
	Pre-tax Profit		1,200
	Bonus (10%)		120
(4)	Fixed Assets		
	(a) Gross block		
	Equipment, Fixtures and Fittings		1,320
	Leasehold Premises (210 + 200 + 190)		600
			1,920
	(b) Depreciation		
	Equipment, Fixtures and Fittings (01.04.2014)	820	
	For the year [15% on (1,320– 820)]	75	895
	Cost of Leasehold Premises written off		25
	[(210 + 200 + 190) ₹ 1/12 ₹ 1/2]		
			920
(5)	Provision for Taxation		
	Profit as per Profit and Loss Account		1,080
	Add back: Provision for doubtful debts	245	
	Cost of Leasehold premises written off	25	345
	Depreciation on equipment, fixtures and fittings	75	1,425
	Less: Depreciation under Income-tax Act		125
	Provision for Tax (@ 50%)		1,300
	(It has been assumed that depreciation calculated under Income-tax Act amounts to ₹ 1,25,000)		650
(6)	(a) Sundry creditors		2,315
	(b) Bank overdraft		525
	(c) Audit fees		100
(7)	Provisions		
	(a) Provision for taxation		650
	(b) Proposed dividend		125
	(c) Provision for bonus		120
			895

Illustration 38.

On 1st April, 2014 Squash Ltd. was incorporated with an authorized capital of ₹ 200 crores. It issued to its promoters equity capital of ₹ 10 crores which was paid for in full. On that day it purchased the running business of Jam Ltd. for ₹ 40 crores and allotted at par equity capital of ₹ 40 crores in discharge of the consideration. The net assets taken over from Jam Ltd. were valued as follows: Fixed Assets ₹ 30 crores, Inventory ₹ 2 crores, Customers' dues ₹ 14 crores and Creditors ₹ 6 crores. Squash Ltd. carried on business and the following information is furnished to you:

(a) Summary of cash/bank transactions (for year ended 31st March, 2015).

		(₹ in crores)
Equity capital raised:		
Promoters (as shown above)	10	
Others	50	60
Collections from customers		800
Sale proceeds of fixed assets (cost ₹ 18 crores)		4
		864
Payments to suppliers	400	
Payments to employees	140	
Payment for expenses	100	640
Investments in Upkar Ltd.		20
Payments to suppliers of fixed assets:		
Instalment due	120	
Interest	10	130
Tax payment		54
Dividend		10
Closing cash/bank balance		10
		864

(b) On 31st March, 2015 Squash Ltd.'s assets and liabilities were:	(₹ in crores)
Inventory at cost	3
Customers' dues	80
Prepaid expenses	2
Advances to suppliers	8
Amounts due to suppliers of goods	52
Amounts due to suppliers of fixed assets	150
Outstanding expenses	6

(c) Depreciation for the year under:

- (i) Companies Act, 2013 ₹ 36 crores
- (ii) Income tax Act, 1961 ₹ 40 crores

(d) Provide for tax at 38.5% of "total income". There are no disallowed expenses for the purpose of income taxation. Provision for tax is to be rounded off.

For Squash Ltd. prepare:

(i) Revenue statement for the year ended 31st March, 2015 and

(ii) Balance Sheet as on 31st March, 2015 from the above information.

Solution:

Name of the company: Squash Ltd.

Balance Sheet as at 31st March, 2015

(₹ In crores)

Ref No.	Particulars		Note No.	31.03.2015	31.03.2014
	1	**EQUITY AND LIABILITIES**			
		(a) Share capital	1	100	
		(b) Reserves and surplus	2	77.40	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**		Nil	
	4	**Current Liabilities**			
		(a) Trade payables	3	52	
		(b) Other current liabilities	4	156	
		(c) Short-term provisions	5	52	
		Total (1+2+3+4)		437.40	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	260.40	
		(b) Non-current investments	7	20	
		(c) Long-term loans and advances	8	54	
	2	**Current assets**			
		(a) inventories	9	3	
		(b) trade receivables	10	80	
		(c) Cash and cash equivalents	11	10	
		(d) Short-term loans and advances	12	10	
		Total (1+2)		437.40	

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

Name of the company: Squash Ltd.

Profit and Loss Statement for the year ended 31st March, 2015

(₹ In crore)

		Note No.		31.03.2015	31.03.2014
I	REVENUE FROM OPERATION	13		866	
	Less: Excise duty				
				866	
II	OTHER INCOME			Nil	
III	TOTAL REVENUE(I+II)			866	
IV	EXPENSES:				
	(a) Cost of material consumed	14	437		
	(b) Purchase of products for sale				
	(c) changes in inventories of finished goods, work-in-progress and products for sale				
	(d) Employees cost/ benefits expenses		140		
	(e) Finance cost		10		
	(f) Depreciation and amortization expenses		36		
	(g) Other expenses	15	104		
	TOTAL EXPENSES			727	
V	PROFIT BEFORE EXCEPTIONAL AND EXTRAORDINARY ITEMS AND TAX (III-IV)			139	
VI	EXCEPTIONAL ITEMS			Nil	
VII	PROFIT BEFORE EXTRAORDINARY ITEMS AND TAX (V-VI)			139	
VIII	EXTRAORDINARY ITEMS			0.40	
IX	PROFIT BEFORE TAX FRON CONTINUING OPERATIONS (VII-VIII)			139.40	
X	Tax expenses:				
	(1) Current Tax			52	
	(2) deferred tax				
XI	PROFIT AFTER TAX FOR THE YEAR FROM CONTINUING OPERATION (IX-X)			87.40	
XII	Profit (loss) from discontinuing operations				
XIII	Tax expenses from discontinuing operations				
XIV	Profit(loss) from discontinuing operations (after tax)(XII-XIII)			Nil	
XV	PROFIT (LOSS) FOR THE PERIOD (XI+XIV)			87.40	
	Balance brought forward from previous year				
	Profit available for appropriation			87.40	
	Appropriation:				
	Proposed dividend			10	
	Balance carried forward			77.40	
XVI	Earning per equity share:			Nil	
	(1) Basic				
	(2) Diluted				

Notes to the Accounts

(₹ In crores)

Note 1. Share Capital	**31.03.2015**	**31.03.2014**
Authorized Equity share capital on ₹ 10 each	200	
Isslued, Subscribed and paid-up Share capital : 10 Crores Equity share of ₹10 each (of which 4 crores equity share have been issued for a consideration other than cash, on take-over of business of Jam Ltd.	100	
Total	100	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	**31.03.2015**		**31.03.2014**	
	Nos.	**Amount (₹)**	**Nos.**	**Amount (₹)**
Opening Balance as on 01.04.11 (Figure in crores)	10	100		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	10	100		
Less: Buy Back of share				
Total	10	100		

Note 2. Reserve & Surplus	**31.03.2015**	**31.03.2014**
Profit and loss A/c	77.40	
Total	77.40	

Note 3. Trade Payables	**31.03.2015**	**31.03.2014**
Sundry Creditors	52	
Total	52	

Note 4. Other Current Liabilities	**31.03.2015**	**31.03.2014**
Amount due to supplier of fixed assets	150	
Outstanding expenses	6	
Total	156	

Note 5. Short- term provisions	**31.03.2015**	**31.03.2014**
Provision for Taxation	52	
Total	52	

Note 6. Tangible Assets		**31.03.2015**	**31.03.2014**
Fixed Assets taken over from Jam Ltd	30		
Add: Purchase (120+150)	270	300	
Less: Sale proceeds	3.60		
Less: Depreciation	36	39.60	
Total		260.40	

Note 7. Non-current Investments	31.03.2015	31.03.2014
Investments in Upkar Ltd	20	
Total	20	

Note 8. Long term loans and advances	31.03.2015	31.03.2014
Advance Tax	54	
Total	54	

Note 9. Inventories	31.03.2015	31.03.2014
Inventories at cost	3	
Total	3	

Note 10. Trade receivables	31.03.2015	31.03.2014
Customer's Due	80	
Total	80	

Note 14. Cost of materials Consumed	31.03.2015	31.03.2014
Prepaid Expenses	2	
Stock taken over	438	
Purchase	440	
Less: Closing Stock	3	
Total	437	

Note 15. Other Expenses	31.03.2015	31.03.2014
Payment for expenses	100	
Add: Outstanding expenses	6	
Less: Prepaid expenses	2	
Total	104	

Illustration 39.

On 1st April, 2014 Zigzag Enterprises Ltd. was incorporated with an Authorised Capital of ₹ 50 lakhs. Its first accounts were closed on 31st March, 2015 by which time it had become a listed company with an issued subscribed and paid up Capital of ₹ 40 lakhs in 4,00,000 Equity Shares of ₹ 10 each. The company started off with two lines of business namely 'First Division' and 'Second Division', with equal asset base with effect from 1st April, 2015. The 'Third Division' was added by the company on 1st April, 2015. The following data is gathered from the books of account of Zigzag Enterprises Ltd:

Trial Balance as on 31st March, 2015.

(₹ in 000's)

	Dr.	Cr.
First Division sales	–	15,000
Cost of First Division sales	6,500	–
Second Division sales	–	20,000

Cost of sales of Second Division	10,750	–
Third Division Sales	–	3,750
Cost of sales of Third Division	2,250	–
Administration costs	5,000	–
Distribution costs	3,750	–
Dividend-Interim	3,000	–
Fixed Assets at cost	22,500	–
Accumulated Depreciation on Fixed Assets	–	3,750
Stock on 31st March, 2015	1,000	–
Trade Debtors	1,100	–
Cash at Bank	400	–
Trade Creditors	–	1,250
Equity Share Capital in shares of ₹ 10 each	–	10,000
Retained Profits	–	2,500
	56,250	56,250

Additional Information:

(a) Administration costs should be split between the Divisions in the ratio of 5 : 3 : 2.

(b) Distribution costs should be spread over the Divisions in the ratio of 3 : 1 : 1.

(c) Directors have proposed a Final Dividend of ₹ 20 lakhs.

(d) Some of the users of Third Division are unhappy with the product and have lodged claims against the company for damages of ₹ 18.75 lakhs. The claim is hotly contested by the company on legal advice.

(e) Fixed Assets worth ₹ 75 lakhs were added in the Third Division on 1.4.2015.

(f) Fixed Assets are written off over a period of 10 years on straight line basis in the books. However for Income tax purposes depreciation at 20% on written down value of the assets is allowed by Tax Authorities.

(g) Income tax rate may be assumed at 35%.

(h) During the year First Division has sold to Hitachi Ltd. goods having a sales value of ₹ 62.5 lakhs. Mr. Rydu, the Managing Director of Zigzag Enterprises Ltd. owns 100% of the issued Equity Shares of Hitachi Ltd. The sales made to Hitachi Ltd. were at normal selling price of Zigzag Enterprises Ltd.

You are required to prepare Profit and Loss Account for the year ended 31st March, 2015 and the Balance Sheet as at the date. Your answer should include notes and disclosures as per Accounting Standards.

Solution:

Name of the company : ZIG ZAG Ltd.

Balance Sheet as at 31st March, 2015

(₹ In crores)

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	1	**EQUITY AND LIABILITIES**			
		(a) Share capital	1	10,000	
		(b) Reserves and surplus	2	3,800	
	2	**Share application money pending allotment**		Nil	
	3	**Non-current liabilities**			
		(a) Deferred tax liabilities (Net)	3	1,102.50	
	4	**Current Liabilities**			
		(a) Trade payables	4	1,250	
		(b) Short-term provisions	5	5,097.50	
		Total (1+2+3+4)		21,250	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	18,750	
	2	**Current assets**			
		(a) inventories	7	1,000	
		(b) trade receivables	8	1,100	
		(c) Cash and cash equivalents	9	400	
		Total (1+2)		21,250	

Name of the company : ZIG ZAG Ltd.

Profit and Loss Statement for the year ended 31st March, 2015

(₹ In crore)

		Note No.		As at 31st March, 2015	As at 31st March, 2014
I	REVENUE FROM OPERATION	10		38,750	
	Less: Excise duty				
				38,750	
II	OTHER INCOME			Nil	
III	TOTAL REVENUE(I+II)			38,750	
IV	EXPENSES:				
	(a) Cost of material consumed				
	(b) Purchase of products for sale				

	(C) changes in inventories of finished goods, work-in-progress and products for sale				
	(d) Cost of sale	11	19,500		
	(d) Employees cost/ benefits expenses				
	(e) Finance cost				
	(f) Depreciation and amortization expenses				
	(g) Other expenses	12	8,750		
	TOTAL EXPENSES			28,250	
V	PROFIT BEFORE EXCEPTIONAL AND EXTRAORDINARY ITEMS AND TAX (III-IV)			10,500	
VI	EXCEPTIONAL ITEMS			Nil	
VII	PROFIT BEFORE EXTRAORDINARY ITEMS AND TAX (V-VI)			10,500	
VIII	EXTRAORDINARY ITEMS			Nil	
IX	PROFIT BEFORE TAX FRON CONTINUING OPERATIONS (VII-VIII)			10,500	
X	Tax expenses:				
	(1) Current Tax		3,097.50		
	(2) deferred tax		577.50	3,675	
XI	PROFIT AFTER TAX FOR THE YEAR FROM CONTINUING OPERATION(IX-X)			6,825	
XII	Profit (loss) from discontinuing operations				
XIII	Tax expenses from discontinuing operations				
XIV	Profit(loss) from discontinuing operations (after tax)(XII-XIII)			Nil	
XV	PROFIT (LOSS) FOR THE PERIOD (XI+XIV)			6,825	
	Balance brought forward from previous year			1,975	
	Profit available for appropriation			8,800	
	Appropriation:				
	Proposed dividend			5,000	
	Balance carried forward			3,800	
XVI	Earning per equity share:			Nil	
	(1) Basic				
	(2) Diluted				

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

Note to the Accounts

(₹ In '000)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorized Equity share capital of ₹10 each	15,000	
Issued, Subscribed and paid-up Share capital : 10,00,000 Equity share of ₹10 each fully paid	10,000	
Total	100	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.11	10,00,000	10,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	10,00,000	10,000		
Less: Buy Back of share				
Total	10,00,000	10,000		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
Retained profits	3,800	
Total	3,800	

Note 3. Deferred Tax Liability	As at 31st March, 2015	As at 31st March, 2014
Opening Deferred tax liability	525	
Add: Deferred tax liability during the year	577.50	
Total	1,102.50	

Note 4. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Trade Creditors	1,250	
Total	1,250	

Note 5. Short-term Provisions	As at 31st March, 2015	As at 31st March, 2014
Provision for Tax	3,097.50	
Proposed Dividend	2,000	
Total	5,097.5	

Note 6. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed Assets- Gross Block	22,500	
Less: Depreciation	3,750	
Total	18,750	

Note 7. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock	1,000	
Total	1,000	

Note 8. Trade receivables	As at 31st March, 2015	As at 31st March, 2014
Trade Debtor's	1,100	
Total	1,100	

Note 9.Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at bank	400	
Total	400	

Note 10. Revenue from operation	As at 31st March, 2015	As at 31st March, 2014
Sales (net of Excise Duty)	38,750	
Total	38,750	

Note 11. Cost of sale	As at 31st March, 2015	As at 31st March, 2014
First Division	6,500	
Second Division	10,750	
Third Division	2,250	
Total	19,500	

Note 12. Other expenses	As at 31st March, 2015	As at 31st March, 2014
Administration costs (2,500+1,500+1,000)	5,000	
Distribution cost (2,250+750+750)	3,750	
Total	8,750	

Notes to Accounts:

1. **Segmental Disclosures (Business Segments)**

(Figures in ₹ 000's)

	First Division	Second Division	Third Division	Total
Sales	15,000	20,000	3,750	38,750
Cost of Sales	6,500	10,750	2,250	19,500
Administration Cost (5:3:2)	2,500	1,500	1,000	5,000
Distribution Cost (3:1:1)	2,250	750	750	3,750
Profit/Loss	3,750	7,000	(250)	10,500
	15,000	20,000	3,750	38,750
Original cost of Assets (Equal Capital Base)	7,500	7,500	7,500	22,500
Depreciation @ 10% p.a. For the year ended 31.3.2014	750	750	NIL	1,500
For the year ended 31.3.2015	750	750	750	2,250

Note: Third division is a reportable segment as per assets criteria.

2. Tax computation

	(₹ in 000's)
Profit before tax for the year ended 31.3.2015	10,500
Add: Depreciation provided in the books (750 + 750 + 750)	2,250
	12,750
Less: Depreciation as per Income Tax Act (1,200 + 1,200 + 1,500)	3,900
Taxable Income	8,850
Tax at 35%	3,097.50

3. Deferred Tax liability (as per AS 22 on Accounting for Taxes on Income)

₹ '000

Opening Timing Difference on 1.4.2014		
WDV of fixed assets as per books		13,500
WDV of fixed assets as per Income Tax Act	12,000	
Difference		1,500
Deferred Tax Liability @ 35% on 1,500	525	
This has been adjusted against opening balance of retained profits.		
Current year (ended 31st March, 2015)	₹.'000	
Depreciation as per Books		2,250
Depreciation as per Income Tax Act (1,200 + 1,200 + 1,500)	3,900	
Difference		1,650
Deferred Tax Liability @ 35% on 1,650 (to be carried forward)	577.50	

4. **Contingent Liabilities not provided:** Company is contesting claim for damages for ₹ 18,75,000 and as such the same is not acknowledged as debts.

5. **Related Party Disclosure:** Para 3 of AS 18 lists out related party relationships. It includes individuals owning, directly or indirectly, an interest in voting power of reporting enterprise which gives them control or significant influence over the enterprises, and relatives of any such individual. In the instant case, Mr. Rydu as a managing director controls operating and financial actions of Zigzag Enterprise Ltd. He is also owning 100% share Capital of Hitachi Ltd. thereby exercising control over it. Hence, Hitachi Ltd. is a related party as per Para 3 of AS 18.

DISCLOSURE TO BE MADE:

Name of the related party	
and nature of relationship	Hitachi Ltd. common director
Nature of the transaction	Sale of goods at normal commercial terms
Volume of the transaction	Sales to Hitachi Ltd. worth ₹62.50 lakhs.

2.6 SPECIAL PURPOSE VEHICLE

Concept

Securitisation offers higher quality assets to investors by virtue of the fact that the structures insulate investors from the bankruptcy risk of the Originator. In order to ensure that the assets actually achieve the bankruptcy remoteness, it is essential to move them out of the balance sheet of the Originator and park them with another independent entity. Typically an SPV is employed to purchase the assets from the Originator and issue securities against these assets. Such a structure provides a comfort to the investors that they are investing in a pool of assets which is held on their behalf only by the SPV and which is not subject to any subsequent deterioration in the credit quality of the Originator. The SPV is usually a thinly capitalised vehicle whose ownership and management are independent of the Originator. The main objective of SPV is to distinguish the instrument from the Originator.

SPVs in other Countries

1. U.S.A.

The US market, which is home to 75% or more of the global securitisation volumes, shows clear division between the MBS & ABS issuance. The MBS market has been subject to successive transformations and presently the three institutions (Fannie Mae, Freddie Mac and Ginnie Mae) act as the principal intermediaries in the market inas much as they perform the activity of purchasing mortgages from home loan Originators and selling MBS. Based upon the same, their role could be likened to those of SPVs. However, over a period of time, these institutions have matured and assumed a greater role in the secondary mortgage market. Both Freddie Mac and Fannie Mae deal overwhelmingly in pools of conventional (i.e. not Federally insured) mortgages. In sharp contrast, Ginnie Mae deals only in Federally insured mortgages. However, all three agencies guarantee their issues against default losses. Government sponsorship of Fannie Mae and Freddie Mac contributed significantly to enlarge these institutions role beyond mere conduits and helped them to become dominant institutions in the residential mortgage market. It was felt that investors would prefer to receive regular payments of principal and interest whether or not the same is collected from the Obligors even though a 100% guaranteed paper would imply lower interest yield. It thus became important for Fannie Mae and others to take on the additional role of guaranteeing the issuance being routed through them. In short, the secondary market scenario even in the most developed markets like the US is characterised by Governmental / regulatory patronage and guarantees. Consequently the securitisation SPV in this segment of the market also displays characteristics which are typical of State facilitation and encouragement. More details of these institutions are given in Chapter 6.

2. Argentina

a) SPVs generally take legal forms of Mutual Funds (MFs), trusts or corporations etc. According to the Trust law in Argentina, a trust (similar to SPV) is established when a person (the trustor) transfers the ownership in trust of certain assets to another person (the trustee) who must "manage" the assets for the benefit of the party specified in the trust agreement (the beneficiary), and transfer the trust property upon termination of the trust to the trustor or the beneficiary. The Trust law states that the property transferred in trust constitutes a separate estate from that of either the trustor or the trustee. Further, the trust property is exempt from any claims of the trustee's creditors and, except in the case of fraud, the trustor's creditors. The obligations of the trust may only be satisfied from the trust property.

b) The trustee is a financial institution or an entity authorised by the CNV (similar to SEBI in India) to act as financial trustee and the beneficiaries are the holders of certificates of participation in the trust property ('certificates") or the debt instruments guaranteed by the trust property ('debt instruments").

c) Financial trustees may be financial entities authorised under Argentine law, entities registered in the Register of Financial trustees held by CNV and the financial institutions chartered by the Central Bank of the Argentine Republic. In order to be included in the Register of Financial Trustees, an entity must be a *corporation* or, in the case of foreign company, must have a branch or other form of representation in Argentina; its legal purpose must include serving as a trustee; it must have a net worth of at least 100,000 pesos; and it must have an adequate administrative organisation to perform its duties as financial trustees, although administrative services may be contracted out.

d) Further:

The trust agreement may not release the trustee or its employees from its responsibility for acts of negligence and wilful misconduct nor from the prohibition on its acquiring assets held by the trust. Upon or after signing the trust agreement, and in accordance with its terms, the trustee will be the transferee of the assets or rights which are the subject of securitisation and as of that moment, the trustee will be endowed with title, in trust, to the rights to such principal, interest fees, collateral security etc., which title and rights may not be challenged by third parties if the transfer and the registration are carried out in accordance with the formalities required by the applicable law.

The portfolio of loans that may be transferred and held by a trustee will at no time be considered part of the trustee's assets for bankruptcy or other purposes.

More details are given in Chapter 6.

3. Morocco

(a) In Morocco, the SPVs can be (i) institutional investors in debt or (ii) other entities which are governed by the legislative or regulatory systems of either Morocco or other foreign countries. The SPV is a separate and autonomous body and has the capacity of a natural person. All its functions are administered by its management depository institution, akin to asset management company (AMC) in India. *It has been considered advisable that for each securitisation operation by an Originator, a separate SPV is created exclusively for that operation, although an AMC may be founder and manager of more than one SPV provided that appropriate, precautionary measures are put in place and described in the relevant administrative rules to prevent conflicts of interest and the mixing of funds.*

(b) Rules of formation of SPV

The minimum framework of rules within which the SPV is founded has been specified in the Act covering the duration of the SPV, particulars of its AMC and the financial intermediary, a description of the planned securitisation operation, nature of assets to be transferred to it, minimum and maximum amounts of intended issue, frequency and nature of mandatory information to be provided to its investors, procedures for meetings with its investors, dissolution of the SPV, etc. As a result of its exclusive purpose for securitisation operation, an SPV cannot undertake any activity or assume any responsibilities other than those prescribed in the rules of its formation.

(c) Minimum disclosure norms

The Act specifies that the rules of formation of the SPV must include the frequency and the nature of mandatory information to be provided to the investors. Any Originator holding or acquiring direct or indirect interest in the

AMC must disclose the fact in the rules of the SPV and the information to be furnished to the investors. The AMCs are required to furnish a copy of the annual report on the SPV and if required by the rules at a greater frequency, duly certified by an auditor.

(d) Separation from the assets of its Originator and AMC

The transfer of the receivables is absolute and cannot be cancelled for any reason even if the Originator becomes insolvent or enters liquidation. The receivables once transferred to the SPV are to be removed from the balance sheet of the Originator. Further, there is no guarantee from the Originator about the solvency of the debtors. All its assets are separate from those of the Originator, its management depository institution and its share/bonds holders.

(e) The SPV is required to follow the *accounting rules* approved by Government in consultation with National Accounting Council or failing this, those, which are in conformity with the accounting rules generally accepted in Morocco. The auditor has been assigned a permanent role in the auditing of the books of the SPV, verification of the consistency and the authenticity of its accounts as also the information related to its financial position prior to its being released.

SPV in the Indian context

In India too, Originator should have the same flexibility in choosing an appropriate legal structure for the SPV based on its individual requirements whether in form of a company, trust (with or without a company as a trustee), MF, a statutory corporation, a society, firm, etc., in short all possible forms of a business entity that is capable of being formed. Consequently, the provisions of the parent law for incorporation of such entity, i.e., the Companies Act, Trust Act, the Partnership Act, etc. will apply to the formation of such SPVs.

While different forms of SPVs have evolved in various markets, Indian mortgage sector has taken cues from the US market. The securitisation SPV assumes a character different from a mere conduit in US. NHB has now taken upon itself the role similar to that being performed by Fannie Mae and Freddie Mac in the US. NHB is presently engaged in bringing to the market its pilot issue of MBS backed by mortgage pool of four Housing Finance Companies. The pilot issue has been under discussion for two years now and currently the structure and the modalities are being finalised by NHB. Based upon the experience of the issue, NHB is likely to take a longer view of what role it needs to play to give a fillip to the secondary mortgage market in India. Other players in the housing market like commercial banks, HUDCO, State housing boards etc. may also desire to participate in the secondary mortgages market as Originator or SPV or ancillary service providers. For this segment of the market, as well as the segment relating to issuance of ABSs, certain other kinds of SPVs would develop over a period of time.

Key features desired in an ideal SPV

Based upon the international practices as discussed above, the WG came to the conclusion that an SPV should, therefore, satisfy the following key characteristics:

(a) An SPV must be capable of acquiring, holding and disposing of assets.

(b) It would be an entity, which would undertake only the activity of asset securitisation and no other activity.

(c) An SPV must be bankruptcy remote i.e. the bankruptcy of Originator should not affect the interests of holders of instruments issued by SPV.

(d) An SPV must be bankruptcy proof. i.e. it should not be capable of being taken into bankruptcy in the event of any inability to service the securitised paper issued by it.

(e) An SPV must have an identity totally distinct from that of its promoters/ sponsors/ constituents/ shareholders. Its creditors cannot obtain satisfaction from them.

(f) The investors must have undivided interest in the underlying asset (as distinguished from an interest in the SPV which is a mere conduit).

(g) A SPV must be tax neutral i.e. there should be no additional tax liability or double taxation on the transaction on account of the SPV acting as a conduit.

(h) A SPV must have the capability of housing multiple securitisation. However, SPV must take precaution to avoid co-mingling of assets of multiple securitisation. In case of transactions involving various kinds of assets, they should restrict the rights of investors to the specific pool.

(i) The SPV agreement may not release its employees or trustees from their responsibility for acts of negligence and a willful misconduct.

Instrument issued by the SPV should have the following characteristics:

(a) Be capable of being offered to the public or private placement.

(b) Permit free or restricted transferability.

(c) Permit issuance of pass through or pay through Securities.

(d) Represent the amounts invested and the undivided interest or share in the assets (and should not constitute debt of SPV or the Originator).

(e) Be capable of being classified as senior / subordinate by differentiation in ranking of security or in receiving payments.

(f) May be issued in bearer form or registered in the holder's name, may or may not be endorsable and may be issued in definitive form or book entry form. *7.4.3 Bankruptcy-remoteness and insolvency laws*

Standard and Poor's[1] has developed the following the 'Special Purpose Entity' criteria which a SPV should satisfy to be deemed as bankruptcy-remote:

- ·Restrictions on objects and powers: The purpose of this restriction is to reduce the SPV's internal risk of insolvency due to claims created by activities unrelated to the securitised assets and issuance of rated securities.
- Debt limitations: An SPV should be restricted from issuing other debt except in circumstances those are consistent with the rated issuance.
- Independent director: Interlocking directorates between he Directors of the SPV and that of its parent present a potential conflict of interest. If the parent becomes insolvent in a situation where the SPV is performing adequately, there maybe an incentive for the parent entity to voluntarily file the SPV into bankruptcy and consolidate its assets with those of the parent. If the SPV has at least one director who is independent from the parent and this director's vote is required in any board action seeking bankruptcy protection for the SPV, the SPV is unlikely to voluntarily file an insolvency petition.
- No merger or reorganisation: This requirement ensures that, while the rated securities are outstanding, the bankruptcy-remoteness of the SPV will not be undermined by nay merger or consolidation with a non-SPV or any reorganisation, dissolution, liquidation, or asset sale.
- Separateness: Separateness covenants are designed to ensure that the SPV holds itself out to the world as an independent entity, on the theory that if an entity does not act as if it had an independent existence, a court may use principles of piercing the corporate veil, alter ego, or substantive consolidation to bring the SPV and its assets into the parent's bankruptcy proceedings.
- Security interests over assets: A debt security interest opinion is generally required that the issuing SPV can grant a security interest over its assets to the holders of the rated securities. This element helps in reaching the analytic conclusion that an issuer is in fact an SPV by reducing the incentives of the parent to involuntarily file the entity. By reducing the practical benefit of insolvency filing, the likelihood of voluntary insolvency is decreased.

Each of these characteristics is important to the overall concept of bankruptcy remoteness and regardless of the specific organizational structure of the SPV, these elements should, generally, be treated in the relevant organisational documents. Such an SPV is regarded as being sufficiently protected against both voluntary and involuntary insolvency risks.

Company, Trust or MF

Reforms may be necessary in essence to establish that an SPV irrespective of its form meets the desired objectives and has the desired characteristics. While three forms of enterprise namely, company, trust and MF have been examined in the following table, the examination is not by any means conclusive of all of the difficulties that may be encountered in the event one is desirous of utilising such business enterprise as an SPV.

Table ; Comparative table of the desired features in a Company, Trust or MF

Sr. No.	Topic	Company*	Company as Trustee of a Trust established for securitisation*	MF [constituted as a Trust under SEBI (MF) Regulations] *
(1)	**(2)**	**(3)**	**(4)**	**(5)**
1.	Capable of acquiring, holding and disposing of assets pursuant to securitisation transactions	Yes	Yes	The position is ambiguous and clarification may be sought from SEBI
2.	Bankruptcy proof SPV	No - Against creditors (i.e. Debt instrument holders) - Against structural bankruptcy	Yes -Subject to suitable provisions in the Trust Deed	Yes -Subject to suitable provisions in the Trust deed and terms of issue of Units under any specific Scheme
3.	Independent corporate existence, limited liability and perpetual succession	Yes	Yes -Subject to suitable provisions in the Trust Deed	Yes -Subject to suitable provisions in the Trust Deed
4.	Tax neutrality	No	Yes -Subject to suitable provisions in the trust deed	Yes
5.	Undivided interest of investors in the underlying assets	No -as a shareholder (whether preference or equity only owner of shares of the company and of the assets of the company) -as a debt instrument holder only entitled to the repayment/payment of principal and interest	Yes -Beneficial owner of the assets	Yes -Beneficial owner of the assets (Unit holder has an undivided beneficial interest in the assets comprised in the specific Scheme of the MF)

6.	Housing of multiple securitisation transactions	No	Yes -Subject to suitable provisions in the Trust Deed -The Trustee would be able to enter into different trust deeds for different transactions	Yes - MF can offer multiple schemes
7.	Capable of issuing paper of different maturities, particularly short maturity paper, publicly or privately	Yes	Yes -Subject to suitable provisions in the Trust Deed	Yes *-Clarification is however necessary from SEBI whether MFs can make private placements*
8.	SPV structures should permit issuance of both "pay through" and "pass through" securities	Yes (in case of structured debt instrument)	Yes -Subject to suitable provisions in the Trust Deed and terms of issue	Yes *Clarification is however necessary from SEBI whether two or more classes of* units can be issued
9.	Regulator	Yes - Companies as such are regulated by DCA and NBFCs are also regulated by RBI	*Could be RBI.* NBFC Regulations should not be applicable In case of public issuance of securities, would be subject to SEBI purview	Yes - MFs as such are regulated by SEBI and in case of money market MFs, SEBI and RBI play a role in regulation

Reforms are desirable to all laws governing the respective entities in all items which renders the particular entity unable to match and meet the essential characteristics.

The pros and cons of various forms of structures for SPV are discussed below:

Company as a SPV

Structuring the SPV as a Company under the Companies Act, 2013, has certain legal and regulatory issues as well as entity level taxation issues.

1. Bankruptcy Proof

A company formed under the Companies Act, 2013 cannot be bankruptcy proof since the Court under Section 271 of the Companies Act can wind it up. Under Section 271 of the Companies Act, a company shall be deemed to have been unable to pay its debts if a creditor to whom the company is indebted to the extent of ₹ 500 has served a notice for payment of the sum and the company does not pay the sum payable within 3 weeks from receipt of such notice or secure the debt or compound the same to the satisfaction of the creditor.

2. The SPV will leave itself open to a winding up for non-payment of a sum as little as ₹ 500. Keeping in mind that one of the essential factors of an SPV established for the purpose of securitisation is that the SPV should be bankruptcy proof; a Company may not fulfill the requirement. Upon the company issuing a debt instrument or raising any money in the form of debt, the company leaves itself open to bankruptcy suits.

However, a Company as SPV can remain bankruptcy remote if there is true sale from Originator of SPV.

nstruments that can be issued by the SPV Characteristics of instruments that can be issued by a Company are set out below:

(i) Shares :

Shares may be equity or preference shares.

Equity Shares:

A public company set up for securitisation purposes issuing equity shares will be a single transaction vehicle. Other conditions such as transferability, stamping etc are the same as for preference shares.

Preference Shares:

Allows for the SPV to be a multiple transaction SPV. However, linking returns (i.e. dividends) to a particular asset pool might present practical problems. Also, while the Companies Act allows (by implication) differential dividends on different classes of preference shares, it is not clear whether this encompasses linking dividends on each class to different sources of profits.

Transferability and Tradability

The shares are marketable if listed. Hence, the transfer and marketability would be dependent on whether the shares are listed or unlisted. Shares can also be traded privately.

Stamp Duty on Issue - This is a State subject.

Stamp Duty on Transfer -This is a Central Subject and is charged at 0.75%.

(ii) Debentures:

Transferability and Tradability

The debentures are marketable if listed. Hence, the transfer and marketability would be dependent on whether the debentures are listed or unlisted. Debentures can also be traded privately.

Stamp Duty on Issue

Stamp duty is as specified by the Central Government. It is an *ad valorem* levy and the duties vary depending on the mode of transfer (whether by endorsement/ separate instrument of transfer or by delivery).

Stamp Duty on Transfer- It is a state subject.

(iii) Other Instruments:

To ensure that the Company is bankruptcy proof, the instrument issued by it should not impose an unconditional liability on it to repay the debt irrespective of the realisations from the underlying assets.

Tax efficiency

A Company is subject to entity level taxation and the income generated by a company is subject to tax. This would increase the cost of securitisation and the transaction would not be cost effective. The nature of the SPV is such that it merely houses the receivables and issues papers for investors. In order to achieve this and to make the paper/ instrument attractive to the ultimate investor it is important that there is no tax burden on the SPV.

Recommended Reforms for an SPV in form of a Company

An SPV as a Company should be able to issue a new class of instrument viz. the PTC that is repaid only from the performance of the *identified assets* held by it for the benefit of the investors in the PTC – this would prevent structural bankruptcy.

This new class of instrument should not be treated as debt obligation of the SPV, but one representing an undivided interest of the investor in the underlying asset.

The instruments are to be issued against a specified pool of assets. Thus multiple securitisation transactions can be handled since instruments can be issued against separate sets of assets.

The Company should not be subject to the NBFC registration norms as specified by the RBI. *Instead, RBI may consider some other form of regulation of the SPVs.*

In the long run, such SPV companies should be declared to be exempt from entity level taxation.

Trust of which a Company is a Trustee (Trustee Company as SPV)

1. The Trustee Company is similar to a Trust with only the role of the Trustee being undertaken by a Company. With individuals becoming increasingly averse from acting as Trustees (as is happening in the case of MFs), a Company may act as the Trustee and issue the PTCs to the investors.
2. Characteristics of the Trustee Company
    - A Company under the Companies Act, 2013 which would act as the SPV.
    - It would acquire the receivables by assignment from the Originator and hold them in its capacity as Trustee.
    - The Trust Deed should ensure that the Company can act as the Trustee and also hold in Trust separate tranches of receivables pertaining to different transactions
    - The SPV/Trustee are not liable for the good performance of the assets.
    - The administration of the SPV's assets for any transaction may be subcontracted back to the Originator or to any other servicer through an Administration Agreement describing the different tasks to be performed by the Originator (in it's capacity as Administrator).

The framework of the Trustee Company would be as in the case of a MF Trustee Company. The security issued by the SPV i.e. the PTC would not be a debt obligation of the Trustee Company. The PTCs would constitute certificates notifying ownership on the pool of the assets/receivables being securitised.

A PTC ideally represents a declaration of interest in a pool of assets transferable when a beneficiary changes. The Trust through the Trustees will recognise the change in the beneficiary by endorsing the PTCs. There is no transfer of ownership interest from the Trust, as it would continue to hold the securities in trust for the changing beneficiaries represented as a class.

The PTC would not be treated as a re-assignment of receivables as there is no transfer of property interest from the Trustee to the PTC holder. The Trustee always holds the property for the beneficiaries from inception of the Trust and never sells or reassigns the interest, as the Trust never dissolves. As there is no assignment of interest at the stage of issuance of PTC, there is no re-assignment when the PTC holder changes.

For each securitisation transaction routed through the Trustee company there would be a Declaration of Trust made separately for each pool of receivables. An information memorandum would be drawn up in each instance. It is similar to a MF scheme where the terms of the scheme and the benefits of the unit holders are specifically described and assigned for each scheme.

Recommended reforms for the SPV in the form of a Trustee Company

- There is lack of clarity as to whether securities issued by a trust are capable of being listed on a stock exchange. At present, MFs are the only trusts, which have been specifically empowered to issue such securities. *SEBI could be requested to recognise such trustee companies and permit them to issue marketable securities as has been done for MF units.*

- Trustee owned assets would be normally treated, as distinct from company owned assets. However, a clarification from tax authorities that such SPV trustee companies would enjoy a tax shield may be necessary.

MF AS SPV

A MF is legally and factually a trust, being administered by a Trustee Company or a Board of Trustees, and whose assets for each scheme are managed by a separate Asset Management Company (AMC). As discussed above, while examining the trustee company concept, a MF is an existing and established legal structure, which conforms, in general, to the requirements of a securitisation SPV.

The schemes established by a MF are independent of one another. Separate maintenance of accounts of each scheme is required. Further, the unitholders of each scheme are owners of undivided beneficial interest in the assets of the Scheme.

Unless it is an assured return scheme, the Unit holders are only entitled to receive such dividends as may be declared by the AMC or the trustees. Further, in case of loss of initial investment (unit capital), the loss devolves on the investors.

A MF possesses most of the characteristics desirable for a securitisation SPV, namely:

- MFs are structured as trusts under the Indian Trusts Act, 1882. This gives them the
- flexibility to issue units under different schemes, and keep the funds raised under schemes
- (and consequently the rights of investors in different schemes) distinct from each other.
- MFs are permitted to issue marketable securities. While normal trusts (i.e., those that are not registered with SEBI as MFs) can borrow funds, it is unclear whether they can raise money by issuing marketable securities i.e. it has not been experimented so far.
- The income earned by MFs is exempt from tax under sec 10(23D) of the Income Tax Act, 1961.

Further recommendations for different forms of SPV

Company as SPV:

Applicability of NBFC Directions

If the SPV for asset securitisation is set up as a joint stock company under Companies Act, the activities undertaken by the SPV would appear similar to those of an investment or loan company and the following issues would arise. However, as explained later, the SPV in effect would only be undertaking an activity akin to trading in debt.

(i) It would require registration with RBI under Section 45-IA of the RBI Act and it should have the statutorily prescribed minimum capital funds and the present requirement is ₹ 200 lakh for a new company and this may not be possible. However, in view of the fact *that it would* ***be a company which would undertake only the activity of asset securitisation and no other activity,*** all the companies incorporated for the purpose could be treated as a class of companies and would be regulated by one or the other Regulatory Authority viz. RBI or SEBI. The Reserve Bank of India in exercise of its powers under section 45NC of the RBI Act could exempt all such companies from the applicability of core provisions of RBI Act as has been done in case of the Stock Broking Companies.

(ii) The SPV raises funds through issue of Pass Through Certificates or Pay Through Certificates (PTCs) and such monies may or may not be treated as public deposits. If so, the SPV would be governed by the comprehensive regulatory framework like capital adequacy requirement, credit/ investment concentration norms. However, the FIs proposing to securitise their asset portfolio may transfer beneficial interest on assets in favour of the SPV, which in turn issues PTC against the backing of assets / future cash flows from these assets. Therefore, PTCs could be treated as a secured instrument and the NBFC Directions should not be applicable. The debentures/bonds, which are fully secured by the assets of the company in respect of which a charge has been created in favour of the trustees for such debenture holders/bond holders, are exempted from the description of public deposits. On the other hand, if the PTCs were treated as near to equity, the NBFC Directions would not cover them because raising of money by contribution to capital is exempt from the definition of deposit.

(iii) If the SPV company is floated by an NBFC as the Originator, it could be reckoned as a company in the same group or its subsidiary and the Net Owned Fund of the Originator NBFC would be severely affected because of the exposure to the group companies. The SPVs promoted for infrastructure development are presently facing the same difficulties. This is a larger issue and the Originators should have an arm length relationship with the SPVs promoted by them and should not have more than the substantial interest. Alternatively, in order to give encouragement to the NBFCs to promote SPVs for the purpose of asset securitisation, RBI would also need to clarify that such SPVs will not be treated as the companies/entities in the same group/subsidiaries of the Originator NBFC because it would have no beneficial interest in the SPV except to the extent of its shareholding or the investments made in the instruments issued by the SPV. It would encourage the NBFCs to promote the SPVs without an adverse impact on their Net Owned Fund.

(iv) If the SPV company were promoted by a bank, it would require prior approval of RBI under the B. R. Act, 1949 for investing more than 30 percent of the paid up capital of the bank or the investee company. The banks could, however, own less than 30 per cent of the equity of the SPV and float the company in association with other financial institutions.

Trust as SPV:

An option that could be examined is the exercise of inherent powers of the Government of India under the Constitution of India and the Government of India Act, 1935, to notify a requisite scheme (akin to the SEBI (MF) Regulations, 1996, under which securitised paper can be issued by a trust established for the purposes of securitisation. Similar steps have been taken in the past by the Government of India, e.g., the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through Depository Receipts Mechanism) Scheme, 1993. The Government of India could under such scheme/regulations (for issue of securitised debt receipts through the securitisation fund) designate an appropriate authority for administration of the scheme/regulations.

MF as SPV

The MF in its current form, however, cannot be used to perform the role of a securitisation SPV due to the following reasons:

A MF cannot buy into assets and actionable claims. The entire SEBI (MF) Regulations mention only 'security' – whether it is in the context of the role of the AMC or in the accounting and valuations aspects.

The existing set of regulations includes, to a large extent, directives that are vital to normal MFs but redundant as far as securitisation SPVs are concerned. The amendment of every clause of the existing regulations to encompass all the activities of the SPV would be a laborious task since the entire spirit and focus of the MF regulations is on regulating activities very different in nature from that of a securitisation SPV. Re-writing a fresh set of regulations for securitisation might prove to be less cumbersome and easier to understand.

Unincorporated bodies (Partnership firm/ society, etc. as SPV - applicability of NBFC guidelines

(a) In view of the fact that securitisation is a financial activity, the unincorporated body (i.e., individual, firm, HUF, association of persons) undertaking such activity would be deemed to be engaged in financial business and the provisions of Chapter III C of the Reserve Bank of India Act, 1934 would be attracted to such activities. The unincorporated entity is, *inter alia,* not allowed to raise deposits from other than the relatives and institutions specified in the Reserve Bank of India Act, 1934.

(b) The bonds, debentures or any other instruments near to equity can be raised only by joint stock companies. The unincorporated entities can, therefore, issue only the PTCs. In so far as they issue PTCs to the specified institutions, *viz.,* FIs, statutory corporations, cooperative societies, companies incorporated under the Companies Act 2013 etc., these borrowings or moneys received through issue of PTCs would be exempt from the purview of 'deposits' and to that extent these entities could act, unhindered, as SPV for issuing securitised papers. In the usual course, initially, the investors are the institutions or corporates only, and the provisions of Chapter III C of the Reserve Bank of India Act, 1934 would not be attracted. There could, however, be instances of unincorporated entities acquiring the PTCs by their purchase in the secondary market. The situation emanating therefrom could be unintended by the issuers and could be an aberration. These should therefore be ignored for the purpose of compliance with the Reserve Bank of India Act, 1934.

(c) There are no regulations on the unincorporated bodies investing in the securitised papers. They can acquire hold, transfer, purchase, repurchase etc., in the usual course of their business and subject to the compliance to the other applicable statutes.

The observations will also apply to SPV as a Trust or MF.

Further, the Working Group discussed whether SPV should be one time entity (transaction specific) or an on-going entity. It was also suggested that a few SPVs might cater to the needs of particular industry and thus acquire specialisation in securitising assets pertaining to a given sector of economy. Another view was that the co-mingling of asset pools from various Originators might not be an appropriate strategy till the system stabilises. The day to day functions of SPV may be performed by an administrator / servicer for a fee.

Conclusion

The fact remains that the MF is the closest available existing and regulated entity, which carries out an activity similar to securitisation. While it may not be feasible to accommodate the spirit of securitisation in its entirety within the MF Regulations, ***SEBI could be prevailed upon to frame a suitable set of guidelines for regulating the securitisation activity on the lines of the MF Regulations.*** A point to note is the recent issuance of Guidelines for collective investment schemes, which again have many aspects in common with securitisation schemes. SEBI's experience in handling similar legal structures involving aggregation of investments (public or private) would help the activity arrive in market in a regulated form.

While the SPV would be incorporated & registered as an entity under its parent legislation, for e.g., a company would be registered with the Registrar o companies; for such a Company to engage in the activity of public issuance of securities, it may be desirable for the entity to be registered with the capital market regulator also. This may be kept in view by SEBI while framing the guidelines for regulating the securitisation activity.

For securitisation to realise its true potential in the infrastructure / housing and other capital deficient sectors, widespread participation in securitisation schemes is highly desirable and should be encouraged. SPV should therefore be capable of issuance of securities to a large variety of investors. The concerns relating to investor protection will be adequately taken care of by the capital market regulator.

Since investor participation in securitised paper will be from both the private placement markets as well as by public issuance, it is desirable that both the activities are regulated from a common point. This is particularly so in view of:

- Common set of guidelines which will rule out duplicity of regulations.

- The informed investor i.e. FIs/mutual funds, etc. will help the activity take off initially by subscribing to the scheme. Other investors like pension funds, insurance companies, etc can gain confidence and participate through the secondary market.
- Likely widening of the potential investor base right from inception in view of the above.

ROLE OF REGULATORS & OTHER AGENCIES

Role of Regulators

Securitisation essentially involves moving the assets from the balance sheet of the Originator to an SPV. The SPV then proceeds to issue securities in which various entities invest their funds. At each stage regulators have a crucial role to play, to ensure that the objectives of securitisation are achieved with the larger interests of the financial system always held uppermost. The role of the regulators emerges, vis-à-vis their regulatory interest in the various facets of the transaction. Since securitisation lends itself primarily to financial assets, more often than not, the Originator would be a FI in which case, the Central Bank of the country would have valid concerns relating to the transaction. These may be related to determination of whether the assets have actually moved off the balance sheet or calculation of any residual risks that may remain with the Originator. An additional aspect may be regarding the health of the Originator's balance sheet subsequent to the cherry picking that normally goes along with securitisation. The regulators would also be concerned with treatment to be accorded to any credit enhancement or other ancillary facilities provided by the FIs to securitisation transactions either of their own assets or to outside transactions. RBI being the Regulator of the major components of the Indian financial system, viz., banks, development financial institutions and NBFCs has a special role to ensure that the financial intermediaries prudently engage themselves in securitisation activities. This is more so because despite the fact that clear benefits accrue to the organisations that engage in securitisation, these activities have the potential to increase the overall risk profile if they are not carried out prudently. For the most part, the types of risks that financial institutions encounter in the securitisation process are identical to those that they face in traditional lending transactions including credit risk, concentration risk, interest rate risk, operational risk, liquidity risk, rural recourse risk and funding risk. However, since the securitisation process separates the traditional lending function into several limited roles such as originator, servicer, credit enhancer, trustee, investor, the type of risks that our institutions will encounter will differ depending on the roles they assume. There is, therefore, a need for the RBI to design an appropriate regulatory framework / prudential guidelines to ensure that these institutions participate in the process of securitisation more prudently and derive the benefits it offers more objectively.

Another major category would be the securities regulator like SEBI and the Stock Exchanges who normally stipulate the disclosure norms about listed and tradable securities. At times, these institutions also lay down norms restricting the type of securities or the class of investors to which they can be issued. Similarly, there would be regulatory issues related to incorporation of the SPV, its capitalisation, tax treatment etc. Accounting standards and tax rulings related to treatment of the upfronted profit in the books of the Originator or the income accruing to the SPV on behalf of the investors in the securitisation issues will also come into play. Thus, Institute of Chartered Accountants of India as well as the tax authorities would have to put into place a system of clear and unambiguous rules, which would serve as guidance for various situations.

Regulation thus would be impacting specified activities as well as the entities that perform these specific activities. This section (Para 8.1) looks at the regulatory aspects on various activities that are involved in a securitisation transaction. Also covered are the areas of regulation required over the entities involved, such as, the Originator, the SPV and Investor balance sheet etc.

Moving assets of the Originator's balance sheet

Securitisation necessarily involves assignment of assets by the Originator to an SPV. This has implications for Originators in the areas of capital adequacy (for financial intermediaries), accounting treatment and taxation. The regulator's role in each of these is discussed below:

(a) Capital Relief

Financial intermediaries can use securitisation to free a portion of their regulatory capital. RBI, which prescribes capital adequacy requirements for these entities, would hence be required to lay down norms for "true sale" and the capital relief. The norms would aim at preventing Originators from getting the benefit of capital relief in events where they either retain asset risk or provide recourse to the investors. These norms would be purely from the point of view of capital adequacy and independent of what "true sale" may mean in the legal, accounting or taxation context.

(b) Post-securitisation financial health of Originators

The pool assets that are securitised are picked and chosen out of an Originator's total portfolio. In securitisation parlance, good assets are "cherry-picked" to make the securities issued attractive to investors. This exercise carries with it the risk that (post-securitisation) the Originator's balance sheet would be left with assets of poorer quality, except in the cases where it can generate fresh assets of the quality of the securitised assets. The RBI would hence be concerned that the financial health of Originators could be in jeopardy, if securitisation is resorted to in too large a scale.

Accounting and Taxation Treatment

Keeping gearing low does have a significant bearing on the risk perception that lenders/ investors have about a corporate. Securitisation in its true form achieves an off-balance sheet effect, and hence has a positive impact on the debt-equity ratio of the Originator. There is thus a requirement for clear standing definitions for a True Sale, which if adhered to would qualify the transaction as an off-balance sheet funding. Since accounting norms / standards are laid down by the Institute of Chartered Accountants of India (ICAI), they would be required to come out with an accounting standard/ guidance note on accounting for securitisation. Clarity would also need to emerge on the tax treatment that would be accorded to the assets moving off the balance sheet or the income being up-fronted. In many cases, it will so happen that the True Sale criteria for one purpose may be different from the criteria for any of the other purposes. Availability of a clear and reliable set of criteria for each purpose would serve as a source of tremendous comfort to both issuers and regulators.

Issuance related Regulation

The activity of issuance of securitised paper would bring into play the role of regulators such as SEBI and Stock Exchanges. These bodies stipulate the information that must be disclosed publicly about listed securities. In some cases, they may also dictate investor classes to which a particular type of security may or may not be sold. An added area of regulation may be on the nature of entities, whose assets can be securitised or the asset classes, which can be securitised.

Disclosure Norms

The nature of securitised paper being considerably different from traditional securities, the nature of disclosure norms on its issuance would also differ. Most of these disclosures are fundamentally different from what is required for normal issues of equity and debt. As the regulator of the capital market, SEBI may have to examine and come out with detailed disclosure norms for issuance of securitised paper, by way of a public issue. In case of private placement also some best practice norms may need to be put in place as detailed in the Annexure - III on Disclosure Norms. These norms would cover the issuance of such securities as well as ongoing disclosure requirements over the life of the instruments. Some of the areas on which disclosure would be required are:

- the characteristics of the underlying assets (factual information about the selected pool on various parameters, representations on past performance, etc.)
- agreed procedure for administration / servicing
- nature and extent of credit enhancement, other ancillary services
- broad purpose and contents of legal documents involved

- legal and financial disclosures on the Originator and SPV, disclaimer of their liability except to the extent explicitly specified
- nature and structure of instrument

Listing Requirements

Stock Exchanges ordinarily lay down the listing requirements for various securities. They would necessarily have a role to play in this regard. The structures of securitised paper would need to keep in mind various parameters, some of these could be:

- Names of exchanges, which permit listing of securitised paper, e.g. only NSE permits listing of securitised debt at the moment in India.
- Minimum issue size.
- Availability of listing in Demat mode and consequent stamp duty concessions. Steps are already being taken by the Ministry of Finance to extend the benefits of demat trading, presently available only to equity, also to debt securities. A point of concern here would be the possible omission of securitised paper in the proposed notification, which would permit dematerialised listing and trading in Debt Securities.

Regulation of the SPV

The SPV may be incorporated in any one of the many legal forms possible. The structure adopted may be that of a Firm, a Company, a Trust or a Mutual Fund etc. Consequently, the provisions of the parent law for incorporation of such entity, i.e. the Partnership Act, the Company Law or Trust Act would need to be adhered to while setting up the entity. In addition, when the SPV is set up as a Mutual Fund Trust, specialised regulators like the SEBI would also come into the picture. These issues, as also the possibility of the SPV falling into the NBFC categorisation have been discussed in detail in Chapter 7. It would, however, be pertinent to maintain here that the RBI being the regulator would need to lay down criteria which would determine that the SPV should remain exempt from NBFC guidelines.

There would be another two aspects of the activity of the SPV, which would attract regulation. These would be the tax treatment and the accounting treatment to be accorded to the transaction being routed through its books. The tax authorities of the country would therefore, need to put into place a clear set of taxation rules which would avoid or prevent double taxation merely because an activity is being routed through an SPV. Similarly, the accounting standards would need to be developed regarding the format of the SPV balance sheet, treatment of the upfronted profit, liability display regarding future performance obligations against securitised assets etc.

Study Note - 3

GROUP FINANCIAL STATEMENTS

This Study Note includes

3.1 Holding Company
3.2 Method of Combination
3.3 Accounting Treatment
3.4 Treatment of Investment in Associate in Consolidated Financial Statement (AS-23)
3.5 Treatment of Investment in Joint Venture in consolidated Financial Statment (AS-27)
3.6 Preparation of Group Cash Flow Statement

3.1 HOLDING COMPANY

The tendency to combine in order to derive advantages of economics of scale as well as market power/monopoly power, firms may amalgamate – one firm may absorb another firm in which case their size increases and legal in a larger firm comes into existence. This implies dissolution of one or more existing firms. A legal procedure has to be followed for this purpose. However, Firms may continue without any dissolution by investing in the shares of another company and thereby, acquiring ownership interest to the extent of the holding. If a company holds more than 51% of the issued share capital of another firm or controls composition of Board of Directors of another firm, the company holding the majority share is termed as holding company and the company whose shares are held is termed as subsidiary company.

A partly owned subsidiary is one in which the holding company (or the group) does not hold all the shares. The interest of shareholders outside the group is called 'Minority Interest'.

While the wholly owned subsidiary is one where all the shares are owned by the holding company. From legal point of view both the companies continue to enjoy, separate legal entity but from the point of view of investor, lender as well as management, then, may very well be regarded as single entity. Legally accounts of these companies are complied separately but a more realistic picture will be presented if consolidated accounts especially with respect to published statements- income and position statements are also included in published reports. For this purpose inter company transactions have to be eliminated from all stages and a single Profit and Loss Account and Balance Sheet compiled for the group as a whole. If a company is a subsidiary company, it is also deemed to be a subsidiary of the holding company.

3.2 METHODS OF COMBINATION

In order to be able to account for combinations, we must first explore some of the methods which may be used to effect them. Such methods may best be classified as to whether or not a group structure results from the combination. Let us take as an example: two companies L and M and assume that the respective Boards of Directors and owners have agreed to combine their business.

Combinations Which Result in a Group Structure

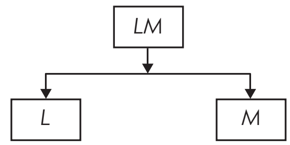
Two such combinations may be considered. In the first case, company L (say) may purchase the shares of Co. M (say) and thereby acquire a subsidiary company, alternatively Co. M may purchase the shares of Co. L. The choice of consideration given in exchange for the shares acquired, will determine whether or not the old shareholders in what becomes the subsidiary Co., have any interest in the combined business. Thus, if Co. L issues shares in exchange for shares in Co. M the old shareholders of

Co. M have an interest in the resulting holding company and thereby in the group. Whereas, if Co. L pay cash for the shares in Co. M, the old shareholders in M take their cash and cease to have any, interest in the resulting group.

In the second case a new company LM (say) may be established to purchase the shares of both M Co. and L Co. Thus the shareholders in L and M may sell their shares to LM in exchange for shares in LM. The resulting group structure would be:-

Holding Company

Subsidiary Companies



The shareholders in LM would be the old shareholders in LM would be the old shareholders in the two separate companies and their respective interests would depend, as in the above examples, upon the valuation placed the two separate companies–which should in turn depend upon the bargaining between the two Boards of Directors.

It would be possible for LM Co. to issue not only shares but also loan stock in order tom purchase shares in L Co. and M Co. It would be difficult for payment to be made in cash and LM Co. is a newly formed company, although it could, of course offer – shares or raise loan to obtain cash.

Combinations not Resulting in Group Structure

Again, two such combinations may be considered. First, instead of purchasing the shares of Co.M.Co.L may obtain control of the net assets of M by making a direct purchase of those net assets. The net assets would thus be absorbed into Co.L and Co.M would itself receive the consideration. This, in due course would be distributed to the shareholders of M by its liquidator. Once again, the choice of consideration determines whether or not the old shareholders in Co. M have any interest in the enlarged Co.L, second, instead of one of the companies purchasing the net assets of the other, a new company may be formed to purchase the net assets of both the existing companies. Thus a new company LM may be formed to purchase the net assets of Co.L and Co.M. If payments is made by issue of shares in Co. LM these will be distributed by the respective liquidators so that the end result in one company, LM which own the net assets previously held by the separate companies and has as its shareholders the old shareholders in the two separate companies.

Preference for Group Structure

The above are methods of effecting combination between two or indeed more, companies. It appears that the majority of large business combination makes use of a group structure rather than a purchase of assets or net assets. Such a structure is advantageous in that separate companies enjoying limited liability as already is existence. It follows that names and associated Goodwill, of the original Companies are not lost and, in addition, that it is not necessary to renegotiate contractual agreement. All sorts of other factors will be important in practice, some example are the desire to retain staff, the impact of taxation and stamp duty, whether or not there is remaining minority interest.

Choice of Consideration

As discussed above, the choice of consideration will determine who is interested in the single business created by the combination and therefore be affected by the size of the companies and also by the intention of the parties to the combination and also by the conditions in the market securities and taxation system in force.

The main type of consideration are cash, loan stock, equity shares and some form of convertible securities, all sorts of combinations of these are possible.

3.3 ACCOUNTING TREATMENT

It seems to be intention of the companies act that the financial year of holding and subsidiary firm should end on the same date. Section 129 of The Companies Act 2013 requires that a holding company shall attach to its Balance Sheet the following documents.

- A copy of the Balance Sheet of the subsidiary.
- A copy of the Profit and Loss Account of the subsidiary.
- A copy of the board of Directors report and auditor's report.
- A statement of holding company's interest.

Accounting Standard AS–21 requires that holding company shall also present consolidated financial statement in addition to the separate financial statements as stated above. Student is advised to study AS–21 in this context. Consolidated Balance Sheet with respect to the consolidation process is carried out on a step by step basis so that common transaction are eliminated and the assets and liabilities of the entire group are presented in a single Balance Sheet and P/L Account at market prices. The consolidation of the Balance Sheet is carried out in the following steps :

1. **Elimination of inter company investments account:** a holding company by definition holds majority shares in the subsidiary company which appears as an investment on the assets side of the Balance Sheet of the holding company. In the context of subsidiary company it is part of issued capital on the liability side.

As a first step in the consolidated process the investment account in the Balance Sheet of the holding company in the subsidiary company is eliminated and the assets (leaving aside fictitious assets or including an adjustment for them) and all outside liabilities will be incorporated into the holding company's Balance Sheet as shown below :-

Extract Balance Sheet as at 31-03-2015

	H	S		H	S
Share Capital @₹ 10 each	20,000	10,000	Sundry Assets (Tangible)	20,000	10,000
Sundry Liabilities	10,000	5,000	Investments in S. Ltd. (1000 shares)	10,000	-
	30,000	15,000		30,000	10,000

Solution:

Name of the Company: H

Consolidated Balance Sheet as at 1st April, 2015

Ref No.	Particulars		Note No.	As at 1st April, 2015	As at 31st March, 2015
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital		20,000.00	-
				20,000.00	-
	2	**Share application money pending allotment**		Nil	-

Ref No.	Particulars		Note No.	As at 1st April, 2015	As at 31st March, 2015
				₹	₹
	3	**Non-current liabilities**		Nil	
				-	-
	4	**Current liabilities**			
		(a) Other current liabilities	1	15,000.00	-
				15,000.00	-
		TOTAL (1+2+3+4)		35,000.00	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	2	35,000.00	-
				35,000.00	-
	2	**Current assets**		Nil	
				-	-
		TOTAL (1+2)		35,000.00	-

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

Note 1. Other Current Liabilities

	Current Year	Previous Year
H	10,000.00	-
S	5,000.00	-
	15,000.00	-

Note 2. Tangible Assets

	Current Year	Previous Year
H	20,000.00	-
S	15,000.00	-
	35,000.00	-

In the above case the subsidiary firm is fully owned by the holding company and therefore the entire net assets of the subsidiary firm are in the ownership of the holding company and for the purpose consolidation they have been incorporated into Balance Sheet of the holding company. However, very often the holding company have holds only majority shares in which case the extent of the ownership interest (no. of shares held in the form of investments by the Holding company/ total issued capital of S limited in terms of number of shares) In the process of consolidated therefore, assets and liabilities should be incorporated only to the extent of ownership interest. However, this method is not allowed in practice as per convention.

2. **Determination of Minority Interest:** The shares of the subsidiary firm held by outsiders i.e. other than the Holding company are in aggregate termed as minority interest since majority shares are held by Holding company. As per I, even in case of partly owned subsidiary firm the entire assets and liabilities of the subsidiary companies are incorporated in the consolidated Balance Sheet and an additional calculation is made to determine the extent of minority interest in the assets of subsidiary firms and this is shown as additional liability in consolidated Balance Sheet. The claim of the majority (or outside) shareholders will consist of the face value of the shares held by them plus a proportional share in any increases in the value of assets of the company minus their portion of company's losses or decrease in the value of assets of the company.

Example 1.

From the following prepare a consolidated Balance Sheet as at 1st April, 2015

			(Figures in Rupees)		
	H	S		H	S
Share Capital@ ₹10 each	20,000	10,000	Shares in S. Ltd.	80,000	
S. Liabilities	10,000	5,000	800 shares		
			Other assets (Tangible)	22,000	15,000
	30,000	15,000		30,000	15,000

H limited has acquired the shares on the closing Date of the Balance Sheet as on 31.3.2015.

Solution:

Name of the Company: H

Consolidated Balance Sheet as at 1st April, 2015

Ref No.		Particulars	Note No.	As at 1st April 2015	As at 31st March, 2015
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital		20,000.00	-
				20,000.00	-
	2	**Minority Interest**		2,000.00	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Other current liabilities	1	15,000.00	-
				15,000.00	-
		TOTAL (1+2+3+4+5)		37,000.00	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	2	37,000.00	-
				37,000.00	-
	2	**Current assets**		Nil	
		TOTAL (1+2)		37,000.00	-

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

Note 1. Other Current Liabilities

	Current Year	Previous Year
H	10,000.00	-
S	5,000.00	-
	15,000.00	-

Note 2. Tangible Assets

	Current Year	Previous Year
H	22,000.00	-
S	15,000.00	-
	37,000.00	-

Net Assets available for distribution of Equity shareholders of S Limited =
(Assets - Liabilities) = (15000 - 5000) = ₹ 10000
Minority Interest = (10000*1/5) = 2000
(800/1000) = (4/5) Majority Interest

3. **Goodwill, Capital Reserve / Cost of Control –** In the Balance Sheet of subsidiary company when a company acquires shares there are likely to be accumulated Profit/Losses. These will not be incorporated into the consolidated Balance Sheet but with respect to the Holding companies cost of investment reflected on the assets side in the holding's company Balance Sheet a comparison will be carried out with the actual value of these investments. The subsidiary Co's Balance Sheet (paid up value of shares + accumulated profit or – accumulated losses = market value of the investment). The difference between the cost of acquisition of share and the market value determined above will be goodwill if cost of acquisition is less and accordingly goodwill A/c or capital reserve A/c will be incorporated into the consolidated Balance Sheet. This figure is also termed as cost of control since the holding company has a controlling investment in the subsidiary firm.

Example 2.

H Ltd. acquires 3/4 of the share capital of S Ltd. On 31-12-2015 whose extract Balance Sheets are as follows:

	H	S		H	S
Share Capital @ ₹ 10 each	20,000	10,000	Fixed assets (Tangible)	20,000	10,000
			Current assets	13,000	12,000
General Reserves	5,000	3,000	Shares in B Ltd. (3/4)	10,000	
P/L Account	3,000	2,000			
10% Debentures	10,000	5,000			
Sundry creditors	5,000	2,000			
	43,000	22,000		43,000	22,000

Required to compile consolidated Balance Sheet on 31-12-2015.

Solution:

In case of partly owned subsidiary firm the H Co's interests in the accumulated profit or loss the subsidiary firm is only to the extent of the ownership interest. The balance due to minority will be adjusted for the minority interest.

Cost of Control

Amount paid for shares in S Ltd. / cost of acquisition Of shares		₹ 10,000
Less: Paid up value in S Ltd. (3/4 of ₹ 10000)	7,500	
Share of General Reserve (3/4 of ₹ 3000)	2,250	
Share of P/L Account (3/4 of ₹ 2000)	1,500	
		11,250
Capital Reserve		1,250

Minority Interest

Paid up value	2,500
General Reserve (1/4)	750
P/L Account (1/4)	500
Minority Interest	3,750

Name of the Company: H Ltd.

Consolidated Balance Sheet as at 31st December, 2015

Ref No.		Particulars	Note No.	As at 31st December, 2015 ₹	As at 31st March, 2015 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital		20,000.00	-
		(b) Reserves and surplus	1	9,250.00	-
				29,250.00	-
	2	**Minority Interest**		3,750.00	-
	3	**Share application money pending allotment**		Nil	-
	4	**Non-current liabilities**			
		(a) Long-term borrowings (10% debentures)	2	15,000.00	-
				15,000.00	-
	5	**Current liabilities**			
		(a) Trade payables	3	7,000.00	-
				7,000.00	-
		TOTAL (1+2+3+4+5)		55,000.00	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	30,000.00	-
				30,000.00	-
	2	**Current assets**			
		(a) Other current assets	5	25,000.00	-
				25,000.00	-
		TOTAL (1+2)		55,000.00	-

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

Note 1. Resesrve & Surplus

	Current Year	Previous Year
General Reserve	5,000.00	-
P/L A/c	3,000.00	-
Capital Reserve	1,250.00	-
	9,250.00	-

Note 2. Long Term Borrowings

	Current Year	Previous Year
10% Debenture		
H	10,000.00	-
S	5,000.00	-
	15,000.00	-

Note 3. Trade Payable

	Current Year	Previous Year
H	5,000.00	-
S	2,000.00	-
	7,000.00	-

Note 4. Tangible Assets

	Current Year	Previous Year
H	20,000.00	-
S	10,000.00	-
	30,000.00	-

Note 5. Other Current Assets

	Current Year	Previous Year
H	13,000.00	-
S	12,000.00	-
	25,000.00	-

S Company Balance Sheet

(Net assets – Debentures – Creditors) = (22,000 - 5,000 - 2,000) = 15,000

= Net assets available for equity shareholders.

Minorities share in 15,000 = (1/4) * 15,000 = 3,750

(including paid up value of share capital and accumulated profits)

4. **Capital profit/ revenue profit:** The date of acquisition of shares by the holding company may not coincide with the closing of financial year i.e they may be acquired during the course of financial year. However, the published statements will be compiled only with respect to the closing date of financial year. In such a case, the date of acquisition of shares does not coincide with the date of Balance Sheet and accordingly adjustments have to be made. **The Profit and Loss of the subsidiary company prior to the date of acquisition are capital in nature while post dated profits are revenue in nature.** From the accounting point of view the pre – acquisition profits will be adjusted for in the cost of control extent of holding company's ownership interest while the post acquisition profit will be treated as revenue in nature and therefore in the closing Balance Sheet as shown in the Profit/Loss Account of the holding company. For this purpose in the absence of any further information it is perfumed that the subsidiary company earns uniformly throughout the year, for example, if the date of acquisition is in the middle of first year 1/2 the profit of the subsidiary company will be capital in nature, the other 1/2 as revenue , with respect to the minorities the treatment is identical for either share in capital or revenue profit which are added on, to the minority interest. In some cases in the analysis of profit additional adjustments have to be made before they are analysed into capital and revenue profit. **All accumulated profit except current year profit which has to be segregated into capital and revenue will be treated as capital profit**.

5. **Inter Company Transactions:** The holding and subsidiary firm may have centered into the following transaction and these common transactions will be eliminated while compiling the consolidated Balance Sheet.

   (a) The holding or the subsidiary firm may have granted loans (short term) to each other.

   (b) They may have sold goods on credit in which case the inter company transactions will be included in debtors and creditors.

   (c) The subsidiary or holding company may have drawn Bills of Exchange on each other in which case the common transaction will be included in Bills Payable/ Bills Receivable.

   In all the above cases where the companies were treated as separate entities, these transactions would appear on the liabilities side on the Balance Sheet of one and on the assets side of the other's Balance Sheet. However, when the entire group is being treated as a single entity it is undesirable to include common transaction and therefore they will be eliminated in the consolidated Balance Sheet from the liabilities as well as assets side.

6. **Contingent Liabilities:** A contingent liability appears as a footnote. This is on account of a liability which may or may not arise in the future. While preparing a consolidated Balance Sheet they may be categorized as external current liabilities or internal current liabilities. External liabilities between the holding and subsidiary firm and the outsiders. Internal current liabilities is on account of transactions between the firms belonging to the same group. The external liabilities continue unchanged for the same group while internal liabilities no longer appears as a footnote as it is generally incorporated on the liability side.

Example 3.

The following are the extract Balance Sheet of H & S Company as on 31-03-2015 (in ₹)

Liabilities	H	S	Assets	H	S
Share Capital @ ₹ 10 each	20,000	10,000	Fixed Assets (Tangible)	30,000	15,000
General Reserve	10,000	5,000	Current Assets	35,000	25,000
P/L A/c (1.4.14)	5,000	4,000	Shares in S Ltd. (8000)	10,000	
12% Debenture	20,000	10,000			
S. creditors	10,000	5,000			
Profit for the year	10,000	6,000			
	75,000	40,000		75,000	40,000

H Limited acquired shares in S Limited on 01-10-2014. S limited has a balance of ₹ 4000 in General Reserve on 01-04-2014. On the account fire goods costing ₹ 2000 of S Limited were destroyed in June, 2014. The loss has been charged to the Profit and Loss Account for the year.

Required to prepare a consolidated Balance Sheet.

Solution:

Working Notes:

1. Date of Acquisition: 01.10.2014
2. Holding Company Share: 800/1000 *100 = 80%
3. Minority Company Share: 200/1000*10 = 20%

Analysis of profit (of S)

Particulars	**Capital Profit**	**Revenue Profit**
General Reserve of 01.04.14	4000.00	-
Profit & Loss of 01.04.14	4000.00	-
Profit for the year prior to Transfer + General Reserve		
(6000+1000+2000)/2	4500.00	4500.00
	12500.00	4500.00
Less: Loss on fire in March	2000.00	-
	10500.00	4500.00
Holding Company's share (80%)	8400.00	3600.00
Minority Company's share (20%)	2100.00	900.00

Cost of Control:-

	Amount (₹)	**Amount (₹)**
Cost acquiring share	—	10000.00
Less: Nominal Value of shares (800*10)	8000.00	—
Share of Capital profits of H	8400.00	16400.00
Capital Reserve	—	**6400.00**

Minority Interest:

Nominal Value of share Capital (200*10)	2000.00
Share of Capital Profit	2100.00
Share of Revenue Profit	900.00
	5000.00

Name of the Company: H Ltd.
Consolidated Balance Sheet as at 31st March, 2015

Ref No.		Particulars	Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital		20,000.00	-
		(b) Reserves and surplus	1	35,000.00	-
				55,000.00	-
	2	**Minority Interest**		5,000.00	-
	3	**Share application money pending allotment**		Nil	-
	4	**Non-current liabilities**			
		(a) Long-term borrowings (10% debentures)	2	30,000.00	-
				30,000.00	-
	5	**Current liabilities**			
		(a) Trade payables	3	15,000.00	-
				15,000.00	-
		TOTAL (1+2+3+4+5)		105,000.00	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	45,000.00	-
				45,000.00	-
	2	**Current assets**			
		(a) Other current assets	5	60,000.00	-
				60,000.00	-
		TOTAL (1+2)		105,000.00	-

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

Note 1. Resesrve & Surplus

	Current Year	Previous Year
General Reserve	10,000.00	-
P/L A/c	-	-
H	15,000.00	-
S	3,600.00	-
Capital Reserve	6,400.00	-
	35,000.00	-

Note 2. Long Term Borrowings

	Current Year	Previous Year
12% Debenture		
H	20,000.00	-
S	10,000.00	-
	30,000.00	-

Note 3. Trade Payable

	Current Year	Previous Year
H	10,000.00	-
S	5,000.00	-
	15,000.00	-

Note 4. Tangible Assets

	Current Year	Previous Year
H	30,000.00	-
S	15,000.00	-
	45,000.00	-

Note 5. Other Current Assets

	Current Year	Previous Year
H	35,000.00	-
S	25,000.00	-
	60,000.00	-

7. **Unrealized gains:** If goods have been sold by holding company to subsidiary company or vice versa, presumably they would be including a profit margin on the cost price. However, when the firms are treated as a single entity, stock or inventory should be valued at cost i.e excluding profits. The firm that has sold the goods must have credited the profit of account of the sales: therefore, profit or selling company has to be reduced and the stock account of the company that has purchased the goods also has to be reduced for which purpose the following entry is passed.

   Profit & Loss A/c (selling company) Dr.

   To stock company (purchasing company)

   (with the company of profit included in the inter

   company sales of goods that can be…..)

   By making a deduction for the inter company sale of goods, the adjustments is made only in relation to those goods that can still be traced in the inventories of the purchasing company. If the goods are not traceable no adjustments is required. A finer accounting analysis can be performed by taking into consideration extent of the ownership interest of the holding company in the subsidiary firm accordingly making the above entry to the extent of ownership interest. As per decision of the Institute Chartered Accountants, this method no longer followed and the total profit included in inventories (irrespective of it belonging to majority or minority) is deducted from both sides of the Balance Sheet.

8. **Revaluation of assets and Liabilities:** The Holding company may revalue the Assets and Liabilities of the subsidiary firm at the time of acquisition of shares in terms of market prices. In such a case the rate of revaluation is, assumed to be the same date as acquisition of shares. The profit or loss on revaluation is capital in nature and accordingly will be adjusted for in the analysis of profit under capital profits. The date of acquisition of shares as considered earlier also may not coincide with date of Balance Sheet in which case as stated earlier the current years profit has to be segregated between capital and revenue. Since the date of revaluation of assets is the date of acquisition of shares, a change in depreciation may be required on the revalued assets from the date of acquisition till the closing of Balance Sheet. For, presumably the Balance Sheet of the subsidiary company has been made or complied in terms of its original values. Information with respect to revaluation has to be explicitly stated by an agreement between the firms at the time of acquisition of majority share by the holding company.

Preference Shares

The Holding or Subsidiary Company may have Preference shares at the time of consolidation. The preference shares of the holding company continue as they are in the consolidated Balance Sheet. With respect to the Subsidiary firm if preference share capital has been issued there are 2 possibilities.

- All preference shares are held by the outsiders i .e. other than holding company i.e which case the paid up value of the preference shares of the Subsidiary company is added to the minority interest.
- It is possible that part whole of the preference. shares of the Subsidiary company is held by the Holding Company. In such a case the cost of acquiring of the preference shares (shown in the investment account in the assets side in the Balance Sheet of the holding company) is compared with the paid up value (shown in Balance Sheet of Subsidiary firm) and the difference if any, adjusted in the cost of control. (if preference shares are issued after date of acquisition the adjustments remain the same)

Arrears of preference dividends may be payable or outstanding at the time of consolidation of Balance Sheet and usually preference dividends are cumulative in nature. If the subsidiary company, has adequate profits, it is reasonable to assume that these dividends will be paid. The minorities shares will be added to Minority Interest while with respect to the holding company the treatment will differ in terms of the divided being paid out of pre acquisition or post acquisition profits or both.

In case the dividends are paid out of pre-acquisition profits (capital profit), the dividend due to the holding company will be adjusted for in the cost of control. In case post acquisitions revenue profits are employed, the dividend due to the holding company will be credited (added on) to the Profit and Loss

Account of the holding company in the consolidated Balance Sheet. It is possible that a combination of both pre and post acquisition profit is employed for the purpose of making dividend payment in which case the dividend paid out of the capital profit will be adjusted for in the cost of control and the portion out of revenue profit will be adjusted for in the P/L Account of Holding company, the total being amount due to the holding company with respect to minorities no distinction is made between capital and revenue profit for the purpose of making dividend payment and the dividend payable to them will be added to minority interest.

Bonus Shares

The Subsidiary company may issue Bonus shares either at the time of acquisition of shares by the holding company or after the acquisition of shares by the Holding company. For issuing bonus shares, the accumulated profits in the Balance Sheet of the subsidiary company are employed. These profits may be capital or revenue in nature or a combination of both. At the time of bonus issue the share of the Holding company as well as the minorities increases proportionately (in terms of the ration of bonus issue) but the proportion of their ownership remains the same as before. If bonus shares are issued out of capital profits are adjusted accordingly and bonus shares transferred to cost of control. If bonus shares issued out of revenue profit of subsidiary company to that extent revenue profit stand capitalized and will affect capital reserve or goodwill as the case may be.

DIVIDEND ON EQUITY SHARES

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

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

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

c. **Dividends Payable:** In some cases, the dividends that have been declared by the Subsidiary firm may have been adjusted for in both the books i.e. the Subsidiary and Holding company. In this case adjustment is made in the books of the Subsidiary company. In the books of the Holding company the dividend that are receivable fro the Subsidiary company will be credited to Profit and Loss Account of the Holding company (in terms of income receivable on investments).It is possible that these dividends have been paid by the subsidiary firm out of Capital profit, revenue profit, combination of both profit

   (i) If dividend of subsidiary company have been declared totally out of capital profit, then it is incorrect that this capital income should stand credited to the revenue P/L Account of the holding company. Therefore one adjustment entry is made for remaining dividend from the P/L Account of the holding company and they are transferred to cost of control.

   P/L Account (H Ltd.) Dr.

   To Cost of control/Investment Account

   With the amount of dividend receivable from the Subsidiary firm

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

   (iii) The dividend receivable by Holding Company may be partly out of capital profit or out of revenue profit of Subsidiary company. The portion paid out of capital profit will be eliminated form P/L Account of Holding company and transferred to cost of control with respect to the portion of the dividend receivable out of revenue profit no adjustment is required. With respect to the minorities irrespective of the dividend declared by the Subsidiary company being payable out of capital profit or revenue profit will be added to minority interest.

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 addition 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 cost of control.

Share Premium:

The share premium account may appear in the Balance Sheet of the Holding company at the time of consolidation. It will continue as share premium account. However if the holding company has issued some of its own shares to the subsidiary company the share premium due on this share will be adjusted for in the cost of control. If share premium appears in the books of subsidiary company, it may be prior to the acquisition of shares by the holding company in which case it is treated as capital profit in the analysis of profit. However, the share premium arises after acquisition of share by H company it will continue as share premium in the consolidated Balance Sheet.

Preliminary Expenses:

If the Holding company has preliminary expenses they continue as such. If subsidiary company has preliminary expenses they may be treated as a capital loss in the analysis of profit or clubbed with preliminary expenses of Holding company.

Provision for Taxation:

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

Sale of Share:

The holding company may sell some of the share of the subsidiary company that it holds as investment. The P/L on such sale is transfer to cost of control. This changes the proportion of the Holding company and minority interest and requires adjustment in calculation of cost of control, minority interest and an analysis of profit will have to be performed.

Purchase of shares in instalments:

The Holding company may acquire shares in the subsidiary firm not in once single instalment but in a number of instalments. If the earlier dates of the acquisition may be ignored. If however, shares have been acquired in major instalments, a step by step analysis of profit after taking into consideration the dates of acquisition will have to be performed in the analysis of profit between capital and revenue.

Debentures:

The subsidiary and the holding may have issued debentures at time of consolidation of Balance Sheet. These will be added and continued to appear in the debenture account in the consolidated Balance Sheet. However, if some portion of these debentures are held by the holding company or subsidiary company, this will be dedicated from the investment account on the asset side and the debentures account on the liabilities side at the time of consolidation.

Goodwill:

A goodwill account may appear in the books of Subsidiary and Holding at the time of consolidation. The aggregate goodwill be the total of these goodwill and will be adjusted for any goodwill or capital reserve that appear in the cost of control.

Interim Dividend:

When a dividend is paid in between an accounting year i.e, prior to completion of final accounts, it is termed as interim dividend. The general presumption with respect to this dividend is that it has been paid i.e, it has been adjusted for in the books of Holding and Subsidiary. No adjustment required with respect to minorities however, with respect to the Holding company, if capital profit have been employed for making dividend payment to the extent (wholly or partly) it will go to the cost of control from the P/L Account of Holding company.

A. PRELIMINARIES OF CONSOLIDATION

Illustration 1: Analysis of Balances in Reserves

Following are the balances in various reserves of P. Ltd., subsidiary of V Ltd. as on the date of controlling acquisition and the date of consolidation -

Accounts	Date of Acquisition (₹)	Date of Consolidation (₹)
General Reserve	60,000	1,20,000
Profit and Loss Account	25,000	80,000
Capital Redemption Reserve	40,000	55,000
Securities Premium	45,000	45,000
Capital Reserve	5,000	25,000
Preliminary Expenses	5,000	1,000
Underwriting Commission	10,000	5,000

Additional information -

1. One year after the date of controlling acquisition, P. Ltd. had issued Bonus Shares for ₹ 60,000 utilizing the balances in Capital Reserve and Capital Redemption Reserve in full, and sourcing the balance from General Reserve. The Director's did not utilize the balance in Securities Premium for this purpose.
2. In the intervening period, Preference Share Capital had been redeemed at a Premium of ₹ 12,000. For statutory Compliance, a sum of ₹ 40,000 had been transferred to Capital Redemption Reserve and a further sum of ₹ 15,000 had been transferred upon redemption of Debentures, which were also redeemed at a Premium of ₹ 10,000.
3. To finance its redemption of Preference Capital, P Ltd. had issued Equity Capital at a Premium. The balance of ₹ 5,000 against Underwriting Commission is incurred in this regard.
4. The Company has been writing off balances in Underwriting Commission A/c and Preliminary Expenses against balance in Securities Premium Account. The balance in Preliminary Expenses as on consolidation date is the amount as on acquisition date not yet written off.
5. P. Ltd. had declared Equity and Preference Dividend of ₹ 20,000 out of its P&L A/c balance as on date of acquisition.

How would the above balances as on date of consolidation be analyzed and classified for the purposes of consolidation?

Solution:

1. General Reserve

Balance as on Consolidation ₹1,20,000

	Date of Acquisition	₹60,000	Acquisition to Consolidation
Less:	Bonus Issue (60,000 - trfd. from Cap. Res. 5,000 - trfd. from CRR 40,000)	₹15,000	(balancing figure) ₹ **75,000**
	Balance **Capital Reserve**	**45,000**	**Revenue Reserve**

2. Profit and Loss A/c

Balance as on Consolidation ₹80,000

	Date of Acquisition	₹25,000	Acquisition to Consolidation
Less:	Dividend out of this	₹20,000	(balancing figure) ₹ **75,000**
	Balance **Capital Reserve**	₹**5,000**	**Revenue Profit**

3. Capital Redemption Reserve
Balance as on Consolidation ₹55,000

	Date of Acquisition	₹40,000	Acquisition to Consolidation
Less:	Bonus Shares	₹40,000	(balancing figure) ₹ 55,000
	Balance **Capital Profit**	**NIL**	

Redemption of Pref. Capital	Redemption of Debentures
₹ **40,000**	₹ **15,000**
Capital Redemption Reserve	**Capital Redemption Reserve**

4. Securities Premium
Balance as on Consolidation ₹45,000

	Date of Acquisition	₹45,000	Acquisition to Consolidation
Less:	Premium on Redemption of Pref. Capital	₹(12,000)	Premium on Fresh Issue of Capital
Less:	Premium on Redemption of Debentures	₹(10,000)	(balancing figure) ₹ **36,000**
Less:	Underwriting Commission and Prelim Exp. written off (10,000 + 4,000)	₹(14,000)	**Securities Premium**
	Balance **Capital Profit**	₹**9,000**	

5. Capital Reserve
Balance as on Consolidation ₹25,000

	Date of Acquisition	₹5,000	Acquisition to Consolidation
Less:	Bonus Shares	₹5,000	(balancing figure) ₹ **25,000**
	Balance **Capital Profit**	**NIL**	**Capital Reserve**

6. Preliminary Expenses
Balance as on Consolidation ₹1,000

	Date of Acquisition	₹5,000	Acquisition to Consolidation
Less:	Written off against Securities Prem.	₹4,000	(balancing figure) ₹ **NIL**
	Balance **Capital Profit**	₹**1,000**	**Preliminary Expenses**

7. Underwriting Commission
Balance as on Consolidation ₹5,000

	Date of Acquisition	10,000	Acquisition to Consolidation
Less:	Written off against Securities Prem.	10,000	₹ **5,000**
	Balance **Capital Profit**	**NIL**	**Underwriting Commission**

Summary

Accounts (1)	Balance on DOC (2) ₹	Considered Capital Profit (3) ₹	Balance considered as such (4) ₹
General Reserve	1,20,000	45,000	75,000
Profit and Loss Account	80,000	5,000	75,000
Capital Redemption Reserve	55,000	NIL	55,000
Securities Premium	45,000	9,000	36,000
Capital Reserve	25,000	NIL	25,000
Preliminary Expenses	1,000	1,000	NIL
Underwriting Commission	5,000	NIL	5,000

Note: In the course of consolidation, the amounts in Col. (3) and (4) shall be apportioned to Holding Company (P Ltd.) and Minority Interest (of V Ltd.) in the ration of their shareholding.

Illustration 2: Analysis of Reserves – Adjustment for Abnormal Loss, Dividend, etc.

A Ltd. Acquired 80% interest in B Ltd. On 01.10.2014. A Ltd is in the process of preparing its Consolidated Financial Statement as on 31.03.2016. The details of Profit and Loss A/c balances of B Ltd. Is as under –

- Balance on 01.04.2014 ₹ 6,000
- Profit for 2014-15 ₹ 10,000 (before Equity Dividend)
- Balance on 31.03.2016 ₹ 33,800

In Julyl 2014, B Ltd. Lost stocks costing ₹ 1,550 due to riots. The Insurance Company admitted a claim of ₹ 650 only.

In November 2015, A. Ltd. Received ₹ 9,600 as Dividend from B Ltd. In respect of the year ending 31.03.2015. B Ltd. has proposed a dividend of ₹ 15,000 for the year ending 31.03.2016.

During 2015-16, B Ltd. had purchased shares of Maya Ltd cum –dividend for ₹ 34,500. B Ltd. received a dividend of ₹ 7,500 on this investment, which was credited to its Profit and Loss Account. A provision for outstanding expenses of ₹ 1,700 provided during the year was considered excessive. The balance in Profit and Loss Account as on 31.03.2016 is after providing for the expenses.

Analyze the balance in Profit and Loss Account as Capital and Revenue for the purposes of Consolidation.

Solution:

Analysis of Profit and Loss Account

		₹
	Balance as given on 31.03.2016	33,800
Less:	Pre-Acqn. Dividend from Maya Ltd.	(7,500) (to credit Investment in Maya A/c)
Less:	Proposed Dividend for 2015-16	(15,000)
Add:	Excess Provision to be written back	1,700 (to debit Outstanding Expenses A/c)
	Corrected Balance as at 31.03.2016	**13,000**

01.04.2014
₹ 6,000
Capital Profit

Profit for 2014-15 10,000
Add: Abnormal Loss 900
Profit without abnormal losses 10,900

- 01.04.2014 to 01.10.2014: 5,450
  Less: Abnormal Loss (900)
  Bal. Capital Profit 4,550
- 01.10.2014 to 31.03.2015: 5,450 Revenue

Dividend for 2014-15
Recd. By A 9,600 for 80%
Total Dividend = 9,600÷80 % = (₹12,000)

- From Opg Bal. (bal. figure) (₹ 2,000) Capital
- From Profit for 01.04.2014 to 01.10.2014 (₹ 4,550) Capital
- From Profit for 01.10.2014 to 31.03.2015 (₹ 5,450) Revenue

Profit for 2015-16
₹ 9,000
Revenue (bal. fig.)
(1,30 – Opg. 60 – Pft for 2014-16 1,00 + Dividend 1,20) (fig in '00)

Total Capital Profit: 6,000 + 4,550 – 2,000 – 4,550 = ₹ 4,000;

Total Revenue Profit: 9,000 + 5,450 – 5,450 = ₹ 9,000

Abnormal Loss = Stock Loss is Riots ₹ 1,550 (-) Insurance Claim received ₹ 650 = ₹ 900

Note:

- It has been assumed that the Profit arose evenly throughout the year.
- Dividend declared for 2014-15 = ₹ 12,000, but profit for 2014-15 is ₹ 10,000. So it is presumed that balance of ₹ 2,000 has been declared from the opening reserve.

Illustration 3: Cost of Investment - Share Split

A Ltd. acquired 5,000 Shares of S Ltd. at ₹ 48 per Share cum-Dividend constituting 62.50% holding in the latter. Immediately after purchase, S Ltd. declared and distributed a dividend at ₹ 4 per Share, which S Ltd. credited to its Profit and Loss Account.

One year later, S Ltd. declared a Bonus of 1 fully paid Equity Share of ₹ 10 each for every 5 Shares held. Later on, S Ltd. proposed to raise funds and made a Rights Issue of 1 Share for 5 held at ₹ 36 per Share. A Ltd. exercised its right.

After some time, at its AGM, S Ltd. had decided to split its Equity Share of ₹ 10 into Two Equity Shares of ₹ 5 each. The necessary resolutions were passed and share certificates issued to all its existing shareholders.

To increase its stake in S Ltd. to 80%, A Ltd. acquired sufficient number of shares at ₹ 30 each.

Ascertain the Cost of Control as on 31st March if S's share in Capital Profits (duly adjusted for purchase in lots) as on that date was ₹ 3,15,000.

Solution: **1. Cost of Investment**

	Particulars		Shares	₹
	Cost of First Acquisition	(5,000 x ₹ 48)	5,000	2,40,000
Less:	Pre-Acquisition Dividend	(5,000 × ₹ 4 per Share)	N.A.	(20,000)
	Corrected Cost of Investment		5,000	2,20,000
Add:	Bonus Shares	(1/5 × 5,000 Shares)	1,000	–
	Cost after Bonus Shares		6,000	2,20,000
Add:	Rights Shares	(1/5 x 6,000 Shares x ₹ 36)	1,200	43,200
	Cost after Rights Issue before Share Split		**7,200**	**2,63,200**
	Cost after share split (WN 1)	(2 Sh. for 1 for 7,200 Sh = 7,200 x 2)	14,400	2,63,200
Add:	Acquisition to increase holding to 80% (WN 2)	(4,032 x ₹ 30)	4,032	1,20,960
	Balance on date of Consolidation		**18,432**	**3,84,160**

Notes:

- **Share Split:** In case of Share Split, the Cost of Acquisition will not undergo any change. Only the number of Equity Shares and the face value will change. This is similar to adjustment for Bonus Issue. However, for Bonus Issue, the face value and paid up value of the share will be the same as the original share. In share split, the face value and paid up value will be lesser than that of the original shares.
- **Calculation of Number of Shares to be acquired to increase stake to 80%**

	Particulars			Shares
a.	Shares held before acquisition			14,400
b.	% of holding			62.5%
c.	Hence, Total Number of Shares of S Ltd.	(a ÷ b)	= (14,400 ÷ 62.50%)	23,040
d.	80% of above	(c x 80%)	= (23,040 x 80%)	18,432
e.	Number of Shares to be acquired	(d - a)	= (18,432 - 14,400)	4,032

2. Cost of Control

Particulars		₹
Cost of Investment	**(A)** (from 1 above)	**3,84,160**
Nominal Value of Equity Capital	(18,432 x ₹ 5 per Share)	92,160
Share in Capital Profit		3,15,000
Total of Above	**(B)**	**4,07,160**
Capital Reserve (if B < A)	**(B-A)**	23,000

Illustration 4: Cost of Control - For different Investment Costs

C Ltd. has acquired 50,000 Shares of ₹ 10 each in A Ltd. constituting 62.5% of the latter's Equity. On the same day, C. Ltd. had also acquired 10,000 8% Preference Shares of ₹ 20 each.

The balances in Reserves of A Ltd. are -

Capital Reserve	₹ 60,000	(Fully Pre Acquisition)
Securities Premium	₹ 15,000	(Fully Post Acquisition)
General Reserve	₹ 78,000	(30% Pre Acquisition 70% Post Acquisition)
Profit and Loss A/c	₹ 90,000	(50% Pre Acquisition 50% Post Acquisition)

Ascertain the cost of control if total cost of investment is (a) ₹ 7,50,000; (b) ₹ 8,50,000; and (c) ₹ 10,00,000.

Solution:

1. Determination of Capital Profit

Reserve Account	Total (₹)	Pre Acquisition Capital Profit (₹)	Post Acquisition Revenue Profit (₹)
Capital Reserve	60,000	60,000	—
Securities Premium	15,000	—	15,000
General Reserve	78,000	23,400 (30% x ₹ 78,000)	54,600 (70% x ₹ 78,000)
Profit and Loss Account	90,000	45,000 (50% x ₹ 90,000)	45,000 (50% x ₹ 90,000)
Total	**₹ 2,43,000**	**₹ 1,28,400**	**₹ 1,14,600**
Share of C Ltd. (62.5% of above)		**₹ 80,250**	**₹ 71,625**

2. Cost of Control

Particulars		₹	₹	₹
Cost of Investment	**(A)**	**7,50,000**	**8,50,000**	**10,00,000**
Nominal Value of Equity Capital	(50,000 x ₹ 10)	5,00,000	5,00,000	5,00,000
Nominal Value of Preference Capital	(10,000 x ₹ 20)	2,00,000	2,00,000	2,00,000
Share in Capital Profit		80,250	80,250	80,250
Total of Above	**(B)**	**7,80,250**	**7,80,250**	**7,80,250**
Goodwill (if A > B)	**(A-B)**	**—**	**69,750**	**2,19,750**
Capital Reserve (if B < A)	**(B-A)**	**30,250**	**—**	**—**

Illustration 5: Cost of Control - For Ex-Dividend and Cum-Dividend Acquisition

D Ltd. has made the following investments in S Ltd. a few years before –

1. 6,000 Equity Shares of ₹ 10 each at ₹ 1,50,000.
2. 200 12% Preference Shares of ₹ 100 each at ₹ 30,000.
3. 500 10% Debentures at ₹ 95 per Debenture.

The Capital Profits of S Ltd. have been ascertained at ₹ 96,000.

Determine the cost of control, under the following situations –

1. Shares were purchased Cum-Dividend and Equity Dividend was declared at 20% and the dividends were
   (a) Credited to Profit and Loss Account
   (b) Credited to Investment Account
2. Shares were purchased Ex-Dividend and Equity Dividend was declared at 20% and the dividends were
   (a) Credited to Profit and Loss Account
   (b) Credited to the Investment Accounts

Solution:

1. Cost of Control

Particulars	Cum-Dividend		Ex-Dividend	
Credited to	**P&L A/c**	**Invt. A/c**	**P&L A/c**	**Invt. A/c**
Cost of Investment				
Equity Capital	1,50,000	1,50,000	1,50,000	1,50,000
Preference Capital	30,000	30,000	30,000	30,000
Total Cost of Investment	1,80,000	1,80,000	1,80,000	1,80,000
Adjustment for Dividend out of Pre–Acquisition Profits				
Less: Only for Cum Dividend Purchase				
Preference Dividend (12% x ₹ 20,000)	(2,400)	–	N.A.	N.A.
Equity Dividend (20% x ₹ 60,000)	(12,000)	–	N.A.	N.A.
Add: Only for Ex-Dividend Purchase				
Preference Dividend (12% x ₹ 20,000)	N.A.	N.A.	–	2,400
Equity Dividend (20% x ₹ 60,000)	N.A.	N.A.	–	12,000
Corrected Cost of Investment (A)	**1,65,600**	**1,80,000**	**1,80,000**	**1,94,400**
Nominal Value of Equity Capital (6,000 x ₹ 10)	60,000	60,000	60,000	60,000
Nominal Value of Pref. Capital (200 x ₹ 100)	20,000	20,000	20,000	20,000
Share in Capital Profit	96,000	96,000	96,000	96,000
Total of Above (B)	**1,76,000**	**1,76,000**	**1,76,000**	**1,76,000**
Goodwill (if A > B) (A - B)	**–**	**4,000**	**4,000**	**18,400**
Capital Reserve (if B < A) (B - A)	**10,400**	**–**	**–**	**–**

Note: Investment in Debentures are not considered for determining Cost of Control since as per AS 21, Cost of Control is required to be determined only to the extent of share in the Equity of the Subsidiary i.e. Shareholders Networth. Debentures are excluded in computing Shareholders Networth and hence should not be considered in the determining Cost of Control. Gain or Loss on elimination of mutually held Debentures in the consolidation process will be adjusted against Group Reserves.

Illustration 6: Minority Interest

X Ltd. acquired 75% of the Equity Shares of Y Ltd. From the following extract Balance Sheet as at 31st March of Y Ltd. and additional information furnished, determine Minority Interest in Y Ltd. as on Balance Sheet date

Liabilities	₹	Assets	₹
Share Capital:		**Fixed Assets:**	
Equity Capital (₹ 100)	20,00,000	(Net Block) (Tangible)	40,00,000
Reserves:		**Current Assets:**	
Securities Premium	3,00,000	Stock in Trade	20,00,000
General Reserve	7,00,000	Debtors	12,00,000
Profit and Loss Account	12,00,000	Other Current Assets	8,00,000
Current Liabilities:			
Creditors	14,00,000		
Bank Overdraft	24,00,000		
Total	**80,00,000**	**Total**	**80,00,000**

When X Ltd. acquired shares, balances in Reserves of Y Ltd. were as under - (a) Securities Premium ₹3,00,000; (b) General Reserve ₹ 1,00,000; (c) Profit and Loss Account ₹ 4,00,000.

Solution:

1. Basic Information

Company Status		Dates		Holding Status	
Holding Company	= X	**Acquisition:**	Not Available	Holding Company	= 75%
Subsidiary	= Y	**Consolidation:**	31st March	Minority Interest	= 25%

2. Analysis of Reserves and Surplus of Y Ltd.

(a) Securities Premium

Balance as per Balance Sheet ₹ 3,00,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **3,00,000**	(balancing figure) ₹ **NIL**
Capital Profit	**Securities Premium**

(b) General Reserve

Balance as per Balance Sheet ₹ 7,00,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **1,00,000**	(balancing figure) ₹ **6,00,000**
Capital Profit	**Revenue Reserve (General Reserve)**

(c) Profit and Loss Account

Balance as per Balance Sheet ₹ 12,00,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **4,00,000**	(balancing figure) ₹ **8,00,000**
Capital Profit	**Revenue Profit (P&L A/c)**

3. Analysis of Net Worth of Y Ltd.

Particulars		Total	Share of X Ltd.	Minority Interest
		100%	75%	25%
(a) Equity Share Capital		**20,00,000**	15,00,000	5,00,000
(b) Capital Profits	Securities Premium	3,00,000		
	General Reserve	1,00,000		
	Profit & Loss Account	4,00,000		
	Total	**8,00,000**	6,00,000	2,00,000
(c) Revenue Reserves	General Reserve	**6,00,000**	4,50,000	1,50,000
(d) Revenue Profits	Profit & Loss A/c	**8,00,000**	6,00,000	2,00,000
Minority Interest				**10,50,000**

Illustration 7: Minority Interest - Investment in Preference Capital

J Ltd. acquired 60% of the Equity Shares and 35% of Preference Shares of K Ltd. The Extract Balance Sheet of K Ltd. as on 31st March is as under —

Liabilities		₹	Assets		₹
Share Capital:	Equity Capital (₹ 100)	3,75,000	**Fixed Assets:**	(Net Block - Tangible)	5,50,000
	Pref. Capital (₹ 100)	2,50,000	**Current Assets:**	Stock In Trade	1,70,000
Reserves:	Capital Reserve	37,500		Debtors	1,87,500
	General Reserve	1,70,000		Other Current Assets	67,500
	Profit and Loss Account	42,500	**Miscellaneous Expenditure:**		
Current Liabs:	Creditors	1,25,000		Preliminary Expenses	25,000
	Total	**10,00,000**		**Total**	**10,00,000**

When J Ltd. acquired shares, balances in Reserves of K Ltd. were as under – (a) Capital Reserve ₹ 20,000; (b) General Reserve ₹ 45,000; (c) Profit and Loss Account ₹ 67,500; (d) Preliminary Expenses ₹ 25,000. Determine Minority Interest for the purpose of Consolidation.

Solution:

1. Basic Information

Company Status		Dates		Holding Status	
Holding Company	= J Ltd.	**Acquisition:**	Not Available	Holding Company	= 60%
Subsidiary	= K Ltd.	**Consolidation:**	31st March	Minority Interest	= 40%

2. Analysis of Reserves and Surplus of J Ltd.

(a) Capital Reserve

Balance as per Balance Sheet ₹ 37,500

Balance on date of acquisition	Acquisition to Consolidation
₹ **20,000**	(balancing figure) ₹ **17,500**
Capital Profit	**Capital Reserve**

(b) General Reserve

Balance as per Balance Sheet ₹ 1,70,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **45,000**	(balancing figure) ₹ **1,25,000**
Capital Profit	**Revenue Reserve (General Reserve)**

(c) Profit and Loss Account

Balance as per Balance Sheet ₹ 42,500

Balance on date of acquisition	Acquisition to Consolidation
₹ **67,500**	(balancing figure) **(₹ 25,000)**
Capital Profit	**Revenue Profit (P&L A/c)**

(d) Preliminary Expenses

Balance as per Balance Sheet ₹ 25,000

Balance on date of acquisition	Acquisition to Consolidation
(₹ 25,000)	(balancing figure) ₹ **NIL**
Capital Profit	**Preliminary Expenses**

3. Analysis of Net Worth of K Ltd.

Particulars		Total	Share of J. Ltd.	Minority Interest
		100%	**60%**	**40%**
(a) Equity Share Capital		**3,75,000**	2,25,000	1,50,000
(b) Pref. Share Capital	**[35 : 65]**	**2,50,000**	87,500	1,62,500
(b) Capital Profits	Capital Reserve	20,000		
	General Reserve	45,000		
	Profit & Loss Account	67,500		
	Preliminary Expenses	(25,000)		
Total		**1,07,500**	64,500	43,000
(c) Capital Reserve		**17,500**	10,500	7,000
(c) Revenue Reserves	General Reserve	**1,25,000**	75,000	50,000
(d) Revenue Profits	Profit & Loss A/c	**(25,000)**	(15,000)	(10,000)
Minority Interest				**4,02,500**

Illustration 8: Elimination of Unrealized Profits – Stock Movement

From the following information determine the amount of unrealized profits to be eliminated and the apportionment of the same, if C Ltd. holds 75% of the Equity Shares of D Ltd. -

1. Sales by C Ltd. to D Ltd. -
   (a) Goods costing ₹ 5,00,000 at a profit of 20% on Sale Price. Entire stock were lying unsold as on the Balance Sheet date.
   (b) Goods costing ₹ 7,00,000 at a profit of 25% on Cost Price. 40% of the goods were included in closing stock of D.
2. Sales by D Ltd. to C Ltd. -
   (a) Goods sold for ₹ 7,50,000 on which D made profit of 25% on Cost. Entire stock were at C's godown as on the Balance Sheet date.
   (b) Goods sold for ₹ 9,00,000 on which D made profit of 15% on Sale Price. 70% of the value of goods were included in closing stock of C.

Solution:

Transaction	Sale by C Ltd. (Holding) to D Ltd. (Subsidiary)	
Nature of Transaction	Downstream Transaction	
Profit on Transfer	Cost ₹ 5,00,000 x Profit on Sale 20% ÷ Cost on Sale 80% = ₹ **1,25,000**	Cost ₹ 7,00,000 x Profit on Cost 25% = ₹ **1,75,000**
% of Stock included in Closing Stock	100%	40%
Unrealized Profits to be eliminated (transferred to Stock Reserve)	₹ 1,25,000 x 100% = ₹ **1,25,000**	₹ 1,75,000 x 40% = ₹ **70,000**
Share of **Majority** - Reduced from Group Reserves	100% x ₹ 1,25,000 = ₹ **1,25,000**	100% x ₹ 70,000 = ₹ **70,000**
Share of Minority	(Unrealized Profit on Downstream Transactions is fully adjusted against Group Reserves. Minority Interest is not relevant)	

Transaction	**Sale by D Ltd. (Subsidiary) to C Ltd. (Holding)**	
Nature of Transaction	Upstream Transaction	
Profit on Transfer	Sale ₹ 7,50,000 x Profit on Cost 25% ÷ Sale to Cost 125% = ₹ **1,50,000**	Sale ₹ 9,00,000* Profit on Cost 15% = ₹ **1,35,000**
% of Stock included in Closing Stock	100%	70%
Unrealized Profits to be eliminated (reduced from Closing Stock)	₹ 1,50,000 x 100% = ₹ **1,50,000**	₹ 1,35,000 x 70% = ₹ **94,500**
Share of Majority - Reduced from Group Reserves	Share of Majority 75% x Unrealized Profits ₹ 1,50,000 = ₹ **1,12,500**	Share of Majority 75% x Unrealized Profits ₹ 94,500 **= ₹ 70,875**
Share of Minority - Reduced from Minority Interest	Share of Minority 25% x Unrealized Profits ₹ 1,50,000 = ₹ **37,500**	Share of Minority 25% x Unrealized Profits ₹ 94,500 = ₹ **23,625**

Illustration 9: Elimination of Unrealized Profits - Transfer of Assets

In each of the following cases, ascertain (a) Unrealized Profits to be eliminated; (b) Unrealized Profits adjusted against Holding Company's Reserve and Minority Interest; and (c) balance in Asset Account as appearing in the Consolidated Balance Sheet –

(a) A Machine costing ₹ 3,50,000 has been sold by Z Ltd. to its subsidiary F Ltd. for ₹ 4,20,000. During the year F Ltd. has charged depreciation of ₹ 35,000 on the machinery. Z Ltd. holds 80% of the Equity of F Ltd. Machinery Account balance as appearing in the books of Companies - Z Ltd. ₹ 9,57,500; F Ltd. ₹ 6,85,000.

(b) C Ltd. sold 8 Workstations to its parent S Ltd. at ₹ 25,000 each. The total cost of the Workstations to C was ₹ 97,500. S holds 70% of the Equity Capital in C. The balances in the Asset Account "Computer and Peripherals" were – C ₹ 2,50,000; S ₹ 5,00,000. Depreciation at 30% was charged by S on the Workstations purchased from C.

Solution:

Sold by	**Z Ltd. (Holding Co.)**	**C Ltd. (Subsidiary Co.)**
Purchased by	F Ltd. (Subsidiary Co.)	S Ltd. (Holding Co.)
Nature of transfer	Downstream Transfer	Upstream Transfer
Sale Price **Less:** Cost to Seller	₹ 4,20,000 ₹ 3,50,000	₹ 25,000 x 8 = ₹ 2,00,000 ₹ 97,500
A. Profit on Transfer	₹ 70,000	₹ 1,02,500
B. Rate of Depreciation	35,000/4,20,000 = 8.33%	30%
C. Depn. on profit element (A × B)	70,000 x 8.33% = ₹ 5,831	1,02,500 x 30% = ₹ 30,750
Unrealized Profit to be eliminated (A - C)	**₹ 64,169**	**₹ 71,750**
- Adjusted against Holding Co's Reserves	100% x ₹ 64,169 = ₹ **64,169**	Share of Holding Co. 70% x ₹ 71,750 = ₹ **50,225**
- Adjusted against Minority Interest	Unrealized profits on downstream transfer are adjusted fully against Group Reserves only	Share of Minority 30% x ₹ 71,750 = ₹ **21,525**
Consolidated Asset Balance (Holding Co. bal. + Subsidiary Co. bal. **Less** Unrealized Profit)	9,57,500 + 6,85,000 - 64,169 = ₹ **15,78,331**	2,50,000 + 5,00,000 - 71,750 = ₹ **6,78,250**

Illustration 10: Elimination of Mutual Owings

The following balances are extracted from the Balance Sheets of X Ltd. and Y Ltd. -

Particulars	**X Ltd. (₹)**	**Y Ltd. (₹)**
Bills Payable	7,50,000	4,50,000
Trade Creditors	5,00,000	7,00,000
Bills Receivable	3,50,000	5,00,000
Trade Debtors	8,00,000	7,00,000
Contingent Liability for Bills Discounted	2,00,000	1,50,000

Additional Information –

1. X Ltd. is wholly owned subsidiary of Y Ltd.
2. Creditors of X Ltd. include ₹ 2,50,000 due to Y Ltd. for goods supplied by it for ₹ 3,00,000. Debtors of Y Ltd. however shows a Debit balance of ₹ 3,00,000 due from X. X had remitted ₹ 50,000 by Demand Draft to Y which was not received by Y on the Balance Sheet date.
3. Bills payable of 'X' include ₹ 3,00,000 drawn in favour of Y Ltd. Y had discounted bills worth ₹ 1,20,000 with its bankers.

Determine how the above given balances will be disclosed in the Consolidated Balance Sheet of Y Ltd.

Solution:

Particulars	Bills Payable	Bills Receivable	Creditors	Debtors	Contingent Liabilities
Y Ltd.	7,50,000	3,50,000	5,00,000	8,00,000	2,00,000
X Ltd.	4,50,000	5,00,000	7,00,000	7,00,000	1,50,000
Total before adj. Mutual Owings	**12,00,000**	**8,50,000**	**12,00,000**	**15,00,000**	**3,50,000**
Less: Mutual Owings					
– For goods supplied	–	–	(2,50,000)	(3,00,000)	–
– Bills drawn in favour of Y (Only to the extent not discounted is reduced) (3,00,000-1,20,000)	(1,80,000)	(1,80,000)	–	–	–
– Bills discounted (Only mutual bills discounted is reduced)	–	–	–	–	(1,20,000)
Balance for CBS	**10,20,000**	**6,70,000**	**9,50,000**	**12,00,000**	**2,30,000**

Note: *In addition to the above, in the Consolidated Balance Sheet, ₹ 50,000 will be shown as "Remittance-in Transit" under Current Assets after Trade Debtors and Bills Receivable.*

Illustration 11: Consolidated Balance Sheet – Line to Line Addition

From the Extract Balance Sheets and information given below, prepare Consolidated Balance Sheet of A Ltd. and K Ltd. as at 31st March, 2015 -

Liabilities	A (₹)	K (₹)	Assets		A (₹)	K (₹)
Equity Capital (₹ 10)	30,000	20,000	Fixed Assets (Tangible)		20,000	15,000
General Reserve	5,000	5,000	Investment in Shares of K		16,000	–
8% Debentures	10,000	5,000	Current Asset:	Stock in Trade	8,000	10,000
Creditors	5,000	5,000		Debtors	4,000	7,000
				Cash & Bank	2,000	3,000
Total	**50,000**	**35,000**	**Total**		**50,000**	**35,000**

A Ltd. holds 80% of Equity Shares in K since its incorporation. Prepare Consolidated Balance Sheet.

Solution:

1. Basic Information

Company Status		Dates		Holding Status	
Holding Co.	= A	**Acquisition:**	K's Incorporation	Holding Company	= 80%
Subsidiary	= K	**Consolidation:**	31st March	Minority Interest	= 20%

2. Analysis of General Reserves of K Ltd.

Balance as per Balance Sheet ₹ 5,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **NIL**	(balancing figure) ₹ **5,000**
Capital Profit	**Revenue Reserve**

Note: *Since A holds shares in K since its incorporation, the entire Reserve balance will be Revenue.*

3. Analysis of Net Worth of K Ltd. (₹ '000)

Particulars	Total	A 80%	Minority 20%
(a) Equity Share Capital	20,000	16,000	4,000
(b) Capital Profits	NIL	–	–
(c) Revenue Reserve (General Reserve)	5,000	4,000	1,000
Minority Interest			**5,000**

4. Cost of Control

Particulars		₹
	Cost of Investment	16,000
Less:	Nominal Value of Equity Capital	(16,000)
Less:	Share of Capital Profits	NIL
	Goodwill / Capital Reserve	**NIL**

Note: *If shares are purchased and held from the date of incorporation of subsidiary, there will not be any Goodwill or Capital Reserve.*

5. Consolidation of Reserves

Particulars	₹
Balance as per Balance Sheet	5,000
Add: Share of Revenue Reserves	4,000
Consolidated Balance	**9,000**

Name of the Company: A Ltd. And its subsidiary K. Ltd.

Consolidated Balance Sheet as at 31st March, 2015

Ref No.		Particulars	Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 100 each		30,000.00	-
		(b) Reserves and surplus	1	9,000.00	-
				39,000.00	-
	2	**Minority Interest**		5,000.00	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings (8% Debenture)	2	15,000.00	-
				15,000.00	-
	5	**Current liabilities**			
		(a) Trade payables	3	10,000.00	-
				10,000.00	-
		TOTAL (1+2+3+4+5)		69,000.00	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	35,000.00	-
				35,000.00	-
	2	**Current assets**			
		(a) Inventories	5	18,000.00	-
		(b) Trade receivables	6	11,000.00	-
		(c) Cash and cash equivalents	7	5,000.00	-
				34,000.00	-
		TOTAL (1+2)		69,000.00	-

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

Note 1. Reserve & Surplus (₹ '000)

	Current Year	Previous Year
General Reserve	9,000	-
	9,000	-

Note 2. Long term Borrowings :- (₹ '000)

	Current Year	Previous Year
8% Debentures		
- A Ltd	10,000.00	-
- K Ltd	5,000.00	-
	15,000.00	-

Note 3. Trade Payable :-

	Current Year	Previous Year
- A Ltd	5,000.00	-
- K Ltd	5,000.00	-
	10,000.00	-

Note 4. Tangible Assets:-

	Current Year	Previous Year
- A Ltd	20,000.00	-
- K Ltd	15,000.00	-
	35,000.00	-

Note 5. Inventories :-

	Current Year	Previous Year
- A Ltd	8,000.00	-
- K Ltd	10,000.00	-
	18,000.00	-

Note 6. Trade Receivable :-

	Current Year	Previous Year
- A Ltd	4,000.00	-
- K Ltd	7,000.00	-
	11,000.00	-

Note 7. Cash and cash Equivalent :-

	Current Year	Previous Year
- A Ltd	2,000.00	-
- K Ltd	3,000.00	-
	5,000.00	-

Illustration 12: Consolidated Balance Sheet – Investment in Debentures – Line Addition

The Extract Balance Sheets of S Ltd. and B Ltd. as at 31st March, 2015 are given below –

Liabilities	S	B	Assets	S	B
Equity Capital (₹ 10)	60,00,000	30,00,000	Fixed Assets (Tangible)	60,00,000	35,00,000
General Reserve	15,00,000	10,00,000	Investment		
Profit and Loss Account	10,00,000	5,00,000	- in 24,000 Shares of B	26,00,000	–
8% Debentures (₹ 100)	20,00,000	10,00,000	- in 500 Debentures of B	6,00,000	–
Bills Payable	6,00,000	7,00,000	- in 1000 Debentures of S	–	9,50,000
Creditors	9,00,000	8,00,000	Current/asset Stock in Trade	10,00,000	12,00,000
			Debtors	15,00,000	10,00,000
			Cash & Bank	3,00,000	3,50,000
Total	**1,20,00,000**	**70,00,000**	**Total**	**120,00,000**	**70,00,000**

The investments in B Ltd. were made on the same day when B's General Reserve was ₹ 5,00,000 and Profit and Loss Account balance showed ₹ 2,00,000.

Prepare Consolidated Balance Sheet.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Co. = S Subsidiary = B	**Acquisition:** Not Given **Consolidation:** 31st March	Holding Company (240,000 ÷ 300,000) = 80% Minority Interest = 20%

2. Analysis of Reserves and Surplus of B Ltd.

(a) General Reserve

Balance as per Balance Sheet ₹ 10,00,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **5,00,000**	(balancing figure) ₹ **5,00,000**
Capital Profit	**Revenue Reserve**

(b) Profit and Loss A/c

Balance as per Balance Sheet ₹ 5,00,000

Balance on date of acquisition	Acquisition to Consolidation
₹ **2,00,000**	(balancing figure) ₹ **3,00,000**
Capital Profit	**Revenue Reserve**

3. Analysis of Net Worth of B Ltd.

Particulars		Total	S 80%	Minority 20%
(a) **Share Capital**	Equity Share Capital	**30,00,000**	24,00,000	6,00,000
(b) **Capital Profits**	General Reserve	5,00,000		
Profit and Loss Account		2,00,000		
Total		**7,00,000**	5,60,000	1,40,000
(c) **Revenue Reserve**	General Reserve	**5,00,000**	4,00,000	1,00,000
(d) **Revenue Profits**	Profit and Loss Account	**3,00,000**	2,40,000	60,000
Minority Interest				**9,00,000**

4. Cost of Control

Particulars		₹
	Cost of Investment	26,00,000
Less:	Nominal Value of Equity Capital	(24,00,000)
Less:	Share of Capital Profits	(5,60,000)
	Capital Reserve on Consolidation	**(3,60,000)**

5. Gain or Loss on elimination of Intra-Group Debentures

Particulars			₹
	Cost of Investment	S in B	6,00,000
		B in S	9,50,000
Less:	**Total Cost of Investment**		**15,50,000**
	Nominal Value of Debentures	(5,00,000 + 10,00,000)	(15,00,000)
	Loss on Elimination	(Adjusted against Group Reserves)	**50,000**

6. Consolidation of Reserves and Surplus

Particulars		Gen. Res.	P&L A/c
	Balance as per Balance Sheet	15,00,000	10,00,000
Add:	Share of Revenue	4,00,000	2,40,000
Less:	Loss on Elimination of Debentures	–	(50,000)
	Consolidated Balance	**19,00,000**	**11,90,000**

Name of the Company: B Ltd. And its subsidiary S. Ltd.

Consolidated Balance Sheet as at 31st March, 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each		60,00,000	-
		(b) Reserves and surplus	1	34,50,000	-
				94,50,000	-
	2	**Minority Interest**		90,000	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings (8% Debenture)	2	15,00,000	-
				15,00,000	-
	5	**Current liabilities**			
		(a) Trade payables	3	17,00,000	-
		(b) Other current liabilities	4	13,00,000	-
				30,00,000	-
		TOTAL (1+2+3+4+5)		1,48,50,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	95,00,000	-
				95,00,000	-
	2	**Current assets**			
		(a) Inventories	6	22,00,000	-
		(b) Trade receivables	7	25,00,000	-
		(c) Cash and cash equivalents	8	6,50,000	-
				53,50,000	-
		TOTAL (1+2)		1,48,50,000	-

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

Note 1. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	19,00,000	-
Profit and loss	11,90,000	-
Capital reserve on consolidation	3,60,000	-
	34,50,000	-

Note 2. Long term Borrowings :-

	Current Year	Previous Year
20000, 8% Debenture in S	20,00,000	-
10000,8% Debenture in B	10,00,000	-
	30,00,000	-
Less: Mutual Owing	15,00,000	
	15,00,000	-

Note 3. Trade Payables :-

	Current Year	Previous Year
Sudry Creditors		
- S Ltd	900,000.00	-
- B Ltd	800,000.00	-
	1,700,000.00	-

Note 4. Current Liabilities :-

	Current Year	Previous Year
Bills Payable:-		
- S Ltd	6,00,000	-
- B Ltd	7,00,000	-
	13,00,000	-

Note 5. Tangible Assets :-

	Current Year	Previous Year
Fixed Assets		
- S Ltd	60,00,000	-
- B Ltd	35,00,000	-
	95,00,000	-

Note 6. Inventories :-

	Current Year	Previous Year
Stock		
- S Ltd	10,00,000	-
- B Ltd	12,00,000	-
	22,00,000	-

Note 7. Trade Receivable :-

	Current Year	Previous Year
Debtors		
- S Ltd	15,00,000	-
- B Ltd	10,00,000	-
	25,00,000	-

Note 8. Cash and Cash equivqlents :-

	Current Year	Previous Year
Cash & Bank		
- S Ltd	3,00,000	-
- B Ltd	3,50,000	-
	6,50,000	-

B. BONUS SHARES

Illustration 13: Bonus issue - Before and After

On 31.03.2015, R Ltd. acquired 1,05,000 Shares of S Ltd. for ₹ 12,00,000. The Extract Balance Sheet of S Ltd. on that date was as under -

(₹ 000's)

Liabilities	₹	Assets	₹
1,50,000 Equity Shares of ₹ 10 each fully paid	1,500	Fixed Assets (Tangible)	1,050
Pre-Incorporation Profits	30	Current Assets	615
Profit & Loss Account	60		
Creditors	75		
Total	**1,665**	**Total**	**1,665**

On 31.03.2016, the Balance Sheets of the two Companies were as follows -

(₹ 000's)

Liabilities	R	S	Assets	R	S
Equity Shares of ₹ 10 each fully paid (before Bonus Issue)	4,500	1,500	Fixed Assets (Tangible)	7,920	2,310
			1,05,000 Equity Shares in	1,200	–
Securities Premium	900	–	S Ltd. at Cost		
Pre-Incorporation Profits	–	30	Current Assets	4,410	1,755
General Reserve	6,000	1,905			
Profit and Loss Account	1,575	420			
Creditors	555	210			
Total	**13,530**	**4,065**	**Total**	**13,530**	**4,065**

Directors of S Ltd. made a bonus issue on 31.03.2016 in the ratio of one Equity Share of ₹ 10 each fully paid for every two Equity Shares held on that date.

Calculate as on 31.3.2016 (i) Cost of Control/Capital Reserve ; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases: (1) Before issue of Bonus Shares; (2) Immediately after the issue of Bonus Shares. It may be assumed that Bonus Shares were issued out of Post-Acquisition Profits by using General Reserve.

Prepare a Consolidated Balance Sheet after the Bonus Issue.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = R Ltd. Subsidiary = S Ltd.	Acquisition: 31.03.2015 Consolidation: 31.03.2016	Holding Company = 70% Minority Interest = 30%

2. Analysis of Reserves and Surplus of S Ltd.

(a) Pre-Incorporation Profits = ₹ 30,000 – **Capital Profit**

(b) General Reserve

Before Bonus Issue

As on 31.3.2016 19,05,000

As on 01.04.15	Tfr between 01.04.15 & 31.3.2016
NIL	**19,05,000**
Capital	**Revenue**

After Bonus Issue

As on 31.3.2016	19,05,000	
Less: Bonus Issue	7,50,000	(15 Lacs x 1/2)
Corrected Bal	11,55,000	

01.04.2015	Tfr between 1.4.15 & 3 1.3.16
NIL	**11,55,000**
Capital	**Revenue**

(c) Profit & Loss Account

As on 31.03.2016 ₹ 4,20,000

As on 01.04.2005	60,000 **Capital**	Profits between 01.04.2015 & 31.03.2016	**3,60,000 Revenue**

3. Analysis of Net Worth of S Ltd.

Particulars	Before Bonus Issue			After Bonus Issue		
	Total	R	Minority	Total	R	Minority
	100%	70%	30%	100%	70%	30%
(a) Share Capital	15,00,000			15,00,000		
Add: Bonus Issue	–			7,50,000		
	15,00,000	10,50,000	4,50,000	**22,50,000**	15,75,000	6,75,000
(b) Capital Profits						
Pre Incorporation Profits	30,000			30,000		
General Reserve	NIL			NIL		
Profit and Loss Account	60,000			60,000		
	90,000	63,000	27,000	**90,000**	63,000	27,000
(c) **Revenue Reserve:** Gen. Reserve	**19,05,000**	13,33,500	5,71,500	**11,55,000**	8,08,500	3,46,500
(d) **Revenue Profits:** P & L A/c	**3,60,000**	2,52,000	1,08,000	**3,60,000**	2,52,000	1,08,000
Minority Interest			**11,56,500**			**11,56,500**

4. Cost of Control

Particulars		Before Bonus Issue	After Bonus Issue
	Cost of Investment	12,00,000	12,00,000
Less:	(a) Nominal Value of Share Capital	(10,50,000)	(15,75,000)
	(b) Share in Capital Profits	(63,000)	(63,000)
	Goodwill / Capital Reserve on Consolidation	**87,000**	**(4,38,000)**

5. Consolidation of Reserves & Surplus

Particulars		Before Bonus Issue		After Bonus Issue	
		Gen. Res.	P&L A/c	Gen. Res.	P&L A/c
	Balance as per Balance Sheet of R Ltd.	60,00,000	15,75,000	60,00,000	15,75,000
Add:	Share of Revenue	13,33,500	2,52,000	8,08,500	2,52,000
	Consolidated Balance	**73,33,500**	**18,27,000**	**68,08,500**	**18,27,000**

Name of the Company: R Ltd. And its subsidiary S Ltd.

Consolidated Balance Sheet as at 31st March 2016

Ref No.	Particulars		Note No.	As at 31st March, 2016	As at 31st March, 2015
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each		45,00,000	-
		(b) Reserves and surplus	1	99,73,500	-
				1,44,73,500	-
	2	**Minority Interest**		11,56,500	-
	3	**Share application money pending allotment**		Nil	

Ref No.		Particulars	Note No.	As at 31st March, 2016 ₹	As at 31st March, 2015 ₹
	4	**Non-current liabilities**		Nil	
	5	**Current liabilities**			
		(a) Other current liabilities	2	7,65,000	-
				7,65,000	-
		TOTAL (1+2+3+4+5)		1,63,95,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	3	1,02,30,000	-
				1,02,30,000	-
	2	**Current assets**			
		(a) Other current assets	4	61,65,000	-
				61,65,000	-
		TOTAL (1+2)		1,63,95,000	-

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

Note 1. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	68,08,500	-
Profit and loss	18,27,000	-
Capital reserve on consolidation	4,38,000	-
Securities Premium	9,00,000	-
	99,73,500	-

Note 2. Current Liabilities :-

	Current Year	Previous Year
Bills Payable:-		
- R Ltd	5,55,000	-
- S Ltd	2,10,000	-
	7,65,000	-

Note 3. Tangible Assets:-

	Current Year	Previous Year
Fixed Assets		
- R Ltd	79,20,000	-
- S Ltd	23,10,000	-
	1,02,30,000	-

Note 4. Current Assets:-

	Current Year	Previous Year
Current Assets		
- R Ltd	44,10,000	-
- S Ltd	17,55,000	-
	61,65,000	-

Illustration 14: Bonus Issue - Unrealized Profits

On 31.03.2015 the extract Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows (in ₹ Lakhs) -

Liabilities	H Ltd.	S Ltd.	Assets	H Ltd.	S Ltd.
Share Capital:			Land and Buildings	2,718	–
Authorised	15,000	6,000	Plant and Machinery	4,905	4,900
Issued and Subscribed:			Furniture and Fittings	1,845	586
Equity Shares (₹ 10) Fully Paid	12,000	4,800	Investments in shares in S Ltd.	3,000	–
General Reserve	2,784	1,380	Stock	3,949	1,956
Profit and Loss Account	2,715	1,620	Debtors	2,600	1,363
Bills Payable	372	160	Cash and Bank Balances	1,490	204
Sundry Creditors	1,461	854	Bills Receivable	360	199
Provision for Taxation	855	394	Sundry Advances	520	–
Proposed Dividend	1,200	–			
	21,387	**9,208**		**21,387**	**9,208**

The following information is also provided to you:

1. H Ltd. purchased 180 Lakhs shares in S Ltd. on 01.04.2014 when the balances to General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 Lakhs and ₹ 1,200 Lakhs respectively.
2. On 04.07.2014 S Ltd. declared a dividend @ 20% for the year ended 31.03.2014. H Ltd. credited the dividend received by it to its Profits and Loss Account.
3. On 01.01.2014 S Ltd. issued 3 fully paid-up shares for every 5 shares held as Bonus Shares out of balances in its General Reserve as on 31.03.2014.
4. On 31.03.2015 all the Bills Payable in S Ltd.'s Balance Sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 Lakhs of these acceptances in hand, the rest having been endorsed in favour of its Creditors.
5. On 31.03.2015 S Ltd.'s stock included goods which it had purchased for ₹ 200 Lakhs from H Ltd. which made a profit @ 25% on cost.

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31.03.2015 bearing in mind the requirements of AS 21.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = H Subsidiary = S	Acquisition: 01.04.2014 Consolidation: 31.03.2015	Holding Company = 60% Minority Interest = 40%

Shareholding Pattern - % of Holding by H Ltd.

Date	Particulars	No. of Shares
01.04.2014	Original Purchase	18
01.01.2015	First Bonus Issue (3/5 x 1,80,000)	10.8
31.03.2015	Total Shares held by H Ltd. in S Ltd.	**28.8**
	Total Shares outstanding in S Ltd. (₹ 4,800 Lakhs / ₹ 10)	**48**
	% of Holding (28.8 / 48)	**60%**

2. Analysis of Reserves and Surplus of S Ltd. (₹ Lakhs)

(a) General Reserves

Balance as on 31.03.2015 ₹ 1,380

	Balance on 1.4.2014 (as oi. acqn. date)	₹ 3,000	Transfer during 2014-15 (upto Consolidation
Less:	Bonus Issue (108/60% x ₹ 10)	₹ 1,800	(balancing figure) ₹ **180**
	Balance **Capital Profit**	**₹ 1,200**	**Revenue Reserve**

(b) Profit and Loss Account

Balance as on 31.03.2015 ₹ 1,620

	Balance on 01.04.2014 (as on acqn. date)	₹ 1,200	Profit for 2014-15 (upto Consolidation)
Less:	Dividend (₹ 3000 x 20%)	₹ 600	(balancing figure) ₹ **1020**
	Balance **Capital Profit**	₹ 600	**Revenue Profit**

3. Analysis of Net Worth of S Ltd. (₹ Lakhs)

Particulars			Total	H	Minority
			100%	60%	40%
(a)	Equity Capital		4,800	2,880	1,920
(b)	Capital Profits	General Reserve	1,200		
		Profit and Loss Account	600		
		Total Capital Profits	1,800	1,080	720
(c)	Revenue Res.	General Reserve	180	108	72
(d)	Revenue Profit	Profit and Loss Account	1,020	612	408
	Minority Interest				**3,120**

4. Cost of Control

	Particulars		₹ Lakhs
	Cost of Investment		3,000
Less:	Pre-Acquisition Dividend Received (₹ 1,800 x 20%)		360
	Adjusted Cost of Investment		2,640
Less:	Nominal Value of Share Capital	2.880	
	Share in Capital Profit of S Ltd.	1,080	(3,960)
	Capital Reserve on Consolidation		**1,320**

5. Consolidation of Reserves and Surplus (₹ Lakhs)

	Particulars	Gen. Res.	P&LA/c
	Balance as per Balance Sheet of H Ltd.	2,784	2,715
Less:	Pre-Acquisition Dividend wrongly credited to P&L A/c		(360)
	Adjusted Cost of Investment	2,784	2,355
Add:	Share of Revenue from S Ltd.	108	612
	Consolidated Balance	2,892	2,967
Less:	Unrealized Profit on Closing Stock (₹ 200 x 25%/125%)		(40)
	Adjusted Consolidated Balance	**2,892**	**2,927**

Name of the Company: H Ltd. And its subsidiary S Ltd.

Consolidated Balance Sheet as at 31st March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2012	As at 31st March, 2011
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	12,000	-
		(b) Reserves and surplus	2	7,139	-
				19,139	-
	2	**Minority Interest**		3,120	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	2,315	-
		(b) Other current liabilities	4	487	-
		(c) Short-term provisions	5	2,449	-
				5,251	-
		TOTAL (1+2+3+4+5)		27,510	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	14,954	-
				14,954	-
	2	**Current assets**			
		(a) Inventories	7	5,865	-
		(b) Trade receivables	8	3,963	-
		(c) Cash and cash equivalents	9	1,694	-
		(d) Short-term loans and advances (Sundry advance)		520	-
		(e) Other current assets	10	5140	-
				12,556	-
		TOTAL (1+2)		27,510	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	15,000	-
Issued and Paid Up	12,000	-
	12,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	2,892	-
Profit and loss	2,947	-
Capital Reserve on Consolidation	1,320	-
	7,159	-

Note 3. Trade Payable

	Current Year	Previous Year
Sundry Creditors		
H	1,461	-
S	854	-
	2,315	-

Note 4. Other Current Liabilities :-

	Current Year	Previous Year
Bills Payable:-		
- H Ltd	372	-
- S Ltd	160	-
	532	-
Less: Mutual Oweings	45	-
	487	-

Note 5. Short Term Provisions

	Current Year	Previous Year
Prov. For taxations		
H Ltd.	855	-
S Ltd.	394	-
	1,249	-
Proposed dividend	1,200	-
	2,449	-

Note 6. Tangible Assets:-

	Current Year	Previous Year
Land and Building	2,718	-
Plant and Machinery (4905+4900)	9,805	-
Furniture (1845+586)	2,431	-
	14,954	-

Note 7. Inventories :-

	Current Year	Previous Year
Stock		
H Ltd	3,949	-
S Ltd.	1,956	-
	5,905	-
Less: Unrealized profit	40	-
	5,865	-

Note 8. Trade Receivable:-

	Current Year	Previous Year
Debtors		
H Ltd	2,600	-
S Ltd.	1,363	-
	3,963	-

Note 9. Cash and cash equivqlent :-

	Current Year	Previous Year
Cash & Bank		
H Ltd	1,490	-
S Ltd.	204	-
	1,694	-

Note 10. Other Current assets :-

	Current Year	Previous Year
Bills Receivable		
H Ltd	360	-
S Ltd.	199	-
	559	-
Less: set off	45	-
	514	-

Illustration 15: Bonus Issue, Reverse Working for Bonus Amount - Investment in Debentures

The summarised Balance Sheet of P Ltd. and Q Ltd. as at 31.03.2015 is given below (₹ in 000's)-

Liabilities	P	Q	Liabilities	P	Q
Equity Share Capital (₹ 10)	5,000	2,400	Goodwill	300	200
Securities Premium	200	140	Buildings	1,000	1,000
General Reserve	1,000	1,600	Machinery	4,000	2,440
Profit & Loss Account	900	600	Investment in Shares:		
8% Debentures	2,000	1,000	-1,92,000 Shares of Q Ltd.	1,500	
Trade Creditors	800	400	Investments in Debentures:		
Outstanding Expenses	270	180	- In Q Ltd. (Face Value ₹ 4,00,000)	450	
			- In P Ltd. (Face Value ₹ 2,00,000)		220
			Sundry Debtors	1,500	1,000
			Stock	1,000	1,000
			Cash and Bank	200	100
			Preliminary Expenses	100	50
			Outstanding Income	120	310
Total	**10,170**	**6,320**	**Total**	**10,170**	**6,320**

1. When the Shares were acquired, Q Ltd. had ₹ 2.2 Lakhs in General Reserve and ₹ 1,00,000 in Securities Premium, ₹ 3,00,000 (Dr.) in Profit and Loss Account.
2. Two years after the date of acquisition Bonus Shares at 1 to 1 were issued out of General Reserve.
3. One year after the Bonus issue, Rights Shares were issued at 10% Premium at 1 for 5 held and P Ltd. purchased all the shares offered to it.
4. P Ltd. received ₹ 1,92,000 dividend for the last year and ₹ 96,000 interim dividend in the current year, i.e. 3 years after the Rights Issue.
5. For the current year 15% dividend (including Interim Dividend) has been proposed by Q Ltd., 10% by P Ltd., but no effect has yet been given in the accounts.
6. On the same day referred to in (5) above, Bonus Dividend has been declared at 1 to 2, but no effect has yet been given.
7. 50% of the shares originally purchased in Q Ltd. were paid for to the shareholders of Q Ltd. by 50,000 shares of P Ltd. issued at 10% premium.
8. Debenture Interest of both the Companies falls due on 31st March, but payments are made a week later.

Prepare Consolidated Balance Sheet as at 31.03.2015.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = P Ltd. Subsidiary = Q Ltd.	Consolidation: 31.03.2015	Holding Company = 80% Minority Interest = 20%

	Shares held as on 31.03.2015	1,92,000
Add:	Second Bonus Issue (1,92,000 x 1/2)	96,000
	Actual Shareholding	2,88,000

DOA - 1 (Original Acquisition)	First Bonus Issue (1 : 1 as at DOA-1)	DOA - 2 Rights Issue	Second Bonus Issue (1 :2 as at DOA-2)
80,000	**80,000**	**32,000**	**96,000**
(balancing figure)	[(1,92,000 - 32,000) ÷ 2]	[1,92,000 x 1 ÷ (5 + 1)]	

40,000	40,000
For Cash	For Shares of P Ltd.

2. Analysis of Reserves & Surplus of Q Ltd.

(a) Securities Premium

Balance on 31.03.2015 ₹ 1,40,000

DOA-1	₹ **1,00,000** **Capital Profit**	Proceeds from Rights Issue ₹ **40,000** **Capital**

(b) General Reserve

	Shares held as on 31.03.2015	16,00,000
Add:	Second Bonus Issue (24,00,000 x 1/2)	12,00,000
	Adjusted Balance	4,00,000

	DOA-1	₹ 22,00,000	Additions upto Consolidation
Less:	First Bonus	(₹ 10,00,000) (80,000 Shares/80% x ₹ 10)	(balancing figure) ₹ **4,00,000**
Less:	Second Bonus	(₹ 12,00,000)	**Revenue Reserve**
	Capital Profit	₹ **NIL**	

Note: In the absence of information in this regard, it is presumed that the second bonus issue has been made out of reserves as on the date of controlling acquisition.

(c) Profit & Loss Account

	Balance as on 31.03.2015	6,00,000	
Less:	Debenture Interest (10,00,000 x 8%)	(80,000)	
Add:	Debenture Interest from P (2,00,000 x 8%)	16,000	
Less:	Proposed Dividend (24,00,000 x 15% – Interim 1,20,000)	(2,40,000)	(See Note)
	Adjusted Balance	2,96,000	

DOA - 1	Additions to P&L A/c
(₹ 3,00,000) Debit balance given	₹ **5,96,000**
Capital Profit	**Revenue Profit**

Note: Interim Dividend received by Holding Company = ₹ 96,000 for 80% holding. Hence, Total Interim Dividend paid by Subsidiary = ₹ 96,000 ÷ 80% = ₹ 1,20,000

3. Analysis of Net Worth of Q Ltd.

Particulars		Total	P	Minority
		100%	**80%**	**20%**
(a) Equity Share Capital:	(including Bonus ₹ 12,00,000)	**36,00,000**	28,80,000	7,20,000
(b) Capital Profits:	Securities Premium Account	1,00,000		
	General Reserve	NIL		
	Profit & Loss Account	(3,00,000)		
	Preliminary Expenses	(50,000)		
		(2,50,000)	(2,00,000)	(50,000)
(c) Securities Premium (after acquisition date)		**40,000**	32,000	8,000
(d) Revenue Reserves:	General Reserve	**4,00,000**	3,20,000	80,000
(e) Revenue Profits:	Profit & Loss A/c	**5,96,000**	4,76,800	1,19,200
(f) Proposed Equity Dividend		**2,40,000**	1,92,000	48,000
Minority Interest				**9,25,200**

4. Cost of Control

	Particulars		₹
	Cost of Investment		15,00,000
Less:	(1) Nominal Value of Equity Capital	28,80,000	
	(2) Share in Capital Profit of Q Ltd.	(2,00,000)	(26,80,000)
	Capital Reserve on Consolidation		**(11,80,000)**

5. Gain / Loss on Consolidation of Debentures

Particulars		₹	
	Cost of Investment in Debentures:		
	Q Ltd. in P Ltd.	2,20,000	
	P Ltd. in Q Ltd.	4,50,000	6,70,000
Less:	Face Value of Debentures (₹ 20,000 + ₹ 40,000)		(6,00,000)
Loss on Consolidation of Debentures (Adjusted against Group Reserves)			**70,000**

6. Consolidation of Reserves & Surplus

Particulars			Securities Premium	Gen. Res	P&L A/c
	Balance as per Balance Sheet of P Ltd.		2,00,000	10,00,000	9,00,000
Less:	Proposed Dividend	(₹ 50,00,000 x 10%)		–	(5,00,000)
Less:	Debenture Interest Due	(₹ 20,00,000 × 8%)	–	–	(1,60,000)
Add:	Share of Dividend from Q Ltd.	(₹ 2,40,000 x 80%)	–	–	1,92,000
Add:	Share of Debenture Int from Q	(₹ 4,00,000 x 8%)	–	–	32,000
	Adjusted Balance		**2,00,000**	**10,00,000**	**4,64,000**
Add:	Share of Reserves of Q Ltd.		32,000	3,20,000	4,76,800
Less:	Loss on Elimination of Debentures on Consolidation				(70,000)
Consolidated Balance			**2,32,000**	**13,20,000**	**8,70,800**

Name of the Company: P Ltd. And its subsidiary Q Ltd.

Consolidated Balance Sheet as at 31st March, 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	50,00,000	-
		(b) Reserves and surplus	2	36,02,800	-
				86,02,800	-
	2	**Minority Interest**		9,25,200	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	25,92,000	-
				25,92,000	-
	5	**Current liabilities**			
		(b) Trade payables	4	12,00,000	-
		(c) Other current liabilities	5	4,50,000	-
		(d) Short-term provisions	6	5,00,000	-
				21,50,000	-
		TOTAL (1+2+3+4+5)		1,42,70,000	-

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	7	84,40,000	-
		(ii) Intangible assets (goodwill)		5,00,000	-
				89,40,000	-
	2	**Current assets**			
		(a) Inventories	8	20,00,000	-
		(b) Trade receivables	9	25,00,000	-
		(c) Cash and cash equivalents	10	3,00,000	-
		(d) Other current assets	11	5,30,000	-
				53,30,000	-
		TOTAL (1+2)		1,42,70,000	-

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

ANNEXURE

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	50,00,000	-
	-	-
	-	-
	50,00,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	13,20,000	-
Profit and loss	8,70,800	-
Capital Reserve on Consolidation	11,80,000	-
Securities Premium	2,32,000	-
	36,02,800	-

Note 3. Long Term Borrowings

8% Debentures	Current Year	Previous Year
P	20,00,000	-
Q	10,00,000	-
	30,00,000	-
Less: Held by Q	2,00,000	-
	28,00,000	-
Less: Held by P	4,00,000	-
	24,00,000	-
Debenture int. accrued	1,92,000	-
	25,92,000	-

Note 4. Trade Payable

Sundry Creditors	Current Year	Previous Year
P	8,00,000	-
Q	4,00,000	-
	12,00,000	-

Note 5. Other Current Liabilities :-

	Current Year	Previous Year
Outstanding Expenses		
P	2,70,000	-
Q	1,80,000	-
	4,50,000	-

Note 6. Short Term Provisions

	Current Year	Previous Year
Proposed dividend	5,00,000	-
	5,00,000	-

Note 7. Tangible Assets :-

	Current Year	Previous Year
Land and Building (1000000+1000000)	20,00,000	
Plant and Machinery (4000000+2440000)	64,40,000	-
	84,40,000	-

Note 8. Inventories :-

	Current Year	Previous Year
Stock		
P Ltd	10,00,000	-
Q Ltd.	10,00,000	-
		-
	20,00,000	-

Note 9. Trade Receivable :-

	Current Year	Previous Year
Sundry Debtors		
P Ltd	15,00,000	-
Q Ltd.	10,00,000	-
	25,00,000	-

Note 10. Cash and cash equivqlent :-

	Current Year	Previous Year
Cash & Bank		
P Ltd	2,00,000	-
Q Ltd.	1,00,000	-
	3,00,000	-

Note 11. Other Current assets :-

	Current Year	Previous Year
Outstanding Income		
P Ltd	1,20,000	-
Q Ltd.	3,10,000	-
	4,30,000	-
Preliminary Expenditure	1,00,000	-
	5,30,000	-

Notes:

- It is presumed that the Companies have not accounted for the inter company owings in respect of Debenture interest and proposed dividends.
- Interest due on Debenture has been shown under Secured Loans together with Debentures in accordance with Schedule III to the Companies Act, 2013.

C. REVALUATION OF ASSETS

Illustration 16: Bonus Issue, Asset Revaluation, Interest not recorded

X Ltd. acquired 80,000 Shares of ₹ 100 each in Y Ltd. on 30.09.2014. The summarized Balance Sheet of two Companies as on 31.03.2015 were as follows -

Liabilities	X Ltd. (₹)	Y Ltd. (₹)	Assets	X Ltd. (₹)	Y Ltd. (₹)
Share Capital (₹ 100)	3,00,00,000	1,00,00,000	**Fixed Assets (Tangible)**	1,50,00,000	1,44,70,000
Capital Reserve	–	55,00,000	Investments in Y Ltd.	1,70,00,000	–
General Reserve	30,00,000	5,00,000	Stock in Hand	40,00,000	20,00,000
Profit & Loss Account	38,20,000	18,00,000	Loan to X Ltd.	–	2,00,000
Loan from Y Ltd.	2,10,000		Debtors	25,00,000	18,00,000
Creditors	17,90,000		Bank	2,00,000	2,00,000
Bills Payable (including ₹ 50,000 to X Ltd.)	–	7,00,000 1,70,000	Bills Receivable (including ₹ 50,000 from Y Ltd.)	1,20,000	–
Total	**3,88,20,000**	**1,86,70,000**	**Total**	**3,88,20,000**	**1,86,70,000**

Contingent Liability (X Ltd.): Bills discounted of ₹ 60,000.

Additional information:

1. Y Ltd. made a bonus issue on 31.03.2015 of one share for every two shares held, reducing the Capital Reserve accordingly, but the accounting effect to this has not been given in the above Balance Sheet.
2. Interest receivable for the year (₹ 10,000) in respect of the loan due by X Ltd. to Y Ltd. has not been credited in the accounts of Y Ltd.
3. The credit balance in Profit & Loss Account of Y Ltd. on 01.04.2014 was ₹ 2,10,000.
4. The Directors decided on the date of the acquisition that the Fixed Assets of Y Ltd. were overvalued and should be written down by ₹ 5,00,000. Consequential adjustments on depreciation are to be ignored.

Prepare the Consolidated Balance Sheet as at 31.03.2015, showing your workings.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = X Ltd. Subsidiary = Y Ltd.	Acquisition: 30.09.2014 Consolidation: 31.03.2015	Holding Company = 80% Minority Interest = 20%

2. Analysis of Reserves and Surplus of Y Ltd.

(a) General Reserve

Balance as per B/s ₹ 5,00,000

As on 01.04.2014 (Date of previous B/s) ₹ **5,00,000**
Assumed that entire balance is available on this date
Capital Profit

01.04.2014 to 31.03.2015 (upto Consolidation)
₹ NIL (balancing figure)
Revenue Reserve

(b) Profit and Loss Account

	Balance as on date of Consolidation	₹ 18,00,000
Add:	Interest on Loan to X (Given)	₹ 10,000
	Corrected Balance	₹ 18,10,000

Balance on 01.04.2014
(Date of previous B/s)
₹ 2,10,000
Capital Profit

Profit for 2014-15 (balancing figure) ₹ **16,00,000**

Upto date of acquisition 01.04.2011 to 30.09.2014 ₹ I6,00,000 x 6/12
Capital Profit ₹ 8,00,000

Acquisition to Consolidation 30.09.2014 to 31.03.2015 ₹ I6,00,000 x 6/ 12
Revenue Profit ₹ 8,00,000

Total Capital Profits: 2,10,000 + 8,00,000 = ₹ **10,10,000; Total Revenue Profits:** ₹ **8,00,000**

(c) Capital Reserve

			Remarks
	Balance as on date of Consolidation	₹ 55,00,000	The entire balance is considered **Capital Profits.**
Less:	Bonus Issue (₹ 1,00,00,000 x 1/2)	₹ 50,00,000	
	Adjusted Balance	₹ **5,00,000**	

(d) Revaluation of Assets: Loss (₹ 5,00,000) = **Capital Profit**

3. Analysis of Net Worth of Y Ltd.

	Particulars	Total	X Ltd	Minority
		100%	**80%**	**20%**
(a)	**Share Capital**	1,00,00,000		
Add:	Bonus Issue [1/2 x 1,00,00,000]	50,00,000		
		1,50,00,000	**1,20,00,000**	**30,00,000**
(b)	**Capital Profits:**			
	General Reserve	5,00,000		
	Profit & Loss Account	10,10,000		
	Capital Reserve	5,00,000		
	Loss on Revaluation of Assets	(5,00,000)		
		15,10,000	**12,08,000**	**3,02,000**
(c)	**Revenue Reserve:**	NIL		
(d)	**Revenue Profits:**			
	Profit & Loss A/c	**8,00,000**	**6,40,000**	**1,60,000**
	Minority Interest			**34,62,000**

4. Cost of Control

	Particulars		₹
	Cost of Investment as per B/Sheet		1,70,00,000
Less:	(1) Nominal Value of Equity Capital	1,20,00,000	
	(2) Share in Capital Profit as calculated above	12,08,000	1,32,08,000
	Goodwill on Consolidation		**37,92,000**

5. Consolidation of Reserves & Surplus

	Particulars	Gen. Res.	P&LA/c
	Balance as per Balance Sheet of X Ltd.	30,00,000	38,20,000
Add:	Share of Revenue Reserve / Profit from Y Ltd.	NIL	6,40,000
	Consolidated Balance	**30,00,000**	**44,60,000**

Name of the Company: X Ltd. And its subsidiary Y Ltd.

Consolidated Balance Sheet as at 31st March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 100 each	1	3,00,00,000	-
		(b) Reserves and surplus	2	74,60,000	-
				3,74,60,000	-
	2	**Minority Interest**		34,62,000	-
	3	**Share application money pending allotment**		Nil	

Ref No.		Particulars	Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	24,90,000	-
		(b) Other current liabilities	4	1,20,000	-
				26,10,000	-
		TOTAL (1+2+3+4+5)		4,35,32,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	2,89,70,000	-
		(ii) Intangible assets (goodwill)		37,92,000	-
				3,27,62,000	-
	2	**Current assets**			
		(a) Inventories	6	60,00,000	-
		(b) Trade receivables	7	43,00,000	-
		(c) Cash and cash equivalents	8	4,00,000	-
		(d) Other current assets	9	70,000	-
				1,07,70,000	-
		TOTAL (1+2)		4,35,32,000	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	3,00,00,000	-
	3,00,00,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	30,00,000	-
Profit and loss	44,60,000	-
	74,60,000	-

Note 3. Trade Payable

	Current Year	Previous Year
Creditors		
X	17,90,0000	-
Y	7,00,000	-
	24,90,000	-

Note 4. Current Liabilities :-

	Current Year	Previous Year
Bills Payable		
Y	1,70,000	-
	-	-
	1,70,000	-
Less: Mutual Owings	50,000	-
	1,20,000	-

Note 5. Tangible Assets :-

	Current Year	Previous Year
Fixed Assets		
X	1,50,00,000	-
Y	1,44,70,000	-
	2,94,70,000	-
Less: Revaluation Loss	5,00,000	-
	2,89,70,000	-

Note 6. Inventories :-

	Current Year	Previous Year
Stock		
X	40,00,000	-
Y	20,00,000	-
	60,00,000	-

Note 7. Trade Receivable :-

	Current Year	Previous Year
Sundry Debtors		
X	25,00,000	-
Y	18,00,000	-
	43,00,000	-

Note 8. Cash and cash equivqlent :-

	Current Year	Previous Year
Bank		
X	2,00,000	-
Y	2,00,000	-
	4,00,000	-

Note 9. Other Current assets :-

	Current Year	Previous Year
Bills Receivable		
X	1,20,000	-
Y	-	-
	1,20,000	-
Less: Mutual Owings	50,000	-
	70,000	-

Contingent Liability for Bills Discounted ₹ 60,000

Note: Fixed Assets have been revalued for the purpose of Consolidation and the depreciation on the revaluation loss has been ignored as its specifically stated in the problem.

Illustration 17: Invt in PSC, Revaluation of Asset & Stock Reserve - Upstream & Downstream.

G Ltd. acquired control in S Ltd. a few years back when S Ltd. had ₹ 25,000 in Reserve and ₹ 14,000 (Cr.) in Profit & Loss Account. Plant Account (Book Value ₹ 66,000) of S Ltd. was revalued at ₹ 62,000 on the date of purchase. Equity Dividend of ₹ 7,500 was received by G Ltd. out of pre-acquisition profit and the amount was correctly treated by G Ltd. Debenture Interest has been paid upto date.

Following are the Extract Balance Sheets of G Ltd. and S Ltd. as at 31st March, 2015 (₹ 000's) -

Liabilities	G	S	Assets	G	S
6% Preference Share Capital (₹ 100)	100	50	Goodwill	50	30
Equity Share Capital (₹ 10)	500	100	Land & Buildings	200	50
General Reserve	30	30	Plant & Machinery	105	100
Profit & Loss Account	40	12	Stock in Trade	130	100
6% Debentures	NIL	100	Sundry Debtors	90	50
Sundry Creditors	90	60	Bills Receivable	30	10
Due to S Ltd.	10	NIL	Due from G Ltd.,	NIL	12
Bills Payable	20	25	Bank	27	25
			Investments in S Ltd.		
			- 300 Preference Shares	28	NIL
			- 7,500 Equity Shares	85	NIL
			- Debentures (Face Value ₹ 50,000)	45	NIL
Total	**790**	**377**	**Total**	**790**	**377**

Additional Information -

1. Cheque of ₹ 2,000 sent by G Ltd., to S Ltd., was in transit.
2. Balance Sheet of S Ltd. was prepared before providing for 6 months dividend on Preference Shares, the first half being already paid.
3. Both the Companies have proposed Preference Dividend only, but no effect has been given in the accounts.
4. Stock of G includes ₹ 6,000 stock purchased from S on which S made 25% profit on cost. Stock of S includes ₹ 10,000 purchased from G on which G made 10% profit on selling price.
5. Since acquisition, S Ltd. has written off 30% of the book value of plant as on date of acquisition by way of depreciation.
6. Bills Receivable of S Ltd. are due from G Ltd.

Prepare Consolidated Balance Sheet as at 31st March, 2015.

Solution:

1. Basic Information

Company Status		Dates	Holding Status	
Holding Company	= G Ltd.	Acquisition: a few years back	Holding Company	= 75%
Subsidiary	= S Ltd.	Consolidation: 31st March	Minority Interest	= 25%

2. Analysis of Reserves & Surplus of S Ltd.

(a) General Reserve

Balance on date of consolidation (given) ₹ 30,000

As on Date of Acquisition (given)	From date of acquisition to date of consolidation
₹ **25,000 Capital Profit**	(balancing figure) = ₹ **5,000 Revenue Reserve**

(b) Profit & Loss Account

	Balance on 31st December	₹	12,000
Less:	Proposed Preference Dividend (₹ 50,000 x 6% x 6/12)	₹	1,500
	Corrected Balance	₹	10,500

	As on date of acquisition	₹	14,000	From date of acquisition to date of
Less:	Equity Dividend for pre-acqn period	₹	10,000	consolidation (balancing figure) =
	(Recd, by G 7,500 ÷ 75%)	₹	**4,000**	₹ **6,500**
			Capital Profits	**Revenue Profits**

(c) Gain / Loss on Revaluation of Assets

- Loss on Revaluation of Machinery = 62,000 - 66,000 **= (₹ 4,000)** **Capital Profit**
- Depreciation Gain on Revaluation Loss = 4,000 x 30% **= ₹ 1,200** **Revenue Profit**

3. Analysis of Net Worth of S Ltd.

Particulars			Total 100%	G Ltd. (75%)	Minority Int (25%)
(a)	**Equity Share Capital**		**1,00,000**	**75,000**	**25,000**
(b)	**Preference Share Capital**		**50,000**	**30,000**	**20,000**
(c)	**Capital Profits:**	General Reserve	25,000		
		Profit & Loss Account	4,000		
		Loss on Revaluation of Assets	(4,000)		
			25,000	**18,750**	**6,250**
(d)	**Revenue Reserves:**	General Reserve	**5,000**	**3,750**	**1,250**
(e)	**Revenue Profits:**	Profit & Loss Account	6,500		
		Depreciation Gain on Revaluation	1,200		
			7,700	**5,775**	**1,925**
(f)	**Preference Dividend**		**1,500**	**900**	**600**
	Minority Interest before Stock Reserve Adjustment				**55,025**
	Less: Stock Reserve on Unrealised Profits i.e. Share of Minority Interest [6,000 x (25/125) x 25%]				**300**
	Minority Interest				**54,725**

Note: Unrealized profits on upstream transaction (i.e. Subsidiary to Holding Company) alone is eliminated from the Minority Interest, towards their share i.e. 25%. The balance of 75% (Holding Company's Share) will be reduced from the Reserves of G Ltd. Unrealized profits on downstream transaction, will be eliminated in full against reserves of G Ltd.

4. Cost of Control

	Particulars		₹
	Cost of Investment in S Ltd.		1,13,000
	7,500 Equity Shares of S Ltd.	85,000	
	300 6% Preference Shares of S Ltd.	28,000	
Less:	(1) Nominal Value of Equity Capital	75,000	
	(2) Nominal Value of Preference Share Capital	30,000	
	(3) Share in Capital Profit of S Ltd.	18,750	(1,23,750)
	Capital Reserve on Consolidation		**(10,750)**

5. Gain or Loss on Elimination of Mutually held Debentures

	Particulars	₹
	Cost of Investment	45,000
Less:	Nominal Value of Debentures	50,000
	Gain on Consolidation - Added to Group Profits	**5,000**

6. Consolidation of Reserves & Surplus

	Particulars		Gen. Res	P&L A/c
	Balance as per Balance Sheet of S Ltd.		30,000	40,000
Less:	Proposed Preference Dividend	(₹ 1,00,000 x 6%)	–	(6,000)
Add:	Share of Proposed Dividend from S Ltd.	(₹ 30,000 x 6% x 6/12)	–	900
	Adjusted Balance		**30,000**	**34,900**
Add:	Share of Revenue Profits / Reserves of S Ltd.		3,750	5,775
	Consolidated Balance		**33,750**	**40,675**
Less:	Unrealised Profits on Closing Stock of G Ltd. - Upstream transaction - ₹ 6,000 x (25 /125) x G Ltd.'s Share 75%		–	(900)
Less:	Unrealised Profits on Closing Stock of S Ltd. - Downstream transaction ₹ 10,000 x 10% - Fully adjusted against G Ltd.'s Reserves		–	(1,000)
Add:	Gain on elimination of mutually held Debentures			5,000
	Adjusted Consolidated Balance		**33,750**	**43,775**

Name of the Company: G Ltd. And its subsidiary S Ltd.

Consolidated Balance Sheet as at 31st March 2015

Ref No.		Particulars	Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 100 each	1	6,00,000	-
		(b) Reserves and surplus	2	88,275	-
				6,88,425	-
	2	**Minority Interest**		54,775	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	50,000	-
				50,000	-
	5	**Current liabilities**			
		(a) Trade payables	4	1,50,000	-
		(b) Other current liabilities	5	35,000	-
		(c) Short-term provisions	6	6,000	-
				1,91,000	-
		TOTAL (1+2+3+4+5)		9,84,200	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	7	4,52,200	-
		(ii) Intangible assets	8	80,000	-
				5,32,200	-
	2	**Current assets**			
		(a) Inventories	9	2,27,800	-
		(b) Trade receivables	10	1,40,000	-
		(c) Cash and cash equivalents	11	52,000	-
		(d) Other current assets	12	32,000	-
				4,51,800	-
		TOTAL (1+2)		9,84,000	-

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

Note 1. Share Capital

Particulars	**Current Year Amount (₹)**	**Previous Year Amount (₹)**
Authorised Capital	-	-
Issued and Paid Up	-	-
Equity Share capital @ ₹ 10	5,00,000	-
6% Pref Share Capital @ ₹ 100	1,00,000	-
	6,00,000	-

Note 2. Reserve and Surplus :-

Particulars	**Current Year Amount (₹)**	**Previous Year Amount (₹)**
General Reserve	33,750	-
Profit and loss	43,775	-
Capital Reserve on Consolidation	10,750	-
	88,275	-

Note 3. Long Term Borrowings

6% Debentures	Current Year	Previous Year
Particulars	**Amount (₹)**	**Amount (₹)**
G	1,00,000	-
Held by G in S	(50,000)	-
	50,000	-

Note 4. Trade Payable

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
G	90,000	-
S	60,000	-
	1,50,000	-

Note 5. Other Current Liabilities :-

	Current Year	Previous Year
Bills Payable		
G	20,000	-
S	25,000	-
	45,000	-
Less: Mutual Owings	10,000	-
	35,000	-

Note 6. Short Term Provisions

	Current Year	Previous Year
Proposed div (Pref)	6,000	-
	6,000	-

Note 7. Tangible Assets :-

	Current Year		Previous Year
Land and Building (2,00,000+50,000)		2,50,000	-
Plant and Machinery (105000+100000)	2,05,000		-
Less: Revaluation Loss	4,000		-
	2,01,000		-
Add: Depreciation gain	1,200	2,02,200	-
		4,52,200	-

Note 8. Intangible Assets:-

	Current Year	Previous Year
Goodwill		
G	50,000	-
S	30,000	-
	80,000	-

Note 9. Inventories :-

	Current Year	Previous Year
Stock		
G	1,30,000	-
S	1,00,000	-
	2,30,000	-
Less: Stock Reserve	2,200	-
[(6,000×25/125) + (10,000×10/100)]	2,27,800	-

Note 10. Trade Receivable :-

	Current Year	Previous Year
Sundy Debtors		
G	90,000	-
S	50,000	-
	1,40,000	-

Note 11. Cash and cash equivqlent :-

	Current Year	Previous Year
Bank		
G	27,000	-
S	25,000	-
	52,000	-

Note 12. Other Current assets :-

	Current Year	Previous Year
Bills receivable		
G	30,000	-
S	10,000	-
	40,000	-
Less: Mutual Owings	10,000	-
	30,000	-
Add: Cheque in Transit	2,000	-
	32,000	

Illustration 18: Asset Revaluation, Pre-acquisition Dividend

On 01.04.2012, H Ltd. acquired 800 Shares of ₹ 100 each of G Ltd. at ₹ 90,000. The Extract Balance Sheet of H Ltd., and G Ltd., as at 31.03.2015 are given below-

Liabilities	H Ltd. (₹)	G Ltd. (₹)	Assets	H Ltd. (₹)	G Ltd. (₹)
Equity Share Capital (₹ 10)	1,00,000	1,00,000	Fixed Assets (Tangible)	60,000	1,10,000
General Reserve	40,000	26,000	Investments	1,00,000	15,000
Profit & Loss Account	36,000	35,000	Debtors	25,000	20,000
Creditors	71,000	48,000	Stock	30,000	40,000
			Bank	32,000	24,000
Total	**2,47,000**	**2,09,000**	**Total**	**2,47,000**	**2,09,000**

1. At the time of acquiring shares, G Ltd. had ₹ 24,000 in General Reserve and ₹ 15,000 in P & L A/c. (Cr.)
2. G Ltd. paid 10% dividends in 2012-13, 12% in 2013-14, 15% in 2014-15 for 2011-12, 2012-13 and 2013-14 respectively. All dividends received have been credited to the Profit & Loss Account of H Ltd.
3. Proposed dividend for both the Companies for 2014-15 is 10%.
4. One bonus share for five fully paid shares held has been declared by G Ltd. out of pre-acquisition reserve on 31.03.2015. No effect has been given to that in the above accounts.
5. On 31.03.2012, Building of G Ltd. which stood at ₹ 50,000 was revalued at ₹ 60,000 but no adjustment has been made in the books. Depreciation has been charged @ 10% p.a. on reducing balance method.
6. In 2014-15, H Ltd. purchased from G Ltd., goods for ₹ 10,000 on which G Ltd. made a profit of 25% on Sales. 20% of such goods are lying unsold on 31.03.2015.

Prepare the Consolidated Balance Sheet as at 31.03.2015.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = H Ltd. Subsidiary = G Ltd.	Acquisition: 31.03.2012 Consolidation: 31.03.2015	Holding Company = 80% Minority Interest = 20%

Note: Number of Shares in G Ltd. after Bonus Issue = 10,000 + 1/5in Bonus = 12,000 Shares. Holding by Ganpat in G Ltd. - Originally Acquired 8,000 Shares + (Bonus at 1/5×8,000) = 9,600 Shares, out of 12,000 Shares = 80%.

2. Analysis of Reserves and Surplus of G Ltd.

(a) General Reserve

	Balance as on date of Consolidation	₹ 26,000
Less:	Bonus Issue (1/5th of ₹ 1,00,000)	₹ 20,000
	Adjusuted Balance	₹ 6,000

	As on date of acquisition 31.03.2012	₹ 24,000	Transfer between 31.03.2012 and 31.03.2015 (acquisition to consolidation)
Less:	Bonus Issue	₹ 20,000	**(balancing figure)** ₹ 2,000
	Balance **Capital Profit**	₹ 4,000	**Revenue Reserve**

(b) Profit & Loss Account

	Balance as on date of Consolidation	₹ 35,000
Less:	Proposed Dividend for 2014-15 (10% of ₹ 1,00,000)	₹ 10,000
	Adjusted Balance	₹ **25,000**

	Bal.on date of acquisition 31.03.12	₹ 15,000	Profits for 2012-13, 2013-14 & 2014-15
Less:	Pre-Acqn Dividend 2011-12 (10%)	₹ 10,000	(balancing figure) ₹ **20,000**
	Balance **Capital Profit**	₹ **5,000**	**Revenue**

(c) Gain / Loss on Revaluation of Building

Gain on Revaluation = ₹ 60,000 - ₹ 50,000 = ₹ **10,000 - Capital Profit**

Depreciation Loss on Revaluation Gain

For 2012-13 - ₹10,000 x 10%	₹ 1,000		
For 2013-14 - ₹ 1,000 x 90%	₹ 900		
For 2014-15 - ₹ 900 x 90%	₹ 810	**(₹ 2,710)**	Revenue Profit

Alternatively, Depreciation gain can be derived as under -

Year	Depreciation on ₹ 50,000 already provided		Depreciation on 60,000 (Required)		Additional Depreciation
2012-13	₹ 50,000 x 10% =	₹ 5,000	₹ 60,000 x 10% =	₹ 6,000	(1,000)
2013-14	₹ 5,000 x 90% =	₹ 4,500	₹ 6,000 x 90% =	₹ 5,400	(900)
2014-15	₹ 4,500 x 90% =	₹ 4,050	₹ 5,400 x 90% =	₹ 4,860	(810)
Total Additional Depreciation to be provided (Revenue Profit)					**(2,710)**

3. Analysis of Net Worth of G Ltd.

Particulars	Total 100%	H Ltd. 80%	Minority 20%
(a) **Equity Share Capital** (including Bonus Issue) ₹ 1,00,000 + 20% of ₹ 1,00,000	**1,20,000**	96,000	24.000
(b) **Capital Profits:** General Reserve	4,000		
Profit & Loss Account	5,000		
Gain on Revaluation of Assets	10,000		
	19,000	15,200	3,800
(c) **Revenue Reserves:** General Reserve	**2,000**	1,600	400
(d) **Revenue Profits:** Profit & Loss Account	20,000		
Depreciation Gain on Revaluation	(2,710)		
	17,290	13,832	3,458
(e) **Proposed Dividend** 10% of ₹ 1,00,000	**10,000**	8,000	2,000
Minority Interest before Stock Reserve Adjustment			**33,658**
Less: Stock Reserve on Closing Stock (10,000 x 20% x 25%) x 20%			(100)
Minority Interest taken to B/Sheet			**33,558**

4. Cost of Control

	Particulars		₹
	Cost of Investment in G Ltd.		90,000
Less:	Dividend out of Pre-acquisition profits (of 2011-12) of G (₹ 80,000 x 10%)		8,000
	Adjusted Cost of Investment		**82,000**
Less:	(1) Nominal Value of Equity Capital	96,000	
	(2) Share in Capital Profit of G Ltd.	15,200	1,11,200
	Capital Reserve on Consolidation		**(29,200)**

5. Consolidation of Reserves & Surplus

	Particulars	Gen. Res	P&L A/c
	Balance as per Balance Sheet of H Ltd.	40,000	36,000
Less:	Dividend out of Pre-acquisition Profits (₹ 80,000 x 10%)	–	(8,000)
Less:	Dividend Proposed for 2014-15 by H (₹ 10% x 1,00,000)	–	(10,000)
Add:	Share of Proposed Dividend of G Ltd. for 2012 (80% x ₹ 10000)	–	8,000
	Adjusted Balance	**40,000**	**26,000**
Add:	Share of Revenue Profits/Reserves of G Ltd.	1,600	13,832
	Consolidated Balance	**41,600**	**39,832**
Less:	Unrealised Profit on Closing Stock [25% x ₹ 10,000 x 20%] x 80%	–	(400)
	Adjusted Consolidated Balance	**41,600**	**39,432**

Name of the Company: H Ltd. And its subsidiary G Ltd.
Consolidated Balance Sheet as at 31st March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	100,000	-
		(b) Reserves and surplus	2	110,232	-
				210,232	-
	2	**Minority Interest**		33,558	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	119,000	-
		(b) Short-term provisions	4	10,000	-
				129,000	-
		TOTAL (1+2+3+4+5)		372,790	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	177,290	-
		(b) Non-current investments	6	25,000	
				202,290	-
	2	**Current assets**			
		(b) Inventories	7	69,500	-
		(c) Trade receivables	8	45,000	-
		(d) Cash and cash equivalents	9	56,000	-
				170,500	-
		TOTAL (1+2)		372,790	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	-
Equity Share capital @ ₹ 10	1,00,000	-
	1,00,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	41,600	-
Profit and loss	39,432	-
Capital Reserve on Consolidation	29,200	-
	1,10,232	-

Note 3. Trade Payable

	Current Year	Previous Year
Creditors		
H	71,000	-
G	48,000	-
	1,19,000	-

Note 4. Short Term Provisions

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
Proposed Dividend (H Ltd)	10,000	-
	10,000	-

Note 5. Tangible Assets :-

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
Fixed Assets		
H	60,000	-
S	1,10,000	-
	1,70,000	-
Add: Revaluation gain	10,000	-
	1,80,000	-
Less: Depreciation loss	2,710	-
	1,77,290	-

Note 6. Non Current Investment :-

	Current Year	Previous Year
Investments		
H	1,00,000	-
G	15,000	-
	1,15,000	-
Less: Held by H ltd. In G Ltd	90,000	-
	25,000	-

Note 7. Inventories :-

	Current Year	Previous Year
Stock		
H	30,000	-
G	40,000	-
	70,000	-
Less: Stock Reserve	500	-
	69,500	-

Note 8. Trade Receivable :-

	Current Year	Previous Year
Debtors		
H	25,000	-
G	20,000	-
	45,000	-

Note 9. Cash and cash equivqlent :-

	Current Year	Previous Year
Bank		
H	32,000	-
G	24,000	-
	56,000	-

D. INVESTMENT IN PREFERENCE CAPITAL

Illustration 19: Bonus Issue, Pre-acquisition Dividend, Preference Dividend

The following are the Extract Balance Sheets of Sky Ltd. and Star Ltd. as on 31.03.2015 -

Liabilities		Sky (₹)	Star (₹)	Assets		Sky (₹)	Star (₹)
Share Capital:				**Fixed Assets:**	Goodwill	60,000	40,000
Equity Shares of ₹ 10 each		5,00,000	2,00,000		Machinery	1,00,000	60,000
12% Pref. Shares of ₹ 100 each		1,00,000	50,000		Vehicles	1,80,000	70,000
Reserves:	General Reserve	1,00,000	60,000		Furniture	50,000	30,000
	Profit & Loss A/c	1,50,000	90,000	**Investment:**	Shares of Star (Cost)	4,80,000	–
Current Liabilities & Provisions:				**Current Assets:**	Stock	70,000	1,40,000
Creditors		1,60,000	70,000		Debtors	1,00,000	1,65,000
Income Tax		70,000	60,000		Bank Balance	40,000	25,000
Total		**10,80,000**	**5,30,000**	**Total**		**10,80,000**	**5,30,000**

The following further information is furnished:

1. Sky Ltd. acquired 12,000 Equity Shares and 400 Preference Shares on 01.04.2014 at a cost of ₹2,80,000 and ₹ 1,00,000 respectively.
2. The Profit & Loss Account of Star Ltd. had a credit balance of ₹ 30,000 as on 01.04.2014 and that of General Reserve on that date was ₹ 50,000.
3. On 01.07.2014, Star Ltd. declared dividend out of its pre-acquisition profit, 12% on its Share Capital; Sky Ltd. credited the receipt of dividend to its Profit & Loss Account.
4. On 01.10.2014 Star Ltd. issued one Equity Share for every three shares held, as Bonus Shares, at a face value of ₹ 100 per share out of its General Reserve. No entry has been made on the books of Sky Ltd. for the receipt of these bonus shares.
5. Star Ltd. owed Sky Ltd. ₹ 20,000 for purchase of goods from Sky Ltd. The entire stock of goods is held by Sea Ltd. on 31.03.2015. Ocean Ltd. made a profit of 25% on cost.

Prepare a Consolidated Balance Sheet as at 31.03.2015.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = Sky Ltd. Subsidiary = Star Ltd	Acquisition: 01.04.2014 Consolidation: 31.03.2015	Holding Company = 80% Minority Interest = 20%

Shareholding Status: Shares held on 31.03.2015 = 12,000+ 1/3 x 12,000 (Bonus) = 16,000 out of 20,000 = 80%.

Note: Share distribution pattern can be determined as under –

Date	Particulars	Held by Sky Ltd.	% of Holding	Total Shares
01.04.2014	Opening Balance	12,000	NIL	15,000 $(12,000 \times \frac{100}{80})$
01.10.2014	Bonus Shares (1 /3 x 12,000)	4,000	80%	5,000 $(4000 \times \frac{100}{80})$
31.03.2015	Closing Balance	16,000	80% (16,000/20,000)	20,000 (From Balance Sheet Given)

2. Analysis of Reserves & Surplus of Star Ltd.

(a) General Reserve

Balance on 31.03.2015 ₹ 60,000

	Balance on 01.04.2014 (acquisition)	50,000	Transfer during 2014-15 (bal. fig)	60,000 Revenue Reserve
Less:	Bonus Issue (1/3 x 15,000 Shares x ₹ 10)	50,000		
	Capital Profit	**Nil**		

(b) Profit & Loss Account

Balance on 31.03.2015 ₹ 90,000

	Balance on 01.04.2014 (acquisition)	30,000		Profit for 2014-15	₹ 84,000
Less:	Dividend on pre-acquisition profit		**Less:**	Preference Dividend	₹ 6,000
	(12% x 15,000 shares x ₹ 10 each)	(18,000)			**₹ 78,000**
Less:	Preference dividend (50,000 x 12%)	(6,000)			**Revenue Profit**
	Balance **Capital Profits**	₹ 6,000			

3. Analysis of Net Worth of Star Ltd.

Particulars		Total	Sky Ltd	Minority
		100%	**80%**	**20%**
(a) **Share Capital:**	Equity	**2,00,000**	1,60,000	40,000
	Preference	**50,000**	40,000	10,000
(b) **Capital Profits:**	General Reserve	Nil		
	Profit & Loss Account	6,000		
		6,000	4,800	1,200
(c) **Revenue Reserve:**		**60,000**	48,000	12,000
(d) **Revenue Profit:**	Profit & Loss Account	**78,000**	62,400	15,600
(e) **Pref. Dividend:**	of Star Ltd. for the year	**6,000**	4,800	1,200
Minority Interest				**80,000**

4. Cost of Control

	Particulars		₹
	Cost of Investment: Equity Shares of Sea Ltd.		1,00,000
	Preference Shares of Sea Ltd.		3,80,000
	Total Cost of Investment		**4,80,000**
Less:	Dividend out of Pre-acquisition profits		
	Preference Shares (400 Shares x ₹ 100 each x 12%)	4,800	
	In Equity Shares (12,000 Shares x ₹ 10 each x 12%)	14,400	(19,200)
	Corrected Cost of Investment		**4,60,800**
Less:	(1) Nominal Value of Equity Share Capital	1,60,000	
	(2) Nominal Value of Preference Share Capital	40,000	
	(3) Share in Capital Profit of Star Ltd.	4,800	(2,04,800)
	Goodwill on Consolidation		**2,56,000**

5. Consolidation of Reserves & Surplus

	Particulars	Gen. Res	P&L A/c
	Balance as per Balance Sheet of Sky Ltd.	1,00,000	1,50,000
Add:	Share of Revenue Profits/ Reserves of Star Ltd.	48,000	62,400
Add:	Share of Preference Dividend from Star Ltd.	–	4,800
Less:	Dividend out of Pre-acquisition Profits (₹ 4,800 + ₹ 14,400)	–	(19,200)
Less:	Preference Dividend payable for the current year by Sky Ltd.	–	(12,000)
Less:	Stock Reserve on Closing Stock (20,000 x 25 /125)	–	(4,000)
	Adjusted Consolidated Balance	**1,48,000**	**1,82,000**

Name of the Company: Sky Ltd. And its subsidiary Star Ltd.
Consolidated Balance Sheet as at 31st March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	600,000	-
		(b) Reserves and surplus	2	330,000	-
				930,000	-
	2	**Minority Interest**		80,000	-
	3	**Share application money pendint allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	110,000	-
		(b) Short-term provisions	4	142,000	-
				252,000	-
		TOTAL (1+2+3+4+5)		1,262,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	490,000	-
		(ii) Intangible assets (goodwill)	6	256,000	-
				746,000	-
	2	**Current assets**			
		(a) Inventories	7	206,000	-
		(b) Trade receivables	8	245,000	-
		(c) Cash and cash equivalents	9	65,000	-
				516,000	-
		TOTAL (1+2)		1,262,000	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	
Equity Share capital @ ₹ 10	5,00,000	-
12% Preference Share	1,00,000	-
	6,00,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	1,48,000	-
Profit and loss	1,82,000	-
	-	-
	3,30,000	-

Note 3. Trade Payable

	Current Year	Previous Year
Sundry Debtors		
Sky	60,000	-
Star	70,000	-
	1,30,000	-
Less: set off	20,000	-
	1,10,000	-

Note 4. Short Term Provisions

	Current Year	Previous Year
Prov. For taxations (70000+60000)	1,30,000	-
Proposed Pref Dividend payable Sky Ltd.	12,000	-
	1,42,000	-

Note 5. Tangible Assets :-

	Current Year	Previous Year
Fixed Assets		
Machinery (100000+60000)	1,60,000	-
Vehicles (180000+70000)	2,50,000	-
Furniture (50000+30000)	80,000	-
	-	-
	4,90,000	-

Note 6. Intangible Assets:-

	Current Year	Previous Year
Goodwill		
Sky	60,000	-
Star	40,000	-
	1,00,000	-
Goodwill on consolidation	1,56,000	-
	2,56,000	-

Note 7. Inventories :-

	Current Year	Previous Year
Stock		
Sky	70,000	-
Star	1,40,000	-
	2,10,000	-
Less: Stock Reserve	4,000	-
	2,06,000	-

Note 8. Trade Receivable :-

	Current Year	Previous Year
Sky	1,00,000	-
Star	1,65,000	-
	2,65,000	-
Less: Set off	20,000	-
	2,45,000	-

Note 9. Cash and cash equivqlent :-

	Current Year	Previous Year
sky	40,000	-
star	25,000	-
	65,000	-

Notes:

- Stock Reserve i.e. unrealized profits on Closing Stock have been eliminated in full against Holding Company's Profits, as it arose from downstream transaction (i.e. Holding to Subsidiary).
- Inter Company Owings have been eliminated in full.

Illustration 20: Bonus Issue Not Recorded / Debenture Interest

The following are the Extract Balance Sheets of K Ltd. and P Ltd. as at 31.03.2015 - (₹ 000's)

Liabilities	K	P	Assets	K	P
Authorized Issued & Paid-up Capital:			**Fixed Assets: (Tangible)**	1,015	819
Equity Shares of ₹ 100 each	800	400	Investments: In P Ltd.		
12% Preference Shares of ₹ 100 each	—	200	3,000 Equity Shares	450	
Reserves & Surplus:			1,500 Preference Shares	180	
General Reserve	360	200	25 10% Debentures (Face Value)	25	
Profit & Loss Account	240	140	**Current Assets:**	300	480
Secured Loans:					
10% Debentures of ₹ 1,000 each		50			
Current Liabilities & Provisions:					
Proposed Dividends on:					
- Equity Shares	120	60			
- Preference Shares	—	24			
Debenture Interest accrued	—	5			
Trade Creditors	450	220			
Total	**1,970**	**1,299**	**Total**	**1,970**	**1,299**

1. K Ltd. acquired its interest in P Ltd. on 01.04.2014, when the balance to the General Reserve Account of P Ltd. was ₹ 1,80,000.
2. The balance in the Profit & Loss Account of P Ltd. as at 31.03.2015 was arrived at as under –

	₹	₹
Balance on 01.04.2014 Add: Current Profits (including Dividends)		40,000 2,04,000
Deduct: Transfer to: General Reserve Proposed Dividends	20,000 84,000	2,44,000 1,04,000
Balance as on 31.03.2015		**1,40,000**

3. Balance to the P & L Account of P Ltd. as on 01.04.2014 was after providing for dividends on Preference Shares and 10% dividends on Equity Shares for the year ended 31.03.2015, these dividends were paid in cash by P Ltd. in August 2014.
4. No entries have been made in the books of K Ltd. for debenture interest due or for proposed dividends of P Ltd. for the year ended 31.03.2015.
5. Mutual indebtedness of ₹ 18,000 is reflected in the balances shown in the Balance Sheets.
6. In January 2015, P Ltd. issued fully paid up Bonus Shares in the ratio of one share for every four shares held by utilizing its General Reserve. This was not recorded in the books of both the Companies.

From the above information, you are required to prepare the Consolidated Balance Sheet of K Ltd., and its subsidiary P Ltd. as at 31.03.2015.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = K Ltd. Subsidiary = P Ltd.	Acquisition: 01.04.2014 Consolidation: 31.03.2015	Holding Company = 75% Minority Interest = 25%

2. Analysis of Reserves and Surplus of P Ltd.

(a) General Reserve

	Balance on 31.03.2015	₹ 2,00,000
Less:	Bonus Issue (₹ 4,00,000 x 1 / 4)	₹ 1,00,000
	Adjusted Balance	₹ **1,00,000**

	Balance on 01.04.2014 (acquisition)	₹ 1,80,000	Transfer during 2014-15	₹ **20,000**
Less:	Bonus Issue	₹ 1,00,000	(balancing figure)	**Revenue Profit**
	Balance **Capital Profit**	₹ **80,000**		

(b) Profit and Loss Account

Balance on 31.03.2015 ₹ 1,40,000

Balance on 01.04.2014	₹ **40,000**	Profit for 2014-15	₹ **1,00,000**
	Capital Profit	(balancing figure)	**Revenue Profit**

3. Analysis of Net Worth of P Ltd.

Particulars		Total 100%	K Ltd. 75%	Minority 25%
(a) Share Capital:	Equity (including Bonus ₹ 1,00,000)	**5,00,000**	3,75,000	1,25,000
	12% Preference Share Capital	**2,00,000**	1,50,000	50,000
(b) Capital Profits	General Reserve	80,000		
	Profit & Loss Account	40,000		
		1,20,000	90,000	30,000
(c) Revenue Reserves:	General Reserve	**20,000**	15,000	5,000
(d) Revenue Profits:	P & L Account	**1,00,000**	75,000	25,000
(e) Proposed Dividend:	Equity Dividend	**60,000**	45,000	15,000
	12% Preference Dividend	**24,000**	18,000	6,000
Minority Interest				**2,56,000**

4. Cost of Control

	Particulars		₹
	Cost of Investment: Equity Shares		4,50,000
	Preference Shares		1,80,000
	Total Cost of Investment		**6,30,000**
Less:	(1) Nominal Value of Equity Capital	3,75,000	
	(2) Nominal Value of Preference Capital	1,50,000	
	(3) Share in Capital Profit of P Ltd.	90,000	6,15,000
	Goodwill on Consolidation		**15,000**

Note: It has been presumed that K Ltd. has correctly recorded the receipt of pre-acquisition dividend to its investment account. If it is presumed that Pre-acquisition dividend have been wrongly taken to P & L Account, Capital Reserve on Consolidation will be ₹ 33,000. Balance in P & L will be reduced by ₹ 48,000.

5. Consolidation of Reserves & Surplus

	Particulars	Gen. Res.	P&LA/c
	Balance as per Balance Sheet of K Ltd.,	3,60,000	2,40,000
Add:	Share of Dividends declared for 2013-14 (75% of ₹ 84,000)		63,000
Add:	Share of Debenture Interest [(25,000/50,000) x ₹ 5,000]		2,500
	Adjusted Balance	**3,60,000**	**3,05,500**
Add:	Share of Revenue Profits / Reserves of Prasad Ltd.	15,000	75,000
	Consolidated Balance	**3,75,000**	**3,80,500**

Name of the Company: k Ltd. And its subsidiary P Ltd.

Consolidated Balance Sheet as at 31st March 2015

Ref No.		Particulars	Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	800,000	-
		(b) Reserves and surplus	2	755,500	-
				1,555,500	-
	2	**Minority Interest**		256,000	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	25,000	-
				25,000	-
	5	**Current liabilities**			
		(a) Trade payables	4	6,52,000	-
		(b) Other current liabilities	5	2,500	-
		(c) Short-term provisions	6	120,000	-
				7,74,500	-
		TOTAL (1+2+3+4+5)		26,11,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	7	1,834,000	-
		(ii) Intangible assets (goodwill)	8	15,000	-
				1,849,000	-
	2	**Current assets**			
		(a) Other current assets	9	7,62,000	-
				7,62,000	-
		TOTAL (1+2)		26,11,000	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	-
Equity Share capital @₹ 10	800,000	-
	-	-
	800,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	375,000	-
Profit and loss	380,500	-
	-	-
	755,500	-

Note 3. Long Term Borrowings

	Current Year	Previous Year
10% debentures	50,000	-
	-	-
	50,000	-
Less: Held by K	25,000	-
	25,000	-

Note 4. Trade Payable

	Current Year	Previous Year
Trade Creditors		
K	4,50,000	-
P	2,20,000	-
	6,70,000	-
Less: set off	18,000	-
	6,52,000	-

Note 5. Other current liabilities

	Current Year	Previous Year
Debenture Interest accrued	2,500	-
	2,500	-

Note 6. Short Term Provisions

	Current Year	Previous Year
Proposed Dividend - Equity	120,000	-
	120,000	-

Note 7. Tangible Assets :-

	Current Year	Previous Year
Fixed Assets		-
K	1,015,000	-
P	8,19,000	-
	18,34,000	-

Note 8. Intagible Assets :-

	Current Year	Previous Year
Goodwill	15,000	-
	15,000	-

Note 9. Other Current assets :-

	Current Year	Previous Year
K	3,00,000	-
P	480,000	-
	7,80,000	-
Less: Mutual Owings	18,000	-
	7,62 ,000	-

E. ACQUISITION IN LOTS

Illustration 21: Purchase in Lots - Before Controlling Acqn. - Loss of Stock post-acquisition

The following are the Extract Balance Sheets of L Ltd. and M Ltd. as at 31.03.2015 -

Liabilities	L Ltd. (₹)	M Ltd. (₹)	Assets	L Ltd. (₹)	M Ltd. (₹)
Equity Share Capital (₹10)	80,000	1,00,000	Shares in M Ltd	98,000	–
Profit & Loss Account Sundry	22,000	30,000	Cash	7,000	4,000
Creditors	3,000	8,000	Other Assets (Tangible)	–	1,34,000
Total	**1,05,000**	**1,38,000**	**Total**	**1,05,000**	**1,38,000**

1. Net Profit during 2014-15 included above were: L Ltd. ₹ 18,000; M Ltd. ₹ 12,000.
2. During 2014-15, M Ltd. credited ₹ 3,000 to its P & L Account in settlement of a claim of loss of stock (costing ₹ 5,400 - included in opening stock) by fire on 30.06.2014.
3. ₹ 300 p.m. expenses incurred by L Ltd. on behalf of M Ltd. has been debited to the Profit & Loss Account of L Ltd. and left unrecorded for in the books of M Ltd.
4. Both the Companies have proposed a dividend of 10% which is yet to be recorded.
5. On 01.04.2014, L Ltd., was formed and on the same day it acquired 4,000 Shares of M Ltd. at ₹ 55,000.
6. On 31.07.2014, 10% dividend was received from M Ltd. and also Bonus Share at 1:4 was received. The dividend was credited to Profit & Loss Account.
7. On 31.8.2014, L Ltd. purchased another 3,000 Shares of M Ltd. at ₹ 43,000.

Draft a Consolidated Balance Sheet for the above Group.

Solution:

1. Basic Information

Company Status	Date of Acquisition	Holding Status
Holding Company = L Ltd. Subsidiary = M Ltd.	First Lot = 4,000 Shares = 01.04.2014 Bonus 1,000 Shares = 31.07.2014 Second Lot = 3,000 Shares = 31.08.2014	Holding Company = 80% Minority Interest = 20%

Date of Consolidation = 31.03.2015

Notes:

- As per M's B/Sheet, number of Shares = 10,000, which is after Bonus Issue of 1:4. Hence, Number of Shares prior to Bonus Issue = 10,000 Less l/5th = 8,000 Shares.
- First Lot of 4,000 Shares do not constitute controlling acquisition. Hence, Date of Control = 31.08.2014. Shares held by L Ltd. = 8,000 Shares out of 10,000 = 80% Holding.

2. Analysis of Profit & Loss Account of M Ltd.

Note:

1. Normal Operating Profit of M for 2014-15 = 12,000 (given) + 2,400 (abnormal loss item) = ₹ **14,400.**
2. Presuming this to be earned uniformly, the Revenue Profits after date of controlling acquisition i.e. the period from 31.08.2014 to 31.03.2015 (i.e. 7 months) = ₹ 14,400 x 7/12 = ₹ **8,400.** Hence, amount relatable to pre-acquisition period = ₹ 14,400 - ₹ 8,400 = ₹ 6,000.

P & L balance on 31.03.2015 ₹ 30,000

Bal.in P&L last year	₹ **46,000**	
Less: Bonus Issue	20,000	(₹ 80,000 x 1 /4)
Less: Dividend	8,000	(₹ 80,000 x 10%)
Less: Stock Loss	2,400	
	15,600	(30,000- 14,400)
2014-15 Pft **(Note 2)**	6,000	(₹ 14,400 x 5/12)
Less: Exp. by L Ltd.	(1,500)	(₹ 300 x 5)
	20,100	**Capital Profit**

Profit from 31.08.2014 to 31.03.2015	8,400
(See **Note 2** above)	
Less: Expenses by L Ltd. (₹ 300 x 7)	(2,100)
Less: 2014-15 Dividend (1,00,000x10%)	(10,000)
	(₹ 3,700)
Revenue Profit	

Note:

- The Opening Balance in P&L A/c ₹ 46,000 is derived by reverse working. From this balance, M Ltd. should have declared bonus shares, paid dividend and written off the stock losses.
- The net balance of Capital and Revenue Profits = ₹ 20,350 - ₹ 3,350 = ₹ **17,000.** This is confirmed with the corrected balance of M's P&L Account i.e. Balance as given = ₹ 30,000 **Less** Expenses incurred by L Ltd., now recorded = ₹ 3,000 **Less** Dividend for 2008-09 = ₹ 10,000; Net Balance = ₹ 17,000.

3. Analysis of Net Worth of M Ltd.

Particulars	Total 100%	L Ltd. (80%)	Minority 20%
(a) **Equity Share Capital**	1,00,000	80,000	20,000
(b) **Capital Profits:**	20,100	16,080	4,020
(c) **Revenue Profits:**	(3,700)	(2,960)	(740)
(d) **Proposed Dividend**	10,000	8,000	2,000
Minority Interest			**25,280**

4. Computation of Pre-acquisition Dividend of L Ltd.

Particulars	Total	1st Lot	2nd Lot
% of Holding on 31.03.2015	80%	50%	30%
Share of dividend	₹ 8,000	₹ 5,000	₹ 3,000
Period of holding during 2014-15	–	12 Months	7 Months
To be Credited to P&L A/c	₹ 6,750	₹ 5,000	₹ 1,750 (3,000x7/12)
To be Credited to Investment A/c (Pre-acquisition Dividend)	₹ 1,250	NIL	₹ 1,250 (3,000x5/12)

5. Cost of Control

	Particulars	₹	
	Cost of Investment in M Ltd.		98,000
Less:	Dividend out of Pre-acquisition Profits (2013-14) of M Ltd. (₹ 8,000 x 50%)		(4,000)
Less:	Dividend out of Pre-acquisition Profits (2014-15) Working Note - 4 above		(1,250)
	Adjusted Cost of Investment		**92,750**
Less:	Nominal Value of Equity Capital	80,000	
	Share in Capital Profit of M Ltd.	16,080	96,080
	Capital Reserve on Consolidation		**(3,330)**

6. Consolidation of Profit and Loss Account

	Particulars		₹
	Balance as per Balance Sheet		22,000
Less:	Proposed Dividend	(₹ 80,000 x 10%)	(8,000)
Add:	Expenses incurred on behalf of M Ltd. by L Ltd.	(₹ 300 x 12 months)	3,600
Less:	Dividend out of Pre-acquisition Profits (2014-15)	(₹ 8,000 x 50%)	(4,000)
Add:	Share of Proposed Dividend for FY 2015-16	(WN4)	6,750
	Adjusted Balance		**20,350**
Less:	Share of Revenue Loss of M Ltd.		(2,960)
	Consolidated Balance		**17,390**

Name of the Company: L Ltd. And its subsidiary M Ltd.
Consolidated Balance Sheet as at 31st March 2015

Ref No.		Particulars	Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	80,000	-
		(b) Reserves and surplus	2	20,720	-
				1,00,720	-
	2	**Minority Interest**		25,280	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	11,000	-
		(b) Short-term provisions	4	8,000	-
				19,000	-
		TOTAL (1+2+3+4+5)		145,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	134,000	-
				134,000	-
	2	**Current assets**			
		(a) Cash and cash equivalents	6	11,000	-
				11,000	-
		TOTAL (1+2)		145,000	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	-
Equity Share capital @ ₹ 10	80,000	-
	-	-
	80,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	17,390	-
Capital Reserve	3,330	-
	-	-
	20,720	-

Note 3. Trade Payable

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
K	3,000	-
P	8,000	-
	11,000	-

Note 4. Short Term Provisions

	Current Year	Previous Year
Proposed Dividend -Shareholders of L. ltd.	8,000	-
	8,000	-

Note 5. Tangible Assets

	Current Year	Previous Year
Other Assets	1,34,000	-
	1,34,000	-

Note 6. Cash and cash equivqlent :-

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
L	7,000	-
M	4,000	-
	11,000	-

Illustration 22: Purchase in Lots - Before Controlling Acqn. - Ex-Dividend & Ex-Bonus

The Summarised Balance Sheets of G Ltd. and M Ltd. as on 31.03.2015 are as follows - (₹)

Liabilities	G	M	Assets	G	M
Share Capital (₹ 100 Shares)	1,60,000	2,00,000	Investment: Shares in M	–	–
Profit & Loss Account	50,000	60,000	Debtors	1,96,000	1,20,000
Creditors		16,000	Stock in Trade		80,000
			Cash at Bank		70,000
			Cash in Hand	14,000	6,000
Total	**2,10,000**	**2,76,000**	**Total**	**2,10,000**	**2,76,000**

Particulars of G Ltd. -

1. This Company was formed on 01.04.2014.
2. It acquired the shares of M Ltd. as under –

Date of Acquisition	No. of Shares	Cost ₹
01.04.2014	800	1,10,000
31.07.2014	600	86,000

3. The shares purchased on 31.07.2014 are ex-dividend and ex-bonus from existing holders.
4. On 31.07.2014 dividend at 10% was received from M and was credited to Profit & Loss Account.
5. On 31.07.2014 it received Bonus Shares from M in the ratio of One Share on every Four Shares held.
6. G incurred an expenditure of ₹ 500 per month on behalf of M Ltd. and this was debited to the Profit and Loss Account of G Ltd, but nothing has been done in the books of M Ltd.
7. The balance in Profit & Loss A/c as on 31.03.2015 included ₹ 36,000 being the net profit made during the year.
8. Dividend proposed for 2014-15 at 10% was not provided for yet.

Particulars of Maurya Ltd. -

1. The balance in the Profit & Loss A/c as on 31.03.2015 is after the issue of Bonus Shares made on 31.07.2014.
2. The Net Profit made during the year is ₹ 24,000 including ₹ 6,000 received from Insurance Company in settlement of the claim towards loss of stock by fire on 30.06.2014 (Cost ₹ 10,800 included in Opening Stock)
3. Dividend proposed for 2014-15 at 10% was not provided for in the accounts.

Prepare the Consolidated Balance Sheet as at 31.03.2015.

Solution: **1. Basic Information**

Company Status	Dates of Acquisition	Holding Status
Holding Company = G Subsidiary = M	Lot 1 800 Shares 01.04.2014 Lot 2 600 Shares 31.07.2014	Holding Company = 80% Minority Interest = 20%

Consolidation: 31.03.2015

Shareholding Status: 800 (Lot 1 on 01.04.2014) + 600 (Lot 2 on 31.07.2014) + 200 (Bonus Issue 1/4th x 800 shares) = 1,600 Shares out of Total 2,000 Shares = 80%

2. Analysis of Profit & Loss Account of M Ltd.

Balance on 31.03.2015 ₹ 60,000

Balance on 01.04.2014	36,000		Profit for 2014-15 (Upto consolidation) (bal fig.)		24,000
(60,000 - 24,000)		**Less:**	Expenses incurred by G Ltd. (₹ 500 x 12)		(6,000)
Less: Dividend adjusted	(2,000)	**Add:**	Abnormal Item - Loss of Stock	₹ 10,800	
(20,000 Less 18,000)			Insurance Claim	₹ 6,000	4,800
Balance Capital Profit	**34,000**		Profit for the year before Dividend		22,800

	01.04.2014 to 31.07.2014 (upto acquisition)		01.07.2014 to 31.03.2015 (upto consolidation)	
	₹ 22,800x4/12=	7,600	₹ 22,800 x 8/12 =	15,200
Less:	Abnormal Item	4,800	**Less:** Dividend 10% x 2,00,000	(15,200)
	Profit after stock loss	2,800	restricted to profits available	
Less:	Balance Dvd ₹ 4,800		Revenue Profit	NIL
	(20,000 - 15,200) adj.	(2,800)		
	to the extent of Profit			
	Balance Capital Profit	NIL		

3. Analysis of Net Worth of M Ltd.

Particulars	Total 100%	G ~~Ltd.~~ 80%	Minority 20%
(a) Equity Share Capital	2,00,000	1,60,000	40,000
(b) Capital Profits: Profit & Loss Account	34,000	27,200	6,800
(c) Revenue Profits: Profit & Loss Account	NIL	–	–
(d) Proposed Dividend	20,000	16,000	4,000
Minority Interest			**50,800**

4. Cost of Control

	Particulars	₹
	Cost of Investment in M Ltd.	1,96,000
Less:	Dividend out of Pre-acquisition profits (2013-14) (800 Shares x ₹ 10 x 10%)	(8,000)
	FY 2013-14 ₹ 2,000 x 80% x 1,000 Shares/1,600 Shares	(1,000)
	Adjusted Cost of Investment	**1,87,000**
Less:	(1) Nominal Value of Equity Capital	(1,60,000)
	(2) Share in Capital Profit of M Ltd.	(27,200)
	Capital Reserve on Consolidation	**(200)**

Note: *Out of the Dividend for the year declared, ₹ 2,000 is from Profits prior to the date of acquisition. Holding Company's share of pre-acquisition dividend ₹ 800 (₹ 2,000 x 80% x 800 Shares ÷ 1,600 Shares)* *(to the extent of 1,000 Shares including bonus of 200 Shares only) should be adjusted against Investment Account. The balance dividend should be credited to Profit and Loss Account only because –*

- For the first lot of 800 Shares, dividends for the preceding year 2013-14 alone should be reduced from Investment Account.
- Second Lot of 600 Shares were purchased ex-dividend and ex-bonus and therefore the entire dividend received on them should be credited to Profit and Loss Account.

5. Consolidation of Profit and Loss Account

	Particulars	₹
	Balance as per Balance Sheet of G Ltd.	50,000
Less:	Proposed Dividend (₹ 1,60,000 x 10%)	(16,000)
Add:	Expenses incurred by M Ltd., (₹ 500 x 12)	6,000
Less:	Dividend out of Pre-acquisition Profits (FY 2013-14 8,000 + FY 14-15 1,000)	(9,000)
Add:	Share of Proposed Dividend for FY 2014-15 (1,600 Shares x ₹ 10 x 10%)	16,000
	Adjusted Balance as at 31.3.2015	**47,000**
Add:	Share of Revenue Profits of M Ltd.	–
	Consolidated Balance	**47,000**

Name of the Company: G Ltd. And its subsidiary M Ltd.
Consolidated Balance Sheet as at 31st, March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	160,000	-
		(b) Reserves and surplus	2	47,200	-
				207,200	-
	2	**Minority Interest**		50,800	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	16,000	-
		(b) Short-term provisions	4	16,000	-
				32,000	-
		TOTAL (1+2+3+4+5)		290,000	-
	B	**ASSETS**			
	1	**Non-current assets**		Nil	
				-	-
	2	**Current assets**			
		(a) Inventories	5	80,000	-
		(b) Trade receivables	6	120,000	-
		(c) Cash and cash equivalents	7	90,000	-
				2,90,000	-
		TOTAL (1+2)		2,90,000	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	-
Equity Share capital @ ₹ 10 each	160,000	-
	160,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
Capital Reserve on consolidation	200	-
Profit and loss	47,000	-
	-	-
	47,200	-

Note 3. Trade Payable

	Current Year	Previous Year
Creditors (M)	16,000	-
	16,000	-

Note 4. Short Term Provisions

	Current Year	Previous Year
Proposed Dividend	16,000	-
	16,000	-

Note 5. Inventories

	Current Year	Previous Year
Stock in Trade	80,000	-
	80,000	-

Note 6. Trade Receivable

	Current Year	Previous Year
Debtors	1,20,000	-
	1,20,000	-

Note 7. Cash and cash equivqlent :-

Particulars	**Current Year Amount (₹)**	**Previous Year Amount (₹)**
Cash in Hand	-	
G	14,000	-
M	6,000	-
	20,000	-
Add: Cash at Bank	70,000	-
	90,000	-

Illustration 23: Purchase in Lots – Treatment of Pre-acquisition Dividend

Following are the Summarised Balance Sheets of M Ltd. and N Ltd. as at 31.03.2015 -

Liabilities	M Ltd.	N Ltd.	Assets	M Ltd.	N Ltd.
Equity Share Capital of ₹ 100 each fully paid	6,00,000	1,00,000	Land & Building	2,00,000	1,00,000
			Machinery	2,80,000	50,000
General Reserve	50,000	30,000	7000 Shares in N	1,00,000	–
Profit & Loss Account	80,000	40,000	Stock in Trade	70,000	40,000
Sundry Creditors	1,00,000	40,000	Debtors	1,50,000	20,000
Bills Payable	30,000	45,000	Bills Receivable	30,000	–
			Cash at Bank	30,000	45,000
Total	**8,60,000**	**2,55,000**	**Total**	**8,60,000**	**2,55,000**

Prepare Consolidated Balance Sheet as at 31st March, 2015 from the following additional Information -

1. All the Bills Receivable of M Ltd. including those discounted were accepted by N Ltd.
2. When M Ltd. had acquired 600 Shares in N Ltd., the latter had ₹ 20,000 in General Reserve and ₹ 5,000 Credit Balance in Profit and Loss Account.
3. At the time of acquisition of further 100 Shares by N Ltd., the latter had ₹ 25,000 General Reserve and ₹ 28,000 Credit Balance in Profit and Loss Account, from which 20% dividend was paid by N Ltd.

4. The dividends received by M Ltd. on these shares were credited to Profit & Loss Account.

5. Stock of N Ltd. includes goods valued at ₹ 20,000 purchased from M Ltd. which has made 25% profit on cost.

6. For the financial year ending 31.03.2015, M Ltd. had proposed a dividend of 10% and N Ltd. has proposed a dividend of 15%, but no effect has yet been given in the above Balance Sheets.

Solution:

1. Basic Information

Company Status	Date of Acquisition	Holding Status
Holding Company = M Ltd. Subsidiary = N Ltd.	Lot 1 = 600 Shares = DOA - 1 Lot 2 = 100 Shares = DOA - 2	Holding Company = 70% Minority Interest = 30%

Date of Consolidation = 31.03.2015

2. Analysis of Reserves & Surplus of Kaurava Ltd.
(a) General Reserve as per B/s = ₹ 30,000

As on DOA-1	For the period DOA-1 to DOA-2 (Lot 2 date)	From DOA-2 to B/s Date
(Lot 1 date)	₹ 25,000 - ₹ 20,000 = ₹ 5,000	(upto Consolidation)
₹ 20,000	For 600 Shares (Lot 1): **Revenue**	₹ **5,0000)** (bal. figure)
Capital	For 100 Shares (Lot 2): **Capital**	**Revenue**

Total Capital Profits = ₹ 20,000; Total Revenue Reserves = ₹ 10,000 **(See Note)**

Note: Addition to Reserves of ₹ 5,000 between DOA-1 and DOA-2 have been considered as Revenue Reserves in full, only for the purpose of determining the share of Minority Interest. After allocating for Minority Interest, the revenue portion of ₹ 500 (i.e. 10% Shares x ₹ 5,000) will be added to Capital Profits.

(b) Profit & Loss Account

	P & L A/c Balance as per B/s	= ₹ 40,000
Less:	Proposed Dividend = 1,00,000 x 15%	= ₹ 15,000
	Adjusted Balance of N Ltd.'s Profits	= ₹ 25,000

As on DOA-1	For the period DOA-1 to DOA-2 (Lot 2 date)	From DOA-2 to B/s Date
(Lot 1 date)	₹ 28,000 - ₹ 5,000 = ₹ 23,000	(upto Consolidation)
₹ 5,000	**Less:** Dividend out of this = ₹ 20,000	₹ **17,000** (bal. figure)
	Net Balance = ₹ **3,000**	
Capital	For 600 Shares (Lot 1): **Revenue**	**Revenue**
	For 100 Shares (Lot 2): **Capital**	

Total Capital Profits = ₹ 5,000; Total Revenue Reserves = ₹ 5,000 **(See Note)**

Note: Addition to P&L A/c ₹ 3,000 between DOA-1 and DOA-2 have been fully considered as Revenue only for the purpose of determining the share of Minority Interest. After allocating for minority Interest, the revenue portion of ₹ 300 (i.e. 10% Shares x ₹ 3,000) will be added to Capital Profits.

3. Analysis of Net Worth of N Ltd.

	Particulars	Total	M Ltd.	Minority
	% of share Holding on Consolidation Date	**100%**	**70%**	**30%**
(a)	**Equity Share Capital**	**1,00,000**	70,000	30,000
(b)	**Capital Profits:** General Reserve	20,000		
	Profit & Loss Account	5,000		
		25,000	17,500	7,500
Add:	Capital Items [Res ₹ 5000 + P&L A/c ₹ 3,000] x 10%		800	
	Net Share in Capital Profit		18,300	
(c)	**Revenue Reserves:** General Reserve	**10,000**	7,000	3,000
Less:	Capital Item included in Revenue [₹ 5,000 x 10%]		(500)	
	Net Share in Revenue Reserves		6,500	
(d)	**Revenue Profits:** Profit & Loss A/c	**20,000**	14,000	6,000
Less:	Capital Item included in Revenue [₹ 3,000 x 10%]		(300)	
	Net Share in Revenue Profit		13,700	
(e)	**Proposed Dividend**	**15,000**	10,500	4,500
	Total Minority Interest			**51,000**

4. Cost of Control

	Particulars		₹
	Cost of Investment in Equity Shares of N Ltd.		1,00,000
Less:	Dividend out of Pre-acquisition profits of N Ltd. (Only for Lot 2 - 1000 Shares) - (₹ 10,000 x 20%)		2,000
	Adjusted Cost of Investment		98,000
Less:	(1) Nominal Value of Equity Capital	70,000	
	(2) Share in Capital Profit of N Ltd.	18,300	88,300
	Goodwill on Consolidation		**9,700**

5. Consolidation of Reserves & Surplus

	Particulars		Gen. Res	P&L A/c
	Balance as per Balance Sheet of M Ltd.		50,000	80,000
Less:	Dividend out of Pre-acquisition Profits	(₹ 20,000 x 10%)	–	(2,000)
Less:	Proposed Dividend	(₹ 6,00,000 x 10%)	–	(60,000)
Add:	Share of Dividend from N Ltd.	(₹ 15,000 x 70%)	–	10,500
	Adjusted Balance		**50,000**	**28,500**
Add:	Share of Revenue Profits/Reserves of N Ltd.		6,500	13,700
	Consolidated Balance		**56,500**	42,200
Less:	Unrealised Profits on Closing Stock ₹ 20,000 x 25 / 125		–	(4,000)
	Adjusted Consolidated Balance		**56,500**	**38,200**

Name of the Company: G Ltd. And its subsidiary M Ltd.

Consolidated Balance Sheet as at 31st, March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015 ₹	As at 31st March, 2014 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	600,000	-
		(b) Reserves and surplus	2	94,700	-
				694,700	-
	2	**Minority Interest**		51,000	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	140,000	-
		(b) Other current liabilities	4	45,000	-
		(c) Short-term provisions	5	60,000	-
				245,000	-
		TOTAL (1+2+3+4+5)		9,90,700	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	630,000	-
		(ii) Intangible assets (goodwill)	7	9,700	-
				639,700	-
	2	**Current assets**			
		(a) Inventories	8	106,000	-
		(b) Trade receivables	9	170,000	-
		(c) Cash and cash equivalents	10	75,000	-
				351,000	-
		TOTAL (1+2)		9,90,700	-

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

Note 1. Share Capital

Particulars	**Current Year Amount (₹)**	**Previous Year Amount (₹)**
Authorised Capital	-	-
Issued and Paid Up	-	
Equity Share capital @ ₹ 100	600,000	
	600,000	-

Note 2. Reserve and Surplus :-

Particulars	**Current Year Amount (₹)**	**Previous Year Amount (₹)**
General Reserve	56,500	-
Profit and loss	38,200	-
	-	-
	94,700	-

Note 3. Trade Payable

	Current Year	Previous Year
Creditors		
M	100,000	-
N	40,000	-
	140,000	- -

Note 4. Other Current Liabilities :-

	Current Year	Previous Year
Bills Payable		
M	30,000	-
N	45,000	-
	75,000	-
Less: Mutual	30,000	-
indebtedness	45,000	-

5. Short Term Provisions

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
Proposed Dividend (M Ltd.)	60,000	-
	-	-
	60,000	-

Note 6. Tangible Assets :-

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
Fixed Assets		-
Land and Building (200000+100000)	300,000	
Plant & Machinery (280000+50000)	330,000	
	630,000	

Note 7. Intigable Assets:-

	Current Year	Previous Year
Goodwill on consolidation	9,700	-
	-	-
	9,700	-

Note 8. Inventories :-

	Current Year	Previous Year
Stock		
M	70,000	-
N	40,000	-
	110,000	-
Less: Stock Reserve	4,000	-
	106,000	-

Note 9. Trade Receivable :-

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
M	150,000	-
N	20,000	-
	170,000	-

Note 10. Cash and cash equivqlent :-

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
Cash at Bank	-	-
M	30,000	-
N	45,000	-
	75,000	-

Note 11. Other Current assets :-

Particulars	Current Year Amount (₹)	Previous Year Amount (₹)
Bills Receivable		
M	30,000	-
N	-	-
	30,000	-
Less: Mutual	30,000	-
	-	-

Notes:

- Balance Sheet items have been consolidated on line-by-line addition basis.
- Stock Reserve i.e. unrealized profits on Closing Stock have been eliminated in full from Group reserves as it relates to downstream transaction (i.e. Holding to Subsidiary).
- Inter-Company Owings have been eliminated in full.

Illustration 24: Purchase in Multiple Lots - Asset sold by Holding Co. to Subsidiary Co.

Z Ltd. acquired 60% of shares of P Ltd. as on 30th September, 2015. As on 31st March, 2015, the Extract Balance Sheet of P Ltd. shows a balance in General Reserves ₹ 2,00,000 and in Profit and Loss Account ₹ 20,000. Subsequently Z Ltd. purchased another 10% shares of P Ltd. on 31th December, 2015. Finally Z Ltd. purchased another 20% Shares as on 28th February, 2016. Given below the Extract Balance Sheets of Z Ltd. and P Ltd. as on 31st March, 2016 -

Liabilities	Z Ltd. (₹)	P Ltd. (₹)	Assets	Z Ltd. (₹)	P Ltd. (₹)
Share Capital	10,00,000	6,00,000	**Fixed Assets (Tangible)**	16,00,000	10,00,000
General Reserve	4,00,000	1,00,000	(-) Accumulated Depreciation	4,00,000	1,70,000
P & L Account	2,00,000	1,00,000			
			Net Block	12,00,000	8,30,000
Loans	3,00,000	4,00,000	Investments	6,00,000	2,00,000
Sundry Creditors	4,00,000	2,00,000	Current Assets		
Provision for Tax	1,00,000	80,000	Stock	4,00,000	3,00,000
Proposed Dividend	2,00,000	1,50,000	Debtors	3,00,000	2,00,000
			Cash & Bank	1,00,000	1,00,000
Total	**26,00,000**	**16,30,000**	**Total**	**26,00,000**	**16,30,000**

Other Information's:

1. The initial of investment in P Ltd. was made by Z Ltd. for ₹ 3,20,000. The second phase of Investment was made by Z Ltd. for ₹ 80,000 and the last phase of investment was made for ₹ 1,90,000.
2. P Ltd. declared and paid Bonus Shares at one for every two Shares held. For this purpose the book closure date was 15th October to 31st October, 2015.
3. Z Ltd. sold a machinery costing ₹ 4,00,000 to P Ltd. on 15th December, 2015 on which the former made a profit of ₹ 1,00,000. P Ltd. charged depreciation at 20% on the plant on time proportion basis.

Prepare a Consolidated Balance Sheet for Z Ltd. and its subsidiary P Ltd. as on 31.03.2016.

Solution:

1. Basic Information

Company Status	Date of Acquisition	Holding Status
Holding Company = Z Ltd. Subsidiary = P Ltd.	Lot 1 = 60% Shares = 30.09.2015 Lot 2 = 10% Shares = 30.02.2015 Lot 3 = 20% Shares = 28.02.2016	Holding Company = 90% Minority Interest = 10%

Date of Consolidation = 31.03.2016

2. Analysis of Reserves & Surplus of P Ltd.

(a) General Reserve

Balance on 31.03.2016 ₹ 1,00,000

Balance on 1.4.2015	2,00,000	Transfer during 2015-16 (balancing figure)	₹ **1,00,000**
Less: Bonus Issue	2,00,000		
Capital Profit	**Nil**		

	Upto 30.9.15	**1.10.15 to 31.12.15**	**1.01.16 to 28.02.16**	**1.03.16 to 31.03.16**
	6 Months	3 Months	**2 Months**	**1 Month**
	1,00,000 x 6/12 = ₹ **50,000**	1,00,000 x 3/12 = ₹ **25,000**	1,00,000 x 2/12 = ₹ **16,667**	1,00,000 x 1/12 = ₹ **8,333**
Capital Profit for	90%	30%	20%	–
Revenue Reserve for	–	60%	70%	90%
Total Holdings by Z Ltd.	90%	90%	90%	90%

Total Capital Profits: ₹ **50,000;** Total Revenue Profits: ₹ **50,000**

Note: Additions to General Reserve Account are fully considered as revenue only for the purpose of determining Minority Interest. After allocating the Minority Interest the respective Capital Portion will be transferred to Capital Profits.

(b) Profit & Loss Account

Balance on 31.03.2016 ₹ 1,00,000

Balance on 1.4.2015	**20,000**	Profit earned during 2015-16 (b/f)	**₹ 80,000**
	Capital Profit	**Add:** Depreciation on Machinery	₹ 29,167
		(₹ 5 Lakhs x 3.5 Months / 12 x 20%)	**₹ 1,09,167**

	Upto 30.9.15	**1.10.15 to 31.12.15**	**01.01.16 to 28.02.16**	**1.03.12 to 31.03.16**
	6 Months	3 Months	2 Months	1 Month
	1,09,167 x 6/12 =	1,09,167 x 3/12 =	1,09,167 x 2/12 =	1,09,167 x 1/12 =
	₹ 54,584	**₹ 27,292**	**₹ 18,195**	**₹ 9,096**
Less: Depreciation	–	₹ 4,167	₹ 16,667	₹ 8,333
	–	(29,167 x 0.5/3.5)	(29,167 x 2.0/3.5)	(29,167 x 1.0/3.5)
	₹ 54,584	**₹ 23,125**	**₹ 1,528**	**₹ 763**
Capital Profit for	90%	30%	20%	–
Revenue Profit for	–	60%	70%	90%
Total Holdings by Z Ltd.		90%	90%	90%

Total Capital Profits: ₹ 54,584 + ₹ 20,000 = ₹ **74,584; Total Revenue Profits:** ₹ **25,416 (= 23,215 + 1,,528 + 763)**

Note:

- Profits are assumed to have been evenly spread out throughout the year.
- Additions to the P&L A/c after 30.09.2015 are fully considered as revenue only for the purpose of determining Minority Interest. After allocating the Minority Interest the respective Capital Portion will be transferred to Capital Profits.

3. Computation of amount to be transferred from Revenue Profits to Capital Profits

Period	% of holding considered as Capital	P&L A/c	General Reserve
30.9.2015-31.12.2015	30%	23,125 x 30% = ₹ 6,938	25,000 x 30% = ₹ 7,500
31.10.2015-28.02.2016	20%	1,528 x 20% = ₹ 306	16,667 x 20% = ₹ 3,333
		₹ 7,244	₹ 10,833

4. Analysis of Net Worth of S Ltd.

Particulars			Total	Z Ltd.	Minority
			100%	**90%**	**10%**
(a) Equity Share Capital			**6,00,000**	5,40,000	60,000
(b) Capital Profits:		General Reserve	50,000		
		Profit & Loss Account	74,584		
			1,24,584	1,12,126	12,458
	Add:	Capital Items (7,244 + 10,833)		18,077	
				1,30,203	
(c) Revenue Reserve:		General Reserve	**50,000**	45,000	5,000
	Less:	Capital Item included in Revenue		(10,833)	
				34,167	
(d) Revenue Profits:		Profit & Loss Account	**25,416**	22,874	2,542
	Less:	Capital Item included in Revenue		(7,244)	
				15,630	
(e) Proposed Dividend			**1,50,000**	1,35,000	15,000
Minority Interest					**95,000**

5. Cost of Control

	Particulars		₹
	Cost of Investment in Equity Shares of P Ltd.		5,90,000
Less:	Pre-acquisition Dividend		(97,500)
	Adjusted Cost of Investment		4,92,500
Less:	(1) Nominal Value of Equity Capital	5,40,000	–
	(2) Share in Capital Profit of P Ltd.	1,30,203	6,70,203
	Capital Reserve on Consolidation		**(1,77,703)**

6. Computation of Pre-acquisition Dividend

Particulars	Pre-Acquisition Dividend	Post Acquisition Dividend
Lot 1 - 60% - Acqd. on 30.9.2015	1,50,000 x 6/12 x 60% = ₹ 45,000	1,50,000 x 6/12 x 40% = ₹ 30,000
Lot 2 - 80% - 01.10.15 to 31.12.15	1,50,000 x 3/12 x 80% = ₹ 30,000	1,30,000 x 3/12 x 20% = ₹ 7,500
Lot 3 - 90% - 31.12.15 to 28.02.16	1,50,000 x 2/12 x 90% = ₹ 22,500	
Total	**₹ 97,500**	**₹ 37,500**

7. Consolidation of Reserves and Surplus

	Particulars		P&L A/c	Gen. Res.
	Balance as per Balance Sheet of Z Ltd.		2,00,000	4,00,000
Add:	Proposed Dividend from P Ltd.		37,500	–
Add:	Share of Revenue Profits / Reserves of P Ltd.		15,630	34,167
Less:	Unrealized Profit on Machinery sold			
	Profit on Sale of Machinery	1,00,000		
Less:	Depreciation on Profit (1,00,000 x 20% x 3.5/12)	(5,833)	(94,167)	–
	Consolidated Balance		**1,58,963**	**4,34,167**

Name of the Company: Z Ltd. And its subsidiary P Ltd.

Consolidated Balance Sheet as at 31st, March 2016

Ref No.	Particulars		Note No.	As at 31st March, 2016 ₹	As at 31st March, 2015 ₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital	1	1,000,000	-
		(b) Reserves and surplus	2	7,70,833	-
				17,70,833	-
	2	**Minority Interest**		95,000	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	7,00,000	-
				-	-
	5	**Current liabilities**			
		(a) Trade payables	4	600,000	-
		(b) Short-term provisions	5	380,000	-
				980,000	-
		TOTAL (1+2+3+4+5)		35,45,833	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	1,935,833	-
		(b) Non-current investments	7	2,10,000	

Ref No.	Particulars		Note No.	As at 31st March, 2016	As at 31st March, 2015
				₹	₹
				2,175,833	-
	2	**Current assets**			
		(a) Inventories	8	700,000	-
		(b) Trade receivables	9	500,000	-
		(c) Cash and cash equivalents	10	200,000	-
				1,400,000	-
		TOTAL (1+2)		35,45,833	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	
Equity Share capital @ ₹ 100	1,000,000	
	1,000,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	434,167	-
Profit and loss	1,58,963	-
Capital Reserve on consolidation	1,77,703	-
	7,70,833	-

Note 3. Long Term Borrowings

	Current Year	Previous Year
Z Ltd.	300,000	-
P Ltd.	400,000	-
	-	-
	700,000	-

Note 4. Trade Payable

	Current Year	Previous Year
Z	400,000	-
P	200,000	-
	600,000	-
	600,000	-

Note 5. Short Term Provisions

	Current Year	Previous Year
Provision for Tax		
z	100,000	-
P	80,000	-
	180,000	-
Proposed Dividend (Hema Ltd.)	200,000	-
	380,000	-

Note 6. Tangible Assets :-

	Current Year	Previous Year
Fixed Assets		
Z	1,200,000	-
P	8,30,000	-
	20,30,000	-
Less: Unrealized Profit	94,167	-
	19,35,833	-

Note 7. Non Current Investment :-

	Current Year	Previous Year
Investment		
z	600,000	-
P	200,000	-
	800,000	-
Less: investments in Subsidiary	590,000	-
	2,10,000	-

Note 8. Inventories :-

	Current Year	Previous Year
Stock in Trade		
Z	400,000	-
P	300,000	-
	700,000	-

Note 9. Trade Receivable :-

	Current Year	Previous Year
Sundry Debtors		
Z	300,000	-
P	200,000	-
	500,000	-

Note 10. Cash and cash equivqlent :-

	Current Year	Previous Year
Cash at Bank	-	-
Z	100,000	-
P	100,000	-
	200,000	-

F. CHAIN HOLDINIG

Illustration 25 : Chain Holding - Multiple Subsidiaries - 100% Subsidiary

P Ltd. purchases its raw materials from H Ltd. and sells goods to Q Ltd. In order to ensure regular supply of raw materials and patronage for finished goods, P Ltd. through its wholly owned subsidiary, G Ltd. acquires on 31.03.2015, 51% of Equity Capital of H Ltd. for ₹ 15 Crores and 76% of Equity Capital of Q Ltd. for ₹ 32 Crores. G Ltd. was floated by P Ltd. in 2010 from which date it was wholly owned by P Ltd.

The following are the Summarised Balance Sheets of the four companies as at 31.3.2015 (₹ Crores) -

Particulars			P Ltd.	G Ltd.	H Ltd.	Q Ltd.
	SOURCES OF FUNDS					
1.	Shareholders Funds:	Equity (Fully paid) ₹ 10 each	25	5	10	15
		Reserves and Surplus	75	20	15	20
			100	25	25	35
2.	Loan Funds:	Secured Loans	15	–	5	20
		Unsecured Loans	10	55	10	15
			25	52	15	35
	Total Sources of Funds		**125**	**77**	**40**	**70**
	APPLICATION OF FUNDS:					
1.	Fixed Assets: Cost (Tangible Assets)		60	–	15	30
	Less: Depreciation		35	–	7	17
			25	–	8	13
2.	Investments at Cost in Fully paid Equity Shares of:					
	G Ltd.		5	–	–	–
	H Ltd.		–	15	–	–
	Q Ltd.		–	32	–	–
	Other Companies (Market Value ₹ 116 Crores)		–	29	–	–
3.	Net Current Assets:	Current,Assets	5	76	–	–
	Less:	Current Liabilities	105	1	96	200
			10		64	143
			95	1	32	57
	Total Application of Funds		**125**	**77**	**40**	**70**

There are no inter-company transactions outstanding between the Companies. Prepare Consolidated Balance Sheet as at 31.03.2015.

Solution:

1. Basic Information (for Consolidation on 31.03.2012)

Company Status		Dates		Holding Status			
Holding Company	= P	Acquisition:				**Holding**	**Minority**
Subsidiary	= G	P in G 2010		a.	G Ltd.	(P)100%	Nil
Sub-Subsidiary 1	= H	G in H:	31.03.2015	b.	H Ltd.	(G) 51%	49%
Sub-Subsidiary 2	= Q	G in Q:	31.03.2015	c.	Q Ltd.	(G) 76%	24%

2. Analysis of Reserves and Surplus of Subsidiary Companies

G Ltd. is wholly owned subsidiary from the beginning and therefore the entire amount of Reserves represents Revenue Portion. H Ltd. and Q Ltd. were acquired only on 31.03.2015 which is also the date of consolidation and hence, entire balance in Reserves and Surplus represents Capital Profits.

3. Analysis of Net Worth of Subsidiaries (₹ Crores)

Particulars		P Ltd. 100%			Minority Interest	
		G Ltd.	H Ltd. (51%)	Q Ltd. (76%)	H Ltd. 49%	Q Ltd. 24%
(a)	**Share Capital**	5.00	10.00	15.00		
Less:	Minority Interest	NIL	4.90	3.60	4.90	3.60
	Holding Co's Share	**5.00**	**5.10**	**11.40**		
(b)	**Capital Profits** Reserves & Surplus	–	15.00	20.00 (15.20)	7.35	4.80
	Tfr of G Share in H & Q	7.65	(7.65)	[20 x 76%]		
		15.20	[15 x 51%]			
		22.85	**7.35**	**4.80**		
Less:	Minority Interest	–	(7.35) [15 x 49%]	4.80 [20 x 24%]		
	Holding Co's Share	**22.85**	**NIL**	**NIL**		
(c)	**Revenue Profits:** Reserves & Surplus	**20.00**	**NIL**	**NIL**	**NIL**	**NIL**
	Minority Interest				**12.25**	**8.40**

4. Cost of Control

Particulars			₹ Crores
	Cost of Investment: P Ltd. in G Ltd.		5.00
	G Ltd. in H Ltd.		15.00
	G Ltd. in Q Ltd		32.00
	Total Cost of Investment		**52.00**
Less:	(a) Nominal Value of Share Capital in: - G Ltd.	5.00	
	- H Ltd.	5.10	
	- Q Ltd.	11.40	(21.50)
	(b) Share in Capital Profits of G Ltd.		(22.85)
	Goodwill on Consolidation		**7.65**

Name of the Company: P Ltd. And its subsidiary G,H,Q Ltd.

Consolidated Balance Sheet as at 31st, March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015 (₹ in Crores)	As at 31st March, 2014 (₹ in Crores)
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital @ ₹ 10 each	1	25.00	-
		(b) Reserves and surplus	2	95.00	-
				120.00	-

Ref No.		Particulars	Note No.	As at 31st March, 2015 (₹ in Crores)	As at 31st March, 2014 (₹ in Crores)
	2	**Minority Interest**		20.65	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	127.00	-
				127.00	-
	5	**Current liabilities**			
		(a) Other current liabilities	4	217.00	-
				217.00	-
		TOTAL (1+2+3+4+5)		484.65	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	46.00	-
		(ii) Intangible assets (goodwill)	6	7.65	-
		(b) Non-current investments	7	29.00	
				82.65	-
	2	**Current assets**			
		(a) Other current assets	8	402.00	-
				402.00	-
		TOTAL (1+2)		484.65	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up Equity Share capital	- 25.00	
	25.00	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
Reserve & Surplus	75.00	-
Add: Shares in Revenue of G Ltd	20.00	-
	95.00	-

Note 3. Long Term Borrowings

	Current Year	Previous Year
Secured Loan		
P	15.00	
H	5.00	
Q	20.00	
Unsecured		
P	10.00	
G	52.00	
H	10.00	
Q	15.00	
	127.00	

Note 4. Other Current Liabilities :-

	Current Year	Previous Year
P	10.00	-
H	64.00	-
Q	143.00	-
	217.00	-

Note 5. Tangible Assets :-

	Current Year	Previous Year
Fixed Assets		
P	60.00	-
H	15.00	-
Q	30.00	-
	-	-
	105.00	-
Less: Depreciation	59.00	-
(35+7+17)	46.00	-

Note 6. Intangiable Assets :-

	Current Year	Previous Year
Goodwill on consolidation	7.65	
	-	
	7.65	

Note 7. Non current Investment :-

	Current Year	Previous Year
Investment in Others Companies	29.00	
(MV ₹ 116 crores)	-	
	29.00	

Note 8. Other Current assets :-

	Current Year	Previous Year
Current Assets, Loans & Advances		
P	105.00	
G	1.00	
H	96.00	
Q	200.00	
	-	
	402.00	

Illustration 26: Chain Holding - Direct & Indirect Method — Abnormal Loss, Dividend

Furnished Summarised Balance Sheets as on 31.03.2015 for the following Companies: (₹ 000s)

Liabilities	A Ltd.	B Ltd.	C Ltd.	Assets	A Ltd.	B Ltd.	C Ltd.
Share Capital (₹ 100)	2,000	1,000	800	Fixed Assets (Tangible)	**1,500**	900	970
General Reserve	600	300	200	Current Assets	**450**	300	300
Securities Premium	200	50	NIL	Investments	**1,400**	580	NIL
Profit & Loss A/c	250	180	120	B Ltd. Balance	**70**	NIL	NIL
Creditors	400	200	140	C Ltd. Balance	**30**	NIL	NIL
A Ltd. Balance	-	50	30	Preliminary Expenses	**NIL**	NIL	20
Total	**3,450**	**1,780**	**1,290**	**Total**	**3,450**	**1,780**	**1,290**

A Ltd. had acquired 8000 Shares in B Ltd. at a total cost of ₹ 12,50,000 on 01.10.2013. On 01.04.2014, A Ltd. and B Ltd. purchased respectively 1,000 and 5,000 Shares in C Ltd. at ₹ 116 per Share.

Particulars about General Reserve and the Profit & Loss Account are as given below (₹ 000's)

Particulars	A Ltd.	BLtd.	CLtd.
General Reserve: As on 1.4.2013	550	250	200
Profit & Loss A/c: As on 1.4.2013	50	40	20
Profit for 2013-14	170	100	100
Dividend paid in November 2014 in respect of 2013-14	10%	12%	10%

A Ltd. and B Ltd. have credited the dividends received by them to their Profit & Loss Accounts. Increase in Reserves were made in 2014-15. On 31.03.2015, C Ltd. sold goods costing ₹ 20,000 to B Ltd. for ₹ 25,000, these were immediately sold for ₹ 28,000 to A Ltd. Prepare the Consolidated Balance Sheet of the Group as at 31.03.2015.

Solution:

1. Basic Information

Company Status	Dates	Holding Status		B Ltd.	C Ltd.
Holding Company = A Ltd.	**Acquisition:**	a.	Holding Co.	**B Ltd.**	**C Ltd.**
Subsidiary = B Ltd.	A in B: 01.10.2013			(A Ltd.) 80%	(A) 12.5%
Sub-Subsidiary = C Ltd.	A in C: 01.04.2014			–	(B) 62.5%
	B in C: 01.04.2014	b.	Minority Int.	20%	25%
	Consolidation 31.03.2015				

Note: *The Shareholding Pattern is analysed as under–*

Co.	Held by A Ltd	Held by B Ltd	Total Holdings	Minority Int.	Total Shares
B Ltd.	8,000 (80%) acquired on 01.10.2013	N.A.	8,000 (80%)	2,000 (20%)	10,000 (100%)
C.Ltd.	1,000 (12.5%) acquired on 01.04.2014	5,000 (62.5%) acquired on 01.04.2014	6,000 (75%)	2,000 (25%)	8,000 (100%)

2. Analysis of Reserves and Surplus of Subsidiary Companies

(a) General Reserve

B Ltd.		
31.03.2015 3,00,000		
01.04.2013	Tfr in 2013-14	Tfr in 2014-15
₹ 2,50,000	NIL	₹ 50,000
Capital	**Capital**	**Revenue**

C Ltd.		
31.12.2012 2,00,000		
01.04.2013	Tfr in 2013-14	Tfr in 2014-15
₹ 2,00,000	NIL	**NIL**
Capital	**Capital**	**Revenue**

(b) Profit & Loss Account C Ltd.

Balance as given on 31.03.2015 ₹ 1,20,000

1.4.2013	Profit for 2013-14	Dividend for 2013-14	Profit for 2014-15
₹ 20,000	₹ 1,00,000	₹ 8 Lacs x 10% = (₹ 80,000)	(b/f) ₹ 80,000
Capital	**Capital**	**Capital**	**Revenue**

Total Capital Profit: 20,000 + 1,00,000 - 80,000 = ₹ **40,000; Total Revenue Profit:** ₹ **80,000**

B Ltd.

	Balance as given on 31.03.2015	1,80,000
Less:	Pre-Acquisition Dividend from C Ltd. (80,000 x 62.5%)	50,000
	Adjusted Balance	**1,30,000**

01.04.2013	Profit for 2013-14	Dividend for 2013-14	Profit for 2014-15
₹ 40,000	₹ 1,00,000	₹ 10 Lacs x 12% = (₹ 1,20,000)	₹ **1,10,000**
Capital			**Revenue** (bal. figure)

Profit for 2013-14:

1.4.2013 to 1.10.2013	1.10.2013 to 31.03.2014
₹ 50,000	₹ 50,000
Capital	**Revenue**

Dividend for 2013-14:

From Opg Bal. (bal. figure)	From Profit for 1.4.13 to 1.10.13	From Profit 1.4.13 to 31.03.14
(₹ 20,000)	(₹ 50,000)	(₹ 50,000)
Capital	**Capital**	**Revenue**

Total Capital Profit: 40,000 + 50,000 - 20,000 - 50,000 = ₹ **20,000;**

Total Revenue Profit: 1,10,000 + 50,000 - 50,000 = ₹ **1,10,000**

Note: • It has been assumed that the Profits arose evenly throughout the year.

• Dividend declared for 2013-14 = ₹ 1,20,000, but profit for 2013-14 is ₹ 1,00,000. So it is presumed that ₹ 20,000 declared from opening reserve.

(c) Securities Premium: B Ltd. = ₹ 50,000 – Capital Profit

(d) Preliminary Expenses: C Ltd. = (₹ 20,000) – Capital Profit

3. Analysis of Net Worth of Subsidiary Companies

Particulars	Indirect Method: A Ltd. 80% B Ltd.	Indirect Method: A Ltd. 12.5% / 62.5% C Ltd.	Indirect: Minority Interest B Ltd. 20%	Indirect: Minority Interest CLtd 25%	Direct Method: A Ltd. 80% B Ltd.	Direct Method: A Ltd. 12.5% / 62.5% C Ltd	Direct: Minority Interest Bharat 20%	Direct: Minority Interest India 25%
(a) Share Capital	**10,00,000**	**8,00,000**	2,00,000	2,00,000	**10,00,000**	**8,00,000**	2,00,000	2,00,000
Less: Minority Interest	(2,00,000)	(2,00,000)			(2,00,000)	(2,00,000)		
	8,00,000	**6,00,000**			**8,00,000**	**6,00,000**		
(b) Capital Profits								
Securities Premium	50,000	–			50,000	–		
General Reserve	2,50,000	2,00,000			2,50,000	2,00,000		
Profit & Loss Account	20,000	40,000			20,000	40,000		
Preliminary Expenses	–	(20,000)			–	(20,000)		
	3,20,000	**2,20,000**			**3,20,000**	**2,20,000**		
Transfer of B's Share in C (62.50% x ₹ 2,20,000)	1,37,500	(1,37,500)	25%		NOT APPLICABLE		25%	
	4,57,500	**82,500**			**3,20,000**	**2,20,000**		
Less: Minority Interest 20%	91,500)	(55,000)	91,500	55,000	(64,000)	(55,000)	64,000	55,000
	3,66,000	**27,500**			**2,56,000**	**1,65,000**		
(c) Revenue Reserve 20%	**50,000**	**NIL**			**50,000**	**NIL**		
Less: Minority Interest	10,000	**NIL**	10,000	NIL	10,000	NIL	10,000	NIL
	40,000	**NIL**			**40,000**	**NIL**		
(d) Revenue Profit	**1,10,000**	**80,000**			**1,10,000**	**80,000**		
Transfer of B's Share in C (62.50% x ₹ 80,000)	50,000	(50,000)	25%		50,000	(50,000)	25%	
20%	**1,60,000**	**30,000**			**1,60,000**	**30,000**		
Less: Minority Interest	(32,000)	(20,000)	32,000	20,000	(32,000)	(20,000)	32,000	20,000
	1,28,000	**10,000**			**1,28,000**	**10,000**		
Minority Interest Before Adjustment			**3,33,500**	**2,75,000**			**3,06,000**	**2,75,000**
Less: Stock Reserve (28,000 - 20,000) x 20%			1,600	–			1,600	–
Minority Interest after Stock Reserve			**3,31,900**	**2,75,000**			**3,04,400**	**2,75,000**

Note: In B Ltd. as the entire stock was immediately sold, no Stock Reserve arises.

4. Cost of Control

	Particulars			Indirect Method		Direct Method	
	Cost of Investment:	A Ltd. in B Ltd.			12,50,000		12,50,000
		A Ltd. in C Ltd.			1,16,000		1,16,000
		B Ltd. in C Ltd.			5,80,000		5.80.000
	Total Cost of Investment				**19,46,000**		**19,46,000**
Less:	**Pre acquisition Dividend**						
	From B to A [20,000 + 50,000) x 80%]			56,000		56,000	
	From C to A [80,000 x 12.5%]			10,000		10,000	
	From C to B [80,000 x 62.5%]			50,000	(1,16,000)	50,000	(1,16,000)
	Adjusted Cost of Investment				**18,30,000**		**18,30,000**
Less:	(a) Nominal Value of Capital:		B Ltd.	8,00,000		8,00,000	
			C Ltd.	6,00,000	(14,00,000)	6,00,000	(14,00,000)
	(b) Share in Capital Profit of:		B Ltd.	3,66,000		2,56,000	
			C Ltd.	27,500	(3,93,500)	1,65,000	(4,21,000)
	Goodwill on Consolidation				**(36,500)**		**(9,000)**

5. Consolidation of Reserves & Surplus

	Particulars	Indirect Method		Direct Method	
		Gen. Res.	P&L A/c	Gen. Res.	P&L A/c
	Balance as per Balance Sheet of A Ltd.	6,00,000	2,50,000	6,00,000	2,50,000
Less:	Pre Acquisition Dividend				
	From B to A [20,000 + 50,000) x 80%]	–	(56,000)	–	(56,000)
	From C to A [80,000 x 12.5%]	–	(10,000)	–	(10,000)
	Adjusted Balance	**6,00,000**	**1,84,000**	**6,00,000**	**1,84,000**
Add:	Share of Revenue Reserves/Profits from: B Ltd.	40,000	1,28,000	40,000	1,28,000
	C Ltd.	NIL	10,000	NIL	10,000
	Consolidated Balance	**6,40,000**	**3,22,000**	**6,40,000**	**3,22,000**
Less:	Stock Reserve [(28,000-25,000)+(25,000-20,000)] x 80%	**–**	(6,400)	**–**	(6,400)
	Adjusted Consolidated Balance	**6,40,000**	**3,15,600**	**6,40,000**	**3,15,600**

Name of the Company: A Ltd. And its subsidiary B & C Ltd.

Consolidated Balance Sheet as at 31st, March 2015

Ref No.		Particulars	Note No.	Indirect Method As at 31st March, 2015	Indirect Method As at 31st March, 2014	Direct Method As at 31st March, 2015	Direct Method As at 31st March, 2014
				₹	₹	₹	₹
	A	**EQUITY AND LIABILITIES**					
	1	**Shareholders' funds**					
		(a) Share capital	1	2,000,000	-	2,000,000	-
		(b) Reserves and surplus	2	11,55,600	-	11,55,600	-
				31,55,600	-	31,55,600	-
	2	**Minority Interest**		6,06,900	-	579,400	-
	3	**Share application money pending allotment**		Nil	-	Nil	-
	4	**Non-current liabilities**		Nil	-	Nil	-

Ref No.		Particulars	Note No.	Indirect Method As at 31st March, 2015 ₹	Indirect Method As at 31st March, 2014 ₹	Direct Method As at 31st March, 2015 ₹	Direct Method As at 31st March, 2014 ₹
	5	**Current liabilities**					
		(a) Other current liabilities	3	7,40,000	-	7,40,000	-
				7,40,000	-	7,40,000	-
		TOTAL (1+2+3+4+5)		45,02,500	-	44,75,000	-
	B	**ASSETS**					
	1	**Non-current assets**					
		(a) Fixed assets					
		(i) Tangible assets	4	3,370,000	-	3,370,000	-
		(ii) Intangible assets (goodwill)	5	36,500	-	9,000	-
		(b) Non-current investments	6	34,000		34,000	
				34,40,500	-	34,13,000	-
	2	**Current assets**					
		(a) Other current assets	7	1,062,000	-	1,062,000	-
				1,062,000	-	1,062,000	-
		TOTAL (1+2)		45,02,500	-	44,75,000	-

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

	Indirect Current Year	Indirect Previous Year	Direct Current Year	Direct Previous Year
Note: 1. Share Capital				
Authorised Capital				
Issued and Paid Up	-	-	-	-
Equity Share capital	2,000,000	-	2,000,000	-
	2,000,000	-	2,000,000	-
Note 2. Reserve and Surplus				
Securities Premium	200,000	-	200,000	-
General Reserve	640,000	-	640,000	-
Profit & Loss A/c	315,600	-	315,600	-
	11,55,600	-	11,55,600	-
Note 3. Current Liabilities				
A Ltd.	400,000	-	400,000	-
B Ltd	200,000	-	200,000	-
C Ltd	140,000	-	140,000	-
	740,000	-	740,000	-
Note 4. Tangible Assets				
A				
B	1,500,000	-	1,500,000	
C	900,000	-	900,000	
	970,000	-	970,000	
	3,370,000		3,370,000	

	Indirect		Direct	
	Current Year	Previous Year	Current Year	Previous Year
Note 5. Intangible assets				
Goodwill	36,500	–	9,000	–
	36,500	–	9,000	–
Note 6. Non-current Investment				
A	1,400,000	-	1,400,000	-
B	580,000	-	580,000	-
	19,80,000	-	19,80,000	-
Inter compnay	19,46,000	-	19,46,000	-
	34,000	-	34,000	-
Note 7. Other Current assets				
A	450,000	-	450,000	-
B	300,000	-	300,000	-
C	300,000	-	300,000	-
Cheque In Transit	20,000	-	20,000	-
	1,070,000	-	1,070,000	-
Less: Stock Reserve	8,000	-	8,000	-
	1,062,000	-	1,062,000	-

Illustration 27: Chain Holding - Direct & Indirect Method

The Summarised Balance Sheets of 3 Companies A Ltd., B Ltd., and C Ltd. as at 31.03.2015 is given below - (₹)

Liabilities	A Ltd.	B Ltd.	C Ltd.	Assets	A Ltd.	B Ltd.	C Ltd.
Share Capital	2,50,000	2,00,000	1,20,000	Fixed Assets (Tangible)	56,000	1,10,000	75,000
Reserves	36,000	20,000	14,400	Investments at Cost			
Profit & Loss A/c	32,000	4,000	10,200	- In Shares of B Ltd.	1,90,000	—	—
Chand Balance	6,600	—	—	- In Shares of C Ltd.	36,000	1,06,000	—
Arun Balance	—	14,000	—	Stock in Trade	24,000	—	—
Sundry Creditors	34,000	10,000	—	Sundry Debtors	36,600	32,000	63,000
				B Ltd.	16,000		
				A Ltd.	—	—	6,600
Total	**3,58,600**	**2,48,000**	**1,44,600**	**Total**	**3,58,600**	**2,48,000**	**1,44,600**

Additional Information:

1. Share Capital of all the Companies is divided in to Shares of ₹ 100 each.
2. A Ltd. held 1,500 Shares of B Ltd. and 300 Shares of C Ltd., B Ltd. held 800 shares of C Ltd.
3. All investments were made on 30.09.2014.
4. On 01.04.2014, B Ltd.'s books showed a Reserves Balance of ₹ 18,000 and Profit & Loss Account stood at ₹ 2,000 (Cr.). On the same date, books of C Ltd. reflected the following balances: Reserves - ₹ 12,000; and P&L A/c - ₹ 1,680 (Cr.).
5. Dividends have not been declared by any Company during the year, nor are any proposed.
6. B Ltd. sold goods costing ₹ 8,000 to A Ltd. at the price of ₹ 8,800. These goods were still unsold on 31.03.2015.
7. A Ltd. remitted ₹ 2,000 to B Ltd. on 30.03.2015, but the same was not received by B Ltd. as at the Balance Sheet date.

Prepare Consolidated Balance Sheet of the Group.

Solution:

1. Basic Information

Company Status	Dates	Holding Status		
Holding Company = A Ltd.	Acquisition: 30.09.2014	a. Holding Co.	(A Ltd.) 75%	(A Ltd.) 25%
Subsidiary = B Ltd.	Consolidation: 31.03.2015		–	(B Ltd.) 67%
Sub-Subsidiary = C Ltd.		b. Minority Int.	25%	8%

Note: *Shareholding Pattern is as under-*

Company	Held by A Ltd.	Held by B Ltd.	Total Holdings	Minority Interest	Total No. of Shares
B	1,500 (75%)	N.A.	1,500 (75.00%)	500 (25.00%)	2,000 (100%)
C	300 (25%)	800 (66.67%)	1,100 (91.67%)	100 (8.33%)	1,200 (100%)

2. Analysis of Reserves and Surplus of Subsidiory Companies

(a) General Reserve

B Ltd.

On B/s date ₹ 20,000

1.4.14 ₹ **18,000** Tfr in 2014-15 ₹ **2,000**

Prev B/s **Capital**

1.4.14 to DOA ₹ **1,000** **Capital** | DOA to DOC ₹ **1,000** **Revenue**

Capital Profit-₹ **19,000**; Revenue Reserve-₹ **1,000**

C Ltd.

On B/s date ₹ 14,400

1.4.14 ₹ **12,000** Tfr in 2014-15 ₹ **2,400**

Prev B/s **Capital**

1.4.14 to DOA ₹ **1,200** **Capital** | DOA to DOC ₹ **1,200** **Revenue**

Capital Profit-₹ **13,200**; Revenue Reserve -₹ **1,200**

(b) Profit & Loss Account

B Ltd.

On B/s date ₹ 4,000

1.4.14 ₹ **2,000** Pft in 2014-15 ₹ **2,000**

Prev B/s **Capital**

1.4.14 to DOA ₹ **1,000** **Capital** | DOA to DOC ₹ **1,000** **Revenue**

Capital Profit-₹ **3,000**; Revenue Reserve-₹ **1,000**

C Ltd.

On B/s date ₹ 10,200

1.4.14 ₹ **1,680** Pft in 2014-15 ₹ **8,520**

Prev B/s **Capital**

1.4.14 to DOA ₹ **4,260** **Capital** | DOA to DOC ₹ **4,260** **Revenue**

Capital Profit-₹ **5,940**; Revenue Reserve - ₹ **4,260**

Note: It has been assumed that the Profits arose evenly throughout the year.

3. Analysis of Net Worth of Subsidiary Companies

Particulars	Indirect Method				Direct Method			
	A Ltd. 75% B Ltd.	A Ltd. 25% C Ltd. (B Ltd. 66.67% C Ltd.)	Minority Interest B Ltd. 25%	Minority Interest C Ltd. 8.33%	A Ltd. 75% B Ltd.	A Ltd. 25% C Ltd. (B Ltd. 66.67% C Ltd.)	Minority Interest B Ltd. 25%	Minority Interest C Ltd. 8.33%
(a) Share Capital	**2,00,000**	**1,20,000**			**2,00,000**	**1,20,000**		
Less: Minority Interest	(50,000)	(10,000)	50,000	10,000	(50,000)	(10,000)	50,000	10,000
	1,50,000	**1,10,000**			**1,50,000**	**1,10,000**		
(b) Capital Profits								
General Reserve	19,000	13,200			19,000	13,200		
Profit & Loss Account	3,000	5,940			3,000	5,940		
	22,000	**19,140**			**22,000**	**19,140**		
Transfer of B Ltd.'s Share in C Ltd. (66.67% x ₹ 19,140)	12,760	(12,760)			NOT APPLICABLE			
	34,760	**6,380**			**22,000**	**19,140**		
Less: Minority Interest	(8,690)	(1,595)	8,690	1,595	(5,500)	(1,595)	5,500	1,595
	26,070	4,785			**16,500**	**17,545**		
(c) Revenue Reserves	**1,000**	**1,200**			**1,000**	**1,200**		
Transfer of B Ltd.'s Share in C Ltd. (66.67% x ₹ 1,200)	800	(800)			800	(800)		
	1,800	**400**			**1,800**	**400**		
Less: Minority Interest	(450)	(100)	450	100	(450)	(100)	450	100
	1,350	**300**			**1,350**	**300**		
(d) Revenue Profits	**1,000**	**4,260**			**1,000**	**4,260**		
Transfer of B Ltd.'s Share in C Ltd. (66.67% x ₹ 4,260)	2,840	(2,840)			2,840	(2,840)		
	3,840	**1,420**			**3,840**	**1,420**		
Less: Minority Interest	(960)	(355)	960	355	(960)	(355)	960	355
	2,880	**1,065**			**2,880**	**1,065**		
Minority Interest			**60,100**	**12,050**			**56,910**	**12,050**
Less: Stock Reserve (8,800 - 8,000) * 25%			200				200	
Minority Interest to CBS			**59,900**	**12,050**			**56,710**	**12,050**

4. Cost of Control

	Particulars		Indirect Method		Direct Method	
	Cost of Investment:	A Ltd. in B Ltd.		190,000		190,000
		A Ltd. in C Ltd.		36,000		36,000
		B Ltd. in C Ltd.		1,06,000		1,06,000
	Total Cost of Investment			3,32,000		3,32,000
Less:	(a) Nominal Value of Share Capital:	B Ltd.	1,50,000		1,50,000	
		C Ltd.	1,10,000	(2,60,000)	1,10,000	(2,60,000)
	(b) Arun's Share in Capital Profit of:	B Ltd.	26,070		16,500	
		C Ltd.	4,785	(30,855)	17,545	(34,045)
	Goodwill on Consolidation			**41,145**		**37,955**

5. Consolidation of Reserves & Surplus

	Particulars		Indirect Method		Direct Method	
			Gen. Res.	P&L A/c	Gen. Res.	P&L A/c
	Balance as per Balance Sheet of A Ltd.		36,000	32,000	36,000	32,000
Add:	Share of Revenue Reserves/Profits from	B Ltd.	1,350	2,880	1,350	2,880
		C Ltd.	300	1,065	300	1,065
	Consolidated Balance		**37,650**	**35,945**	**37,650**	**35,945**
Less:	Stock Reserve (₹ 8,800 - ₹ 8,000) x 75%			(600)		(600)
	Adjusted Consolidated Balance		**37,650**	**35,345**	**37,650**	**35,345**

Name of the Company: A Ltd. And its subsidiary B & C Ltd.

Consolidated Balance Sheet as at 31st, March 2015

Ref No.		Particulars	Note No.	Indirect Method: As at 31st March, 2015	Indirect Method: As at 31st March, 2014	Direct Method: As at 31st March, 2015	Direct Method: As at 31st March, 2014
				₹	₹	₹	₹
	A	**EQUITY AND LIABILITIES**					
	1	**Shareholders' funds**					
		(a) Share capital	1	250,000	-	250,000	-
		(b) Reserves and surplus	2	72,995	-	72,995	-
				322,995	-	322,995	-
	2	**Minority Interest**		71,950	-	68,760	-
	3	**Share application money pending allotment**		Nil		Nil	
	4	**Non-current liabilities**		Nil		Nil	
				-	-	-	-
	5	**Current liabilities**					
		(a) Trade payables	3	44,000	-	44,000	-
				44,000	-	44,000	-
		TOTAL (1+2+3+4+5)		4,38,945	-	4,35,775	-
	B	**ASSETS**					
	1	**Non-current assets**					
		(a) Fixed assets					
		(i) Tangible assets	4	241,000	-	241,000	-
		(ii) Intangible assets (goodwill)	5	41,145	-	37,955	-
				282,145	-	278,955	-
	2	**Current assets**					
		(a) Inventories	6	23,200	-	23,200	-
		(b) Trade receivables	7	131,600	-	131,600	-
		(c) Other current assets	8	2,000	-	2,000	-
				156,800	-	156,800	-
		TOTAL (1+2)		4,38,945	-	4,35,755	-

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

	Indirect		Direct	
	Current Year	Previous Year	Current Year	Previous Year
Note 1. Share Capital				
Authorised Capital	-	-	-	-
Issued and Paid Up				
Equity Share capital	250,000	-	250,000	-
	250,000	-	250,000	-
Note 2. Reserve and Surplus				
General Reserve	37,650	-	37,650	-
Profit & Loss A/c	35,345	-	35,345	-
	72,995	-	72,995	-
Note 3. Trade Payable				
A	34,000	-	34,000	-
B	10,000	-	10,000	-
	44,000.00	-	44,000	-

Note 4. Tangible Assets

		Indirect			Direct	
	Current Year	Current Year	Previous Year	Current Year	Current Year	Previous Year
Fixed Assets						
A	56,000	-	-	56,000	-	-
B	110,000	-	-	110,000	-	-
C	75,000	-	-	75,000	-	-
	241,000			241,000		
Note 5. Intangible Assets						
Goodwill on consolidation	41,145			37,955	-	
	41,145			37,955	-	

	Indirect		Direct	
	Current Year	Previous Year	Current Year	Previous Year
Note 6. Inventories				
Stock in Trade				
A Ltd.	24,000	-	24,000	-
Less: Stock Reserve	800	-	800	-
	23,200	-	23,200	-
Note 7. Trade Receivable				
Sundary Debtors				
A	36,600	-	36,600	-
B	32,000	-	32,000	-
C	63,000	-	63,000	-
	131,600	-	131,600	-

	Indirect		Direct	
	Current Year	Previous Year	Current Year	Previous Year
Note 8. Other Current assets				
Cheque In Transit	2,000	-	2,000	-
	2,000	-	2,000	-

Illustration 28: Triangle Holding - Trfr of Shares by Holding Company to its Subsidiary

K Ltd. acquired 15,000 Equity Shares out of 20,000 Equity Shares of ₹ 10 each of G Ltd. on 01.04.2014 for ₹ 2,40,000. As on 01.07.2014, it transferred 5,000 Shares to its Subsidiary M Ltd. for ₹ 90,000. The summarised Balance Sheets of K Ltd., M Ltd., and G Ltd. as on 31.03.2015 were as follows - (₹ 000's)

(₹)

Liabilities	K Ltd.	M Ltd.	G Ltd.	Assets	K Ltd.	M Ltd.	G Ltd.
Share Capital (₹ 10 each)	1,000	500	200	Fixed Assets (Tangible)	1,000	500	300
General Reserve	500	200	40	Investments			
Profit & Loss A/c	100	40	20	- In M Ltd.	250	–	–
14% Loans	50	100	100	- In G Ltd.	160	90	–
Sundry Creditors	50	80	40	- Others	100	50	20
Proposed Dividends	200	100	40	Inventories	100	50	50
				Debtors	100	200	40
				Loan to M Ltd.	100	-	-
				Loan to G Ltd.	50	50	-
				Cash & Bank	40	80	30
Total	**1,900**	**1,020**	**440**	**Total**	**1,900**	**1,020**	**440**

K Ltd. acquired 60% shares of M Ltd. on 01.04.2014. As on that date, balances in M Ltd.'s General Reserve and P & L were ₹ 1,00,000 and ₹ 10,000 respectively.

As on 01.04.2014, G Ltd.'s books showed General Reserve ₹ 10,000 and Profit and Loss Account ₹ 2,000. Interest on Inter-Corporate Loans within the group has not been accounted for.

Prepare Consolidated Balance Sheet of K Ltd. and its Subsidiary M Ltd. and G Ltd. as on 31.03.2015.

Solution:

1. Basic Information

Company Status		Dates	Holding Status		
Holding Company	= K Ltd.	Acquisitions 1.04.2014		**M Ltd.**	**G Ltd.**
Subsidiary	= M Ltd.	Consolidation: 31.03.2015	a. Holding Co.	(K Ltd.) 60%	(K Ltd.) 50%
Sub-Subsidiary	= G Ltd.			–	(M Ltd.) 25%
			b. Minority Int.	40%	25%

Note: *Shareholding Pattern is as under–*

Company	Held by K Ltd.	Held by M Ltd.	Total Holdings	Minority Interest	Total number of shares
M Ltd.	30,000 (60%)	–	30,000 (60%)	20,000 (40%)	50,000
G Ltd.	10,000 (50%)	5,000 (25%)	15,000 (75%)	5,000 (25%)	20,000

3. Analysis of Reserves and Surplus of G Ltd.

(a) General Reserve

Balance on 31.3.2015 ₹ 40,000

Balance on 1.4.2014 (Acquisition date)	**10,000** **Capital Profit**	Transfer during 2014-15 (bal. fig)	₹ **30,000** **Revenue Reserve**

(b) Profit & Loss Account

	Balance on 31.03.2015	₹ 20,000
Less:	Loan Interest (₹ 1,00,000 x 14%)	₹ 14,000
	Corrected Balance	₹ **6,000**

Balance on 1.4.2014 (Acquisition date)	₹ **2,000** **Capital Profits**	Profit for 2014-15 (balancing figure)	₹ **4,000** **Revenue Profits**

4. Analysis of Reserves & Surplus of M Ltd.

(a) General Reserve

Balance on 31.3.2015 ₹ 2,00,000

Balance on 1.4.2014 (Acquisition date)	**1,00,000** **Capital Profit**	Transfer during 2014-15 (bal. fig)	**1,00,000** **Revenue Reserve**

(b) Profit & Loss Account

	Balance on 31.03.2015	₹ 20,000
Add:	Dividend from G Ltd. (40,000 x 25% x 9/12)	₹ 7,500
Add:	Loan Interest receiced from G Ltd. (50,000 x 14%)	₹ 7,000
Less:	Loan Interest (₹ 1,00,000 x 14%)	₹ 14,000
	Adjusted Balance	₹ **40,500**

Balance on 1.4.2014 (Given Acqn Date)	₹ **10,000** **Capital Profit**	Profit for 2014-15 (balancing figure)	₹ **30,500** **Revenue Profit**

Total Capital Profits: ₹ 10,000; Total Revenue Profits: ₹ 30,500

Note: Proposed Dividend from G Ltd. is considered only to the extent of period of holding by M Ltd. The balance dividend for 3 months will be reduced from Cost of Investments as it relates to pre-acquisition period.

5. Computation of Minority Interest

Particulars		K Ltd. 60% M Ltd.	K Ltd. 50% G Ltd. (M Ltd. 25%)	Minority M Ltd. 40%	Interest G Ltd. 25%
(a) Share Capital		5,00,000	2,00,000		
Less: Minority Interest		(2,00,000)	(50,000)	2,00,000	50,000
		3,00,000	**1,50,000**		
(b) Capital Profits	General Reserve	1,00,000	10,000		
	Profit & Loss A/c	10,000	2,000		
		1,10,000	**12,000**		
Transfer of M's Share in G (12000 x 25% x 9/12)		2,250	(2,250)		
		1,12,250	**9,750**		
Less: Minority Interest		(44,900)	(3,000)	44,900	3,000
		67,350	**6,750**		
(c) Revenue Reserve:		**1,00,000**	**30,000**		
Transfer of M's Share in G (30,000 x 25% x 9/12)		5,625	(5,625)		
		1,05,625	24,375		
Less: Minority Interest		(42,250)	(7,500)	42,250	7,500
		63,375	**16,875**		
(d) Revenue Profits:		**30,500**	**4,000**		
Transfer of M's Share in G (4,000 x 25% x 9/12)		750	(750)		
		31,250	**3,250**		
Less: Minority Interest		(12,500)	(1,000)	12,500	1,000
		18,750	**2,250**		
(e) Proposed Dividend:		1,00,000	40,000		
Less: Minority Interest		(40,000)	(10,000)	40,000	10,000
		60,000	**30,000**		
Total Minority Interest				**3,39,650**	**71,500**

For G Ltd.: Capital Reserve, Revenue Reserve & Revenue Profits are to be considered only from the period of holding of M Ltd.

6. Cost of Control

	Particulars			₹
	Cost of Investment in Equity Shares	K Ltd. in M Ltd.		2,50,000
		K Ltd. in G Ltd.		1,60,000
		M Ltd. in G Ltd.		90,000
	Total Cost of Investment			**5,00,000**
Less:	Dividend out of Pre-acquisition profits in M Ltd. (40,000 x 25% x 3/12)		2,500	
Less:	Unrealized Profit on sale of Investment by K to M [90,000 - (240000 / 5,000 / 15,000)		10,000	12,500
	Adjusted Cost of Investment			**4,87,500**
Less:	Nominal Value of Equity Capital:	M Ltd.	3,00,000	
		G Ltd.	1,50,000	
	Share in Capital Profit:	M Ltd.	67,350	
		G Ltd.	6,750	(5,24,100)
	Capital Reserve on Consolidation			**36,600**

7. Consolidation of Reserves and Surplus

Particulars			Gen. Res.	P&L A/c
	Balance as per Balance Sheet of K Ltd.		5,00,000	1,00,000
Add:	Proposed Dividends	From G Ltd. (₹ 40,000 x 50/100)		20,000
		From M Ltd. (₹ 1,00,000 x 60/100)		60,000
Add:	Interest on Loans [₹ 1,00,000 to M + ₹ 50,000 to G) x 14%]			21,000
Add:	Share of Revenue Profits / Reserves:	M Ltd.	63,375	18,750
		G Ltd.	16,875	2,250
Less:	Unrealized Profit on Sale of Investment to M			(10,000)
	Consolidated Balance		**5,80,250**	**2,12,000**

Name of the Company: K Ltd. And its subsidiary M & G Ltd.

Consolidated Balance Sheet as at 31st, March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital	1	1,000,000	-
		(b) Reserves and surplus	2	8,28,850	-
				18,28,850	-
	2	**Minority Interest (339650 + 71500)**		411,150	-
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	50,000	-
				-	-
	5	**Current liabilities**			
		(a) Trade payables	4	170,000	-
		(b) Short-term provisions	5	200,000	-
				370,000	-
		TOTAL (1+2+3+4+5)		26,60,000	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	1,800,000	-
		(b) Non-current investments	7	170,000	-
				19,70,000	-
	2	**Current assets**			
		(a) Inventories	8	200,000	-
		(b) Trade receivables	9	340,000	-
		(c) Cash and cash equivalents	10	150,000	-
				690,000	-
		TOTAL (1+2)		26,60,000	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	
Equity Share capital	1,000,000	
	-	
	1,000,000	-

Note 2. Reserve and Surplus :-

	Current Year	Previous Year
General Reserve	580,250	
Profit & Loss A/c	212,000	
Capitla Reserve on consolidation	36,600	
	8,28,850	

Note 3. Long Term Borrowings

	Current Year	Previous Year
K	50,000	
M	100,000	
G	100,000	
	250,000	
Less: Loan to M & G	150,000	
	100,000	
Less: Loan to M by G	50,000	
	50,000	

Note 4. Trade Payable

	Current Year	Previous Year
Sundary Creditors		
K	50,000	
M	80,000	
G	40,000	
	170,000	
	-	
	170,000	

Note 5. Short Term Provision

	Current Year	Previous Year
Proposed Dividend	200,000	
	200,000	

Note 6. Tangible Assets :-

	Current Year	Previous Year
K	1,000,000	
M	500,000	
G	300,000	
	-	
	1,800,000	

Note 7. Non Current Investment

	Current Year	Previous Year
K	100,000	
M	50,000	
G	20,000	
	170,000	-

Note 8. Inventories

	Current Year	Previous Year
Stock in Trade		
K	100,000	
M	50,000	
G	50,000	
	200,000	

Note 9. Trade Receivable

	Current Year	Previous Year
Sundary Debtors		
K	100,000	
M	200,000	
G	40,000	
	340,000	

Note 10. Cash and cash equivqlent

	Current Year	Previous Year
Cash and Bank		
K	40,000	
M	80,000	
G	30,000	
	150,000	

Illustration 29: Chain Holding /Unrealized Profits on Upstream Transaction

A Ltd. is a holding Company and B Ltd. and C Ltd. are subsidiaries of A Ltd. Their Summarised Balance Sheets as on 31.03.2015 are given below- (₹)

Liabilities	A Ltd.	B Ltd.	C Ltd.	Assets	A Ltd.	B Ltd.	C Ltd.
Share Capital	1,00,000	1,00,000	60,000	Fixed Assets	20,000	60,000	43,000
Reserves	28,000	10,000	9,000	Investments in:			
Profit & Loss A/c	16,000	12,000	9,000	- Shares of B Ltd.	75,000	—	—
C Ltd. Balance	3,000	—	—	- Shares of C Ltd.	13,000	53,000	—
Sundry Creditors	7,000	5,000	—	Stock in Trade	12,000	—	—
A Ltd. Balance	—	7,000	—	B Ltd. Balance	8,000	—	—
				Sundry Debtors	26,000	21,000	32,000
				A Ltd. Balance	—	—	3,000
Total	**1,54,000**	**1,34,000**	**78,000**	**Total**	**1,54,000**	**1,34,000**	**78,000**

The following particulars are given:

1. The Share Capital of all Companies is divided into shares of ₹ 10 each.
2. A Ltd. held 8,000 shares in B Ltd. and 1,000 shares of C Ltd.
3. B Ltd. held 4,000 shares of C Ltd.
4. All these investments were made on 30.4.2013.
5. On 31.03.2014, the position was as shown below: (Amount in ₹)

Particulars	Reserve	P&LA/c	Creditors	Fixed Assets	Stock	Debtors
B Ltd.	8,000	4,000	5,000	60,000	4,000	48,000
C Ltd.	7,500	3,000	1,000	43,000	35,500	33,000

6. 10% Dividend is proposed by each Company.
7. The whole of stock in trade of B Ltd. as on 30.09.2014 (₹ 4,000) was later sold to A Ltd. for ₹ 4,400 and remained unsold by A Ltd. as on 31.03.2015.
8. Cash in transit from B Ltd. to A Ltd. was ₹ 1,000 as at the close of business. You are required to prepare the Consolidated Balance Sheet of the group as at 31.03.2015.

Solution:

1. Basic Information

Company Status		Dates	Holding Status		
Holding Company	= A Ltd.	Acquisition: 30.09.2013		B Ltd.	C Ltd.
Subsidiary	= B Ltd.	Consolidation: 31.03.2015	a. Holding Co.	(A) 80%	(A) 16.67%
Sub–Subsidiary	= C Ltd.			–	(B) 66.66%
			b. Minority Int.	20%	16.67%

Note: *The Shareholding Pattern is as under*

Company	Held by A	Held by B	Total Holdings	Minority Interest	Total No. of Shares
B Ltd.	8,000 (80%)	N. A.	8,000 (80%)	2,000 (20%)	10,000 (100%)
C Ltd.	1,000 (16.67%)	4,000 (66.67%)	5,000 (83.33%)	1,000 (16.67%)	6,000 (100%)

2. Analysis of Reserves and Surplus of Subsidiary Companies

(a) General Reserve

B Ltd.

Balance on 31.03.2015 ₹ 10,000

1.4.14 Prev. B/s **8,000** **Capital** | Tfr in 2014-15 ₹ 2,000

Tfr in 2014-15: 1.4.14 to DOA **₹ 1,000 Capital** | DOA to DOC **₹ 1,000 Revenue**

Capital Profit - ₹ **9,000**; Revenue Profit - ₹ **1,000**

C Ltd.

31.12.2012 ₹ 9,000

1.4.14 Prev. B/s **7,500** **Capital** | Tfr in 2014-15 ₹ 1,500

Tfr in 2014-15: 1.4.14 to DOA **₹ 750 Capital** | DOA to DOC **₹ 750 Revenue**

Capital Profit - ₹ 8,250; Revenue Profit - ₹ 750

(b) Profit & Loss Account

B Ltd.

	Balance on 31.03.2015	12,000
Less:	Proposed Dividend (10% x 100000)	(10,000)
Add:	Dividend from C Ltd. (6/12 x 6,000 x 66.67%)	2,000
	Adjusted Balance	**4,000**

1.4.14 Prev. B/s **4,000 Capital** | Profit in 2014-15 NIL

C Ltd.

	Balance on 31.03.2015	9,000
Less:	Proposed Dividend (10%x60,000)	6,000
	Adjusted Balance	**3,000**

1.4.14 Prev. B/s **3,000 Capital** | Profit in 2014-15 **NIL Revenue**

3. Analysis of Net Worth of Subsidiary Companies (Indirect Method)

	Particulars	**A Ltd.**		**Minority Interest**	
		80%	**16.67%**	**B Ltd.**	**C Ltd.**
		B	**66.67% C**	**20%**	**16.67%**
(a)	**Share Capital**	**1,00,000**	**60,000**		
Less:	Minority Interest	(20,000)	(10,000)	20,000	10,000
	Holding Co's Share	**80,000**	**50,000**		
(b)	**Capital Profits**				
	General Reserve	9,000	8,250		
	Profit & Loss Account	4,000	3,000		
		13,000	**11,250**		
Trfr.	B's share in C (66.67% x ₹11,250)	7,500	(7,500)	16.67%	
		20% 20,500	3,750		
Less:	Minority Interest	(4,100)	(1,875)	4,100	1,875
	Holding Co's Share	**16,400**	**1,875**		
(c)	**Revenue Reserve:**	1,000	750		
Trfr.	B's share in C (66.67% x ₹ 750)	500	(500)	16.67%	
		20% 1,500	250		
Less:	Minority Interest	(300)	(125)	300	125
Holding Co.'s Share		**1,200**	**125**	–	–
(d)	**Revenue Profits**	**NIL**	**NIL**		
(e)	**Proposed Dividend**	10,000	6,000	2,000	1,000
Less:	Minority Interest	(2,000)	(1,000)		
	Holding Co's Share	**8,000**	**5,000**		
	Minority Interest Before Stock Reserve Adjustment			**26,400**	**13,000**
Less:	Share of Minority Interest of B in Unrealized Profits (4,400 - 4,000) x 20%			(80)	–
	Minority Interest			**26,320**	**13,000**

4. Cost of Control

Particulars			₹	
	Cost of Investment:	A Ltd. in B Ltd.	75,000	
		A Ltd. in C Ltd.	13,000	
		B Ltd. in C Ltd.	53,000	**1,41,000**
Less:	Dividend out of Pre-acqn. Pfts	(For 01.04.2014 to 30.09.2014)		
	From B Ltd.	(8000 Shares x ₹ 10 x 10% x 6/12]	4,000	
	From C Ltd.	(5000 Shares x ₹ 10 x 10% x 6/12)	2,500	**6,500**
	Adjusted Cost of Investment			**1,34,500**
Less:	(a) Nominal Value in Share Capital of:	B Ltd.	80,000	
		C Ltd.	50,000	(1,30,000)
	(b) Share in Capital Proffits	B Ltd.	16,400	
		C Ltd.	1,875	**(18,275)**
	Capital Reserve on Consolidation			**13,775**

5. Consolidation of Reserves and Surplus

Particulars			Gen. Res.	P & L A/c
	Balance as per Balance Sheet of A Ltd.		28,000	16,000
Less:	Proposed Dividend	(₹ 1,00,000 x 10%)	–	(10,000)
Add:	Share of Proposed Dividend	(01.10.2014 to 31.03.2015) from		
		B (8000 Shares x ₹ 10 x 10% x 6/12)	–	4,000
		C (1000 Shares x ₹ 10 x 10% x 6/12)	–	500
	Adjusted Balance		**28,000**	**10,500**
Add:	Share of Revenue from	B Ltd.	1,200	NIL
		C Ltd.	125	NIL
	Consolidated Balance		29,325	10,500
Less:	Stock Reserve [₹ 4,400 - ₹ 4,000] x 80%		–	(320)
	Corrected Consolidated Balance		**29,325**	**10,180**

Name of the Company: A Ltd. And its subsidiary B & C Ltd.
Consolidated Balance Sheet as at 31st, March 2015

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	A	**EQUITY AND LIABILITIES**			
	1	**Shareholders' funds**			
		(a) Share capital	1	100,000	-
		(b) Reserves and surplus	2	53,280	-
				153,280	-
	2	**Minority Interest**		39,320	-
	3	**Share application money pending allotment**		Nil	-
	4	**Non-current liabilities**		Nil	-
				-	-
	5	**Current liabilities**			
		(a) Trade payables	3	12,000	-
		(b) Short-term provisions	4	10,000	-
				22,000	-
		TOTAL (1+2+3+4+5)		2,14,600	-
	B	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	123,000	-
				12,300	-

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
				₹	₹
	2	**Current assets**			
		(a) Inventories	6	11,600	-
		(b) Trade receivables	7	79,000	-
		(c) Cash and cash equivalents	8	1,000	-
				91,600	-
		TOTAL (1+2)		214,600	-

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

Note 1. Share Capital

	Current Year	Previous Year
Authorised Capital	-	-
Issued and Paid Up	-	-
Equity Share capital	1,00,000	-
	-	-
	1,00,000	-

Note 2. Reserve and Surplus

	Current Year	Previous Year
General Reserve	29,325	-
Profit & Loss A/c	10,180	-
Capital Reserve	13,775	-
on Consolidation	53,280	-

Note 3. Trade Payable

	Current Year	Previous Year
Sundary Creditors		
A	7,000	-
B	5,000	-
	12,000	-

Note 4. Short Term Provisions

	Current Year	Previous Year
Proposed Dividend	10,000	-
	-	-
	-	-
	10,000	-

Note 5. Tangible Assets

	Current Year	Previous Year
Fixed Assets		
A	20,000	-
B	60,000	-
C	43,000	-
	123,000	-

Note 6. Inventories

	Current Year	Previous Year
Stock in Trade		
A	12,000	-
	12,000	-
Less: Stock Reserve	400	-
	11,600	-

Note 7. Trade Receivable

	Current Year	Previous Year
Sundry Debtors		
A	26,000	-
B	21,000	-
C	32,000	-
	79,000	-

8. Cash and cash equivqlent

	Current Year	Previous Year
Cash in Trainsit		
A	8,000	-
B	-	-
C	3,000	-
	11,000	-
Less: A	3,000	-
Less: B	7,000	-
	-	-
	1,000	-

Illustration 30.

From the following Balance Sheets of a group of companies and the other information provided, draw up the consolidated Balance Sheet as on 31.3.2015. Figures given are in ₹ Lakhs:

The summarised Balance Sheets as on 31.3.2015.

	X	Y	Z		X	Y	Z
Shares capital (in shares of ₹ 10 each)	1,650	1,100	550	Fixed Assets less depreciation	715	825	550
Reserves	275	220	165	Cost of investment in Y Ltd.	990	-	-
Profit and loss balance	330	275	220	Cost of investment in Z Ltd.	220	-	-
Bills payables	55	-	27.5	Cost of investment in Z Ltd.	-	440	-
Creditors	165	55	50	Stock	275	110	110
Y Ltd. balance	-	-	82.5	Debtors	385	55	110
Z Ltd. balance	275	-	-	Bills receivables	-	55	110
				Z Ltd. balance	-	55	-
				X Ltd. balance	-	-	165
				Cash and bank balance	165	110	55
	2,750	1,650	1,100		2,750	1,650	1,100

(a) X Ltd. holds 8,80,000 shares and 1,65,000 shares respectively in Y Ltd. and Z Ltd.; Y Ltd. holds 3,30,000 shares in Z Ltd. These investments were made on 1.7.2013 on which date the provision was as follows:

	Y Ltd.	Z Ltd.
Reserves	110	55
Profit and loss account	165	88

(b) In December, 2014 Y Ltd. invoiced goods to X Ltd. for ₹ 220 lakhs at cost plus 25%. The closing stock of X Ltd. includes such goods valued at ₹ 27.5 lakhs.

(c) Z Ltd. sold to Y Ltd. an equipment costing ₹ 132 lakhs at a profit of 25% on selling price on 1.1.2015. Depreciation at 10% per annum was provided by Y Ltd. on this equipment.

(d) Bills payables of Z Ltd. represent acceptances given to Y Ltd. out of which Y Ltd. had discounted bills worth ₹ 16.5 lakhs.

(e) Debtors of X Ltd. Include ₹ 16.5 lakhs being the amount due from Y Ltd.

(f) X Ltd. proposes dividend at 10%.

Solution:

Name of the Company : X Ltd.

Consolidated Balance Sheet of X Ltd. And its subsidiaries Y Ltd. and Z Ltd. as at 31st March, 2015

₹ in Lakhs

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	1,650.00	
		(b) Reserves and surplus	2	835.45	
	2	**Minority Interest (W.N.4)**		436.15	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Trade payables	3	247.5	
		(b)Other current liabilities	4	209	
		(c) Short-term provisions	5	165	
		Total (1+2+3+4+5)		**3543.10**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	6	2047.10	
	2	**Current assets**			
		(a) inventories	7	489.50	
		(b) trade receivables	8	522.50	
		(c) Cash and cash equivalents	9	330	
		(d) Other current assets	10	154	
		Total (1+2)		**3543.10**	

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

(₹ in lacks)

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorized, Issued, Subscribed and paid-up Share capital:-		
165 lakhs Equity share of ₹ 10 each	1,650	
Total	1,650	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.14	165	1,650		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	165	1,650		
Less: Buy Back of share				
Total	165	1,650		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
Capital Reserve	73.70	
Other reserve	448.80	
Profit and loss A/c	312.95	
Total	835.45	

Note 3. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors (165+55+55)	275	
Less: Mutual debts	27.5	
Total	247.5	

Note 4. Other Current liabilities		As at 31st March, 2015	As at 31st March, 2014
Bills Payable- (55+27.5)	82.50		
Less: Mutual debts	11.00	71.50	
Current account balance- (275+82.50)	357.50		
Less: Mutual debts	220.00	137.50	
	Total	209.00	

Note 5. Short- term provisions	As at 31st March, 2015	As at 31st March, 2014
Proposed dividend	165	
Total	165	

Note 6. Tangible Assets		As at 31st March, 2015	As at 31st March, 2014
Fixed Assets less depreciation- X Ltd	715.00		
Y Ltd	825.00		
Z Ltd	550.00	2090.00	
Less: Unrealised Proffit		42.90	
Total		2047.10	

Note 7. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock (275+110+110)	495	
Less: Unrealised profit	5.5	
Total	489.5	

Note 8. Trade Receivables	As at 31st March, 2015	As at 31st March, 2014
Debtors (more than six months considered good) – (385+55+110)	550.00	
Less: mutual debts	27.50	
Total	522.50	

Note 9. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash and Bank balance (165+110+55)	330.00	
Total	330.00	

Note 10.Other current assets	As at 31st March, 2015	As at 31st March, 2014
Bills receivables- (55+110)	165.00	
Less: mutual debts	11.00	
Total	154.00	

Working Notes:

				(₹ in lakhs)
(1)	**Analysis of Profits of Z Ltd.**	**Capital Profit**	**Revenue Reserve**	**Revenue profit**
	Reserves on 1.7.2014	55.00		
	Profit and Loss A/c on 1.7.2014	88.00		
	Increase in Reserves		110.00	
	Increase in Profit			132.00
		143.00	110.00	132.00
	Less: Minority Interest (10%)	14.30	11.00	13.20
		128.70	99.00	118.80
	Share of X Ltd.	42.90	33.00	39.60
	Share of Y Ltd.	85.80	66.00	79.20
(2)	**Analysis of Profits of Y Ltd.**			
	Reserves on 1.7.2014	110.00		
	Profit and Loss A/c on 1.7.2014	165.00		
	Increase in Reserves		110.00	
	Increase in Profit			110.00
		275.00	110.00	110.00
	Share in Z Ltd.		66.00	79.20
		275.00	176.00	189.20
	Less: Minority Interest (20%)	55.00	35.20	37.84
	Share of X Ltd.	220.00	140.80	151.36

(3)	**Cost of Control**			
	Investments in Y Ltd.			990.00
	Investments in Z Ltd.			660.00
				1,650.00
	Less: Paid up value of investments			
	in Y Ltd.	880.00		
	in Z Ltd.	495.00	1,375.00	
	Capital Profit			
	in Y Ltd.	220.00		
	in Z Ltd.	128.70	348.70	1,723.70
	Capital Reserve			73.70
(4)	**Minority Interest**	**Y Ltd.**	**Z Ltd.**	
	Share Capital	220.00	55.00	
	Capital Profit	55.00	14.30	
	Revenue Reserves	35.20	11.00	
	Revenue Profits	37.84	13.20	
		348.04	93.50	
	Less: Unrealised profit on stock (20% of 5.5)	1.1		
	Unrealised profit on equipment (10% of 42.90)		4.29	
		346.94	89.21	
(5)	**Unrealised Profit on equipment sale**			
	Cost	132.00		
	Profit	44.00		
	Selling Price	176.00		
	Unrealised profit = 44 – 44 × $\frac{10}{100} \times \frac{3}{12}$ = 44.00 – 1.1 = 42.90			
(6)	**Profit and Loss Account – X Ltd.**			
	Balance	330.00		
	Less: Proposed Dividend	165.00		
		165.00		
	Share in Y Ltd.	151.36		
	Share in Z Ltd.	39.60		
		355.96		
	Less: Unrealised profit on equipment (90% of 42.90)	38.61		
		317.35		
	Less: Unrealised profit on stock $\left(27.50 \times \frac{25}{125} \times 80\%\right)$	4.4		
		312.95		
(7)	**Reserves – X Ltd.**			
	X Ltd.	275.00		
	Share in Y Ltd.	140.80		
	Share in Z Ltd.	33.00		
		448.80		

Illustration 31

Following are the summarised Balance Sheets of Mumbai Limited, Delhi Limited, Amritsar Limited and Kanpur Limited as at 31st March, 2015:

Liabilities	**Mumbai Ltd.**	**Delhi Ltd.**	**Amritsar Ltd.**	**Kanpur Ltd.**	
Share Capital (₹ 100 face value)	1,00,00,000	80,00,000	40,00,000	1,20,00,000	
General Reserve	40,00,000	8,00,000	5,00,000	20,00,000	
Profit & Loss Account	20,00,000	8,00,000	5,00,000	6,40,000	
Sundry Creditors	6,00,000	2,00,000	1,00,000	1,60,000	
		1,76,00,000	98,00,000	51,00,000	1,48,00,000
Assets					
Investments :					
60,000 shares in Delhi Ltd.	70,00,000	—	—	—	
20,000 shares in Amritsar Ltd	22,00,000	—	—	—	
10,000 shares in Amritsar Ltd.	—	10,00,000	—	—	
Shares in Kanpur Ltd. @ ₹ 120	72,00,000	36,00,000	12,00,000	—	
Fixed Assets	—	40,00,000	30,00,000	1,40,00,000	
Current Assets	2,00,000	12,00,000	9,00,000	8,00,000	
		1,76,00,000	98,00,000	51,00,000	1,48,00,000

Balance in General Reserve Account and Profit & Loss Account, when shares were purchased in different companies were:

	Mumbai Ltd.	Delhi Ltd.	Amritsar Ltd.	Kanpur Ltd.
General Reserve Account	20,00,000	4,00,000	2,00,000	12,00,000
Profit & Loss Account	12,00,000	4,00,000	1,00,000	1,20,000

Required :

Prepare the consolidated Balance Sheet of the group as at 31st March, 2015 (Calculations may be rounded off to the nearest rupee).

Solution:

Name of the Company : Mumbai Ltd.

Consolidated Balance Sheet of Mumbai Ltd. andits subsidiaries Delhi Ltd., Amritsar Ltd. and Kanpur Ltd. as at 31st March, 2015

Ref No.	**Particulars**		**Note No.**	**As at 31st March, 2015**	**As at 31st March, 2014**
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	1,00,00,000	
		(b) Reserves and surplus	2	80,64,375	
	2	**Minority Interest (WN.V)**		62,50,625	

	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Trade payables	3	10,60,000	
		Total (1+2+3+4+5)		**2,53,75,000**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	2,10,00,000	
		(ii) Intangible assets	5	12,75,000	
	2	**Current assets**			
		(a) Cash and cash equivalents	6	31,00,000	
		Total (1+2)		2,53,75,000	

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

Notes to the Accounts

(₹)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorized, Issued, Subscribed and paid-up Share capital:-		
1,00,000 Equity share of ₹100 each	1,00,00,000	
Total	1,00,00,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	**As at 31st March, 2015**		**As at 31st March, 2014**	
	Nos.	**Amount (₹)**	**Nos.**	**Amount (₹)**
Opening Balance as on 01.04.14	1,00,000	1,00,00,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	1,00,000	1,00,00,000		
Less: Buy Back of share				
Total	1,00,000	1,00,00,000		

Note 2. Reserve & Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
General Reserve	51,02,083	
Profit and Loss A/c	29,62,292	
Total	80,64,375	

Note 3. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors (6,00,000+2,00,000+1,00,000+1,60,000)	10,60,000	
Total	10,60,000	

Note 4. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed Assets (40,00,000+30,00,000+1,40,00,000)	2,10,00,000	
Total	2,10,00,000	

Note 5. Intangible assets	As at 31st March, 2015	As at 31st March, 2014
Goodwill (WN.iv)	12,75,000	
Total	12,75,000	

Note 6. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at Bank	31,00,000	
Total	31,00,000	

Working Notes:

(i) Analysis of profits of Kanpur Ltd.

Capital	Revenue	Revenue		
		Profit	Reserve	Profit
		₹	₹	₹
General Reserve on the date				
of purchase of shares	12,00,000			
Profit and Loss A/c on the date of				
purchase of shares	1,20,000			
Increase in General Reserve		8,00,000		
Increase in profit			5,20,000	
		13,20,000	8,00,000	5,20,000
Less : Minority Interest (1/6)	1,10,000	1,33,333	86,667	
		11,00,000	6,66,667	4,33,333
Share of Mumbai Ltd. (1/2)	6,60,000	4,00,000	2,60,000	
Share of Delhi Ltd. (1/4)	3,30,000	2,00,000	1,30,000	
Share of Amritsar Ltd. (1/12)	1,10,000	66,667	43,333	

(ii) Analysis of profits of Amritsar Ltd.

Capital	Revenue	Revenue	
	Profit	Reserve	Profit
	₹	₹	₹
General Reserve on the date			
of purchase of shares	2,00,000		
Profit and Loss A/c on the date of			
purchase of shares	1,00,000		

Increase in General Reserve	3,00,000		
Increase in Profit and Loss A/c		4,00,000	
Share in Kanpur Ltd.	66,667	43,333	
	3,00,000	**3,66,667**	**4,43,333**
Less : Minority Interest (1/4)	**75,000**	**91,667**	**1,10,833**
	2,25,000	**2,75,000**	**3,32,500**
Share of Mumbai Ltd. (1/2)	**1,50,000**	**1,83,333**	**2,21,667**
Share of Delhi Ltd. (1/4)	**75,000**	**91,667**	**1,10,833**

(iii) Analysis of profits of Delhi Ltd.

	Capital Profit	Revenue Reserve	Revenue Profit
	₹	₹	₹
General Reserve on the date			
of purchase of shares	4,00,000		
Profit and Loss A/c on the date of			
purchase of shares	4,00,000		
Increase in General Reserve	4,00,000		
Increase in Profit and Loss A/c		4,00,000	
Share in Kanpur Ltd.	2,00,000	1,30,000	
Share in Amritsar Ltd.	91,667	1,10,833	
	8,00,000	**6,91,667**	**6,40,833**
Less : Minority Interest (1/4)	**2,00,000**	**1,72,917**	**1,60,208**
Share of Mumbai Ltd. (3/4)	**6,00,000**	**5,18,750**	**4,80,625**

(iv) Cost of control

	Investments in	₹		
	Delhi Ltd.		70,00,000	
	Amritsar Ltd.		32,00,000	
	Kanpur Ltd.		1,20,00,000	
				2,22,00,000
	Paid up value of investments in			
	Delhi Ltd.		60,00,000	
	Amritsar Ltd.		30,00,000	
	Kanpur Ltd.		1,00,00,000	
	Capital profits in			(1,90,00,000)
	Delhi Ltd.		6,00,000	
	Amritsar Ltd.		2,25,000	
	Kanpur Ltd.		11,00,000	(19,25,000)
	Goodwill			**12,75,000**
(v) Minority interest				
	Share Capital:			
	Delhi Ltd. (1/4)	20,00,000		
	Amritsar Ltd. (1/4)	10,00,000		
	Kanpur Ltd (1/6)	20,00,000		50,00,000

	Share in profits & reserves			
	(Pre and Post-Acquisitions)			
	Delhi Ltd.	5,33,125		
	Amritsar Ltd.	2,77,500		
	Kanpur Ltd.	4,40,000		12,50,625
				62,50,625
(vi) General Reserve — Mumbai Ltd.				
	Balance as on 31.03.2015 (given)			40,00,000
	Share in			
		Delhi Ltd.		5,18,750
		Amritsar Ltd.		1,83,335
		Kanpur Ltd.		4,00,000
				51,02,083
(vii) Profit and Loss Account — Mumbai Ltd.				
	Balance as on 31.03.2015 (given)			20,00,000
	Share in			
		Delhi Ltd.		4,80,625
		Amritsar Ltd.		2,21,667
		Kanpur Ltd.		2,60,000
				29,62,292

Illustration 32.

A Limited is a holding company and B Limited and C Limited are subsidiaries of A Limited. Their summarised Balance Sheets as on 31.03.2015 are given below:

	A Ltd.	B Ltd.	C Ltd.		A Ltd.	B Ltd.	C Ltd.
	₹	₹	₹		₹	₹	₹
Share Capital	3,00,000	3,00,000	1,80,000	Fixed Assets	60,000	1,80,000	1,29,000
Reserves	1,44,000	30,000	27,000	Investments			
Profit & Loss Account	48,000	36,000	27,000	- Shares in B Ltd.	2,95,000		
C Ltd. Balance	9,000			- Shares in C Ltd.	39,000	1,59,000	
Sundry Creditors	21,000	15,000		Stock in Trade	36,000		
A Ltd. Balance		21,000		B Ltd. Balance	24,000		
				Sundry Debtors	78,000	63,000	96,000
				A Ltd. Balance			9,000
	5,22,000	4,02,000	2,34,000		5,22,000	4,02,000	2,34,000

The following particulars are given:

(i) The Share Capital of all companies is divided into shares of ₹ 10 each.

(ii) A Ltd. held 24,000 shares of B Ltd. and 3,000 shares of C Ltd.

(iii) B Ltd. held 12,000 shares of C Ltd.

(iv) All these investments were made on 30.9.2014.

(v) On 31.03.2014, the position was as shown below:

	B Ltd.	C Ltd.
	₹	₹
Reserve	24,000	22,500
Profit & Loss Account	12,000	9,000
Sundry Creditors	15,000	3,000
Fixed Assets	1,80,000	1,29,000
Stock in Trade	12,000	1,06,500
Sundry Debtors	1,44,000	99,000

(vi) 10% dividend is proposed by each company.

(vii) The whole of stock in trade of B Ltd. as on 30.9.2014 (₹ 12,000) was later sold to A Ltd. for ₹13,200 and remained unsold by A Ltd. as on 31.03.2015.

(viii) Cash-in-transit from B Ltd. to A Ltd. was ₹ 3,000 as at the close of business.

You are required to prepare the Consolidated Balance Sheet of the group as on 31.03.2015.

Solution:

Consolidated Balance Sheet of A Ltd.
and its subsidiaries B Ltd. and C Ltd.as on 31st March, 2015

₹ in crores

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	3,00,000	
		(b) Reserves and surplus	2	1,80,915	
	2	**Minority Interest (W.N.5)**		1,13,460	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Trade payables	3	36,000	
		(b) Short-term provisions	4	30,000	
		Total (1+2+3+4+5)		**6,60,375**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	3,69,000	
		(ii) Intangible assets	6	16,575	
	2	**Current assets**			
		(b) inventories	7	34,800	
		(c) trade receivables	8	2,37,000	
		(d) Cash and cash equivalents	9	3,000	
		Total (1+2)		**6,60,375**	

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

Notes to the Accounts

₹ in crores

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorized, Issued, Subscribed and paid-up Share capital:-		
30,000 Equity share of ₹ 10 each	3,00,000	
Total	3,00,000	

Reconciliation of Share Capital

For Equity Share	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.14 (crores)	30,000	3,00,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	30,000	3,00,000		
Less: Buy Back of share				
Total	30,000	3,00,000		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
Reserve	1,47,975	
Profit & Loss A/c	32,940	
Total	180,915	

Note 3. Trade payables	As at 31st March, 2015	As at 31st March, 2014
Sundry creditors- (21,000+15,000)	36,000	
Total	36,000	

Note 4. Short-term provision	As at 31st March, 2015	As at 31st March, 2014
Proposed dividend	30,000	
Total	30,000	

Note 5. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed assets	3,69,000	
Total	3,69,000	

Note 6. Intangible Assets	As at 31st March, 2015	As at 31st March, 2014
Goodwill	16,575	
Total	16,575	

Note 7. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock in trade	36,000	
Less: Provision for Unrealized profit	1,200	
Total	34,800	

Note 8. Sundry debtors	As at 31st March, 2015	As at 31st March, 2014
Sundry debtors (more than six months considered good) (78,000+63,000+96,000)	2,37,000	
Total	2,37,000	

Note 9. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash in transit (24,000-21,000)	3,000	
Total	3,000	

Working Notes:

(1) Position on 30.09.2014

	Reserves (₹)	Profit and Loss Account (₹)
B Ltd.		
Balance on 31.03.2015	30,000	36,000
Less: Balance on 31.03.2014	24,000	12,000
Increase during the year	6,000	24,000
Estimated increase for half year	3,000	12,000
Balance on 30.09.2014	27,000 (24,000+3,000)	24,000 (12,000 + 12,000)
C Ltd.		
Balance on 31.03.2015	27,000	27,000
Balance on 31.03.2014	22,500	9,000
Increase during the year	4,500	18,000
Estimated increase for half year	2,250	9,000
Balance on 30.09.2014	24,750 (22,500+2,250)	18,000 (9,000 + 9,000)

(2) Analysis of Profits of C Ltd.

	Capital Profit	Revenue Reserve	Revenue profit
	₹	₹	₹
Reserves on 30.09.2014	24,750		
Profit and Loss A/c on 30.09.2014	18,000		
Increase in reserves		2,250	
Increase in profit			6,000
	42,750	2,250	6,000
Less: Minority interest (1/6)	7,125	375	1,500
	35,625	1,875	7,500
Share of A Ltd. (1/6)	7,125	375	1,500
Share of B Ltd. (4/6)	28,500	1,500	6,000

(3) Analysis of Profits of B Ltd.

	Capital Profit	Revenue Reserve	Revenue profit
	₹	₹	₹
Reserves on 30.09.2014	27,000		
Profit and Loss A/c on 30.09.2014	24,000		
Increase in reserves		3,000	
Increase in profit			12,000
Share in C Ltd.		1,500	6,000
	51,000	4,500	18,000
Less: Minority interest (2/10)	10,200	900	3,600
Share of A Ltd. (8/10)	40,800	3,600	14,400

(4) Cost of control

	₹	₹
Investments in		
B Ltd.	2,85,000	
C Ltd.	1,98,000	
		4,83,000
Paid up value of investments in		
B Ltd.	2,40,000	
C Ltd.	1,50,000	
		(3,90,000)
Capital profits in		
B Ltd.	40,800	
C Ltd.	(35,625)	
		(76,425)
Goodwill		16,575
(5) Minority Interest	₹	₹
Share Capital:		
B Ltd.	60,000	
C Ltd.	30,000	90,000
Share in profits and reserves (Pre and Post-Acquisitions)		
B Ltd.	14,700	
C Ltd.	9,000	23,700
		1,13,700
Less: Provision for unrealized profit (20% of ₹ 1,200)		240
		1,13,460
(6) Reserves – A Ltd.		₹
Balance as on 31.03.20125 (given)		1,44,000
Share in		
B Ltd.		3,600
C Ltd.		375
		1,47,975

(7) **Profit and Loss Account – A Ltd.**		₹
Balance as on 31.03.2015 (given)		48,000
Share in		
B Ltd.		14,400
C Ltd.		1,500
		63,900
Less: Proposed dividend (10% of ₹ 3,00,000)		30,000
Provision for unrealised profit on stock		960
80% of (₹ 13,200 – ₹ 12,000)		
		32,940

Note: The above solution has been done by direct method. Alternatively, students may follow indirect method. In indirect method, the share in pre-acquisition profits of B Ltd. in C Ltd. amounting ₹ 28,500 will be included as capital profit while analysing the profits of B Ltd. and will not be considered for the purpose of cost of control. Thus, in this case, the amounts of goodwill and minority interest will increase by ₹ 5,700 (2/10 of ₹ 28,500). Goodwill and minority interest will be shown at ₹ 22,275 and ₹ 1,19,160 respectively in the consolidated balance sheet. Therefore, the total of the assets and liabilities side of the consolidated balance sheet will be ₹ 6,66,075.

Illustration 33.

On 31st March, 2014 Bee Ltd. became the holding company of Cee Ltd. and Dee Ltd. by acquiring 900 lakhs fully paid shares in Cee Ltd. for ₹ 13,500 lakhs and 480 lakhs fully paid shares in Dee Ltd. for ₹ 4,320 lakhs. On that date, Cee Ltd. showed a balance of ₹ 5,100 lakhs in General Reserve and a credit balance of ₹ 1,800 lakhs in Profit and Loss Account. On the same date, Dee Ltd. showed a debit balance of ₹ 720 lakhs in Profit and Loss Account. While its Preliminary Expenses Account showed a balance of ₹ 60 lakhs.

After one year, on 31st March, 2015 the Extract Balance Sheets of three companies stood as follows:

	(All amounts in lakhs of Rupees)		
Liabilities	Bee Ltd.	Cee Ltd.	Dee Ltd.
Fully paid equity shares of ₹ 10 each	54,000	15,000	6,000
General Reserve	66,000	6,300	-
Profit and Loss Account	18,000	2,400	1,500
15 lakh fully paid 9.5%			
Debentures of ₹ 100 each	-	-	3,000
Loan from Cee Ltd.	-	-	150
Bills Payable	-	-	300
Sundry Creditors	28,200	5,400	1,860
	1,66,200	29,100	12,810
Assets			
Machinery	78,000	15,000	4,200
Furniture and Fixtures	12,000	3,000	1,200
Investments:			
900 lakhs shares in Cee Ltd.	13,500	-	-
480 lakhs shares in Dee Ltd.	4,320	-	-
6 lakhs debentures in Dee Ltd.	588	-	-
Stocks	33,000	6,000	3,000
Sundry Debtors	18,000	2,700	2,580
Cash and Bank balances	6,402	2,100	1,800
Loan to Dee Ltd.	-	180	-
Bills Receivable	390	120	-
Preliminary Expenses	-	-	30
	1,66,200	29,100	12,810

The following points relating to the above mentioned Balance Sheets are to be noted:

(i) All the bills payable appearing in Dee Ltd.'s Balance Sheet were accepted in favour of Cee Ltd. out of which bills amounting to ₹ 150 lakhs were endorsed by Cee Ltd. in favour of Bee Ltd. and bills amounting to ₹ 90 lakhs had been discounted by Cee Ltd. with its bank.

(ii) On 29th March, 2015 Dee Ltd. remitted ₹ 30 lakhs by means of a cheque to Cee Ltd. to return part of the loan; Cee Ltd. received the cheque only after 31st March, 2015.

(iii) Stocks with Cee Ltd. includes goods purchased from Bee Ltd. for ₹ 400 lakhs. Bee Ltd. invoiced the goods at cost plus 25%.

(iv) In August, 2014 Cee Ltd. declared and distributed dividend @ 10% for the year ended 31st March, 2013. Bee Ltd. credited the dividend received to its Profit and Loss Account.

You are required to prepare a Consolidated Balance Sheet of Bee Ltd. and its subsidiaries Cee Ltd. and Dee Ltd. as at 31st March, 2015.

Solution:

Consolidated Balance Sheet of Bee Ltd. and its subsidiaries Cee Ltd. and Dee Ltd. as at 31st March, 2015

₹ In Lakhs

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	54,000	
		(b) Reserves and surplus	2	86,800	
	2	**Minority Interest (W.N.2)**		10,974	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	2,400	
	5	**Current Liabilities**			
		(a) Trade payables	4	35,460	
		(b) Other current liabilities	5	90	
		Total (1+2+3+4+5)		**1,89,724**	
	II	**ASSETS**			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	6	1,13,400	
		(ii) Intangible assets	7	492	
	2	**Current assets**			
		(a) inventories	8	41,920	
		(b) trade receivables	9	23,280	
		(c) Cash and cash equivalents	10	10,332	
		(d) Other current assets	11	300	
		Total (1+2)		**1,89,724**	

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

₹ In Lakhs

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorized, Issued, Subscribed and fully paid-up Share capital:-		
5400 Lakhs Equity share of ₹10 each	54,000	
	54,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.14	5,400	54,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	5,400	54,000		
Less: Buy Back of share				
Total	5,400	54,000		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
General Reserve (WN.4)	66,720	
Profit & Loss A/c (WN.4)	20,080	
Total	86,800	

Note 3. Long- term borrowings	As at 31st March, 2015	As at 31st March, 2014
9.5% Debentures	2,400	
Total	2,400	

Note 4. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors (28,200+5,400+1,860)	35,460	
Total	35,460	

Note 5. Other Current liabilities	As at 31st March, 2015	As at 31st March, 2014
Bills Payable	90	
Total	90	

Note 6. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Machinery	97,200	
Furniture & Fixture	16,200	
Total	1,13,400	

Note 7.Intangible assets	As at 31st March, 2015	As at 31st March, 2014
Goodwill (WN.3)	492	
Total	492	

Note 8. Inventories	As at 31st March, 2015	As at 31st March, 2014
Stock	42,000	
Less: unrealized profit	80	
Total	41,920	

Note 9.Trade Receivables	As at 31st March, 2015	As at 31st March, 2014
Debtors (more than six months considered good) – (18,000+2,700+2,580)	23,280	
Total	23,280	

Note 10. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash and bank	10,302	
Cash-in-transit	30	
Total	10,332	

Note 11.Other current assets	As at 31st March, 2015	As at 31st March, 2014
Bills receivables	510	
Less: mutual debts(WN.5)	210	
Total	300	

Working Notes:

(1) Calculation of pre and post acquisition profits of subsidiaries:

			(₹ in lakhs)	
		Pre-acquisition capital profit	**Post-acquisition**	
			General Reserve	**Profit/Loss A/c**
Cee Ltd.				
General Reserve (Cr.)		5,100	1,200	
Profit and Loss A/c (Cr.)	1,800			
(-) Dividend	1,500	300		2,100
		5,400	1,200	2,100
Holding (60%)		3,240	720	1,260
Subsidiary (40%)		2,160	480	840

		(₹ in lakhs)	
	Pre-acquisition capital profit	Post-acquisition	
		Preliminary expenses	Profit / Loss A/c
Dee Ltd.			
Profit and Loss A/c (Cr.)	(720)		2,220
Preliminary expenses (Dr.)	(60)	30	
(-) Dividend	(780)	30	2,220
Holding (80%)	(624)	24	1,776
Subsidiary (20%)	(156)	6	444

(2) Minority Interest (₹ in lakhs)

Cee Ltd.				
Share capital			6,000	
Capital profit		2,160		
Revenue General Reserve		480		
Profit/Loss		840	3,480	9,480
Dee Ltd.				
Share capital			1,200	
Capital profit		(156)		
Revenue profit (Cr.)	444			
Add: Preliminary expenses written off	6	450	294	1,494
				10,974

(3) Cost of Control (₹ in lakhs)

Cee Ltd.			
Investment	13,500		
Less: Dividend received and wrongly credited to Profit and Loss	900	12,600	
Less: Paid-up share capital (60%)	9,000		
Capital profit	3,240	12,240	360
Dee Ltd.			
Investment in Shares	4,320		
in debentures	588	4,908	
Less: Paid-up share capital (80%)	4,800		
Nominal value of debentures	600		
Capital profit	(624)	4,776	132
Goodwill			492

(4) Consolidated General Reserve and Profit and Loss Account (₹ in Lakhs)

	General Reserve ₹	Profit and Loss A/c ₹
Bee Ltd.	66,000	18,000
Less: Wrong dividend credited	-	900
	66,000	17,100
Cee Ltd.	720	1,260
Dee Ltd. (1,776 + 24)	-	1,800
	66,720	20,160
Less: Unrealised profit on stock	-	80
	66,720	20,080

(5) Mutual owing regarding bills = ₹ (300 – 90) lakhs = ₹ 210 lakhs.

(6) Unrealised profit = $\left(400 \times \frac{25}{125}\right)$ lakhs = ₹ 80 lakhs

(7) Amount of dividend wrongly credited to Profit and Loss A/c = 60% of ₹ 1,500 lakhs = ₹ 900 lakhs.

Illustration 34.

The following are the summarised Balance Sheets of Arun Ltd., Brown Ltd. and Crown Ltd. as at 31.03.2015:

Liabilities:	Arun Ltd.	Brown Ltd.	Crown Ltd.
	₹	₹	₹
Share Capital (Shares of ₹ 100 each)	10,80,000	7,20,000	4,32,000
Reserves	1,44,000	72,000	54,000
Profit and Loss Account	3,60,000	2,16,000	1,80,000
Sundry Creditors	1,44,000	1,80,000	1,08,000
Arun Ltd.	--	72,000	57,600
Total	17,28,000	12,60,000	8,31,600

Assets:

Goodwill	1,44,000	1,08,000	72,000
Fixed Assets	5,04,000	3,60,000	4,32,000
Shares in:			
Brown Ltd. (5,400 Shares)	6,48,000	--	--
Crown Ltd. (720 Shares)	1,08,000	--	--
Crown Ltd. (2,520 Shares)	--	3,74,000	--
Due from: Brown Ltd.	86,400	--	--
Crown Ltd.	57,600	--	--
Current Assets	1,80,000	4,17,600	3,27,000
Total	17,28,000	12,60,000	8,31,000

(i) All shares were acquired on 1.10.2014.

(ii) On 1.4.2012 the balances to the various accounts were as under:

Particulars	Arun Ltd. ₹	Brown Ltd. ₹	Crown Ltd. ₹
Reserves	72,000	72,000	36,000
Profit and Loss account	36,000	(Dr.) 36,000	21,600

(iii) During 2014-15, Profits accrued evenly.

(iv) In November, 2014, each company paid interim dividend of 10%. Arun Ltd. and Brown Ltd. have credited their profit and loss account with the dividends received.

(v) During 2014-15, Crown Ltd. sold an equipment costing ₹ 72,000 to Brown Ltd. for ₹ 86,400 and Brown Ltd. in turn sold the same to Arun Ltd. for ₹ 93,600.

Prepare the consolidated Balance Sheet as at 31.03.2015 of Arun Ltd. and its subsidiaries.

Solution:

Consolidated Balance Sheet of Arun Ltd. and its subsidiaries as on 31.03.2015 (₹)

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	10,80,000	
		(b) Reserves and surplus	2	6,07,088	
	2	**Minority Interest (W.N.4)**		4,02,712	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Trade payables	3	4,32,000	
		Total (1+2+3+4+5)		**25,39,800**	
	II	**ASSETS**			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	4	12,74,400	
		(ii) Intangible assets	5	3,25,800	
	2	**Current assets**			
		(d) Cash and cash equivalents	6	9,39,600	
		Total (1+2)		**25,39,800**	

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

Notes of the Accounts

(₹)

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorized, Issued, Subscribed and paid-up Share capital:-		
10,800 Equity share of ₹100 each	10,80,000	
Total	10,80,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.14	10,800	10,80,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	10,800	10,80,000		
Less: Buy Back of share				
Total	10,800	10,80,000		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
Reserve (wn.8)	1,49,438	
Profit and Loss (WN.8)	4,57,650	
Total	6,07,088	

Note 3. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors (1,44,000+1,80,000+1,08,000)	4,32,000	
Total	4,32,000	

Note 4. Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed Assets	12,74,400	
Total	12,74,400	

Note 5. Intangible assets	As at 31st March, 2015	As at 31st March, 2014
Goodwill (WN.5)	3,25,800	
Total	3,25,800	

Note 6. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at Bank other than cash in transit	9,25,200	
Cash in transit	14,400	
Total	9,39,600	

Note 10.Other current assets	As at 31st March, 2015	As at 31st March, 2014
Bills receivables- (55+110)	165	
Less: mutual debts	11	
Total	154	

Working Notes:

1. Shareholding Pattern

In Brown Ltd.:	Number of Shares	%age of Holding
Arun Ltd.	5,400	75%
Minority Interest	1,800	25%
In Crown Ltd.:		
Arun Ltd.	720	16.667%
Brown Ltd.	2,520	58.333%
Minority Interest	1,080	25%

2. Analysis of apportionment of profit in Crown Ltd.

(a) Calculation of Unrealized Profit in Equipment

Crown Ltd sold equipment to Brown Ltd. at a profit of ₹ 14,400 and this would be apportioned to

	₹
Arun Ltd.	2,399
Brown Ltd.	8,401
Minority Interest	3,600
	14,400

Brown Ltd sold the equipment to Arun Ltd. at a profit of ₹ 7,200. This would be apportioned to:

	₹
Arun Ltd.	5,400
Minority Interest	1,800
	7,200

The above amounts are to be deducted from the respective share of profits.

(b) Reserves

	₹	
Closing balance	54,000	
Opening balance	36,000	Capital Profit
Current year Appropriation	18,000	
Apportionment of Profit from 1.4.2014 to 30.9.2014	9,000	Capital Profit
Apportionment of Profit from 1.10.2014 to 31.03.2015	9,000	Revenue Reserve

(c) Profit and Loss Account

Closing balance	1,80,000	
Opening balance	21,600	Capital Profit
Current year profits before interim dividend	2,01,600	
Apportionment of Profit from 1.4.2014 to 30.9.2014	1,00,800	
Less: Interim Dividend	43,200	
	57,600	Capital Profit
From 1.10.2014 to 31.03.2015	1,00,800	Revenue Profit

(d) Apportionment of profits of Crown Ltd.

	Pre-Acquisition	Post Acquisition	
	Capital Profit ₹	Revenue Reserve ₹	Revenue Profit ₹
Reserves	45,000	9,000	--
Profit & Loss Account	79,200	--	1,00,800
	1,24,200	9,000	1,00,800
Arun Ltd [16.667%]	20,700	1,499	16,799
Brown Ltd. [58.333%]	72,450	5,251	58,801
Minority Interest [25%]	31,050	2,250	25,200

3. Analysis of Profit of Brown Ltd

(a) Reserves

	₹	
Closing balance	72,000	
Opening balance	72,000	(Capital Profit)
Current year Appropriation	Nil	

(b) Profit and Loss Account

	₹
Closing balance	2,16,000
Opening balance (Dr.)	36,000
Current year Appropriation after interim dividend	2,52,000
Interim Dividend	72,000
Profit before Interim Dividend	3,24,000
Less: Dividend from Crown Ltd.	25,200
	2,98,800
Apportionment of Profit from 1.4.2014 to 30.9.2014	1,49,400
Less: Interim Dividend	72,000
Capital profit	77,400
Apportionment of Profit from 1.10.2014 to 31.03.2015 (Revenue profit)	1,49,400

(c) Apportionment of Profit of Brown Ltd.

	Pre-Acquisition	Post-Acquisition	
	Capital Profit ₹	Revenue Reserve ₹	Revenue Profit ₹
Reserves	72,000	--	--
Profit & Loss Account (Opening balance (-) 36,000 + 77,400)	41,400		1,49,400
Less: Unrealised Profit of Equipment from Crown Ltd.			(8,401)
Share of Post-Acquisition Profit of Crown Ltd.	--	5,251	58,801
	1,13,400	5,251	1,99,800
Arun Ltd. 75%	85,050	3,938	1,49,850
Minority Interest 25%	28,350	1,312	49,950

4. Minority Interest

	Brown Ltd. ₹	Crown Ltd. ₹
Share Capital	1,80,000	1,08,000
Capital Profit	28,350	31,050
Revenue: Reserves	1,312	2,250
Profit & Loss Account	49,950	25,200
Unrealised Profit on Equipment	(1,800)	(3,600)
	2,57,812	1,62,900
Total Minority Interest: ₹ 2,57,812+ ₹ 1,62,900 = ₹ 4,20,712		

5. Cost of Control

	Arun Ltd. in Brown Ltd. ₹	Arun Ltd. in Crown Ltd. ₹	Brown Ltd in Crown Ltd. ₹
Amount Invested	6,48,000	1,08,000	3,74,400
Less: Pre-acquisition dividend[4*]	54,000	7,200	25,200
Adjusted Cost of Investment (A)	5,94,000	1,00,800	3,49,200
Share capital	5,40,000	72,000	2,52,000
Capital Profit	85,050	20,700	72,450
(B)	6,25,050	92,700	3,24,450
Capital Reserve/Goodwill (A)-(B)	(31,050)	8,100	24,750
Net Goodwill	₹ 1,800		
Goodwill on Consolidation ₹ (1,44,000+ 1,08,000 + 72,000 + 1,800) = ₹ 3,25,800			

6. Dividend declared

	Brown Ltd. ₹	Crown Ltd. ₹
Dividend declared	72,000	43,200
Share of: Arun Ltd.	54,000	7,200
Brown Ltd.		25,200
Minority	18,000	10,800

7. Inter-Company Transactions

(a) Owings

	Dr.	Cr.	Cr.
	Arun Ltd. ₹	Brown Ltd. ₹	Crown Ltd. ₹
Balance in books	1,44,000	72,000	57,600
Less: Inter- co. owings	1,29,600	72,000	57,600
Cash-in-transit	14,400	NIL	NIL

(b) Fixed Assets

	₹
Total Fixed Assets	12,96,000
Less: Unrealised Profit on sale of equipment	21,600
Amount to be taken to consolidated Balance Sheet	12,74,400

8. Reserves and Profit and Loss Account balances in the Consolidated Balance Sheet

	Reserves ₹	Profit and Loss A/c ₹
Balance in Books	1,44,000	3,60,000
Add: Shares of Post Acquisition Profits:		
From Brown Ltd.	3,938	1,49,850
From Crown Ltd	1,499	16,799
Less: Pre-Acquisition dividend:		
From Brown Ltd.		(54,000)
From Crown Ltd		(7,200)
Less: Unrealised Profit on Equipment:		
From Brown Ltd.		(5,400)
From Crown Ltd.		(2,399)
	1,49,437	4,57,650

Illustration 35.

The draft Balance Sheets of 3 Companies as at 31st March, 2015 are as below:

			(In ₹ 000's)
Liabilities	**Morning Ltd.**	**Evening Ltd.**	**Night Ltd.**
Share Capital – shares of ₹ 100 each	1,00,000	50,000	25,000
Reserves	4,500	2,500	2,250
P/L A/c (1.4.13)	3,750	5,000	2,000
Profit for 2013-14	17,500	9,500	4,500
Loan from Morning Ltd.	-	12,500	--
Creditors	6,250	2,500	3,500
	1,32,000	82,000	37,250

Assets			
Investments:			
4,00,000 shares in Evening	45,000	-	-
1,87,000 shares in Night	20,000	-	-
Loan to Evening Ltd.	12,500	-	-
Sundry assets	54,500	82,000	37,250
	1,32,000	82,000	37,250

Following additional information is also available:

(a) Dividend is proposed by each company at 10%.

(b) Stock transferred by Night Ltd. to Evening Ltd. fully paid for was ₹ 20 lacs on which the former made a Profit of ₹ 7.5 lacs. On 31st March, 2015, this was in the inventory of the latter.

(c) Loan referred to is against 8% interest. Neither Morning Ltd. nor Evening Ltd. has considered the interest.

(d) Reserves as on 1.4.2014 of Evening Ltd. and Night Ltd. were ₹ 20,00,000 and ₹ 18,75,000 respectively.

(e) Cash-in-transit from Evening Ltd. to Morning Ltd. was ₹ 2,50,000 as on 31.3.2015.

(f) The shares of the subsidiaries were all acquired by Morning Ltd. on 1st April, 2014.

Prepare consolidated Balance Sheet as on 31st March, 2015. Workings should be part of the answer.

Solution:

Consolidated Balance Sheet of Morning Ltd. with its subsidiaries Evening Ltd. and Night Ltd.
As on 31st March, 2015

(₹ in thousand)

Ref No.		Particulars	Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	1,00,000.00	
		(b) Reserves and surplus	2	29,112.50.00	
	2	**Minority Interest** (12,200+7812.5)		20,012.50	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Trade payables	3	12,250.00	
		(b) Short-term provisions	4	11,625.00	
		Total (1+2+3+4+5)		**1,73,000.00**	
	II	**ASSETS**			
	1	**Non-current assets**			
	2	**Current assets**			
		(a) inventories	5	86,125.00	
		(b) Cash and cash equivalents	6	86,875.00	
		Total (1+2)		**1,73,000.00**	

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

Notes on the Accounts

(₹ In '000)

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorized, Issued, Subscribed and paid-up Share capital:-		
1,000 Equity share of ₹100 each	1,00,000	
Total	1,00,000	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.14	1,000	1,00,000		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	1,000	1,00,000		
Less: Buy Back of share	–	–		
Total	1,000	1,00,000		

Note 2. Reserve & Surplus		As at 31st March, 2015	As at 31st March, 2014
Capital Reserve (wn.5)		2,256.00	
General reserve- Morning Ltd	4,500		
Evening Ltd	400		
Night Ltd	281.25	5,181.25	
Profit & Loss A/c			
Balance as on 1.04.14	3,750		
Profit during the year	17,500		
Add: Interest on loan	1,000		
Less: Proposed dividend	(10,000)	12,250.00	
Profit & Loss of Evening Ltd		6,800.00	
Profit & Loss of Night Ltd		2625.00	
Total		29,112.50	

Note 3. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors- Morning Ltd	6,250	
Evening Ltd	2,500	
Night Ltd	3,500	
Total	12,250	

Note 4. Short-term provisions	As at 31st March, 2015	As at 31st March, 2014
Proposed dividend- Morning Ltd	10,000	
Evening Ltd- (Minority)	1,000	
Night Ltd- (Minority)	625	
	11,625	

Note 5. Inventories		As at 31st March, 2015	As at 31st March, 2014
Stock in trade- Morning Ltd		27,250	
Evening Ltd	41,000		
Less: Unrealised Profit	750	40,250	
Night Ltd		18,625	
Total		86,125	

Note 6. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at Bank- Morning Ltd	27,250	
Evening Ltd	41,000	
Night Ltd	18,625	
Total	86,875	

Workings Notes:

A. Morning Ltd.'s holding in Evening Ltd. is 4,00,000 shares out of 5,00,000 shares, i.e., 4/5th or 80%; Minority holding 1/5th or 20%.

B. Morning Ltd.'s holding in Night Ltd. is 1,87,500 shares out of 2,00,000 shares, i.e., 3/4th or 75%; Minority holding 1/4th or 25%.

Analysis of Reserves and Profits of Subsidiary Companies

		Evening Ltd. (₹'000)	Night Ltd ₹('000)	Minority interest in Evening Ltd. (1/5) ₹('000)	Minority interest in Night Ltd. (1/4) ₹('000)
1.	**Capital Reserve (pre-acquisition reserves and profits)**				
	Reserves on 1.04.2014	2,000	1,875		
	Profit on 1.04.2014	5,000	2,000		
		7,000	3,875		
	Less: Minority interest	1,400	968.75	1,400	968.75
		5,600	2,906.25		
2.	**General Reserve**				
	Reserves as per Balance Sheet	2,500	2,500		
	Less: Capital Reserve [See Note A]	2,000	1,875		
		500	625		
	Less: Minority interest	100	156.25	100	37.5
		160	468.75		

3.	**Profit and Loss Account**				
	Profit for the year as per Balance Sheet	9,500	4,500		
	Less: Interest on Loan (12,500 × 8%)	1,000			
		8,500			
	Less: Minority Interest	1,700	1,125	1,750	1,125
		6,800	3,375		
	Less: Unrealised profit on stock transfer	______	750[6*]		
		6,800	2,625		
4.	**Share Capital**				
	As per Balance sheet	50,000	25,000		
	Less: Minority interest	10,000	6,250	10,000	6,250
	Transferred for computation of Goodwill/Capital Reserve	40,000	18,750	13,200	8,437.50
	Less: Proposed dividend shown separately			1,000	625
	Transferred to Consolidated Balance Sheet			12,200	7,812.50

5. Computation of Cost of Control i.e. Goodwill / Capital Reserve on consolidation

(₹ in thousand)

	Evening Ltd.	Night Ltd.
Cost of Investments	45,000	20,000
Less: Paid up value of shares [Refer Note 4]	40,000	18,750
	5,000	1,250
Less: Capital Reserve [Refer Note 1]	5,600	2,906.25
	(600)	(1,656.25)
Total Capital Reserve (₹ 600 + ₹ 1,656.25)	2,256.25	

Illustration 36.

X Ltd. purchases its raw materials from Y Ltd. and sells goods to Z Ltd. In order to ensure regular supply of raw materials and patronage for finished goods, X Ltd. through its wholly owned subsidiary, X Investments Ltd. acquires on 31st March, 2015, 51% of equity capital of Y Ltd. for ₹ 150 crores and 76% of equity capital of Z Ltd. for ₹ 300 crores. X Investments Ltd. was floated by X Ltd. in 2008-09 from which date it was wholly owned by X Ltd.

The following are the Balance Sheets of the four companies as on 31st March, 2015:

(₹ in crores)

	X Ltd.		X Investments Ltd.		Y Ltd.		Z Ltd.	
(₹ in crores)	₹		₹		₹		₹	
Share Capital:								
Equity (Fully paid) ₹ 10 each	250		50		100		150	
Reserves and Surplus	750	1,000	200	250	150	250	200	350
Loan Funds:								
Secured	150		-		50		200	
Unsecured	100	250	500	500	100	150	150	350
Total Sources		**1250**		**750**		**400**		**700**

Fixed Assets:								
Cost	600		-		150		300	
Less: Depreciation	350	250	-	-	70	80	170	130
Investments at cost in Equity Shares, fully paid								
X Investments Ltd.		50		-		-		-
Y Ltd.		-		150		-		-
Z Ltd.		-		300		-		-
Other Companies								
(Market Value ₹ 1160 Cr.)		-		290		-		-
Net Current Assets:								
Current Assets	1050		10		960		2000	
Current Liabilities	100	950	-	10	640	320	1430	570
		1250		**750**		**400**		**700**

There are no intercompany transactions outstanding between the companies.

You are asked to prepare consolidated balance sheet as at 31st March, 2015 in vertical form.

Solution:

Consolidated Balance Sheet of X Ltd. and its subsidiaries
X Investments Ltd., Y Ltd. and Z Ltd. as at 31st March, 2015

(₹ in crores)

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	250	
		(b) Reserves and surplus	2	950	
	2	**Minority Interest (W.N.3)**		206.50	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
		(a) Long-term borrowings	3	1,250	
	5	**Current Liabilities**			
		(b) Trade payables	4	2,170	
		Total (1+2+3+4+5)		**4,826.50**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	460	
		(ii) Intangible assets	6	56.50	
		(b) Non-current investments	7	290	
	2	**Current assets**			
		(a) Cash and cash equivalents	8	4020	
		Total (1+2)		**4,826.50**	

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

Notes on the Accounts

(₹ in crores)

Note 1. Share Capital	**As at 31st March, 2015**	**As at 31st March, 2014**
Authorized, Issued, Subscribed and paid-up Share capital -		
25 crores Equity share of ₹ 10 each	250	
Total	250	

Note 2. Reserve & Surplus	**As at 31st March, 2015**	**As at 31st March, 2014**
General reserve (750+200)	950	
Total	950	

Note 3. Long-Term Borrowings	**As at 31st March, 2015**	**As at 31st March, 2014**
Loan fund- Secured (150+50+200)	400	
Unsecured (100+500+100+150)	850	
Total	1,250	

Note 4. Trade Payables	**As at 31st March, 2015**	**As at 31st March, 2014**
Sundry Creditors- (100+640+1,430)	2,170	
Total	2,170	

Note No. 5 Tangible Assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Fixed assets- Gross block	1,050	
Less: Depreciation	590	
Total	460	

Note 6. Intangible Assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Goodwill on consolidation- Y Ltd.	22.50	
Z Ltd.	34.00	
Total	56.50	

Note 7.Non-current Investments	As at 31st March, 2015	As at 31st March, 2014
Investment at cost	290	
(Equity share of other companies- Market value ₹116 crores) Winter Ltd.		
Total	290	

Note 8. Cash and cash equivalents	As at 31st March, 2015	As at 31st March, 2014
Cash at bank – (1,050+10+960+2,000)	4,020	
Total	4,020	

Working Notes:

(A) X Investments Ltd.

(₹ in crores)

(1)	**Analysis of Profits and Share Capital:**				
			Capital Profit	**Revenue Profit**	**Share Capital**
	(i)	Y Ltd.	150.00	-	100.00
		Minority Interest (49%)	73.50	-	49.00
		Share of X Investments Ltd.	76.50	-	51.00
	(ii)	Z Ltd.	200.00	-	150.00
		Minority Interest (24%)	48.00	-	36.00
		Share of X Investments Ltd.	152.00	-	114.00
(2)	**Cost of Control:**		**Y Ltd.**		**Z Ltd.**
	Cost of investments		150.00		300.00
	Less: Paid up value of shares 51.00			114.00	
	Capital profits 76.50			152.00	
			127.50		266.60
	Goodwill on consolidation		22.50		34.00
(3)	**Minority interest**		**Y Ltd.**		**Z Ltd.**
	Share Capital		49.00		36.00
	Capital Profits		73.50		48.00
	Revenue Profits		-		-
			122.50		**84.00**

Name Of the Company: X Investments Ltd.

Consolidated balance Sheet of X Investments Ltd. and its subsidiaries Y Ltd. and Z Ltd. as at 31st Mach, 2015.

(₹ in crores)

Ref No.	Particulars		Note No.	As at 31st March, 2015	As at 31st March, 2014
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholder's Fund**			
		(a) Share capital	1	50.00	
		(b) Reserves and surplus	2	200.00	
	2	**Minority Interest (W.N.3)**		206.50	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**			
		(a) Long-term borrowings	3	1,000.00	
	5	**Current Liabilities**			
		(a) Trade payables	4	2,070.00	
		Total		3,526.50	
	II	**ASSETS**			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets	5	210.00	
		(ii) Intangible assets	6	56.50	
		(b) Non-current investments	7	290.00	
	2	**Current assets**			
		(a) Cash and cash equivalents	8	2,970.00	
		Total		3,526.50	

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

Notes to the Accounts (₹ in cror es)

Note 1. Share Capital	As at 31st March, 2015	As at 31st March, 2014
Authorized, Issued, Subscribed and paid-up Share capital:-		
5 crores Equity share of ₹10 each	50	
Total	50	

RECONCILIATION OF SHARE CAPITAL

FOR EQUITY SHARE	As at 31st March, 2015		As at 31st March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening Balance as on 01.04.14 (crores)	5	5 0		
Add: Fresh Issue (Including Bonus shares, right shares, split shares, share issued other than cash)				
	5	50		
Less: Buy Back of share				
Total	5	50		

Note 2. Reserve & Surplus	As at 31st March, 2015	As at 31st March, 2014
General reserve	200	
Total	200	

Note 3. Long-Term Borrowings	As at 31st March, 2015	As at 31st March, 2014
Loan fund- Secured(50+200)	250	
Unsecured (500+100+150)	750	
Total	1,000	

Note 4. Trade Payables	As at 31st March, 2015	As at 31st March, 2014
Sundry Creditors- (640+1,430)	2 ,070	
Total	2,070	

Note No. 5 Tangible Assets	As at 31st March, 2015	As at 31st March, 2014
Fixed assets- Gross block	450	
Less: Depreciation	240	
Total	210	

Compendium: Advanced Financial Accounting and Reporting

Note 6. Intangible Assets	**As at 31st March, 2015**	**As at 31st March, 2014**
Goodwill on consolidation- Y Ltd.	22.50	
Z Ltd.	34	
Total	56.50	

Note 7.Non-current Investments	**As at 31st March, 2015**	**As at 31st March, 2014**
Investment at cost	290	
(Equity share of other companies- Market value ₹116 crores) Winter Ltd.		
Total	290	

Note 8. Cash and cash equivalents	**As at 31st March, 2015**	**As at 31st March, 2014**
Cash at bank – (10+960+2,000)	2,970	
Total	2,970	

X Ltd.

(i) Analysis of Profits of X Investments Ltd.:

		Capital Profit	**Revenue Profit**
	Reserves and Surplus		200
	Minority Interest		
	(X Investments Ltd. being wholly owned		
	subsidiary of X Ltd.)		
(ii)	Minority Interest in X Investments Ltd.		
(iii)	Cost of Control:		
	Cost of investments in X Investments Ltd.		50
	Less: Paid-up value of shares held in X		
	Investments Ltd. by X Ltd.	50	
	Capital Profit		50
	Cost of Control		

DISPOSAL OF SHARES

Illustration 37.

Sale of share Cum – Dividend

The summarized balance sheets of Soubhagya Ltd. and Tirtha Ltd as at 31.03.2015 are as follows-

Liabilities	Soubhagya Ltd. ₹	Tirtha Ltd. ₹	Assets	Soubhagya Ltd. ₹	Tirtha Ltd. ₹
Equity Share Capital (₹10)	1,75,000	50,000	Fixed assets	2,00,000	80,000
Reserves	20,000	5,000	Current Assets	32,000	8,000
Profit & Loss Account – as	30,000	10,000	Investments at cost:	35,000	-
at 01.04.2014			3,000 Shares in Tharini Ltd.		
Add: Profit for the year	8,000	8,000			
Add: Dividends from Tharini Ltd	4,000	-			
Less: Dividends paid	-	(5,000)			
Creditors	30,000	20,000			
Total	**2,67,000**	**88,000**	**Total**	**2,67,000**	**88,000**

Soubhagya Ltd acquired 4,000 shares in Tirtha Ltd at ₹20 each on 01.04.2014 and sold 1,000 of them at the same price on 01.01.2015. The sale cum- dividend. An interim dividend of 10% was paid by Tirtha Ltd on 01.10.2014.

Prepare the consolidated Balance Sheet as at 31.03.2015.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding company = Soubhagya Ltd. Subsidiary = Tirtha Ltd.	Acquisition: 01.04.14 Consolidation: 31.03.15	Holding Co: = 60% Minority Interest: = 40%

2. Analysis of Reserves and surplus of Tirtha Ltd

(a) **General Reserve**

Balance as on 31.03.2015 ₹5,000

Balance on 01.04.2014 (date of acquisition)
₹ 5,000
(Capital Profit)

Transfer during 2014-15 (upto consolidation)
(balancing figure) ₹ **NIL**
(Revenue Reserve)

(b) **Profit and Loss Account**

Balance as on 31.03.2015 ₹13,000

Balance on 01.04.2014 (date of acquisition)
₹3,000 ₹10,000
(Capital Profit)

Profit for 2014-15 (upto consolidation)	8,000
Less: Interim Dividend	5,000
Revenue Profit	3,000

3. Computation of Cost of Control & Minority Interest

Particulars	Total	Minority Interest	Pre-Acquisition.	Post Acquisition.	
Tirtha Ltd (Holding 60%, minority 40%)				**Gen.Res.**	**P&L A/c**
Equity Capital General Reserves Profit and Loss A/c	50,000 5,000 13,000	20,000 2,000 5,200	30,000 3,000 6,000		1,800
Minority interest		**27,200**			
Total [Cr.] **Cost of Investment [Dr.] (Note 1)** Parent's Balance (Note 1)			**39,000** **(35,000)**	20,000	42,000
For consolidated balance sheet			**(4,000)** **(Capital Reserve)**	**20,000**	**43,800**

Note: adjustment for dividend is required since the shares are sold on cum – dividend basis i.e. including dividend. The dividend when declared will be received by the buyer of the shares.

Name of the Company: Soubhagys Ltd. and its subsidiary Tirtha Ltd.

Balance Sheet as at : 31.03.2015

Ref No.		Particulars	Note No.	As at 31.03.15	As at 31.03.14
				(₹)	(₹)
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholders' fund**			
		(a) Share capital	1	1,75,000	
		(b) Reserves and surplus	2	67,800	
	2	**Minority Interest (W.N)**		27,200	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Other current liabilities	3	50,000	
		Total		**3,20,000**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	2,80,000	
	2	**Current assets**			
		(a) Other current assets	5	40,000	
		Total		**3,20,000**	

Workings: (₹)

1. Share capital	31.03.15	31.03.14
Equity Share Capital	1,75,000	
Total	**1,75,000**	

2. Reserve and Surplus	31.03.15	31.03.14
General Reserve	20,000	
Profit & Loss A/c Capital Reserve	43,800	
Total	**67,800**	

3. Other current liabilities	31.03.15	31.03.14
Current Liabilities (30,000 + 20,000)	50,000	
Total	**50,000**	

4. Tangible Assets	31.03.15	31.03.14
Other Fixed Assets (2,00,000+80,000)	2,80,000	
Total	**2,80,000**	

5. Other Current Assets	31.03.15	31.03.14
Current Assets (32,000 + 8,000)	40,000	
Total	**40,000**	

Sale & Subsequent Purchase of shares in subsidiary company
Acquisition and Disposal of Shares in subsidiary

Illustration 38.

Abhi Ltd acquired 60% of Bob Ltd on 01.04.2013 for ₹80,000 (Nominal Value ₹60,000) and 90% of Chand Ltd on 01.04.2012 for ₹55,000 (Nominal Value ₹45,000).

On 30.09.2014, 15% of Chand Ltd was sold for ₹8,000 and 15% of Bob Ltd was further acquired for ₹17,000.

The following were the profit & Loss Account balance on different dates –

Company / Dates	01.04.2012	01.04.2013	01.04.2014	31.03.2015
Bob Ltd	12,000	15,000	40,000	90,000
Chand Ltd	8,000	20,000	30,000	(10,000)

Assuming that there was no other balance in Reserves, find out:

1. Goodwill / Capital reserve on Consolidation.
2. Current Profit on the different relevant dates for the consolidated Balance Sheet as at 31.03.2013, 31.03.2014 and 31.03.2015
3. Minority interest on these dates.

Solution:

A. **FOR CONSOLIDATION ON 31.03.2013**

1. **Basic Information**

Company	Share of Abhi	Minority Interest	Date of Acquisition
Bob Ltd	(No Acquisition on 31.03.2013)		N .A
Chand Ltd	90%	10%	01.04.2012

2. Analysis of Profit & Loss Account of Subsidiaries – Chand Ltd

Balance on 31.03.2013 ₹20,000

As on 01.04.2012 ₹8,000 (Date of Acquisition) **Capital Profits**

Profit for 2012-13 ₹12,000 (balancing figure) **Revenue Profit**

3. Consolidation of Balances

Particulars	Total	Minority Interest	Pre-Acquisition	Post Acqn
Chand Ltd (Holding 90%, Minority 10%)				**P&L A/c-**
Equity Capital	50,000	5,000	45,000	
Profit and Loss A/c	20,000	2,000	7,200	10,800
Minority Interest		**7,000**		
Total [Cr]			**52,200**	**10,800**
Cost of Investment [Dr.]			**(55,000)**	
For Consolidated Balance sheet			**2,800 (Goodwill)**	

B. **FOR CONSOLIDATION ON 31.03.2014**

1. Basic Information

Company	Share of Abhishek	Minority Interest	Date of Acquisition
Bob Ltd	60%	40%	01.04.2013
Chand Ltd	90%	10%	01.04.2012

2. Analysis of Profit & Loss Account of subsidiaries

Bob Ltd.,

As on 31.03.2014 ₹40,000

01.04.13 ₹**15,000** (DOA) **Capital**

Profit for ₹25,000 **2013 – 14 Revenue**

Chand Ltd.

As on 31.03.2014 ₹30,000

01.04.12 ₹ **8,000** (DOA) **Capital**

Profit for ₹ **22,000** 12 – 13 & 2013 – 14 **Revenue**

3. Consolidation of Balances

Particulars	Total	Minority Interest	Pre-Acquisition	Post Acqn P&L A/c-
Bob Ltd (Holding 60%, Minority 40%)				
Equity Capital	1,00,000	40,000	**60,000**	
Profit and Loss A/c	40,000	16,000	**9,000**	15,000
Minority Interest		**56,000**	**69,000**	**15,000**
Chand Ltd (Holding 90%, Minority 10%)				
Equity Capital	50,000	5,000	45,000	19,800
Profit and Loss A/c	30,000	3,000	7,200	
Minority Interest		**8,000**	**52,200**	**19,800**
Total [Cr]			**1,21,200**	**34,800**
Cost of Investment [Dr.] (₹80,000 + ₹55,000)			(1,35,000)	
For Consolidated Balance sheet			**13,800 (Goodwill)**	

C. FOR CONSOLIDATION ON 31.03.2015

1. Basic Information

Company	Share of Abhi Ltd	Minority Interest	Date of Acquisition
Bob Ltd	60% + 15% (Acquired on 30.09.14) = 75%	25%	01.04.2013
Chand Ltd	90% - 15% (Sold on 30.09.14) = 75%	25%	01.04.2012

2. Analysis of Profit & Loss account of subsidiaries

(a) **Chand Ltd**

As on 31.03.2015 (₹10,000)

01.04.12 (DOA) ₹ **8,000 Capital**

Profit for 12 – 13, 13 – 14 and 14- 15 **(₹18,000) Revenue**

(b) **Bob Ltd**

As on 31.03.2015 (₹90,000)

01.04.13 (DOA) ₹**15,000**
Capital

Profit for 13 – 14, 14 – 15 **(₹ 75,000)**

2013 -14 **25,000**
for 60% Revenue
for 15% Capital

2014 – 15 **50,000**

01.04.14 to 30.09.14
25,000
for 60% Revenue
for 15% Capital

01.10.14 to 31.03.15
25,000
Revenue
Capital

					Total
Minority Int.(25%)	3,750	6,250	6,250	6,250	22,500
Group Interest (75%)					
Pre	75% = 11,250	15% = 3,750	15% = 3,750	-	18,750
Post	-	60% = 15,000	60% = 15,000	75%= 25,000	55,000

3. Consolidation of Balances

Particulars	Total	Minority Interest	Pre-Acquisition	Post Acqn P&L A/c-
Bob Ltd (Holding 75%, Minority 25%)				
Equity capital	1,00,000	25,000	75,000	
Profit and Loss A/c	90,000	22,500	18,750	55,000
Minority Interest		**47,500**	**93,750**	**55,000**
Chand Ltd (Holding 75%, Minority 25%)				
Equity Capital Profit and Loss A/c	50,000 (10,000)	12,500 (2,500)	37,500 6,000	 (13,500)
Minority Interest		**10,000**	**43,500**	**(13,500)**
Total [Cr.] **Cost of Investment [Dr.] (₹97,000 + ₹48,000)**			**1,37,250** **(1,45,000)**	
For Consolidated Balance Sheet			**7,750** **(Goodwill)**	

Note:

1. Adjusted Cost of Investment

Particulars	Bob	Chand
Cost of Investment (as at 31.03.2013) **Add**: Acquisition of 15% Share Capital of Bobby **Less**: Sale of 15% Share Capital of Chand (₹42,000 x 15% / 90%)	80,000 17,000 -	55,000 - (7,000)
Adjusted cost of Investment (as at 31.03.2015)	**97,000**	**48,000**

DISPOSAL OF SHARES IN SUBSIDIARY – GAIN / LOSS

Illustration 39.

Rupmati Ltd owns 80% of voting power of Srimathy Ltd, its only investment, acquired on 01.04.2014 for ₹70,000. The net assets of Srimathy Ltd on 01.04.2014 was ₹1,00,000. On 01.10.2015, the investment in Srimathy Ltd was sold for ₹ 1,80,000. The Net Assets of Srimathy Ltd on 31.03.2015 and 30.09.2015 were ₹1,50,000 and ₹1,80,000, respectively the difference representing the profit for the period. Compute the gain/ Loss on disposal of the subsidiary. Determine the gain or loss if the sale consideration was ₹1,10,000 and the shares were sold on 31.03.2015.

Solution:

1. Cost of Control

Particulars	₹
Share in Net Assets as on date of acquisition (₹1,00,000 x 80%) Less: Cost of Investment	80,000 (70,000)
Capital Reserve	**10,000**

2. Gain / Loss on disposal of investment in Subsidiary

Particulars	01.10.2015	31.03.2015
Sale Consideration	1,80,000	1,10,000
Less: Share in Net Assets as on date of sale (1,80,000 x 80%) / (1,50,000 x 80%)	(1,44,000)	(1,20,000)
Transfer to Profit and Loss Account	36,000	10,000
	Gain	Loss

FOREIGN SUBSIDIARY – INTEGRAL VS NON – INTEGRAL OPERATIONS

Illustration 40.

The draft balance Sheets of A Ltd. and its American subsidiary B Inc. as at 31.03.2015 are as under –

Liabilities	A Ltd	B Inc.	Assets	A Ltd	B Inc.
	₹	US $		₹	US $
Share Capital in Equity shares	30,00,000	30,000	Fixed assets	18,00,000	20,000
Profit & Loss Account	20,00,000	40,000	Investments in B	17,00,000	-
Loan Funds	13,00,000	20,000	Stocks	12,00,000	30,000
Trade Creditors	6,00,000	10,000	Debtors	24,00,000	60,000
Provision for Taxation	10,00,000	20,000	Cash and Bank	8,00,000	10,000
Total	79,00,000	1,20,000	Total	79,00,000	1,20,000

1. A Ltd. acquired 80% of shares in B Inc. on 01.04.2011, when the P & L A/c showed a balance of $20,000.
2. Exchange rates per $ prevalent dates were: 01.04.2011: ₹30, 01.04.2014 = ₹ 36 : 31.03.2015: ₹42.
3. A Ltd decided to amortise goodwill, if any, over a period of eight years.
4. Prepare the consolidated Balance shaeet of A Ltd and its subsidiary at 31.03.2015.

Solution:

1. Basic information

Company Status	Dates	Holding Status
Holding Company = A Ltd. Subsidiary = B Inc.	Acquisition: 01.04.2011 Consolidation: 31.03.2015	Holding Company = 80% Minority Interest = 20%

1. **Analysis of Profit and Loss Account of B Inc. (for Translation Purposes)**

Balance on 31.03.2015 $40,000

01.04.2011 (Acquisition) **$20,000** Addition between 01.04.11 to 31.03.15 **$20,000**

Capital (balancing figure) **Revenue**

Translation into ₹

Particulars	Pre Acquisition reserve	Post Acquisition Reserve	Total
In American Dollar	20,000	20,000	40,000
Conversion rate Per $	30 (date of Acqn.)	(30 + 42)/2 = 36 (Average rate)	
In Indian ₹	6,00,000	7,20,000	13,20,000

2. **Translation of B Inc's Balance sheet into Indian Rupees**

Particulars			Integral Operations			Non – Integral Operations		
	Debit ($)	Credit ($)	₹ per $	Debit (₹)	Credit (₹)	₹ per $	Debit (₹)	Credit (₹)
Share Capital		30,000	30		9,00,000	30		9,00,000
Reserves		40,000	WN 2		13,20,000	WN 2		13,20,000
Loan Funds		20,000	42		8,40,000	42		8,40,000
Creditors		10,000	42		4,20,000	42		4,20,000
Taxation		20,000	42		8,40,000	42		8,40,000
Fixed Assets	20,000		30	6,00,000		42	8,40,000	
Stock in Trade	30,000		42	12,60,000		42	12,60,000	
Debtors	60,000		42	25,20,000		42	25,20,000	
Cash in Bank	10,000		42	4,20,000		42	4,20,000	
Total	**1,20,000**	**1,20,000**		**48,00,000**	**43,20,000**		**50,40,000**	**43,20,000**
Exch. Rate Gain					**4,80,000**			**-**
Translation reserve					**-**			**7,20,000**
Total				**48,00,000**	**48,00,000**		**50,40,000**	**50,40,000**

3. **Analysis of Reserves & Surplus on B Inc. (for Consolidation Purposes)**

(a) **Profit & Loss Account:** Balance on 31.03.2015 ₹13,20,000

As on date of Acquisition	Acquisition to consolidation
01.04.2011 ₹**6,00,000**	Profit between 01.04.11 to 31.03.15 ₹ **7,20,000**
Capital Profits	(balancing figure) **Revenue**

(b) **Exchange Gain (Only for Integral Operation) = ₹4,80,000 = Revenue Profit**

4. **Consolidation of Balances**

Particulars	Integral Operations				Non Integral Operations				
	Total	Minority Interest	Pre. Acqn.	Post. Acqn. P& L A/c	Total	Minority Interest	Pre. Acqn	Post. Acqn.	
								P& L A/c	Trams. Res.
Equity Capital	9,00,000	1,80,000	7,20,000		9,00,000	1,80,000	7,20,000		
Profit & Loss A/c	13,20,000	2,64,000	4,80,000	5,76,000	13,20,000	2,64,000	4,80,000	5,76,000	5,76,000
Exchange. Rate Gain	4,80,000	96,000		3,84,000	-	-			
Trans. Reserve					7,20,000	1,44,000			
Sub Total		5,40,000	12,00,000	9,60,000		5,88,000	12,00,000		
Cost of Investment			(17,00,000)	20,00,000			(17,00,000)	20,00,000	
Part's balances									
Consolidated Balance		5,40,000	(5,00,000)	29,60,000		5,88,000	(5,00,000)	25,76,000	5,76,000
			(Goodwill)	(2,00,000)			(Goodwill)	(2,00,000)	
Goodwill Already Amortized			2,00,000				2,00,000		
For CBS		5,40,000	(3,00,000)	27,60,000		5,88,000	(3,00,000)	23,76,000	5,76,000

Name of the Company: A Ltd. and its subsidiary B Ltd.

Balance Sheet as at : 31.03.2015

Ref No.		Particulars	Note No.	Integral As at 31.03.15	Integral As at 31.03.14	Non Integral As at 31.03.15	Non Integral As at 31.03.14
				(₹)	(₹)	(₹)	(₹)
	I	EQUITY AND LIABILITIES					
	1	Shareholders' fund					
		(a) Share capital	1	30,00,000		30,00,000	
		(b) Reserves and surplus	2	27,60,000		33,36,000	
	2	Minority Interest (W.N 4)		Nil		Nil	
	3	Share application money pending allotment		5,40,000		5,88,000	
	4	Non-current liabilities		Nil		Nil	
	5	Current Liabilities					
		(a) Short-term borrowings	3	21,40,000		21,40,000	
		(b) Trade payables	4	10,20,000		10,20,000	
		(c) Short-term provisions	5	18,40,000		18,40,000	
		Total		1,12,20,000		1,12,20,000	
	II	ASSETS					
	1	Non-current assets					
		(a) Fixed assets					
		(i) Tangible assets	6	24,00,000		24,00,00	
		(ii) Intangible assets	7	3,00,000		3,00,000	
	2	Current assets					
		(a) Inventories	8	24,60,000		24,60,000	
		(b) Trade receivables	9	49,20,000		49,20,000	
		(c) Cash and cash equivalents	10	12,20,000		12,20,000	
		Total		1,12,20,000		1,12,20,000	

Workings:

	Integral		Non Integral	
1. Share capital	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Equity Share Capital	30,00,000		30,00,000	
Total	30,00,000		30,00,000	

	Integral		Non Integral	
2. Reserve and Surplus	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Profit & Loss A/c	27,60,000		27,60,000	
Foreign Exchange Translation Reserve	-		5,76,000	
Total	**27,60,000**		**33,36,000**	

	Integral		Non Integral	
3. Short Term Borrowings	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Loan Fund (13,00,000 + 8,40,000)	21,40,000		21,40,000	
Total	21,40,000		21,40,000	

	Integral		Non Integral	
4. Trade Payables	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Creditors	10,20,000		10,20,000	
Total	**10,20,000**		**10,20,000**	

	Integral		Non Integral	
5. Short Term Provisions	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Taxation	18,40,000		18,40,000	
Total	**18,40,000**		**18,40,000**	

	Integral		Non Integral	
6. Tangible Assets	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Tangible Assets	24,00,000		26,40,000	
Total	**24,00,000**		**26,40,000**	

	Integral		Non Integral	
7. Intangible Assets	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Goodwill	3,00,000		3,00,000	
Total	**3,00,000**		**3,00,000**	

	Integral		Non Integral	
8. Inventories	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Stock	24,60,000		24,60,000	
Total	**24,60,000**		**24,60,000**	

	Integral		Non Integral	
9. Trade receivables	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Debtors	49,20,000		49,20,000	
Total	**49,20,000**		**49,20,000**	

	Integral		Non Integral	
10. Cash and cash equivalents	**31.03.15**	**31.03.14**	**31.03.15**	**31.03.14**
Cash	12,20,000		12,20,000	
Total	**12,20,000**		**12,20,000**	

FOREIGN SUBSIDIARY – INTEGRAL OPERATIONS

Illustration 41.

The following summarized Balance Sheets as on 31.03.2015 are given – (₹ in '000s)

Liabilities	AA Ltd	BB Ltd	CC Ltd	Assets	AA Ltd	BB Ltd	CC Ltd
	₹	₹	~~Ts.~~		₹	₹	₹
Share Capital (100)	2,000.00	500.00	500.00	Fixed Assets	1600.00	500.00	600.00
Reserves & surplus	600.00	250.00	350.00	Investment In BB	472.50	-	-
Loan from BB (incl. Interest)	225.00	-	-	Investment in CC	525.00	-	-
				Loan – AA	-	200.00	-
Bank Overdraft	-	140.00	-	Loan – others	45.00	-	30.00
Sundry Creditors	240.00	210.00	160.00	Cash at Bank	120.00	16.00	60.00
				Other Current assets	302.50	384.00	320.00
Total	3065.00	1100.00	1010.00	Total	3065.00	1100.00	1010.00

Additional Information:

1. CC Ltd. is a Tanzanian Company, and the amount expressed above is in Tanzanian Shilling.
2. The reserves of the various companies as on 01.04.2015 are: AA Ltd- ₹4,30,000; BB Ltd - ₹2,00,000; CC Ltd – ~~Ts.~~1,70,000.
3. BB Ltd had advanced the loan to AA Ltd on 01.04.2015.
4. On 01.10.2015, BB Ltd had issued fully paid Bonus Shares at the rate of one Share for every Four held. On the same date, a dividend of 10% was paid for the year 2014-15
5. AA Ltd had purchased 4,375 Shares in BB Ltd on 01.07.2015, but had disposed of 375 shares on 31.01.2016 at ₹140, the sale proceeds being credited to the concerned investment Account which so far has only this entry in addition to that made on the acquisition of shares.
6. 3,500 shares were acquired in CC Ltd on 30.09.2015 at ₹150 per share.
7. Stock of CC Ltd include goods costing ₹10,000 sent by A Ltd at the invoice value of ₹12,500 which were recorded in the books of CC Ltd at ~~Ts.~~ 11,625.
8. There has been no movement in the Fixed Assets or Share Capital of CC Ltd during the year.
9. CC Ltd paid in January 2016 an interim dividend at 6% p.a. for six months. CC Ltd remitted the amount due to AA Ltd when ₹100 was equal to ~~Ts.~~ 94.
10. The exchange rates between India and Tanzania during 2015-16 were as follows- 01.04.2015 - ₹100 = ~~Ts.~~ 92; 30.09.2015 - ₹100 = ~~Ts.~~ 90; 31.03.2016 - ₹100 = ~~Ts.~~ 93. Average ₹100 = ~~Ts.~~ 91.

Prepare the consolidated balance Sheet of the Group.

Solution:

1. **Basic Information**

Company Status	Date of Acquisition		Holding Status	
			Held by AA	Minority
Holding company = AA Ltd	01.07.15 Purchase	4,375 shares		
Subsidiary 1 = BB Ltd	31.03.16 Sales	(375) shares	80%	20%
Subsidiary 2 = CC Ltd	31.03.16 Balance	4,000 shares	70%	30%
	30.09.2015	3,500 shares		

Date of consolidation = 31.03.2016

Shareholding in BB Ltd. Lot 1 Purchase 3,500 shares + Bonus at 1 for 4 held (3,500 x ¼) 875 Shares – Sale 375 Shares = 3,500 shares.

2. **Translation of CC Ltd's Balance sheet in to Indian Rupees**

Particulars	Debit (~~Ts.~~)	Credit (~~Ts.~~)	(~~Ts.~~) per ₹100	Debit (~~Ts.~~)	Credit (~~Ts.~~)
Share Capital		5,00,000	90		5,55,555
Reserves & Surplus		3,50,000	WN		3,87,790
Creditors		1,60,000	93		1,72,043
Fixed Assets	6,00,000		90	6,66,667	
Investment	30,000		90	33,333	
Cash in Bank	60,000		93	64,516	
Stock in Trade			93	12,500	
supplied by A	11,625				
Other Current Assets (Total 3,20,000 – Stock from A 11,625)	3,08,375			3,31,586	
Total	**10,10,000**	**10,10,000**		**11,08,602**	**11,15,388**
Loss on Exch. Rate difference				**6,786**	
Total				**11,15,388**	**11,15,388**

Working Note:

Translation and Analysis of Reserves

Balance as per Balance Sheet ₹3,50,000

As on 01.04.2015 (preceding B/S date)

~~Ts.~~1,70,000

Capital

Addition during 2015-16 (bal. figure) ₹1,80,000

01.04.2015 to 30.09.2015

(upto acquisition)

~~Ts.~~1,80,000/2 = ₹**90,000**

Capital

01.10.15 to 31.03.16 (acquisition to Consolidation)

~~Ts.~~1,80,000/2 = ₹**90,000**

Revenue

Total Pre Acquisition reserves = 1,70,000 + 90,000 = ~~Ts.~~2,60,000; Total acquisition Reserve = ₹90,000

Conversion into ₹

Particulars	Pre Acquisition Reserve	Post Acquisition Reserve	Total
In Tanzanian Shilling	2,60,000	90,000	3,50,000
Conversion Rate per ₹100	90 (Date of Acqn.)	91 (Average Rate)	N. A.
In Indian ₹	2,88,889	98,901	3,87,790

3. **Analysis of reserves and Surplus of Subsidiaries**

CC Ltd.

Balance on 31.03.2016 ₹3,87,790

Capital Profit	Revenue Reserve
₹2,88,889	₹98,901
(from 2 above)	(from, 2 above)

BB Ltd

Balance on 31.03.2016	₹ 2,50,000
Add: Interest	₹ 25,000
Corrected Balance	₹ 2,75,000

01.04.15 (Prev. b/s)	2,00,000
Bonus	(1,00,000)
Dividend	(40,000)
Capital	**60,000**

Profit for 2015-16 (b/f) 2,15,000

01.04.15 – 30.06.15	01.07.15 - 31.03.16
(upto acqn.)	(acqn. To cons.)
(215000 x 3/12)	(215000 x 9/12)
₹**53,750**	₹**1,61,250**
Capital	**Revenue**

Total capital Profit = 60000 + 53750 = ₹1,13,750;

Revenue Profit = ₹1,61,250

Note: Bonus for BB Ltd: ₹5,00,000 x 1/5 = ₹1,00,000; Dividend: 10% of (₹5,00,000 - ₹1,00,000) = ₹40,000; Interest: Balance as per AA Ltd ₹2,25,000 Less Balance as per BB Ltd's books ₹2,00,000 = ₹25,000

4. **Consolidation of Balances**

Particulars	**Total**	**Minority Interest**	**Pre- Acqn.**	**Post Acqn. Reserves**
BB Ltd (Holding 80%, Minority 20%)				
Equity Capital	5,00,000	1,00,000	4,00,000	
Reserves and surplus	2,75,000	55,000	91,000	1,29,000
Minority interest		**1,55,000**		
CC Ltd (holding 70%, Minority 30%)				
Equity Capital	5,55,555	1,66,666	3,88,889	69,231
Reserves and surplus	3,87,790	1,16,337	2,02,222	(4,750)
Exchange Rate Loss	(6,786)	(2,036)		
Minority Interest		**2,80,967**		
Total [Cr]		**4,35,967**	**10,82,111**	**1,93,481**
Cost of Investment [Dr.] (Note)			(9,61,830)	5,64,330
Parent's Balance (Note 1)				(2,500)
Stock Reserve (₹12,500 - ₹10,000) (Note 2)				
For consolidated Balance sheet		**4,37,967**	**1,20,281 (Cap. Res.)**	**7,55,311**

Note:

1. **Parent's P & L A/c balance and Cost of Investment**

Particulars	Investment		P & L A/c
	BB Ltd	CC Ltd	
Balance as per balance sheet	4,72,500	5,25,000	6,00,000
Add: Sale proceeds wrongly credited in full (375 shares x ₹140)	52,500	-	52,500
Less: Pre acquisition dividend for 2014-15 (BB Ltd 3500Sh. × ₹100 x 10%)	(35,000)	-	(35,000)
Less: Pre acquisition dividend for 01.01.15 to 30.09.15 – CC Ltd: 3500 shares x ~~Rs.~~100 per Share x 6% x 6/12 months x ₹100 / ~~Rs.~~94		(11,170)	(11,170)
Adjusted Cost of Investment	**4,90,000**	**5,13,830**	
Less: Cost of BB Ltd shares Sold [375/4375 (incl. Bonus)] x ₹4,90,000	(42,000)	**-**	(42,000)
For Consolidation of Balance	**4,48,000**	**5,13,830**	**5,64,330**

Total cost of Investment = ₹4,48,000 + ₹5,13,830 = 9,61,830

2. Stock Reserve: Stock Reserve i.e. unrealized profits on closing Stock have been eliminated in full from group reserve as it relates to downstream transaction.

   Name of the Company: AA Ltd. and its two subsidiaries BB Ltd. and CC Ltd.

   Balance Sheet as at : 31.03.2016

(₹ in thousands)

Ref No.	Particulars		Note No.	As at 31.03.16	As at 31.03.15
				(₹)	(₹)
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholders' fund**			
		(a) Share capital	1	20,00,000	
		(b) Reserves and surplus	2	8,75,592	
	2	**Minority Interest (W.N 4)**		4,37,967	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Trade payables	3	7,62,043	
		Total		**40,73,602**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	27,66,667	
	2	**Current assets**			
		(a) Cash and cash equivalents	5	2,00,516	
		(b) Short-term loans and advances	6	78,333	
		(c) Other current assets	7	10,28,086	
		Total		**40,73,602**	

Workings:

1. Share capital	**31.03.16**	**31.03.15**
Equity Share Capital	20,00,000	
Total	**20,00,000**	

2. Reserve and Surplus	31.03.16	31.03.15
Capital Reserve	1,20,281	
Profit & Loss A/c	7,55,311	
Total	**8,75,592**	

3. Trade Payables	31.03.16	31.03.15
Creditors (2,40,000+2,10,000+1,72,043)	6,22,043	
Bank Overdraft	1,40,000	
Total	**7,62,043**	

4. Tangible Assets	31.03.16	31.03.15
Tangible Fixed Assets (16,00,000+5,00,000+6,66,667)	27,66,667	
Total	**27,66,667**	

5. Cash and Cash Equivalent	31.03.16	31.03.15
Bank (1,20,000+16,000+64,516)	2,00,516	
Total	**2,00,516**	

6. Short-term loans and advances	31.03.16	31.03.15
Loans Receivable (45,000+33,333)	78,333	
Total	**78,333**	

7. Other Current Assets	31.03.16	31.03.15
Other Current Assets (3,03,5000+3,84,000+3,44,086-2,500) Stock Reserve	10,28,086	
Total	**10,28,086**	

3.4 TREATMENT OF INVESTMENT IN ASSOCIATE IN CONSOLIDATED FINANCIAL STATEMENT (AS-23)

1. **Associate:** An Associate is an enterprise in which the Investor has **significant influence** and which is neither a subsidiary nor a joint Venture of the Investor.
2. **Investor:** An Investor is an enterprise or person who has a significant influence over the Associate.
3. **Equity** is the **Residual Interest** in the assets of an enterprise after deducting all its liabilities**.**
4. **Equity Method** is a method of accounting with the following features-
   - **(a) Acquisition:** Investment is initially recorded at **cost**, identifying any goodwill / Capital Reserve arising at the time of acquisition.
   - **(b) Post Acquisition Profits:** The carrying amount of the Investment is **adjusted** to recognise the **investor's Share** of Profits or Losses of the investee (i.e. the Associate) after the date of acquisition.
   - **(c) Consolidated P & L Account**: The consolidated Statement of profit and Loss reflects the Investor's Share of the results of operations of the investee (i.e. the Associate).
   - **(d) Distributions:** Distributions received from an Investee **reduce** the carrying amount of the investment.

The major principles used in application of the Equity Method:

I. **Principles of AS – 21[para 10]:** The application of the Equity Method is similar to the consolidation procedures set out in AS – 21. The broad concepts underlying the consolidation procedures used in the acquisition of a subsidiary are adopted on the acquisition of an investment in an Associate.

II. **Relevant Date [para 11]:** An Investment in an Associate is accounted for under the Equity Method from the date on which it falls within the definition of an Associate.

III. **Goodwill / Capital Reserve [para 12]:**

(a) When cost of Acquisition > Share of the Equity; it is treated as Goodwill

(b) When cost of Acquisition < Share of the Equity, it is treated as Capital Reserve

(c) Such Goodwill / Capital Reserve arising on the acquisition of an Associate is included in the carrying Amount of Investment in the Associate and **disclosed separately**.

IV. **Elimination of Unrealised profits/Losses [para 13]:** Unrealised profits and Losses resulting from transactions between the investor (or its consolidated Subsidiaries) and the associate are **eliminated** to the extent of the investor's interest in the Associate. However, Unrealised Losses should not be eliminated if and to the extent, the cost of the transferred asset cannot be recovered.

V. **Arrears of Fixed Cumulative Dividend to be provided [para 17]:** If an Associate has outstanding cumulative preference Shares held outside the Group, the Investor should compute its Share of profits or Losses after adjusting for preference Dividends, whether or not the dividends have been declared.

VI. **Provision for Proposed Dividend [ASI – 16]:** Carrying amount of investment is reduced by the distributions (dividends received) from Associates. However, when the Associate has made a provision for proposed Dividend in its Financial Statements, the investor's Share from the Associate should be computed **without** taking into consideration the proposed Dividend.

VII. **Changes in share of Equity without routing through P & L [para 6 and ASI – 17]:** Where adjustments are required for items which are reflected in the Associate's P & L, the same should be reflected in the carrying amount of investment, without routing it through the Investor's consolidated P & L Account.

VIII. **Excessive Losses = Nil value of Investment [para 17]:** If an investor's share of Losses of an Associate **equals or exceeds the carrying amount** of the investment, the Investor ordinarily **discontinues** recognising its share of further losses and the investment is reported at **Nil Value.**

IX. **Additional Losses due to Investor's obligations [para 18]:** Additional losses are provided for to the extent that the Investor has incurred obligations or made payments on behalf of the Associate to satisfy obligations of the Associate that the Investor has guaranteed or to which the Investor is otherwise committed.

X. **Subsequent profits & Prudence principle [para 18]:** If the Associate subsequently reports profits, the Investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised. See point VI above.

XI. **Subsidiary's CFS to be used [para 19]:** Where an Associate presents Consolidated Financial statements, the Results and Net Assets to be taken into account are those reported in that Associate's CFS.

XII. **Permanent Decline in value [para 20]:** The Carrying Amount of investment in an Associate should be reduced to **recognise a decline, other than temporary**, in the value of the Investment, such reduction being determined and made for each Investment **individually**.

XIII. **Dates of Reporting [para 14 – 15]:** Generally, the Associate uses the same reporting date as that of the Investor, so that consolidation procedures/ equity method application is made simple.

XIV. **Uniform Accounting Policies [para 16]:** when an associate uses different accounting policies (from that of the investors), appropriate adjustments are made to its (the Associate's) Financial statements. If it is not practicable to do so, that fact is disclosed along with a brief description of the difference between the accounting policies.

3.5 TREATMENT OF INVESTMENT IN JOINT VENTURES IN CONSOLIDATED FINANCIAL STATEMENT (AS-27)

A. **Jointly controlled Operations (JCO)**

a. **Meaning: JCO** is an arrangement where two or more Ventures combine their operations, resources and expertise, to manufacture, market and distribute, a product **Jointly.**

b. **Example(s):** Different parts of the manufacturing process of a product (say Aircraft) are carried out by each of the venturers, each venture bearing its own costs and sharing the revenue from the sale of the aircraft, such share being determined in accordance with the contractual arrangement.

c. **Legal Entity:** Not a separate entity.

d. **Creation and Ownership of Assets:** Venturer creates and fully owns the assets.

e. **Books of Account:** Not maintained separately.

f. **Financial Statements:** Not prepared separately.

g. **Recognition Principle in Venture's books:**

In both SFS and CFS –

- Asset it controls and the Liability it incurs
- Expenses incurred by it and its share of Income from the JCO

B. **Jointly controlled Assets (JCA)**

a. **Meaning: JCA** exists when there is (a) joint control and (b) joint Ownership by the ventures, of one or more assets, which are contributed to/ acquired for and dedicated to the purposed of the JV.

b. **Example(s):**

(i) Oil pipelines jointly controlled and operated by a number of oil production companies, each company uses the pipeline to transport its own products and bears an agreed proportion of the operating expenses;

(ii) Two enterprises jointly control a property, each taking a share of the rents received and bearing a share of the expenses.

c. **Legal Entity:** Not a separate entity.

d. **Creation and Ownership of Assets:** Venture does not fully own the assets, but owns them jointly or there is a common control over the assets.

e. **Books of Account:** Not maintained separately.

f. **Financial Statements:** Not prepared separately.

g. **Recognition Principle in Venture's books: In both SFS and CFS –**

- Share in JCA classified according to the nature of the Asset.
- Direct Liabilities incurred by the Venture
- Share in Joint Liabilities, if any, incurred
- Share of Income & Exps

C. **Jointly controlled Entities (JCE)**

a. **Meaning: JCE** is a separate entity, whose economic activity is jointly controlled by two or more jointly Ventures as a result of a contractual arrangement**.**

b. Example(s):

(i) When two enterprise combine their activities in a particular line of business by transferring the relevant assets and liabilities in to a JCE;

(ii) When an enterprise establishes a JCE abroad, in conjunction with the Government or other Agency in that country, the JCE jointly controlled by the enterprise & the Government / other Agency.

c. Legal Entity: Separate Legal Entity.

d. Creation and Ownership of Assets: Venture does not own the asset, but owns the interest in the JCE jointly with others leading to common control.

e. Books of Account: Maintained separately.

f. Financial Statements: Prepared separately for applying proportionate consolidation Method.

g. Recognition Principle in Venture's books: In both SFS and CFS –

- **In SFS:** Interest in JCE will be accounted as per AS – 13.
- **In CFS:** Proportionate Consolidation Method will be used. Income, Expenses, Assets or Liabilities will be reflected as **separate line items**.

Particulars	Jointly controlled Operations (JCO)	Jointly controlled Assets (JCA)	Jointly controlled Entities (JCE)
Contribution/ sale of asset by Venturer to JV	1. Recognize the share of profit or Loss attributable to other Venturers. 2. Recognize fully Loss if there is reduction in NRV of current Asset or Impairment Loss		**In SFS:** Fully gain / Loss should be recognised. **In CFS:** Principles 1 and 2 given here will apply.
Purchase of asset by venture from JV	1. Recognize the share of profit or Loss when it resells the asset to an independent party. 2. Recognize fully Loss if there is reduction in NRV of current Asset or Impairment Loss.		**In SFS:** Fully gain / Loss should be recognised. **In CFS:** Principles 1 and 2 given here will apply.
Disclosure Requirements	**In SFS as well as CFS:** • List of all Joint Ventures and description of interest in significant Joint ventures • Proportion of ownership interest, name and country of incorporation or residence in respect of JCE's • Aggregate amount of the following **Contingent Liabilities** (unless the probability of loss is remote) disclosed **separately** – (a) Any contingent Liabilities that the venture has incurred in relation to its interests in JV and its share in each of the contingent Liabilities which have been incurred jointly with other ventures, (b) Its share of the Contingent Liabilities of the JV's themselves for which it is contingently liable; and (c) Those contingent Liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a Joint venture. • Aggregate amount of the following **commitment**s disclosed **separately** – (a) Any capital commitments of the venturer in relation to its interests in JV's and its share in the capital commitments that have been incurred jointly with other venturers; and (b) Its share of the capital commitments of the joint ventures themselves. **In SFS only**: Aggregate amounts of each of the Assets, Liabilities, income and Expenses related to its interests in the JCE's.		

Illustration on Investment in Associates & Joint Ventures

Investment in Associate – Disclosure in Consolidated Balance Sheet

Illustration 42.

Amrit Ltd acquired 25% of shares in Balu Ltd as on 31.03.2014 for ₹6 Lakhs. The Extract Balance Sheet of Balu Ltd as on 31.03.2014 is given below-

Liabilities	₹	Assets	₹
Share Capital Reserves and Surplus	10,00,000 10,00,000	Fixed Assets Investments Current Assets	10,00,000 4,00,000 6,00,000
Total	**20,00,000**	**Total**	**20,00,000**

Following additional information are available for the year ended 3103.2015 –

1. Amrit Ltd received dividend from Balu Ltd for the year ended 31.03.2014 at 40% from the Reserves.
2. Balu Ltd made a profit After Tax of ₹14 Lakhs for the year ended 31.03.2015.
3. Balu Ltd declared a dividend @ 50% for the year ended 31.03.2012 on 30.04.2015.

Amrit Ltd is preparing consolidated Financial Statements in accordance with AS – 21 for its various subsidiaries.

1. Calculate Goodwill if any on acquisition of Balu Ltd.'s shares.
2. How Amrit Ltd will reflect the value of investment in Balu Ltd in the consolidated Financial Statements?
3. How the dividend received from Balu Ltd will be shown in the consolidated Financial Statements?

Solution:

1. **Basic Information**

Amrit's stake in Balu Ltd	Nature of Investment in Balu	Date of Consolidation
25% Shares	Associate in terms of AS 23	31.03.2015

2. **Calculation of Goodwill**

Particulars	₹ Lakhs
Amrit's share in the Equity of Balu Ltd (as at the date of investment) [25% of ₹10 lakhs (Equity Capital ₹5 Lakhs + Reserves ₹5 Lakhs)] **Less:** Cost of Investment	5.00 (6.00)
Goodwill	**(1.00)**

3. **Extract of Consolidate Profit and Loss Account of Amrit Ltd for the year ended 31.03.2015**

Expenditure	₹ Lakhs	Income		₹ Lakhs
		By Share of Profits from Balu (25% x Profits of ₹14 lakhs) By Dividend from Balu (10 lakhs x 25% invst x 40%) **Less**: Transfer to Investment in Balu A/c	 1.00 (1.00)	3.50 Nil

4. **Extract of Consolidated Balance Sheet of Amrit Ltd as at 31.03.2015**

Liabilities	₹ Lakhs	Assets		₹ Lakhs
		Fixed Assets Goodwill		1.00
		Investments		
		Investment in Balu (Cost)	6.00	
		Less: Goodwill on Consolidation	(1.00)	
		Less: Dividend Received	(1.00)	
		Add: Share of Profit for FY 2013-14	3.50	7.50

Note: Dividend declared on 30.04.2016 will not be recognized in consolidated Financial Statements.

Subsidiary & Associates Enterprise – Consolidation

Illustration 43.

Given below are the Financial Position of Anu Ltd (the investor company), Bhanu Ltd (an Associate) and Chanu Ltd (Subsidiary) as on 31st March of 2015 – (₹ Lakhs)

Long Term Funds	Anu	Bhanu	Chanu	Net Assets	Anu	Bhanu	Chanu
Share Capital	1,000	300	200	Net Block	3,100	600	400
Reserves & Surplus	2,000	500	300	Investment in:	400	-	-
Loan Funds	1,000	200	100	- Chanu Ltd	400	-	-
				- Bhanu Ltd	100	400	200
				Net Current Assets			
Total	**4,000**	**1,000**	**600**	**Total**	**4,000**	**1,000**	**600**

Anu Ltd acquired 40% shares in Bhanu Ltd and 80% shares in Chanu Ltd at the beginning of the calendar year when the balance of Reserves & Surplus of Bhanu Ltd and Chanu Ltd were ₹600 Lakhs and ₹400 Lakhs respectively.

Both Bhanu Ltd and Chanu Ltd have sustained a loss of ₹100 Lakhs each during the year. They have not declared any dividend so far. Prepare the consolidated Balance Sheet for the Group.

Solution:

1. Basic Information

Company Status	Dates	Holding Status
Holding Company = Anu Associate Enterprise = Bhanu Subsidiary = Chanu	Acquisition: 01st April, 2014 Consolidation: 31st Mar, 2015	% held by Anu Ltd in Bhanu Ltd = 40% % held by Anu Ltd in Chanu Ltd = 80% Minority Interest (Chanu Ltd) = 20%

2. Classification of Reserves and Surplus

Chanu Ltd – subsidiary Company Balance as per B/s ₹**300**		**Bhanu Ltd – Associate Company** Balance as per B/s ₹**500**	
As on 1st April (Date of Acquisition) ₹400 **Capital Profit**	Loss for the year (upto consolidation) **(₹100)** **Revenue Profit**	As on 1st April (Date of Acquisition) ₹600 **Capital Profit**	Loss for the year (upto consolidation) **(₹100)** **Revenue Profit**

3. **Consolidation of Balances**

(a) **Chanu Ltd – subsidiary (Holding 80%, Minority 20%)**

Particulars	**Total**	**Minority Interest**	**Pre- Acqn.**	**Post Acqn.** Reserves & Surplus
Equity Capital	200	40	160	
Reserves and Surplus	300	60	320	**(80)**
Minority Interest		100		
Total [Cr.]			480	(80)
Cost of Investment [Dr.]			(400)	
For consolidated Balance Sheet			80 (Capital Reserve)	

(b) **Bhanu Ltd – Associates – 40%**

Particulars	₹
Equity Capital (₹300 x 40%)	120
Reserves and Surplus – pre-acquisition (₹600 x 40%)	240
Total [Cr.]	360
Cost of Investment [Dr.]	(400)
Capital Reserve / (Goodwill) on Consolidation	(40)

P & L A/c balance for Consolidated Balance Sheet: ₹2,000 (Anu's balance) - ₹80 (share from Chanu) - ₹40 (Share from Chanu) = ₹1,880

4. **Carrying Amount of Investment in Associate (Bhanu Ltd)**

Particulars	**₹ Lakhs**
Share of net assets on date of acquisition (₹300 capital + ₹600 reserves) x 40%	360
Goodwill on consolidation	40
Cost of Investment	400
Less: Share in post Acquisition (₹100 Lakhs x 40%)	(40)
Carrying Amount of Investment	360

Name of the Company: Anu. Ltd its Subsidiary Chanu Ltd. and its Associate Bhanu Ltd.

Consolidated Balance Sheet as at : 31st March, 2015

(₹ Lakhs)

Ref No.		Particulars	Note No.	As at 31.03.15	As at 31.03.14
				(₹)	(₹)
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholders' fund**			
		(a) Share capital	1	1,000	
		(b) Reserves and surplus	2	1,960	
	2	**Minority Interest (W.N)**		100	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Short-term borrowings	3	1,100	
		Total		**4,160**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	4	3,500	
		(b) Non-current investments	5	360	
	2	**Current assets**			
		(a) Other current assets	6	300	
		Total		**4,160**	

Workings:

1. Share capital	**31.03.15**	**31.03.14**
	(₹)	(₹)
Equity Share Capital	1,000	
Total	**1,000**	

2. Reserve and Surplus	**31.03.15**	**31.03.14**
	(₹)	(₹)
Capital Reserve	80	
Profit & Loss A/c	1,880	
Total	**1,960**	

3. Short–term Borrowing	**31.03.15**	**31.03.14**
	(₹)	(₹)
Loans Fund	1,100	
Total	**1,100**	

4. Tangible Assets	**31.03.15**	**31.03.14**
	(₹)	(₹)
Tangible Fixed Assets (3,100+400)	3,500	
Total	**3,500**	

5. Non-current Investments	31.03.15	31.03.14
	(₹)	(₹)
Investments in Bhanu Ltd (Associate) (including Goodwill of ₹40 Lakhs)	360	
Total	**360**	

6. Other Current Assets	31.03.15	31.03.14
	(₹)	(₹)
Current Assets (100+200)	300	
Total	**300**	

Joint Venture Entity – Proportionate Consolidation Method

Illustration 44.

The Consolidated Balance Sheet of Bold Ltd and its subsidiary Smart Ltd. and Balance Sheet of Joint Venture Lucky Ltd as at 31.03.2015 are as follows –

(₹)

Liabilities	Bold Ltd	Lucky Ltd	Assets	Bold Ltd	Lucky Ltd
Equity share Capital (₹100)	6,00,000	2,00,000	Fixed assets	4,50,000	1,50,000
General Reserve	2,00,000	-	Investment in Lucky Ltd:		
Profit & Loss Account	80,000	-	- 6% Debenture at par	90,000	-
6% Debentures	-	1,50,000	-1500 Equity Shares at ₹80	1,20,000	-
Trade Creditors	75,000	67,500	Stock in trade	1,40,000	60,000
			Debtors	80,000	45,000
			Cash at Bank	75,000	12,500
			Profit & Loss Account	-	1,50,000
Total	**9,55,000**	**4,17,500**	**Total**	**9,55,000**	**4,17,500**

Bold Ltd acquired the shares on 01.08.2014. The Profit & Loss Account of Lucky Ltd showed a debit balance of ₹2,25,000 on 01.04.2014. During June 2014, goods costing ₹9,000 were destroyed against which the insurer paid only ₹3,000. Trade Creditors of Lucky Ltd include ₹30,000 for goods supplied by Bold Ltd on which Bold Ltd made a profit of ₹3,000. Half of the goods were still in stock on 31.03.2015.

Prepare a Consolidated Balance Sheet incorporating the Joint Venture Entity operation using proportionate consolidation method.

Solution:

1. Basic information

Company Status	Dates	Holding Status
Holding Company = Bold Subsidiary = Smart Joint Venture with = Lucky	Acquisition: 01.08.2014 Consolidation: 31.03.2015	% of Holding by Bold Ltd in Joint Venture = 1,500 ÷ 2000 = 80% Outsiders' Interest = 20%

2. Analysis of Profit and Loss Account of Lucky Ltd

Balance on 31.03.2015 (₹1,50,000)

on 01.04.2015 **(₹2,25,000)**
Capital Profit

Profit for the year ₹**75,000** (bal. figure)
Add: Abnormal Loss ₹6,000
₹ **81,000**

Upto acquisition
01.04.2014 to 30.07.2014
81,000 x 4/12 = ₹27,000
Less: Abnormal Loss ₹**6,000**
Capital Profit ₹**21,000**

Acquisition to Consolidation
01.08.2014 to 31.03.2015
₹81000 x 8/12 = ₹**54,000**
Revenue Profit

Total Capital Profits = (₹2,25,000) + ₹21,000 = **(₹2,04,000)**; Total Revenue Profit = ₹**54,000**

3. Consolidation of balances

Particulars	**Pre- Acquisition**	**Post Acquisition**	
Lucky Ltd (Bold Ltd 75%, outsider's interest 25%)		**General reserve**	**P&L a/c**
Equity Capital	1,50,000		
Profit and Loss a/c	(1,53,000)	-	40,500
	[(₹2,04,000) x 75%]		(₹54,000 x 75%)
Total [Cr]	(3,000)		**40,500**
Cost of Investment [Dr.]	(1,20,000)	2,00,000	80,000
Parent's Balances			(1,125)
Stock reserve (Profit of ₹3,000 x 50% x Bold Ltd's share of 75%)			
For Consolidated Balance Sheet	(1,23,000)	2,00,000	1,19,375
	(Goodwill)		

Name of the Company: Bold Ltd, Subsidiary Smart Ltd and Joint Venturer Lucky Ltd

Consolidated Balance Sheet as at : 31.03.2015

Ref No.	**Particulars**		**Note No.**	**As at 31.03.15**	**As at 31.03.14**
				(₹)	(₹)
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholders' fund**			
		(a) Share capital	1	6,00,000	
		(b) Reserves and surplus	2	3,19,375	
	2	**Minority Interest (W.N)**		Nil	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Short-term borrowings	3	1,12,500	

		(b) Trade payables	4	1,25,625	
		Total		**11,57,500**	
	II	**ASSETS**			
	1	**Non-current assets**			
		(a) Fixed assets			
		(i) Tangible assets	5	5,62,500	
		(ii) Intangible assets	6	1,23,000	
		(b) Non-current investments	7	90,000	
	2	**Current assets**			
		(a) Inventories	8	1,83,875	
		(b) Trade receivables	9	1,13,750	
		(c) Cash and cash equivalents	10	84,375	
		Total		**11,57,500**	

Workings:

1. Share capital	**31.03.15**	**31.03.14**
	(₹)	(₹)
Equity Share Capital	6,00,000	
Total	**6,00,000**	

2. Reserve and Surplus	**31.03.15**	**31.03.14**
	(₹)	(₹)
General Reserve	2,00,000	
Profit & Loss A/c	1,19,375	
Total	**3,19,375**	

3. Short–term Borrowing	**31.03.15**	**31.03.14**
	(₹)	(₹)
Debentures (1,50,000X75%)	1,12,500	
Total	**1,12,500**	

4. Trade Payables	**31.03.15**	**31.03.14**
	(₹)	(₹)
Creditors (75,000 + 75% of 67,500)	1,12,500	
Total	**1,12,500**	

5. Tangible Assets	**31.03.15**	**31.03.14**
	(₹)	(₹)
Tangible Fixed Assets (4,50,000+75% 1,50,000)	5,62,500	
Total	**5,62,500**	

6. Intangible Assets	**31.03.15**	**31.03.14**
	(₹)	(₹)
Goodwill on proportionate consolidation	1,23,000	
Total	**1,23,000**	

7. Non-current Investments	31.03.15	31.03.14
	(₹)	(₹)
Investment in debenture	90,000	
Total	**90,000**	

8. Inventories	31.03.15	31.03.14
	(₹)	(₹)
Stock (1,40,000+75% of 12,500)	1,83,875	
Total	**1,86,875**	

9. Trade Receivables	31.03.15	31.03.14
	(₹)	(₹)
Debtors (80,000+ 75% of 45,000)	1,13,750	
Total	**1,13,750**	

10. Cash and Cash Equivalent	31.03.15	31.03.14
	(₹)	(₹)
Cash at Bank (75,000+75% of 12,500)	84,375	
Total	**84,375**	

Note: Balance Sheet items are added on line by line basis but only to the extent of share in the Co-venture Company.

Illustration 45.

The Draft Balance sheet of three companies P, Q, R, as at 31.3.2015 is as under:

₹ in thousands

Assets	P	Q	R
Fixed assets	2,091	1,944	1,047
Investments 4,80,000 shares in Q	1,686	-	-
2,40,000 shares in R	552	-	-
Cash at bank	303	285	240
Trade receivables	1,158	963	753
Inventory	1,485	1,167	861
Total	7,275	4,359	2,901
Liabilities			
Share capital (Nominal value ₹1 per share)	1,800	600	600
Reserves	3,150	2,550	1,434
Trade payables	1,125	759	567
Debentures	1,200	450	300
Total	7,275	4,359	2,901

You are given the following information:

(a) P purchased the shares in Q on 13.10.2010 when the balance in reserves was ₹1,500 thousands.

(b) The shares in R were purchased on 11.5.2010 when the balance in reserves was ₹726 thousands.

(c) The fallowing dividend have been declared but not accounted for before the accounting year end.

P	₹195 thousands
Q	₹90 thousands
R	₹45thousands

(d) Included in inventory figure of R is inventory valued at ₹60 thousands which had been purchased from P at cost plus 25%.

(e) Goodwill in respect of the acquisition of Q has been fully written off.

(f) On 31.3.2015 Q made bonus issue of one share for every share held. This had not been accounted in the balance sheet as on 31.3.2015.

(g) Included in trade payables of P is ₹54 thousands to R, which is included in trade receivables of R.

Prepare consolidated Balance Sheet of P as at 31.3.2015.

Solution:

Name of the Company: P Ltd.

Consolidated Balance Sheet of P Ltd. And its subsidiaries Q Ltd, as at 31st March, 2015.

(₹ in thousands)

Ref No.	Particulars		Note No.	As at 31.03.15	As at 31.03.14
				(₹)	(₹)
	I	**EQUITY AND LIABILITIES**			
	1	**Shareholders' fund**			
		(a) Share capital	1	1,800.00	
		(b) Reserves and surplus- (W.N.4)	2	4,067.40	
	2	**Minority Interest (W.N.3)**		612.00	
	3	**Share application money pending allotment**		Nil	
	4	**Non-current liabilities**		Nil	
	5	**Current Liabilities**			
		(a) Short-term borrowings	3	1,650.00	
		(b) Trade payables	4	1,884.00	
		(c) Short-term provisions	5	213.00	
		Total		**10,226.40**	
	II	**ASSETS**			
	1	Non-current assets			
		(a) Fixed assets			
		(i) Tangible assets (2,091+1,944)	6	4,035.00	
		(b) Non-current investments	7	812.40	
	2	**Current assets**			
		(a) Inventories	8	2,652.00	
		(b) Trade receivables	9	2121.00	
		(c) Cash and cash equivalents (303+285)	10	588.00	
		(d) Other current assets	11	18.00	
		Total		**10,226.40**	

Notes to the accounts (₹ in thousands)

Note1 Share capital	As At 31st Mrch, 2015	As At 31st March, 2014
Authorized, Issued, Subscribed and paid-up share capital		
1800,000 Equity shares of ₹1 each fully paid	1,800.00	
Total	**1,800.00**	

RECONCILIATION OF SHARE CAPITAL

For equity share	As at 31st March, 2015		As at 31ST March, 2014	
	Nos.	Amount (₹)	Nos.	Amount (₹)
Opening balance as on 01.04.2014	18,00,000	18,00,000		
Add: Fresh issue (Including Bonus Shares, right shares, split shares, share issued other than cash)				
Less: Buy Back of Share				
Total	**18,00,000**	**18,00,000**		

Note 2 Reserve & Surplus	As At 31st March, 2015	As At 31st March, 2014
Consolidated Reserve (W.N 4)	4,067.40	
Total	**4,067.40**	

Note 3 Short-Term Borrowings	As At 31st March, 2015	As At 31st March, 2014
Debenture (1,200+450)	1,650.00	
Total	**1,650.00**	

Note 4 Trade Payables	As At 31st March, 2015	As At 31st March, 2014
Trade Payables(1,125+759)	1,884.00	
Total	1,884.00	

Note 5 Short Term Provision	As At 31st March, 2015	As At 31st March, 2014
Proposed Dividend (W.N 6)	213	
Total	213	

Note 6 Tangible Assets	As At 31st March, 2015	As At 31st March, 2014
Fixed Assets (2,091+1,944)	4,035.00	
Total	4,035.00	

Note 7 Non Current Investments	As At 31st March, 2015	As At 31st March, 2014
Investment in Associates (W.N 5)	812.40	
Total	**812.40**	

Note 8 Inventories	As At 31st March, 2015	As At 31st March, 2014
Inventories (1,485+1,167)	2,652.00	
Total	**2,652.00**	

Note 9 Trade Receivables	As At 31st March, 2015	As At 31st March, 2014
Trade Receivables (1,158+963)	2,121.00	
Total	2,121.00	

Note 10. Cash and cash equivalents	As At 31st March, 2015	As At 31st March, 2014
Cash at Bank	588.00	
Total	588.00	

Note 11. Other Current Asset	As At 31st March, 2015	As At 31st March, 2014
Dividend receivable from R	18.00	
Total	**18.00**	

Working Notes:

1. **Analysis of profits of Q** **(₹ in thousands)**

	Pre acquisition P Profits	Post acquisition Profits
Reserves on the date of acquisition	1,500	1,050
Less: Bonus issue	600	-
	900	**1,050**
Less: Dividend Declared on 31.3.2015	-	90
	300	**960**
Minority interest (20%)	180	192
W's Share (80%)	720	768

2. **Cost of control/goodwill** **(₹ in thousands)**

Amount paid for investment		1,686
Less: Paid up value of shares including bonus (80% of 1,200)	960	
Share in pre acquisition profits Q	720	1,680
Goodwill		6

3. **Minority Interest** **(₹ in thousands)**

Paid up value of share including bonus issue (1,200x20%)	240
Share in pre acquisition profits of Q	180
Share in post acquisition profits of Q	192
	612

4. **Consolidated Reserves** **(₹ in thousands)**

BALANCE AS PER P,S Balance sheet		3,150.00
Add: Share in post acquisition profits of Q		768.00
Dividend from Q		72.00
Share of profit from associate R	260.40	
Add: Dividend from R	18.00	278.40
		4,268.40
Less: Dividend payable	195.00	
Goodwill written off	6.00	201.00
		4,067.40

5. **Investment in Associate R as on 31.03.2015 (As Per AS 23)** **(₹ in thousands)**

Amount paid for investment		552.40
Less: Paid up value of shares	240	
Share in pre acquisition reserves(40% of 726)	290.40	530.40
Goodwill (Identified at the time of purchase)		21.60
Initial cost		552
Add: Increase in equity reserves[40%of (1434-45-726)]	(4.8)	260.40
Less: Unrealised profit (60x25/125x40%)		812.40
Share of profit from associate R (812.40-552+18)		278.40

6. **Proposed Dividend** **(₹ in thousands)**

W	195
Minority Interest(90-72)	18
	213

3.6 PREPARATION OF GROUP CASH FLOW STATEMENT

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

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

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

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

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

NBV for additions acquired subsidiary NBV

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

Problem:

A Ltd. acquires 80% of the shares of B Ltd. on 31st March 20xx. The fair values of B Ltd. assets at that date are

	₹ in '000
Tangible fixed assets	60
Stocks	20
Cash	10
	90

The purchase consideration consists of 50,000 at ₹1 ordinary shares valued at par and ₹ 50, 000 cash. The summary consolidated Balance Sheet as at 31st December 20×× and 20×× the Profit and Loss accounts for the year are as follows:

Statement of Cash Flows

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

LEARNING OBJECTIVES

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

- When a company earns profit that may not be available in cash. Cash profit and accounting profit are different.
- What is the meaning of 'cash and cash equivalent'?
- How to classify cash flow from operational activities, financing activities and investment activities?
- How to reconcile cash balance of a company? and

Importance of Cash flows

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

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

Meaning of Cash and Cash Equivalent

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

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

Types of Cash flow

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

- Cash flow from operating activities;

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

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

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

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

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

Elements of operating cash flow

Given below are elements of operating cash flow:

Description of elements of operating cash flow
• Cash receipts from sale of goods and rendering services.
• Cash receipts from royalty, fees, commissions and other revenue.
• Cash payments to suppliers for goods and services.
• Cash payments to and on behalf of employees.
• Cash receipts and cash payments by an insurance enterprise for premiums and claims, annuities and other policy benefits.
• Cash payments and refunds of income taxes unless these are specifically identified as cash flow from financing or investment.
• Cash receipts and payments relating to contracts held for dealing or trading purposes.
• Cash flow arising from dealing in securities when an enterprise holds securities for such purpose.
• Cash advances and loans made by financial institutions including all contracts held for trading purposes which may range from sale licence, export-import quota, any other operating contract. This may not necessarily be a contract relating to derivative instruments.

Elements of cash flow from investment activities

Given below are eight elements of investment cash flow:

Elements of cash flow from investment activities:	
1.	Cash payments for acquisition of fixed assets including intangibles.
2.	Cash receipts from disposal of fixed assets.
3.	Cash payments to acquire shares, warrants or debt instruments of other enterprises and interests in joint venture.
	This does not include an item covered in cash equivalents and items held for dealing or trading purposes.
4.	Cash receipts from disposal of shares, warrants or debt instruments of other enterprises and interests in joint venture.
	This does not include an item covered in cash equivalents and items held for dealing or trading purposes.

5.	Cash advances and loans made to third parties.
	This does not include loans and advances made by financial institutions as these fall under operating cash flow.
6.	Cash receipts from repayments of advances and loans made to third parties. This does not include loans and advances made by financial institutions as these fall under operating cash flow.
7.	Cash payments for future, forward, option and swap contracts.
	This does not include contracts held for dealing or trading purposes or contracts which are classified as financing activities.
8.	Cash receipts from future, forward, option and swap contracts.
	This does not include contracts held for dealing or trading purposes or contracts which are classified as financing activities.

Classification of derivative transactions –

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

Elements of cash flow from financing activities

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

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

Cash Flow from Operating Activities

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

Direct Method

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

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

Notes:

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

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

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

(4) Interest expense is financing cash outflow.

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

Indirect Method

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

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

Illustrations on Cash Flow Statement

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

Example:

Profit and Loss Account of ABC Ltd. for the year ended 31-03-2015	
	(₹ in Lakhs)
Revenue	
Sales	4150
Interest and dividend	100
Stock adjustment	20
Total	**4270**
Expenditure	
Purchases	2400
Wages and salaries	800
Other expenses	200
Interest	60
Depreciation	100
Total	**3560**
Profit before tax	710
Tax Provision	200
Profit after tax	**510**
Balance of Profit & Loss Account	50
Profit available for distribution	560
Appropriation	
Transfer to General Reserve	200
Proposed dividend	300
Distribution tax	30
Total	**530**
Balance	30

Relevant Balance Sheet information	**31-03-2015**	**31-03-2014**
	(₹ in Lakhs)	(₹ in Lakhs)
Debtors	400	250
Inventories	200	180
Creditors	250	230
Outstanding wages	50	40
Outstanding expenses	20	10
Advance tax	195	180
Tax provision	200	180
Assessed tax liability		180

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

Computation of cash flow from Operating		
Activities		
Direct Method		
Cash Receipts		
Cash sales & Collection from debtors		
Sales+Opening Debtors - Closing Debtors	(4150+250-400)	4000
Cash Payments		
Cash purchases & Payment to creditors		
Purchases+ Opening Creditors - Closing creditors	(2400+230-250)	2380
Wages & salaries paid	(800+40-50)	790
Cash Expenses	(200+10-20)	190
Taxes paid - Advance tax		195
		3555
Cash Flow from Operating Activities		**445**
Indirect Method		
Profit before tax		710
Add : Non-cash items : Depreciation		100
Add : Interest : Financing cash outflow		60
Less : Interest and Dividend : Investment		
Cash inflow		-100
Less : Tax paid		-195
Working Capital Adjustments		
Debtors	(250-400)	-150
Inventories	(180-200)	-20
Creditors	(250-230)	20
Outstanding wages	(50-40)	10
Outstanding expenses	(20-10)	10
Cash Flow from Operating Activities		**445**

Illustration 46.

MZ Ltd.

Profit and Loss account for the year ended 31st March, 2015

Income

Sales		10,000
Stock adjustment		
Closing stock Less: opening stock	4,000 3,000	 1,000
Other Income:		
Income from Investments		1,200
		12,200
Expenditure		
Raw Materials Consumed:		
Opening stock	2,000	
Add : Purchases	5,000	
	7,000	
Less : Closing stock	1,500	5,500
Salaries and Contribution to Retirement		
Benefit Schemes		2,500
Other Expenses		2,000
Depreciation		500
		10,500
Profit Before Interest and Tax Interest		1,700
Interest		800
Profit Before Tax		900
Tax Provision		100
Profit After Tax		800
Balance from last year		100
		900
Appropriations		
Transfer to General Reserve		250
Proposed Dividend		600
Balance c/d		50
		900

Balance Sheet

(₹ in Lakhs)

	31.03.2015		**31.03.2014**	
Sources				
Share capital		4,000		3,000
General Reserve		1,000		750
P & L A/c		50		100
Secured Loans		6,000		4,000
		11,050		**7,850**

Applications				
Fixed Assets				
Gross Block		8,000		6,000
Less : Accumulated Depn.		1,500		1,000
		6,500		**5,000**
Invesment		1,500		1,000
(A) Current Assets and Loans & Advance				
Inventories	5,500		5,000	
Sundry Debtors	2,000		1,500	
Cash & Bank Balances	500		600	
Advance Tax	100		150	
Total of (A)	**8,100**		**7,250**	
(B) *Less* : Current liabilities and provisions				
Sundry Creditors	4,200		4,650	
Tax Provision	100		150	
Other provision	150		150	
Proposed Dividend	600		450	
Total of (B)	**5,050**		**5,400**	
Net Current Assets - (A – B)		**3,050**		**1,850**
		11,050		**7,850**

Consider the above Profit and Loss account and Balance Sheet and derive Cash flows from operating activities using direct and indirect method.

Solution:

Computation of cash flows from operating activities by direct method:

	(₹ in Lakhs)	(₹ in Lakhs)
Cash inflows		
Sales	10,000	
Add : Opening S/Debtors	1,500	
	11,500	
Less : Closing S/Debtors	2,000	9,500
Cash outflows		
Creditors :		
Opening balance	4,650	
Add : Purchases	5,000	
Less : Closing balance	4,200	5,450
Salaries and Contributions to retirement Benefit Schemes		2,500
Other Expenses		2,000
		9,950
Cash flow from operating activities		(450)
Less : Advance tax paid		(100)
Cash flow from after tax operating activities		(550)

- Figures within bracket indicate cash outflows.

Notes :

- Cash inflows from sale of goods and services are given by cash sales plus collection from debtors.
- Cash outflows on account of purchase of materials are given by cash purchases plus payment to creditors.
- It may be noted that income from investments is classified as cash flows from investment activities and interest payment on long term loans is classified as cash flows for financing activities. Dividend payment also falls under the category of cash flows for financing activities.

Computation of Operating Cash Flow using Indirect Method:

		(₹ in Lakhs)
Increase in General Reserve		250
Decrease in P & L A/c		(50)
Tax provision		100
Proposed Dividend		600
Interest		800
Depreciation		500
		2,200
Less : Income from Investments		1,200
		1,000
Working Capital Adjustments :		
Inventories	(500)	
Sundry Debtors	(500)	
Sundry Creditors	(450)	(1,450)
Cash from operating activities		(450)
Less : Advance tax paid		(100)
Cash flow from after tax operating activities		(550)

Working Capital Adjustments : Increase in current asets like inventories, debtors, prepayments blocks the cash flows, whereas decrease in current assets releases cash. Although there was profit before interest and depreciation amounting to ₹ 1000 lacs, such profit was not represented by cash since it was blocked in inventories and debtors.

Similarly, any increase in current liabilities means withholding cash payments. In other words, increase in current liabilities means increase in cash flows from opening activities. On the other hand, decrease in current liabilities means additional cash outflows which further reduces cash flows from operating acitivies.

After the working capital adjustments, it appears that there was net cash outflows from operating activities.

However, under both the direct and indirect methods cash flows from operating activities can be derived at a same level.

Reconciliation : In case indirect method is followed, it is better to have a reconciliation of cash flows and PAT.

		(₹ in Lakhs)
Cash flows from operating activities		(450)
Add : Working Capital adjustments		1450
		1000
Less : Depreciation		(500)
Less : Interest		(800)
		(300)
Add : Income from investments		1200
PBT		900
Less : Tax Provision		100
PAT		800

Illustration 47. (a) Taking the data given in Illustration 2, and using the following additional information derive cash flow from investment activities :

Take 10% of the investments given in the Balance Sheets as risk-free and readily encashable and remaining of the investments as long term investments.

Cash flow from Investment Activities

			(₹ in Lakhs)
Purchase of fixed assets			
Increase in gross block			(2,000)
Purchase of long term investments			
	31-3-14	31-3-15	
	1,000	1,500	
Less : Cash equivalents	100	150	
	900	1,350	450
			(2,450)
Income from Investments			1,200
			(1,250)

Thus there was net cash outflows for investing activities.

Illustration 47. (b): Take the information given in Illustration 2. & 2.(a) and derive cash flow from financing activities :

Cash flows from financing activities	(₹ in Lakhs)
Issue of shares	1,000
Loans	2,000
Interest	(800)
Dividend	(450)
	1,750

Thus there was net cash inflows from financing activities.

Illustration 47. (c): Use the data given in Illustration 2 & 2.(a) and find out change in cash and cash equivalents:

(₹ in Lakhs)

	31-03-14	31-03-15	Increase/ (Decrease)
Cash and bank Balances	600	500	(100)
Risk-free and readily encashable Investments	100	150	50
	700	650	(50)

There was a decrease in Cash and Cash equivalents by ₹ 50 lacs.

Illustration 47. (d) : Now using data given in Illustration 2-2.(c), prepare a cash flow statements :

Cash Flow Statement	(₹ in Lakhs)
Cash flows from operating activities	(550)
Cash flows from investment activities	(1250)
Cash flows from financing activities	1750
Decrease in cash and cash equivalents :	(50)

Cash flows statement is largely used fro management decisions. However, there is global trend in favour of inclusion of cash flows statement as a part of corporate financial statements. In India, the SEBI has already issued a notification requiring the listed companies to include a cash flow statement in the annual report. The Institute of Chartered Accountants of India has also issued Accounting Standard 3 (AS-3) Cash Flow Statement. It has now become part of the financial statements of the listed companies.

Illustration 48.

Given below is the Balance Sheets of Alkrit Sugar Ltd. as at 31-03-15 and 31-03-14. You are required to prepare a Cash Flow Statement for the year 2014-15.

(₹ in Thousand)

Balance Sheet		**31-03-15**		**31-03-14**
Equity share capital	1500		1000	
General Reserve	3200		2700	
Profit & Loss Account	300		200	
Share Premium Account	500			
Shareholders' Funds		5500		3900
Secured Loans	800		1000	
Unsecured Loans	1600		1200	
Loan Funds		2400		2200
Sources		7900		6100
Fixed Assets				
Gross Block	7000		5000	
Accumulated Depreciation	1100		800	
Net Block		5900		4200
Investments		1100		800

Balance Sheet		31-03-15		31-03-14
Current Assets, Loans & Advances				
Inventories	1650		1670	
Debtors	760		450	
Cash & Bank Balances	240		120	
Loans	400		200	
Advance Tax	500		400	
	3550		2480	
Creditors	1470		970	
Outstanding expenses	200		110	
Tax Provision	500		400	
Proposed Dividend	600		400	
	2770		1880	
Net Current Assets		780		960
Miscellaneous Expenditure		120		140
Applications		7900		6100

Other Information:

(1) Fixed assets costing ₹ 40,000, accumulated depreciation ₹ 2,000 were sold for ₹ 30,000.

(2) Actual tax liability for 2014-15 was ₹ 4,00,000.

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

(4) Interest on loan funds for 2014-15 was ₹ 3,48,000 and interest and dividend income were ₹ 1,95,000.

Solution: (₹ in Thousand)

Cash Flow from Operating Activities		
Change in general reserve	500	
Change in profit and loss account	100	
Proposed dividend	600	
Provision for tax	500	
Profit Before tax		1700
Add : Depreciation	302	
Add : Misc. Expn.	20	
Add/(Less) Loss (profit) on sale of fixed assets	8	
Funds flow from operations	2030	
Add : Interest paid	348	
Less : Interest and Dividend Received	-195	
Add/Less Working Capital Adjustment		
Inventories	20	
Debtors	-310	
Creditors	500	
Outstanding expenses	90	300
Cash Flow from Operating Activities (Before tax)		2483

Less: Advance tax for 2014-15		500
Cash flow from Operating Activities (After Tax)		1983
Cash flow Financing Activities		
Issue of shares		
Face value	500	
Premium	500	1000
Repayment of Secured Loans	-200	
Raising of Unsecured Loans	400	
Net loan		200
Interest payment		-348
Dividend payment for 2013-14		-400
		452
Cash flow from Investment Activities		
Purchase of Fixed Assets	-2040	
Sale of Fixed Assets	30	
Fixed Assets (Net)		-2010
Purchase of Investments		-300
Loans		-200
Interest & Dividend Income		195
		-23 15
Cash Flow Statement		
Cash flow from Operating Activities (After Tax)		1983
Cash flow Financing Activities		452
Cash How from Investment Activities		-2315
Increase/decrease in Cash & Bank Balance		120

Illustration 49.

Given below are Balance Sheets of Calcutta Jute Ltd. as at 31-03-15 and 31-03-14. You are required to prepare Cash Flow Statement for the year 2014-15.

(₹ in thousand)

Balance Sheet	**31-03-15**		**31-03-14**	
Equity share capital	5500		4000	
General Reserve	5100		4200	
Profit & Loss Account	450		400	
Share Premium Account	1500			
Shareholders' Funds		12550		8600
Secured Loans	1800		3400	
Unsecured Loans	2300		1200	
Loan Funds		4100		4600
Sources		16650		13200

Balance Sheet	31-03-15		31-03-14	
Fixed Assets				
Gross Block	15000		12000	
Accumulated Depreciation	1800		1300	
Net Block		13200		10700
Capital Work-in-progress		1200		700
Investments		1700		1400
Current Assets, Loans & Advances				
Inventories	2510		2600	
Debtors	1090		1200	
Cash & Bank Balances	240		340	
Loans	1700		200	
Advance Tax	850		700	
	6390		5040	
Creditors	1050		1200	
Outstanding expenses	2100		1540	
Tax Provision	850		700	
Proposed Dividend	2200		1600	
	6200		5040	
Net Current Assets		190		0
Miscellaneous Expenditure		360		400
Applications		16650		13200

Other Information :

(1) Fixed assets costing ₹ 1,20,000, accumulated depreciation ₹ 60,000 were sold for ₹ 70,000.

(2) Actual tax liability for 2014-15 was ₹ 7,00,000.

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

(4) Interest on loan funds for 2014-15 was ₹ 5,94,500 and interest and divider income were ₹ 4,42,000.

(5) Investments costing ₹ 6,00,000 were sold for ₹ 7,00,000.

Solution: (₹ in thousand)

Cash flow from operating activities		
Change in general reserve	900	
Change in profit and loss account	50	
Proposed dividend	2200	
Provision for tax	850	
Profit Before tax		4000
Add: Depreciation	560	
Add: Misc. Expn.	40	
Add/(Less) Loss (profit) on sale of fixed assets	-10	

Add/(Less) Loss (profit) on sale of Investments	-100	
Funds flow from operations		4490
Add: Interest paid		594.5
Less : Interest and Dividend Received		-442
Add/Less Working Capital Adjustment		
Inventories	90	
Debtors	110	
Creditors	-150	
Outstanding expenses	560	610
Cash Flow from Operating Activities (Before tax)		5252.5
Less Advance tax for 2014-15		850
Cash flow from Operating Activities (After Tax)		4402.5
Cash flow Financing Activities		
Issue of shares		
Face value	1500	
Premium	1500	3000
Repayment of Secured Loans	-1600	
Raising of Unsecured Loans	1100	
Net loan		-500
Interest payment		-594.5
Dividend payment for 2014-15		-1600
		305.5
Cash flow from Investment Activities		
Purchase of Fixed Assets	-3120	
Sale of Fixed Assets	70	
Capital WIP	-500	
Fixed Assets (Net)		-3550
Purchase of Investments	-900	
Sale Proceeds of Investments	700	
Investments (Net)		-200
Loans		-1500
Interest & Dividend Income		442
		-4808
Cash Flow Statement		
Cash flow from Operating Activities (After Tax)		4402.5
Cash flow Financing Activities		305.5
Cash flow from Investment Activities		-4808
Increase/decrease in Cash & Bank Balance		-100

Illustration 50.

Deepak Chemicals presents the following Balance Sheets as at 31-03-15 and 31-03-14. You are required to prepare cash flow statement.

(₹ in thousand)

Balance Sheet		**31-03-15**		**31-03-14**
Equity share capital	8500		7000	
General Reserve	3800		4000	
Profit & Loss Account	0		250	
Share Premium Account	1500		750	
Shareholders' Funds		13800		12000
Secured Loans	4800		500	
Unsecured Loans	5350		4000	
Loan Funds		10150		9000
Sources		23950		21000
Fixed Assets				
Gross Block	22400		21000	
Accumulated Depreciation	3450		3200	
Net Block		18950		17800
Capital Work-in-progress		1860		0
Investments		1650		2320
Current Assets, Loans & Advances				
Inventories	2150			
Debtors	1090			
Cash & Bank Balances	120			
Loans	1700			
Advance Tax	0			
Creditors	1050		1200	
Outstanding expenses	30		0	
Tax Provision	0		500	
Proposed Dividend	3400		2800	
	4480		4500	
Net Current Assets		940		280
Miscellaneous Expenditure		550		600
Applications		23950		21000

Other Information:

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

(2) Actual tax liability for 2013-14 was ₹ 5,00,000.

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

(4) Interest on loan funds for 2013-14 was ₹14,21,000 and interest and dividend income were ₹ 4,02,000.

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

Solution: (₹ in thousand)

Cash flow from operating activities		
Change in general reserve	-200	
Change in profit and loss account	-250	
Proposed dividend	3400	
Provision for tax	0	
Profit Before tax		2950
Add : Depreciation	550	
Add : Misc.Expn.	50	
Add/(Less) Loss (profit) on sale of fixed assets	-50	
Add/(Less) Loss (profit) on sale of Investments	-500	
Funds flow from operations		3000
Add: Interest paid		1421
Less Interest and Dividend Received		-402
Add/Less Working Capital Adjustment		
Inventories	90	
Debtors	110	
Creditors	-150	
Outstanding expenses	30	80
Cash Flow from Operating Activities (Before tax)		4099
Less Advance tax for 2014-15		0
Cash flow from Operating Activities (After Tax)		4099
Cash flow Financing Activities		
Issue of shares		
Face value	1500	
Premium	750	2250
Repayment of Secured Loans	-200	
Raising of Unsecured Loans	1350	
Net loan		1150
Interest payment		-1421
Dividend payment for 2013-14		-2800
		-821
Cash flow from Investment Activities		
Purchase of Fixed Assets	-1800	
Sale of Fixed Assets	150	
Capital WIP	-1860	
Fixed Assets (Net)		-3510
Purchase of Investments	-1330	
Sale Proceeds of Investments	2500	
Investments (Net)		1170
Loans		-1500
Interest & Dividend Income		402
		-3438
Cash Flow Statement		
Cash flow from Operating Activities (After Tax)		4099
Cash flow from Financing Activities		-821
Cash flow from Investment Activities		-3438
Increase/decrease in Cash & Bank Balance		-160

Illustration 51.

Given below are summarised Balance Sheets of Harsh Chemicals Ltd. as at 31-03-14 and 31-03-15. The company issued one bonus share for every 4 shares held. The company also acquired machinery amounting to ₹ 30,00,000 from Levenz of France on deferred credit basis. You are required to prepare the cash flow statement.

(₹ in thousand)

Balance Sheet		31-03-15		31-03-14
Equity share capital	8,500		4,000	
General Reserve	7,000		7,600	
Profit & Loss Account	1,200		1,000	
Share Premium Account	1,500		750	
Shareholders' Funds		18,200		13,350
Secured Loans	4,800		5,400	
Unsecured Loans	5,350		4,000	
Deferred Credit	3,000		0	
Loan Funds		13,150		9,400
Sources		31,350		22,750
Fixed Assets				
Gross Block	22,400		17,000	
Accumulated Depreciation	3,450		3,200	
Net Block		18,950		13,800
Capital Work-in-progress		8,200		3,000
Investments		1,650		2,320
Current Assets, Loans & Advances				
Inventories	4,000		3,200	
Debtors	1,090		2,200	
Cash & Bank Balances	540		750	
Loans	1,700		200	
Advance Tax	1,600		1,400	
	8,930		7,750	
Creditors	1,050		1,600	
Outstanding expenses	880		120	
Tax Provision	1,600		1,400	
Proposed Dividend	3,400		1,600	
	6,930		4,720	
Net Current Assets		2,000		3,030
Miscellaneous Expenditure		550		600
Applications		31350		22750

Other Information:

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

(2) Actual tax liability for 2013-14 was ₹ 14,00,000.

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

(4) Interest on loan funds for 2014-15 was ₹18,41,000 and interest and dividend income were ₹ 4,02,000.

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

Solution: (₹ in thousand)

Cash flow from operating activities		
Change in general reserve	400	
Change in profit and loss account	200	
Proposed dividend	3,400	
Provision for tax	1,600	
Profit before tax		5,600
Add : Depreciation	550	
Add : Misc. Expenses	50	
Add/(Less) Loss (profit) on sale of fixed assets	(50)	
Add/(Less) Loss (profit) on sale of Investments	(500)	
Funds flow from operations		5,650
Add : Interest paid		1,841
Less : Interest and Dividend Received		-402
Add/Less Working Capital Adjustment		
Inventories	(800)	
Debtors	1,110	
Creditors	(550)	
Outstanding expenses	760	520
Cash Flow from Operating Activities (Before tax)		7,609
Less : Advance tax for 2014-15		1,600
Cash flow from Operating Activities (After Tax)		6,009
Cash flow Financing Activities		
Issue of shares		
Face value	3,500	
Premium	750	4,250
Repayment of Secured Loans	(600)	
Raising of Unsecured Loans	1350	
Net loan		750
Interest payment		-1,841
Dividend payment for 2013-14		-1,600
		1,559
Cash flow from Investment Activities		
Purchase of Fixed Assets	(5,800)	
Sale of Fixed Assets	150	
Capital WIP	(2,200)	
Fixed Assets (Net)		(7,850)
Purchase of Investments	(1,330)	
Sale Proceeds of Investments	2,500	
Investments (Net)		1,170
Loans		(1,500)
Interest & Dividend Income		402
		(7,778)
Cash Flow Statement		
Cash flow from Operating Activities (After Tax)		6,009
Cash flow from Financing Activities		1,559
Cash flow from Investment Activities		(7,778)
Increase/decrease in Cash & Bank Balance		(210)

Illustration 52.

From the following Summary Cash Account of X Ltd. prepare Cash Flow Statement for the year ended 31st March, 2015 in accordance with AS 3 (Revised) using the direct method. The company does not have any cash equivalents.

Summary Cash Account for the year ended 31.03.2015

Particulars	₹ '000	Particulars	₹ '000
Balance on 1.4.2014	50	Payment to Suppliers	2,000
Issue of Equity Shares	300	Purchase of Fixed Assets	200
Receipts from Customers	2,800	Overhead expense	200
Sale of Fixed Assets	100	Wages and Salaries	100
		Taxation	250
		Dividend	50
		Repayment of Bank Loan	300
		Balance on 31.3.2015	150
	3,250		3,250

Solution:

X Ltd.
Cash Flow Statement for the year ended 31st March, 2015
(Using the direct method)

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

Illustration 53.

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

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

(b) P Ltd. has 60% voting right in Q Ltd. Q Ltd. has 20% voting right in R Ltd. Also, P Ltd. directly enjoys voting right of 14% in R Ltd. R Ltd. is a listed company and regularly supplies goods to P Ltd. The management of R Ltd. has not disclosed its relationship with P Ltd.

How would you assess the situation from the viewpoint of AS 18 on Related Party Disclosures?

(c) Lessee Ltd. took a machine on lease from Lessor Ltd., the fair value being ₹7,00,000. The economic life of the machine as well as the lease term is 3 years. At the end of each year Lessee Ltd. pays ₹3,00,000. Guaranteed Residual Value (GRV) is ₹ 22,000 on expiry of the lease. Implicit Rate of Return (IRR) is 15% p.a. and present value factors at 15% are 0.869, 0.756 and 0.657 at the end of first, second and third years respectively.

Calculate the value of machine to be considered by Lessee Ltd. and the interest (Finance charges) in each year.

Solution:

(a) **Cash Flow Statement**

Cash flows from operating activities		(₹ in Lakhs)
Net profit		60,000
Less: Exchange gain		(8,000)
Less: Profit on sale of investments		(12,000)
		40,000
Add: Depreciation on assets		11,000
Change in current assets and current liabilities		51,000
(-) Increase in debtors	(8,000)	
(+) Decrease in stock	12,000	
(-) Decrease in creditors	(6,000)	(2,000)
Net cash from operating activities		49,000
Cash flows from investing activities		
Sale of investments	70,000	
Purchase of fixed assets	(65,000)	
Net cash from Investing activities		5,000
Cash flows from financing activities		
Issue of preference shares	9,000	
Loan raised	4,500	
Redemption of Debentures	(5,700)	
Interest paid	(945)	
Dividend paid	(1,400)	
Net cash from financing activities		5,455
Net increase in cash & cash equivalents		59,455
Add: Opening cash and cash equivalents		12,341
Closing cash and cash equivalents		71,796

Illustration 54.

The following information is available in respect of ABC Ltd. : as on December, 2014.

(1) Materials are purchased and received one month before being used and payment is made to suppliers two months after receipt of materials.

(2) Cash is received from customers three months after finished goods are sold and delivered to them.

(3) No time lag applies to payments of wages and expenses.

(4) The following figures apply to recent and future months:

Month 2015	Materials received ₹	Sales ₹	Wages and Expenses ₹
January	20,000	30,000	9,500
February	22,000	33,000	10,000
March	24,000	36,000	10,500
April	26,000	39,000	11,000
May	28,000	42,000	11,500
June	30,000	45,000	12,000
July	32,000	48,000	12,500
August	34,000	51,000	13,000

(5) Cash balance at the beginning of April is ₹ 10,000.

(6) All the products are sold immediately they have been made and that materials used and sums spent on wages and expenses during any particular month relate strictly to the sales made during that month.

Prepare projected cash flow forecast month by month from April to July, 2015 profit and loss forecast for four months (April-July) and a movement of funds statement for the four months period (April-July).

Solution:

Cash forecast from April to July, 2015

Amount in ₹

	April	May	June	July
Opening Balance	10,000	7,000	4,500	2,500
Collections from debtors	30,000	33,000	36,000	39,000
	40,000	40,000	40,500	41,500
Payments:				
Wages and Expenses	11,000	11,500	12,000	12,500
Payment to suppliers	22,000	24,000	26,000	28,000
	33,000	35,500	38,000	40,500
Closing balance	7,000	4,500	2,500	1,000

Profit and Loss forecast for 4 months April-July, 2015

		₹
Sales (April to July)		1,74,000
Closing Stock (July Purchase)		32,000
		2,06,000
Less: Opening stock- (March purchase)	24,000	
Purchases (April to July)	1,16,000	
Wages and Expenses (April to July)	47,000	
		1,87,000
Profit for the 4 months period		19,000

Movement of Funds Statement

Stock (Opening)	April	March purchase		24,000
Receivables (Opening)	April	Credit allowed 3 months		
		January Sales	30,000	
		February Sales	33,000	
		March Sales	36,000	
				99,000
Creditors (Opening)	April	Credit received 2 months		
		February Purchase	22,000	
		March Purchase	24,000	
				46,000
Closing stock (end of July), July Purchase				32,000
Receivable (end of July), May to July Sales				1,35,000
Creditors (end of July), June and July Purchase				62,000

Now movement of funds statement can be worked out as :

		₹
Sources:		
Profit earned during 4 months	19,000	
Add: Increase in creditors (62,000 - 46,000)	16,000	
		35,000
Application:		
Less: Increase in receivables (1,35,000-99,000)	36,000	
Less: Increase in stock (32,000-24,000)	8,000	
		44,000
		(-)9,000
Opening Cash balance		10,000
Hence closing cash balance		1,000

Illustration 55.

The following information is available as on 31.03.2014:

Alcobex Metal Company (AMC) does business in three products P1, P2 and P3. Products P1 and P2 are manufactured in the company, while product P3 is procured from outside and resold as a combination with either product P1 or P2. The expected sales volume for the three products for the year 2014-2015 (April-March) are as under :

Products	₹ in Lakhs
P1	1,200
P2	500
P3	400

Based on the sales value forecast, the cash flow forecast for the company is prepared based on the following assumptions:

(1) Sales realisation is considered at:

50% Current month

25% Second month

25% Third month

(2) Production Programme for each month is based on the sales value of the next month.

(3) Raw material consumption of the company is kept at 59% of the month's production.

(4) 81% of the raw materials consumed are components.

(5) Raw material and components to the extent, at 25% are procured through import.

(6) The Purchases budget is as follows:

(i) Indigenous raw materials are purchased two months before the actual consumption.

(ii) Components are procured in the month of consumption.

(iii) Imported raw materials and components are brought three months prior to the month of consumption.

(7) The company avails of the following credit terms from suppliers:

(i) Raw materials are paid for in the month of purchases;

(ii) Company gets one month's credit for its components;

(iii) For imported raw material and components payments are made one month prior to the dates of purchases.

(8) Currently the company has a cash credit facility of ₹ 140.88 lakhs

(9) Expenses are given below and are expected to be constant throughout the year:

Wages and Salaries	₹ 312 lakhs
Administrative Expenses	₹ 322 lakhs
Selling and Distribution Expenses	₹ 53 lakhs

(10) Dividend of ₹ 58.03 lakhs is to be paid in October.

(11) Tax of ₹ 23.92 lakhs will be paid in equal installments in four-quarters: i.e., January, April, July and October.

(12) The term-loan of ₹ 237.32 lakhs is repayable in two equal installments half-yearly. i.e June/ December.

(13) Capital expenditure of ₹ 292.44 lakhs for the year is expected to be spread equally during the 12 months period.

You are required to prepare a projected Cash Flow Statement for the period of June-November, 2014.

Solution:

Alcobex Metal Company

Projected Cash Flow statement for the period of June – November, 2014

(₹ in Lakhs)

	June	July	August	September	October	November	Total cash flow
Opening Balance	(140.88)	(273.98)	(294.40)	(310.35)	(326.31)	(405.03)	(140.88)
(Refer to Assumption)							
Collection from customers	166.67	166.67	169.17	170.42	171.67	171.67	1,016.27
(Refer to working note 1)							
Total	25.79	(107.31)	(125.23)	(139.93)	(154.64)	(233.36)	875.39
Payment to supplier	99.49	101.70	103.5	104.76	104.76	104.76	618.97
(Refer to working note 4)							
Wages and Salaries	26	26	26	26	26	26	56.00
Administrative expenses	26.83	26.83	26.83	26.83	26.83	26.83	160.98
Selling and Distribution	4.42	4.42	4.42	4.42	4.42	4.42	26.52
Dividend					58.03		58.03
Tax	-	5.98	-	5.98	-	-	11.96
Capital Expenditure	24.37	24.37	24.37	24.37	24.37	24.37	146.22
Repayment of term loan	118.66						118.66
Total	**299.77**	**189.30**	**185.12**	**186.38**	**250.39**	**186.38**	**1,297.34**
Closing balance	(273.98)	(294.40)	(310.35)	(326.31)	(405.03)	(419.74)	(421.95)

Assumptions:

1. Since the opening cash balance as on June, 2014 is not given, it is assumed that the credit facility enjoyed by the company of ₹ 140.88 lakhs is its opening balance.
2. Since the question does not provide relevant information regarding purchase price and payment terms to the suppliers in respect of Product P3 which is procured from outside and sold as a combination with either Product P1 or P2. It is assumed that the Product P3 is manufactured within the company and its production programme and production costs are same as to the manufacturing of Products P1 or P2.
3. In the working notes some of the calculations are taken from December for the sake of completeness otherwise they are not required.

Working Notes :

1. Collection from debtors:

	Sales	Product P2	Product P3	Total Sales	Current month collection	2nd month collection	3rd month collection	Total collection
	(i)			(ii)	(iii)	(iv)	(v)	(vi)=(ii)+(iii)+(iv)
December	100	41.67	20	161.67	80.83	0	0	80.83
January	100	41.67	20	161.67	80.83	40.42	0	121.25
February	100	41.67	20	161.67	80.83	40.42	40.42	161.67
March	100	41.67	20	161.67	80.83	40.42	40.42	161.67
April	100	41.67	25	166.67	83.33	40.42	40.42	164.17
May	100	41.67	25	166.67	83.33	41.67	40.42	165.42
June	100	41.67	25	166.67	83.33	41.67	41.67	166.67
July	100	41.67	25	166.67	83.33	41.67	41.67	166.67
August	100	41.67	30	171.67	85.83	41.67	41.67	169.17
September	100	41.67	30	171.67	85.83	42.92	41.67	170.42
October	100	41.67	30	171.67	85.83	42.92	42.92	171.67
November	100	41.67	30	171.67	85.83	42.92	42.92	171.67
December	100	41.67	45	186.67	93.33	42.92	42.92	179.17
January	100	41.67	45	186.67	93.33	46.67	42.92	182.92
February	100	41.67	45	186.67	93.33	46.67	46.67	186.67
March	100	41.67	45	186.67	93.33	46.67	46.67	186.67
Total	**1600**	**666.67**	**480**	**2746.67**	**1373.33**	**640.00**	**593.33**	**2606.67**

2. Production Programme

Months	Sales value (Refer to working note (i) column (ii))	Total raw material consumption	Components	Other raw material	Imported raw material & components	Indigenous raw material & components	Indigenous raw material	Indigenous components
	(i)	(ii)=59% of (i)	(iii)=81% of (ii)	(iv)=(ii)-(iii)	(v)=25%of (ii)	(vi)=(ii)-(v)	(vii)=75% of (iv)	(viii)=75% of (iii)
December	161.67	95.38	77.26	18.12	23.85	71.54	13.59	57.95
January	161.67	95.38	77.26	18.12	23.85	71.54	13.59	57.95
February	161.67	95.38	77.26	18.12	23.85	71.54	13.59	57.95
March	166.67	98.38	79.65	18.68	24.58	73.75	14.01	59.74
April	166.67	98.33	79.65	18.68	24.58	73.75	14.01	59.74
May	166.67	98.33	79.65	18.68	24.58	73.75	14.01	59.74
June	166.67	98.33	79.65	18.68	24.58	73.75	14.01	59.74
July	171.67	101.28	82.04	19.24	25.32	75.96	14.43	61.53
August	171.67	101.28	82.04	19.24	25.32	75.96	14.43	61.53

Months	Sales value (Refer to working note (i) column (ii))	Total raw material consumption	Components	Other raw material	Imported raw material & components	Indigenous raw material & components	Indigenous raw material	Indigenous components
	(i)	(ii)=59% of (i)	(iii)=81% of (ii)	(iv)=(ii)-(iii)	(v)=25%of (ii)	(vi)=(ii)-(v)	(vii)=75% of (iv)	(viii)=75% of (iii)
September	171.67	101.28	82.04	19.24	25.32	75.96	14.43	61.53
October	171.67	101.28	82.04	19.24	25.32	75.96	14.43	61.53
November	186.67	110.13	89.21	20.93	27.53	82.60	15.69	66.91
December	186.67	110.13	89.21	20.93	27.53	82.60	15.69	66.91
January	186.67	110.13	89.21	20.93	27.53	82.60	15.69	66.91
February	186.67	110.13	89.21	20.93	27.53	82.60	15.69	66.91
Total	**2585.05**	**1525.15**	**1235.38**	**289.76**	**381.27**	**1143.86**	**217.29**	**926.57**

3. Purchase Programme

Months	Indigenous others (Refer to working note 2 above) (column vii)	Indigenous Components (Refer to working note 2 above) (column viii)	Imported others
	(i)	**(ii)**	**(iii)**
December	13.59	57.95	24.58
January	14.01	57.95	24.58
February	14.01	57.95	24.58
March	14.01	59.74	24.58
April	14.01	59.74	25.32
May	14.43	59.74	25.32
June	14.43	59.74	25.32
July	14.43	61.53	25.32
August	14.43	61.53	27.53
September	15.69	61.53	27.53
October	15.69	61.53	27.53
November	15.69	66.91	27.53
December	15.69	66.91	-
January	0.00	66.91	-
February	0.00	66.91	-

4. Payment to Suppliers (₹ in lakhs)

Months	Indigenous others	Indigenous Components (Previous month paid now)	Imported others and components (Next month purchase advance payment)	Total Payment
December	13.59	0	24.58	13.59
January	14.01	57.95	24.58	96.54
February	14.01	57.95	24.58	96.54
March	14.01	57.95	25.32	96.54
April	14.01	59.74	25.32	99.07
May	14.43	59.74	25.32	99.49
June	14.43	59.74	25.32	99.49
July	14.43	59.74	27.53	101.70
August	14.43	61.53	27.53	103.50
September	15.69	61.53	27.53	104.76
October	15.69	61.53	27.53	104.76
November	15.69	61.53	0.00	104.76
December	15.69	66.91	0.00	82.60
January	0.00	66.91	0.00	66.91
February	0.00	66.91	0.00	66.91
March		66.91	0.00	66.91
		0.00	0.00	

Illustration 56.

XYZ Ltd. Company's Comparative Balance Sheet for March 2016 and March 2015 and the Company's Income Statement for the year March 31, 2016 are as follows:

XYZ Ltd.
Comparative Balance Sheet
March 2016 and March 2015

(₹ in Crores)

		2016		**2015**
Sources of funds:				
Shareholder's funds	140		140	
Share Capital	110	250	92	232
Loan funds		135		40
		385		272
Application of funds				
Fixed Assets				
Plant and Equipment	430		309	

		2016		2015
Less : Accumulated depreciation	(218)	212	(194)	115
Investments		60		75
Current Assets				
Inventory	205		160	
Accounts receivable	180		270	
Pre-paid expenses	17		20	
Cash	26	428	10	460
Less : Current liabilities and provisions				
Accounts payable	230		310	
Accrued liabilities	70		60	
Deferred income-tax provision	15	315	113	8
		378	82	
			385	272

XYZ Ltd.

Income Statement

For the year ended 31st March, 2016

	(₹ in Crores)
Sales	1,000
Less : Cost of goods sold	530
Gross margin	470
Less : Operating expenses	352
Net operating income	118
Non-operating items:	
Loss on sale of equipment	(4)
Income before taxes	114
Less : Income-taxes	48
Net income	66

Additional information:

(i) Dividends of ₹ 48 crores were paid in 2015-16.

(ii) The loss on sale of equipment of ₹ 4 crore reflects a transaction in which equipment with an original cost of ₹ 12 crore and accumulated depreciation of ₹ 5 crore were sold for ₹ 3 crore in cash.

Required:

Using the indirect method, determine the net cash provided by operating activities for 2015-16 and construct a statement of cash flows.

Solution:

Statement of net cash flows provided by operating activities by using indirect method for the year ended 31st March, 2016

	(₹ in Crores)
Operating Activities	
Net Income	66
Adjustment to convert net income to a cash basis	
Depreciation and amortization charges	29
Decrease in accounts receivable	90
Increase in inventory	(45)
Decrease in pre-paid expenses	3
Decrease in accounts payable	(80)
Increase in accrued liabilities	10
Increase in deferred income tax	7
Loss on sale of equipment	4
Net cash provided by operating activities	84
Cash Flow from Investing Activities	
Additions to property, building & equipment	(133)
Decrease in long term investments	15
Proceeds from sale of equipment	3
Net cash used in investing activities	(115)
Cash Flows from Financing Activities	
Increase in bonds payable	95
Cash dividends paid	(48)
Net cash used in financing activities	47
Net increase in cash & cash equivalents	16
Cash & cash equivalents at the beginning of year	10
Cash & cash equivalents at the end of year	26

Illustration 57.

The following is the income statement XYZ Company for the year 2015-16:

			(₹)
Sales			1,62,700
Add: Equity In ABC Company's earning			6,000
			1,68,700
Expenses		₹	
Cost of goods sold		89,300	
Salaries		34,400	
Depreciation		7,450	
Insurance		500	
Research and development		1,250	
Patent amortisation		900	
Interest		10,650	
Bad debts		2,050	
Income tax :			
Current	6,600		
Deferred	1,550	8,150	
Total expenses			1,54,650
Net income			14,050

Additional informations are :

(i) 70% of gross revenue from sales were on credit.

(ii) Merchandise purchases amounting to ₹ 92,000 were on credit.

(iii) Salaries payable totaled ₹ 1,600 at the end of the year.

(iv) Amortisation of premium on bonds payable was ₹ 1,350.

(v) No dividends were received from the other company.

(vi) XYZ Company declared cash dividend of ₹ 4,000.

(vii) Changes in Current Assets and Current Liabilities were as follows:

	Increase (Decrease) ₹
Cash	500
Marketable securities	1,600
Accounts receivable	(7,150)
Allowance for bad debt	(1,900)
Inventory	2,700
Prepaid insurance	700
Accounts payable (for merchandise)	5,650

	₹
Salaries payable	(2,050)
Dividends payable	(3,000)

Prepare a statement showing the amount of cash flow from operations.

Solution:

Statement showing cash flow from Operations

	₹	₹
Cash flow from operations		
Cash sales (30% 1,62,700)	48,810	
Collection from debtors	1,20,890	
Total cash from operations		1,69,700
Uses of cash from operations		
Payment to suppliers	86,350	
Salaries expense	36,450	
Payment for insurance	1,200	
Research and development	1,250	
Interest payment	12,000	
Income tax payment	6,600	
Total operating cash payment	1,43,850	
Net cash flow from operations	25,850	

Notes:

		₹
(1)	Collection from debtors	
	Credit sales (70%× 1,62,700)	1,13,890
	Less : Bad debts (2,050 less 1,900)	150
		1,13,740
	Add : decrease in accounts receivables	7,150
	Collection from debtors on credit sales	1,20,890

(2) Dividends earned ₹6,000 on equity of ABC Company has not been considered as it has not been received in cash.

		₹	
(3)	Payment to suppliers		
	Cost of goods sold	89,300	
	Add: Increase in inventory	2,700	
	Purchases	92,000	
	Less: increase in accounts payable	5,650	
	Payment to suppliers		86,350
(4)	Calculation of salaries payment		
	Salary expense	34,400	

Add : decrease in salary payable	2,050
Payment of salaries	36,450
(5) Insurance payments	
Insurance	500
Add : increase in prepaid insurance	700
Payment for insurance	1,200
(6) Interest payment	
Interest expenses	10,650
Add : Amortisation of bond premium	1,350
Interest payments	12,000
(7) Income tax payments	
Income tax expense	8,150
Less: Deferred tax	1,550
	6,600
Changes in current tax payable	Nil
Income tax payments	6,600

Illustration 58.

From the information contained in Income Statement and Balance Sheet of 'A' Ltd., prepare Cash Flow Statement:

Income Statement for the year ended March 31, 2015

		₹
Net Sales	(A)	2,52,00,000
Less:		
Cash Cost of Sales		1,98,00,000
Depreciation		6,00,000
Salaries and Wages		24,00,000
Operating Expenses		8,00,000
Provision for Taxation		8,80,000
	(B)	2,44,80,000
Net Operating Profit (A – B)		7,20,000
Non-recurring Income – Profits on sale of equipment		1,20,000
		8,40,000
Retained earnings and profits brought forward		15,18,000
		23,58,000
Dividends declared and paid during the year		7,20,000
Profit and Loss Account balance as on March 31, 2015		16,38,000

Extract Balance Sheet

Assets	March 31, 2014 (₹)	March 31, 2015 (₹)
Fixed Assets:		
Land	4,80,000	9,60,000
Buildings and Equipment	36,00,000	57,60,000
Current Assets:		
Cash	6,00,000	7,20,000
Debtors	16,80,000	18,60,000
Stock	26,40,000	9,60,000
Advances	78,000	90,000
	90,78,000	1,03,50,000

Extract Balance Sheet

Liabilities and Equity	March 31, 2014 (₹)	March 31, 2015 (₹)
Share Capital	36,00,000	44,40,000
Surplus in Profit and Loss Account	15,18,000	16,38,000
Sundry Creditors	24,00,000	23,40,000
Outstanding Expenses	2,40,000	4,80,000
Income-tax payable	1,20,000	1,32,000
Accumulated Depreciation on Buildings and Equipment	12,00,000	13,20,000
	90,78,000	1,03,50,000

The original cost of equipment sold during the year 2014-15 was ₹ 7,20,000.

Solution:

Cash Flow Statement of Company A Ltd. for the year ending March 31, 2015
Cash flows from Operating Activities

	₹
Net Profits before Tax and Extra-ordinary Item	16,00,000
Add: Depreciation	6,00,000
Operating Profits before Working Capital Changes	22,00,000
Increase in Debtors	(1,80,000)
Decrease in Stock	16,80,000
Increase in Advances	(12,000)
Decrease in Sundry Creditors	(60,000)
Increase in Outstanding Expenses	2,40,000
Cash Generated from Operations	38,68,000
Income tax Paid	8,68,000
Net Cash from Operations	30,00,000

Cash flows from Investment Activities

	₹
Purchase of Land	(4,80,000)
Purchase of Buildings and Equipment	(28,80,000)
Sale of Equipment	3,60,000
Net Cash used in Investment Activities	(30,00,000)

Cash flows from Financing Activities

		₹
Issue of Share Capital	8,40,000	
Dividends Paid	(7,20,000)	
Net Cash from Financing Activities		1,20,000
Net increase in Cash and Cash Equivalents		1,20,000
Cash and Cash Equivalents at the beginning		6,00,000
Cash and Cash Equivalents at the end		7,20,000

Buildings and Equipment Account

Dr. **Cr.**

	₹		₹
To Balance b/d	36,00,000	By Sale of Asset	7,20,000
To Cash/Bank (purchase)		By Balance c/d	57,60,000
(Balancing figure)	28,80,000		
	64,80,000		64,80,000

Accumulated Depreciation on Buildings and Equipment Account

Dr. **Cr.**

	₹		₹
To Sale of Asset		By Balance b/d	12,00,000
(Accumulated depreciation)	4,80,000	By Profit and Loss (Provisional)	6,00,000
To Balance c/d	13,20,000		
	18,00,000		18,00,000

Sale of Asset Account

	₹
Original Cost	7,20,000
Less: Accumulated Depreciation	4,80,000
Net Cost	2,40,000
Profit on Sale of Asset	1,20,000
Sale Proceeds from Asset Sales	3,60,000

Illustration 59.

X Ltd. has the following balances as on 1st April, 2014

	₹
Fixed Assets	11,40,000
Less; Depreciation	3,99,000
	7,41,000
Stocks and Debtors	4,75,000
Bank Balance	66,500
Creditors	1,14,000
Bills payable	76,000
Capital (Shares of ₹ 100 each)	5,70,000

The Company made the following estimates for financial year 2014-15:

(i) The company will pay a free of tax dividend of 10% the rate of tax being 25%.

(ii) The company will acquire fixed assets costing ₹1,90,000 after selling one machine for ₹ 38,000 costing ₹ 95,000 and on which depreciation provided amounted to ₹ 66,500.

(iii) Stocks and Debtors, Creditors and Bills payables at the end of financial year are expected to be ₹ 5,60,500, ₹ 1,48,200 and ₹ 98,800 respectively.

(iv) The profit would be ₹ 1,04,500 after depreciation of ₹ 1,14,000.

Prepare the projected cash flow statement and ascertain the bank balance of X Ltd. at the end of Financial year 2014-15.

Solution:

Working:

		₹
(i)	Cash Flow from operations	
	Profit for the year	1,04,500
	Add: Depreciation (non cash item)	1,14,000
		2,18,500
	Less: Profit on sale of machine	9,500
		2,09,000
	Add increase in:	
	Creditors (₹ 1,48,200 – ₹ 1,14,000) = ₹ 34,200	
	Bills payable (₹ 98,800 – ₹ 76,000) = ₹ 22,800	57,000
		2,66,000
	Less : Increase in stocks & debtors (₹ 5,60,500 – ₹ 4,75,000)	85,500
	Cash from operations	1,80,500
(ii)	Payment of Dividend	
	10% on capital ₹ 5,70,000 = ₹ 57,000	
	Gross up Amount	
	Total Dividend	₹ 76,000
	Tax 25%	₹ 19,000
	Payment of Dividend	₹ 57,000

Note: Income Tax on Company's Profit Ignored

Projected Cash Flow Statement

for the Year ending on 31st March, 2015

		₹	₹
Bank Balance as on 1st April, 2014			66,500
Add:	Inflow of Cash		
	Sale of Machine	38,000	
	Cash From operation	1,80,500	2,18,500
Less:	Outflow of Cash		2,85,000
	Purchase of Fixed Assets	1,90,000	
	Payment of Dividend	57,000	
	Tax Paid	19,000	2,66,000
Bank Balance on 31st March, 2015			19,000

Illustration 60.

Astor Limited had the following condensed Trial Balance as at 31-03-2015:

(₹)

Debit	**Amount**	**Credit**	**Amount**
Cash	7,500	Current Liabilities	15,000
Account Receivable	30,000	Long-Term Notes Payable	25,500
Investments	20,000	Bonds Payable	25,000
Plant Assets	67,500	Capital Stock	75,000
Land	40,000	Retained Earnings	24,500
	1,65,000		1,65,000

During 2014-2015, the following transactions took place :

(i) A tract of land was purchased for ₹ 7,750 cash.

(ii) Bonds payable in the amount of ₹ 6,000 were retired for cash at face value.

(iii) An additional ₹ 20,000 equity shares were issued at par for cash.

(iv) Dividends totalling ₹ 9,375 were paid.

(v) Net income for 2014-2015 was ₹ 28,450 after allowing for depreciation of ₹ 9,500.

(vi) Land was purchased through the issuance of ₹ 22,500 in bonds.

(vii) Usha Ltd. sold a part of its investments portfolio for ₹ 12,875 cash. The transaction resulted in a gain of ₹ 1,375 for the firm.

(viii) Current liabilities increased to ₹ 18,000 at 31-3-2015.

(ix) Accounts receivable at 31-3-2015 total ₹ 38,000.

Prepare a statement of cash flows for 2014-2015 with the indirect method as per AS-3 (Revised).

Solution :

Cash Flow Statement for the year ended 31-03-2015

Cash Flows from Operating Activities		
Net Profit	28,450	
Add : Depreciation	9,500	
Less : Gain on Sale of Investment	(1,375)	
Operating Profit before Working Capital changes	36,575	
Add : Increase in current liabilities	3,000	
Less : Increase in accounts receivable	(8,000)	
Net Cash from operating activities		31,575
Cash Flows from Investing activities		
Sale of Investment	12,875	
Purchase of Land (For cash only)	(7,750)	
Net Cash from investing activities		5,125
Cash Flows from Financing Activities		
Issue of shares	20,000	
Redemption of Bonds	(6,000)	
Dividend Paid	(9,375)	
Net Cash from financing activities		4,625
Net Increase in cash and cash equivalents during the period		41,325
Add : Cash and cash equivalents in the beginning of the period		7,500
Cash and cash equivalents at the end of the period		48,825

Note : Significant Non-cash Transactions : Purchase of land by issue of bonds ₹ 22,500.

Illustration 61.

From the following information, prepare cash flow statement by using indirect method as per AS-3.

(₹)

Extract Balance Sheet

Liabilities	**31.03.2014**	**31.03.2015**	**Assets**	**31.03.2014**	**31.03.2015**
Capital	50,00,000	50,00,000	Plant & Machinery	27,30,000	42,70,000
Retained Earnings	26,50,000	36,90,000	*Less* : Depreciation	6,10,000	7,90,000
Debentures	—	9,00,000		21,20,000	38,40,000
Current Liabilities :			*Current Assets :*		
Creditors	8,80,000	8,20,000	Debtors	23,90,000	28,30,000
Bank Loan	1,50,000	3,00,000	*Less* : Provision	1,50,000	1,90,000
Liability for Expenses	3,30,000	2,70,000		22,40,000	26,40,000
Dividend Payable	1,50,000	3,00,000	Cash	15,20,000	18,20,000
Creditors for plant and machinery purchased	—	2,00,000	Marketable Securities	11,80,000	15,00,000
			Inventories	20,10,000	19,20,000
			Prepaid Expenses	90,000	1,20,000
	91,60,000	1,14,80,000		91,60,000	1,14,80,000

Additional Information:

(1) Net Income for the year ended 31.03.2015, after charging depreciation ₹ 1,80,000 is ₹ 22,40,000.

(2) Debtors of ₹ 2,30,000 were determined to be worthless and were written off against the provisions for doubtful debts account.

(3) The Board of Directors declared dividend of ₹ 12,00,000.

Note : Marketable securities are treated as cash equivalents.

Solution:

Cash Flow Statement for the year ended 31-03-2015

Cash Flows from Operating Activities		
Net Income	22,40,000	
Add: Depreciation	1,80,000	
	24,20,000	
Add: Decrease in Inventories	90,000	
Increase in Provision for Doubtful Debts*	40,000	
	25,50,000	
Less: Increase in Current Assets:		
Debtors*		(4,40,000)
Prepaid Expenses		(30,000)
Decrease in Current Liabilities:		
Creditors		(60,000)
Expenses Outstanding		(60,000)
Net Cash from Operating Activities		19,60,000
Cash Flows from Investing Activities		
Payment for Purchase of Plant & Machinery (15,40,000–2,00,000)	(13,40,000)	
Cash outflow from Investing Activities		(13,40,000)
Cash Flows from Financing Activities		
Bank Loan Raised	1,50,000	
Issue of Debentures	9,00,000	
Payment of Dividend	(10,50,000)	
Cash flows from Financing Activities		—
Net Increase in cash and Cash equivalents during the year		6,20,000
Add : Opeaning balance of cash and cash equivalents		27,00,000
Cash balance as on 31-03-2015		33,20,000

*Alternatively, provision for doubtful debts created (₹ 40,000) + ₹ 2,30,000 (Bad Debts) may be added. In that case, increase in debtors (including bad debts written off) ₹ 6,70,000 (₹ 4,40,000 + ₹ 2,30,000) is subtracted. However, net effect will remain same. It is only a matter of presentation. Adjustment for interest on bank loan is ignored as rate of interest is not given.

Illustration 62.

From the following balance sheets of X Ltd. and additional information, prepare statement of changes in financial position (working capital basis) :

Liabilities	Previous Year	Current Year	Assets	Previous Year	Current Year
Share capital	2,50,000	3,50,000	Goodwill	60,000	50,000
Reserves	1,30,000	1,65,000	Fixed Assets	2,90,000	3,95,000
Porposed Dividend	20,000	35,000	Current Assets	1,90,000	2,85,000
Provision for tax	50,000	60,000			
Current Liability	90,000	1,20,000			
	5,40,000	7,30,000		5,40,000	7,30,000

Additional Information:

(i) Depreciation on fixed assets provided during the year ₹ 30,000; Net profit during the year ₹ 80,000; Income-tax paid ₹ 50,000; Final dividend paid ₹ 20,000; Interim dividend was also paid.

(ii) Fixed asset costing ₹ 60,000 (accumulated depreciation ₹ 35,000) sold for ₹ 30,000.

(iii) Fixed asset costing ₹ 50,000 was purchased by issue of Share Capital.

Solution :

Cash Flow Statement for the year ended ....

(₹)

Cash Flows from Operating Activities		
Net profit for the year	80,000	
Adjustment for:		
Provision for taxation (closing)	60,000	
Depreciation	30,000	
Goodwill written off	10,000	
Profit on sale of fixed assets	(5,000)	
Operating profit before working capital changes	1,75,000	
Add : Increase in current liabilities	30,000	
Less : Increase in current assets (excluding cash and		
cash equivalent [(2,85,000–55,000)] – [1,90,000–20,000]		(60,000)
Cash provided by operations	1,45,000	
Less : Tax paid	50,000	
Net cash flow provided by operating activities		95,000
Cash Flows from Investing Activities		
Sale of Fixed Assets	30,000	
Purchase of Fixed Asset	(1,10,000)	
Net cash used in operating activities		(80,000)

Cash Flows from Investing Activities		
Issue of shares for cash	50,000	
Payment of Final Dividend	(20,000)	
Payment of Interim Dividend	(10,000)	
Net cash flow from financing activities		20,000
Net increase in cash during the year		35,000
Add opening balance of cash and cash equivalents		20,000
Closing balance of cash and cash equivalents		55,000

Note: Significant non-cash trasnsactions: Fixed assets worth ₹ 50,000 purchased by issue of shares.

Working Notes:

Dr. **Fixed Assets Account** **Cr.**

To Balance b/d	2,90,000	By Bank A/c (Sale)	30,000
To Share capital A/c	50,000	By Depreciation A/c	30,000
To Profit & Loss A/c (Profit on sale)	5,000	By Balance c/d	3,95,000
To Bank A/c (balance figure)	1,10,000		
- Purchase	4,55,000		4,55,000

Calculation of Funds from Operating Activities

	₹
Net Profit for the year	80,000
Add : Depreciation on Fixed Assets	30,000
Provision for Taxation (Closing balance)	60,000
Goodwill written off (60,000 – 50,000)	10,000
Less : Profit on sale of Fixed Assets	1,80,000
Funds from Operating Activities before Tax	5,000
	1,75,000

Dr. **Reserves Account** **Cr.**

To Proposed Dividend	35,000	By Balance b/d	1,30,000
To Interim Dividend (balancing fig.)	10,000	By Net Profit	80,000
To Balance c/d	1,65,000		
	2,10,000		2,10,000

Illustration 63.

The balance sheet of Hari Ltd. for 2013-14 and 2014-15 are given below:

Extract Balance Sheet

Liabilities	**2013-14**	**2014-15**	**Assets**	**2013-14**	**2014-15**
Share Capital	6,00,000	8,00,000	Fixed Assets	16,00,000	19,00,000
Capital Reserve	—	20,000	Less : Depreciation	4,60,000	5,80,000
General Reserve	3,40,000	4,00,000		11,40,000	13,20,000
Profit & Loss A/c	1,20,000	1,50,000	Investment	2,00,000	1,60,000

Debentures	4,00,000	2,80,000	Current Assets	5,60,000	6,60,000
Current Liabilities	2,40,000	2,60,000	Preliminary Expenses	40,0000	20,000
Proposed Dividend	60,000	72,000			
Provision for Tax	1,80,000	1,70,000			
Unpaid dividends	—	8,000			
	19,40,000	21,60,000		19,40,000	21,60,000

Additional Information:

During the year 2014-15, the Company:

1. Sold one machine for ₹ 50,000, the cost of which was ₹ 1,00,000 and the depreciation provided on it was ₹ 40,000;
2. Provided ₹ 1,80,000 as depreciation;
3. Sold some investment at a profit of ₹ 20,000, which was credited to Capital Reserve;
4. Redeemed 30% of the Debentures @ 105;
5. Decided to value stock at cost, whereas previously the practice was to value stock at cost less 10%. The stock according to books on 31-03-2014 was ₹1,08,000. The stock on 31-03-2015 was correctly valued at ₹ 1,50,000; and
6. Decided to write of fixed assets costing ₹ 28,000 on which depreciation amounting to ₹ 20,000 has been provided.

Prepare cash flow statement using indirect method. Assume that investments are long-term investments and current assets in the beginning of and at the end of the year do not include cash and bank balance.

Solution:

Cash Flow Statement for the year ended ....

Cash Flow from Operating Activities		
Cash flow before working capital chages	5,44,000	
Add: Increase in current Liabilities	20,000	
	5,64,000	
Less: Increase in Current Assets (6,60,000–5,72,000)	(88,000)	
Cash generated by operations	4,76,000	
Less: Tax paid	(1,80,000)	
		2,96,000
Net Cash flow provided by operating activities		
Cash flow from Investing Activities		
Purchase of Fixed Asset	(4,28,000)	
Sale of Fixed Asset	50,000	
Sale of Investment	60,000	
Net Cash flow used in investing activites		(3,18,000)
Cash Flow from Financing Activities		
Issue of share capital		2,00,000
Redemption of Debentures	(1,26,000)	
Dividend Paid	(52,000)	
Net Cash flow provided by financing activities		22,000

Net increase (decrease) in cash and Cash Equivalents during the year		—
Add : Balance in the beginning		—
Balance of Cash and Cash equivalents at the end of the year		—

Working Notes:

Calculation of Funds from Operation before tax

Increase in Profit and Loss A/c [1,50,000 – (1,20,000 + 12,000)]	18,000
Add: Transfer to general reserve	60,000
Preliminary Expenses written off	20,000
Depreciation	1,80,000
Loss on sale of machine	10,000
Decrease in fixed assets (28,000 – 20,000)	8,000
Premium on redemption of debentures	6,000
Proposed dividend	72,000
Provision for tax	1,70,000
Funds from operating activities before tax	5,44,000

Dr. Fixed Assets Account Cr.

To Balance b/d	16,00,000	By Asset Disposal A/c	1,00,000
To Bank A/c (balancing fig.)	4,28,000	By Asset Disposal A/c	28,000
		By Balance c/d	19,00,000
	20,28,000		10,28,000

Sale of Investment = Decrease in balance + Gain on sale

= (2,00,000 – 1,60,000) + 20,000 = ₹ 40,000

Loss on Sale of fixe Assets = Cost – Accumulated Depreciation – Sale Price

= 1,00,000 – 40,000 – 50,000 = ₹10,000

3. Unpaid dividend is taken as non-current item and dividend paid is shown on the application side. Alternatively, unpaid dividend may be taken as current liability and dividend declared (paid plus unpaid) is shown as application of funds.

4. Revaluation of stock will increase opening stock by ₹12,000 and also the opening balance of profit and loss account by ₹12,000. The opening balance of profit and loss account after revaluation of stock will be ₹ 1,32,000 (1,20,000 + 12,000).

5. Working capital at the end = 6,60,000 – 2,60,000 = 4,00,000

Working capital in the beginning = (5,60,000 + 12,000) – 2,40,000 = 3,32,000

68,000

Illustration 64.

ABC Limited gives you its Extract Balance Sheet as on 31st March, 2014 and its projected Profit and Loss Account for the year ended 31st March, 2015:

Extract Balance Sheet

Liabilities	**Amount**	***Assets***		**Amount**
Share Capital :		Fixed Assets :		
Equity Shares of ₹ 100		Machinery at cost	7,00,000	
each fully paid	6,00,000	Less : Depreciation	1,40,000	5,60,000
Reserves and Surplus :		Motor car at cost	80,000	
Securities Premium	20,000	Less : Depreciation	30,000	50,000
General Reserve	1,30,000	Current Assets :		
Profit and Loss Account	65,000	Stock		5,60,000
Secured Loans :		Book Debts		2,20,000
8% Debentures	3,00,000	Bank balances		1,20,000
Current Liabilities :		Loans & Advances :		
Sundry Creditors	2,85,000	Advance Income Tax		1,00,000
Provision for Taxation	1,40,000	Miscellaneous Expenditure:		
Proposed Dividend (Equity)	90,000	Preliminary Expenses		20,000
	16,30,000			16,30,000

Projected Profit and Loss Account for the year ended 31st March, 2015

To Opening Stok		5,60,000	By Sales :		
To Purchase		14,40,000	Cash		3,70,000
To Wages		80,000	Credit		18,00,000
To Manufacturing Expenses		40,000	By Stock		4,20,000
To Office & Administration Exp.		50,000	By Profit on Sale of Machinery		10,000
To Selling & Distribution Exp.		30,000			
To Interest		24,000			
To Depreciation :					
Machinery	56,000				
Car	14,000	70,000			
To Preliminary Expences		10,000			
To Provision for Taxation		1,36,000			
To Proposed Dividend on Equity		1,00,000			
To Balance		60,000			
		26,00,000			26,00,000

The company proposes to issue one equity share for two equity shares with nominal value of ₹ 3,00,000 at a premium of 10%. Machinery will be acquired for ₹ 1,00,000. The cost of machinery to be sold in the year ended 31st March, 2015 is ₹ 80,000 with a depreciation provision of ₹ 45,000.

It is expected that:

(i) Tax liability upto 31st March, 2015 will be settled for ₹ 1,20,000 within 31st March, 2017.

(ii) Advance Income Tax amounting to ₹ 1,30,000 is proposed to be paid in 2014-2015.

(iii) Book Debts will be 10% more than warranted by the credit period of two months.

(iv) Creditors for goods will continue to extend one and half months' credit and manufacturing expenses outstanding at the end of March, 2015 will be ₹ 5,000.

You are required to:

(i) Draft the Company's projected Balance Sheet as on 31st March, 2015.

(ii) Draft the statemet showing cash flows during the year ended 31st March, 2015 using direct method.

Solution:

Projected Cash Flow Statement for the year ended 31-03-2015

Cash Flow from Operating Activities		
Cash sales	3,70,000	
Cash Received from debtors	16,90,000	
	20,60,000	
Payment to creditors	15,45,000	
	5,15,000	
Payment of Expenses (80,000-5,000+40,000+50,000+30,000)	1,95,000	
Cash generated by operations	3,20,000	
Tax Paid (1,20,000 - 1,00,000 + 1,30,000)	1,50,000	
Net Cash flow from operating activities		1,70,000
Cash Flows from Investing Activities		
Sale of machinery	45,000	
Purchase of machinery	(1,00,000)	
Net cash used in investing activities		(55,000)
Cash Flows from Financing Activities		
Issue of shares at a premium	3,30,000	
Interest paid	(24,000)	
Dividend paid	(90,000)	
Net cash from financing activities		2,16,000
Net increase in bank balances		3,31,000
Bank balances at the beginning of period		1,20,000
Bank balances at the end of period		4,51,000

Projected Balance Sheet as on 31st March, 2015

(₹)

Liabilities		**Amount**	***Assets***		**Amount**
Share Capital :			*Fixed Assets* :		
9,000 Equity Shares			Machinery (see WN 1)	7,20,000	
of ₹ 100 each fully paid		9,00,000	*Less* : Depreciation (WN 2)	1,51,000	5,69,000
Reserves & Surplus :			Motor Car	80,000	
Securities Premium		50000	*Less* : Depreciation	44,000	36,000
General Reserve		1,30,000	Current Assets, Loans & Advances:		
Profit & Loss A/c:			Current Assets:		
Balance in the beginning	65,000		Stock		4,20,000
Add : Profit for the year	60,000		Debtors (Two months Sales+10%)		3,30,000
		1,45,000	Bank		4,51,000
Excess Tax provision of last year	20,000		Miscellaneous Expenditure: Preliminary Expenses		10,000
Secured Loans:					
Debentures		3,00,000			
Current Liabilities & Provisions:					
Current Liabilities:					
Creditors (1½ month purchases)		1,80,000			
Expenses Creditors		5,000			
Provision:					
Taxation	1,36,000				
Less : Advance tax		6,000			
	1,30,000				
Proposed Dividend on Equity Shares		1,00,000			
		18,16,000			18,16,000

Working Notes:

Dr. **Machinery Account** **Cr.**

To	Balance b/d	7,00,000	By	Balance A/c (80,000-45,000+10,000)	45,000
To	Profit on Sale A/c	10,000			
To	Bank A/c	1,00,000	By	Provision for Dep. A/c	45,000
			By	Balance c/d	7,20,000
		8,10,000			8,10,000

Dr. **Provision for Depreciation on Machinery Account** **Cr.**

To	Machinery A/c	45,000	By	Balance b/d	1,40,000
To	Balance c/d	1,51,000	By	Profit and loss A/c	56,000
		1,96,000			1,96,000

Sundry Debtors Account

Dr.					Cr.
To	Balance b/d	2,20,000	By	Bank A/c (balancing fig.)	16,90,000
To	Sales A/c	18,00,000	By	Balance c/d	3,30,000
		20,20,000			20,20,000

Sundry Creditors Account

Dr.					Cr.
To	Bank A/c (balancing fig.)	15,45,000	By	Balance c/d	2,85,000
To	Balance c/d	1,80,000	By	Purchase A/c	14,40,000
		17,25,000			17,25,000

Illustration 65.

Examine the following schedule prepared by K Ltd.:

Schedule of funds provided by operations for the year ended 31st March, 2015

₹ ('000)

Sales		32,760	
Add: Decrease in bills receivable		1,000	
Less: Increase in accounts receivable		(626)	
Inflow from operating revenues			33,134
Cost of goods sold	18,588		
Less: Decrease in inventories	(212)		
Add: Decrease in trades payable	81	18,457	
Wages and Salaries	5,284		
Less: Increase in wages payable	(12)		
Administrative Expenses	3,066		
Add: Increase in repaid expenses	11	3,077	
Property taxes		428	
Interest expenses	532		
Add: Amortisation of premium on bonds payable	20	552	
Outflow from operating expenses			27,786
Net inflow from operations			5,384
Rent Income	207		
Add: Increase in unearned rent	3		210
			5,558
Income-tax	1,330		
Less: Increase in deferred tax	50		1,280
Funds from operations			4,278

Required:

(i) What is the definition of funds shown in the schedule?

(ii) What amount was reported as gross margin in the income statement?

(iii) How much case was collected from the customers?

(iv) How much cash was paid for the purchases made?

(v) As a result of change in inventories, did the working capital increase or decrease and by what amount?

(vi) How much rent was actually earned during the year?

(vii) What was the amount of tax expenses reportd on the income statement?

(viii) Which method of calculating funds from operation is used?

(ix) Can you reconcile the profit after tax with the funds provided by the operations?

Solution:

(i) 'Funds' shown in the schedule refer to the cash and cash equivalents as defined in AS-3 (Revised) on 'Cash Flow Statement'.

(ii)

Gross margin in the income statement ₹ ('000)

Sales	32,760
Cost of goods sold	18,588
	14,172

(iii) Cash collected from the customers 33,134

(iv) Cash paid for purchases made 18,457

(v) Change in inventories would reduce the working capital by 212

(vi) Rental income earned during the year 207

(vii) Tax expenses reported in the income statement 1330

(viii) Direct method of calculating cash flow from operating activities is used.

(ix)

Reconciliation of Profit after Tax with Cash Funds ₹ ('000)

Profit after tax	3,719
Decrease in bills receivable	1,000
Increase in accounts receivable	(626)
Decrease in inventories	212
Decrease in trades payable	(81)
Increase in wages payable	12
Increase in prepaid expenses	(11)
Increase in unearned rent	3
Increase in deferred tax	50
Funds (i.e. cash and cash equivalents) from operations as shown in the schedule	4,278

Working Notes :

(i)

Calculation of Profit after Tax ₹ ('000)

Sales			32,760
Less:	Cost of goods sold		18,588
Gross margin			14,172
Add:	Rental income		207
			14,379
Less:	Wages and salaries	5,284	
	Administrative expenses	3,066	
	Property taxes	428	
	Interest expenses	532	
	Amortisation of premium on bonds payable	20	
			9,330
Profit before tax			5,049
Less:	Income-tax		1,330
Profit after tax			3,719

(ii) Amortisation of premium payable on bonds is not an operating transaction. It should be taken as part of financing activities. Further, it is assumed that premium amortised was paid during the year and, therefore, it is a cash item affecting flow of cash.

Study Note - 4

SUSTAINABILITY REPORTING

This Study Note includes

4.1 Concept of Triple Bottom Line Reporting
4.2 Global Reporting Initiative (GRI)
4.3 International Federation of Accountants (IFAC)

4.1 CONCEPT OF TRIPLE BOTTOM LINE REPORTING

There is no single, universally accepted definition of TBL reporting. In its broadest sense, and for the purposes of this booklet, TBL reporting is defined as corporate communication with stakeholders that describes the company's approach to managing one or more of the economic, environmental and/or social dimensions of its activities and through providing information on these dimensions.

Consideration of these three dimensions of company management and performance is sometimes referred to as sustainability or sustainable development. However, the term TBL is used throughout this booklet.

In its purest sense, the concept of TBL reporting refers to the publication of economic, environmental and social information in an integrated manner that reflects activities and outcomes across these three dimensions of a company's performance.

Economic information goes beyond the traditional measures contained within statutory financial reporting that is directed primarily towards shareholders and management. In a TBL context, economic information is provided to illustrate the economic relationships and impacts, both direct and indirect, that the company has with its stakeholders and the communities in which it operates.

The concept of TBL does not mean that companies are required to maximise returns across three dimensions of performance - in terms of corporate performance, it is recognized that financial performance is the primary consideration in assessing its business success.

- An expanded spectrum of values and criteria for measuring organizational and societal success – economic, environmental, social.
- In the private sector, a commitment to CSR implies a commitment to some form of TBL reporting.

The Triple Bottom Line is made up of "Social, Economic and Environmental"

"People, Planet, Profit "

The trend towards greater transparency and accountability in public reporting and communicatino is reflected in a progression towards more comprehensive disclosure of corporate performance to include the environmental, social and economic dimensions of an entity's activities.

Reporting information on any one or moer of these three elements is referred to as TBL (Triple Bottom Line) Reporting. This trend is being largely driven by stakeholders, who are increasingly demanding information on the approach and performance of companies in managing the environmental and social/community impact of their activities and obtaining a broader perspective of their economic impact.

TREND TOWARDS TRIPLE BOTTOM LINE REPORTING

Companies are increasingly including economic, environmental and social information in their public reporting, in addition to the financial information required for statutory reporting. For some companies, this involves publication of a separate report or reports. For others, it involves including such information within their annual reporting to shareholders.

A number of factors are driving this shift in public reporting, including response to mandatory requirements; consistency with emerging public commitments by business through voluntary codes of behaviour or charters and their associated business and signatory requirements; and the increasing and changing demands from stakeholders for greater transparency about operating policies and results. Stakeholders are placing increasing emphasis on understanding the approach and performance of companies in managing the environmental and social/community impact of their activities, and on obtaining a broader perspective of the economic impact of companies.

The importance of stakeholders

Stakeholders typically include the following groups:

- Shareholders and investors;
- Employees;
- Customers;
- Suppliers;
- Community;
- Commonwealth, State and Local governments;
- Other stakeholders, including: business partners, local

authorities and regulatory bodies, trade unions, and non-governmental organizations.

It is impossible for a company to accommodate the often-competing interests of all stakeholder groups in its public reporting. Essentially the company will seek to prioritise among these stakeholder groups and target its reporting to those stakeholder groups, and on those issues most critical to the company's success.

As TBL reporting develops, increased attention will be given to its role as part of an integrated communications strategy seeking to meet the requirements of *key* stakeholder groups - the delivery of such 'stakeholder appropriate' reporting is seen to provide greater value to the reporting company and better communicate information to the respective stakeholders to whom the reporting is directed.

Alignment with business strategy

TBL reporting has little relevance to the reporting company or its stakeholders if it is not aligned to the company's overall business strategy. A decision to move to full TBL reporting should not be taken lightly. It must have senior management endorsement and commitment, as it may have major resource implications, and a half-hearted approach is likely to be worse than not adopting it all.

Benefits of TBL Reporting

The business case for TBL reporting centres on improved relationships with key stakeholders such as employees, customers, investors and shareholders.

Specific commercial advantages include:

- enhancement of reputation and brand
- securig a social licence to operate
- attraction and retention of high calibre employees

- improved access to investors
- reduced risk profile
- identification of potential cost savings
- increased scope for innovation
- alilgning stakeholder needs with management focus, and
- creatino of sound basis for stakeholder dialogue

A substantial and varied body of literature dealing with the 'business case' for TBL reporting has been developed during the last five to ten years.

Alignment of company reporting with the expectations of key stakeholders serves to improve the quality of a company's relationships with such stakeholders and thus protect and enhance the value of the organisation. Some of the specific organisational benefits identified include:

- *Reputation and brand benefits* - corporate reputation is a function of the way in which a company is perceived by its stakeholders. Effective communication with stakeholders on one or more of the environmental, social, and economic dimensions can play an important role in managing stakeholder perceptions, and, in doing so, protect and enhance corporate reputation.
- *Securing a 'social licence to operate'* - a 'licence to operate' is not a piece of paper, but informal community and stakeholder support for an organisation's operations. Business is increasingly recognising the link between ongoing business success and its 'licence to operate', especially in the resources sector where the concept of a social licence to operate has been central for some years. Communication with stakeholders is often critical to securing and maintaining a 'licence to operate'

Communities and stakeholders generally, are likely to be more supportive of companies that communicate openly and honestly about their management and performance in relation to environmental, social and economic factors.

- *Attraction and retention of high calibre employees* - existing and prospective employees have expectations about corporate environmental, social and economic behaviour, and include such factors in their decisions. The publication of TBL-related information can play a role in positioning an employer as an 'employer of choice' which can enhance employee loyalty, reduce staff turnover and increase a company's ability to attract high quality employees.
- *Improved access to the investor market* - a growing number of investors are including environmental and social factors within their decisionmaking processes. The growth in socially responsible investment and shareholder activism is evidence of this. Responding to investor requirements through the publication of TBL-related information is a way of ensuring that the company is aligning its communication with this stakeholder group, and therefore enhancing its attractiveness to this segment of the investment market.
- *Establish position as a preferred supplier* - obtaining a differentiated position in the market place is one way to establish the status of preferred supplier. Effectively communicating with stakeholder groups on environmental, social and economic issues is central to obtaining a differentiated position in the market place.
- *Reduced risk profile* - there is an expanding body of evidence to suggest that performance in respect of economic, social and environmental factors has the capacity to affect the views of market participants about a company's exposure to, and management of, risk. TBL reporting enables a company to demonstrate its commitment to effectively managing such factors and to communicate its performance in these areas. A communication policy that addresses these issues can play an important role in the company's overall risk management strategy.

- *Cost savings* - TBL reporting often involves the collection, collation and analysis of data on resource and materials usage, and the assessment of business processes. For example, this can enable a company to better identify opportunities for cost savings through more efficient use of resources and materials.
- *Innovation* - The development of innovative products and services can be facilitated through the alignment of R&D activity with the expectations of stakeholders. The process of publishing TBL reporting provides a medium by which companies can engage with stakeholders and understand their priorities and concerns.
- *Aligning stakeholder needs with management focus* - External reporting of information focuses management attention on not only the integrity of the data but also the continuous improvement of the indicator being reported.
- *Creating a sound basis for stakeholder dialogue* - Publication of TBL reporting provides a powerful platform for engaging in dialogue with stakeholders. Understanding stakeholder requirements and alignment of business performance with such requirements is fundamental to business success. TBL reporting demonstrates to stakeholders the company's commitment to managing all of its impacts, and, in doing so, establishes a sound basis for stakeholder dialogue to take place.
- In addition to the benefits obtained through superior relationships with key stakeholder groups, the decision to be publicly accountable for environmental and social performance is often recognised as a powerful driver of internal behavioural change. The availability of relevant information on economic, environmental and social performance that previously may not have been collected and evaluated in a readily understood manner may enable executives to identify and focus attention on specific aspects of corporate performance where improvement is required.

Forms of Reporting

A number of options, ranging from the inclusion of minimal TBL-related information within statutory reporting through to the publication of a full TBL report, are available to companies considering TBL reporting.

In choosing an appropriate path forward, companies are likely to take into account a diversity of factors including: the overall strategic objectives; current capacity to report; prioritization of stakeholder requirements; and the reporting activities within the industry sector.

Relationship with financial reporting

The information contained within a TBL report is of a different nature to that included in a financial report. However, TBL reporting enables environmental and social risks that have the capacity to materially affect financial performance to be identified and, therefore, taken into consideration when preparing financial reports.

Implementation and Strategy

Critical issues for consideration in the development and implementation of TBL reporting include: clear definition of the role of TBL reporting in driving strategic business objectives; establishment of the resource and cost requirements; awareness of associated legal implications; and understanding the risks involved in publishing TBL information.

Key challenges associated with implementation include:

- Awareness of relevant issues associated with TBL reporting;
- Understanding stakeholder requirements;
- Aligning TBL reporting with objectives and risks; and
- Determining and measuring performance indicators.

The importance of metrics and performance indicators

The use of appropriate performance indicators, presented in a consistent and recognisable manner, can distil a large amount of complex information into a relevant and readily understood form. It is important that companies develop indicators that reflect their own strategic objectives and the requirements of key stakeholder groups.

Triple Bottom Line Accounting

- Expanding the traditional reporting framework
- Take into account environmental and social performance in addition to financial performance.
- Company's responsibility to 'stakeholders' rather than shareholders.

Legislation

- Legislation permitting corporations to adopt a 'Triple Bottom Line' is under consideration in some jurisdictions.
- The triple bottom line has been adopted as a part of the State Sustainability Strategy

What is Triple Bottom Line Reporting?

- At its narrowest TBL reporting is a framework for measuring and reporting corporate

  (organizational) performance against economic,social and environmental parameters"

  www.sustainability.com
- A move from one dimensional economic, reporting to three dimensional economic, social and environmental reporting

How is TBL reporting accomplished?

1. **Economic**

   Generally Accepted Accounting Principles

   Customers

   Suppliers

   Employees

2. **Social**

   Bribery and corruption

   Political contributions

   Child labor

   Security practices

   Indigenous rights

   Training and diversit

3. **Environmental**

   Energy

   Water

   Biodiversity

   Emissions, effluents, and waste

- Through the application of what is called the *Global Reporting Initiative* 2002 or GRI and is defined as "*a common framework for sustainability reporting*"

4.2 GLOBAL REPORTING INITIATIVE (GRI)

GLOBAL REPORTING INITIATIVE (GRI)

- **The Global Reporting Initiative attempts to make the Triple Bottom Line operational**
- **VISION**

The Global Reporting Initiative's (GRI) vision is that reporting on economic, environmental, and social performance by all organizations becomes as routine and comparable as financial reporting. GRI accomplishes this vision by developing, continually improving, and building capacity around the use of its Sustainability Reporting Framework.

How organizations strategically manage CSR through triple bottom line reporting ?

TBL reporting enables organizations to:

- Measure and manage their financial and non-financial performance and impacts, or lack thereof
- Have their performance and impacts verified independently
- Communicate effectively with consumers,governments, investors, employees, other stakeholders and watchdog groups

The implementation of a TBL reporting approach to CSR is an incremental process, dealing with the complex and contestable issues involved in attempting to effectively integrate economic, environmental and social performance measurement into a single report.

"You cannot talk about CSR unless you love your people and your country"

Qualities and characteristics of information in TBL reports

TBL reports usually contain both qualitative and quantitative information. In order for all reported information to be credible, regardless of whether the information is qualitative or quantitative, it is suggested that it should possess the following characteristics. These include:

Reliability - information should be accurate, and provide a true reflection of the activities and performance of the company.

Usefulness - the information must be relevant to both internal and external stakeholders, and be relevant to their decision-making processes.

Consistency of presentation - throughout the report there should be consistency of presentation of data and information. This includes consistency in aspects such as format, timeframes, graphics, and metrics.

Full disclosure - reported information should provide an open explanation of specific actions undertaken and performance outcomes.

Reproducible - information is likely to be published on an ongoing basis, and companies must ensure that they have the capacity to reproduce data and information in future reporting periods.

Auditability - alignment with the trend towards external verification requires that all statements and data within the report be able to be readily substantiated.

Where the reported information possesses these characteristics, the reporting company is able to present objective, balanced and credible information that delivers benefits to both the reporting company and its stakeholders, while also minimising any potential reputation risk associated with the publication of TBL reporting.

A Progression Towards Triple Bottom Line Reporting

1. Brief marketing publications including newsletters and brochures
2. Inclusion of limited environmental/ social information within statutory reporting
3. Commencement of consistent annual reporting on environmental/ social issues, primarily descriptive in nature with minimal quantitative data
4. Publication of separate environment and/or community reports (emergence of independent report verification)
5. Annual reporting based upon detailed environmental/ social performance data with clear linkage to objectives and outcomes. The report is publicised and provided through a range of distribution channels to stakeholders
6. Integration of economic, environmental and social performance measurement into a single report - Triple Bottom Line reporting

This table is a means of indicating that there is no "one size fits all" approach to communicating TBL-related information to stakeholders.

As discussed above, for companies to derive maximum value from public reporting, alignment with stakeholder requirements, and maintaining the qualitative characteristics of reported information is critical.

For some companies, those forms of reporting identified in the early stages of the progression may be most suitable for the stakeholder groups to whom such reporting is targeted and, accordingly, any progression towards full TBL reporting is likely to be inappropriate, at least initially.

The reporting process

The major steps involved in undertaking the reporting process are:

1. Planning for Reporting

- Understand the national, international and industry sector trends in TBL reporting
- Identify key stakeholders
- Establish the 'business case' and set high-level objectives for TBL reporting
- Secure support from the Board and senior executives
- Identify resource requirements and determine budget

2. Setting the Direction for TBL Reporting

- Engage with stakeholders to understand their requirements
- Prioritise stakeholder requirements and concerns
- Set overall objectives for TBL reporting
- Review current approach and assess capability to deliver on reporting objectives
- Identify gaps and barriers associated with current approach, and prioritise risks associated with overall reporting objective
- Review of associated legal implications
- Develop TBL reporting strategy
- Determine performance indicators for inclusion in report
- Establish appropriate structure and content of the report

3. **Implementation of TBL Reporting Strategy**

   - Implementation of TBL reporting strategy (including required data collection and review processes)
   - **Clarify relationship to statutory financial reporting**

4. **Publication of TBL Report**

   - Prepare draft report
   - Review content and structure of report internally, and modify accordingly
   - Obtain independent assurance - external verification
   - Publish TBL report
   - Seek feedback from stakeholders and incorporate into planning for the next period's reporting.

Key challenges

Specific challenges associated with TBL reporting vary from company to company and between industry sectors. In working to overcome challenges associated with the implementation of TBL reporting, the principal areas requiring specific effort include:

- Gaining an awareness of relevant issues associated with TBL to the reporting organisation;
- Obtaining an understanding of the requirements of key stakeholders in relation to public reporting;
- Achieving clarity in relation to the company's objectives and the risks related to reporting; and
- Determining key indicators of environmental, social and economic performance, and basis of measurement.

Managing key challenges

Matters to be considered in addressing challenges in implementation of TBL reporting are summarized in Table 1 on page 26.

Guidelines, frameworks and toolkits have been developed with the purpose of achieving greater standardisation and consistency in TBL reporting. However, given the unique circumstances and issues in different industry sectors, a uniform "one size fits all" approach across all industry sectors is neither practical nor appropriate.

Questions to consider when assessing measurement indicators for inclusion in Triple Bottom Line reports:

- Does the indicator address the requirements and concerns of key stakeholders?
- Is the indicator aligned to company obj ectives and policy?
- Will the indicator provide management with information to guide decision-making?
- Does the indicator adequately convey information about performance that is specific to the industry sector?
- Does the indicator facilitate comparison with competitors?
- Can internal systems generate accurate, reproducible data?
- What is the risk in publishing a specific measure of performance?
- Is it a significant management issue for the reporting entity?

In order to develop metrics that provide a meaningful measure of performance, companies must identify the factors that drive business value and understand the sources of such value. They should seek to identify and develop measurement indicators that align with stakeholder needs and expectations, are consistent with company objectives and strategy, and drive tangible business improvement.

The GRI has committed significant effort to the development of sustainability/TBL indicators and, while prescriptive in approach, these have obtained broad acceptance. The GRI has established two groups of indicators -"Core Indicators" and "Additional Indicators". Companies stating that they comply with the GRI Guidelines are expected to apply the core indicators or explain why such indicators are not applicable.

Additional indicators are those to be used at the discretion of the reporting company. The GRI approach classifies indicators in the three areas of company impact: economic, environmental and social; with each area being further subdivided into Categories and Aspects as illustrated in Table 2. "Core" and "Additional" indicators are then prescribed for each category.

While providing a useful framework for considering performance indicators, the reality for a majority of Australian companies that do not undertake operations in developing countries is that a number of the areas of measurement listed in the *Guidelines* will bear little relevance to their specific business activities.

This reinforces the importance of reporting companies developing indicators in a structured way that reflects their own objectives and the requirements of key stakeholder groups.

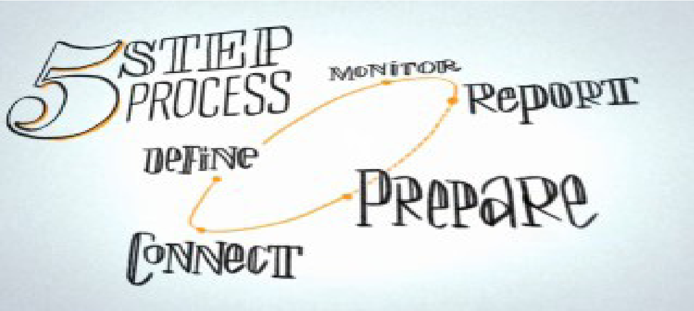
Performance indicators are detailed for each of the aspects detailed in Table 2. For example, in the Social Performance Indicators category of Labour practices and decent work, under the aspect of Employment, the *Guidelines* propose the following specific core indicators:

- Breakdown of workforce (where possible) by:
- Region/country
- Status (employee/non-employee)
- Employment type (full time/part time)
- Employment contract (indefinite, fixed term or temporary)
- Identify workers retained in conjunction with other employers (temporary agency workers or workers in co-employment relationships), segmented by region/country.
- Net employment creation and average turnover segmented by region/country.

The following additional indicators are also proposed under the aspect of Employment:

Employee benefits beyond those legally mandated (e.g. contributions to health care, disability, maternity, education, and retirement).

How do I Start Reporting?



What is Sustainability Reporting?

A sustainability report is an organizational report that gives information about economic, environmental, social and governance performance.

For companies and organizations, sustainability – the capacity to endure, or be maintained – is based on performance in these four key areas.

An increasing number of companies and organizations want to make their operations sustainable. Establishing a sustainability reporting process helps them to set goals, measure performance, and manage change. A sustainability report is the key platform for communicating positive and negative sustainability impacts.

To produce a regular sustainability report, organizations set up a reporting cycle – a program of data collection, communication, and responses. This means that their sustainability performance is monitored on an ongoing basis. Data can be provided regularly to senior decision makers to shape company strategy and policy, and improve performance.

Sustainability reporting is therefore a vital step for managing change towards a sustainable global economy – one that combines long term profitability with social justice and environmental care Sustainability reporting can be considered as synonymous with other terms for non-financial reporting; triple bottom line reporting, corporate social responsibility (CSR) reporting, and more. It is also an intrinsic element of integrated reporting; a recent development that combines the analysis of financial and non-financial performance.

A sustainability report enables companies and organizations to report sustainability information in a way that is similar to financial reporting. Systematic sustainability reporting gives comparable data, with agreed disclosures and metrics.

Major providers of sustainability reporting guidance include:

- The Global Reporting Initiative (The GRI Sustainability Reporting Framework and Guidelines)
- Organization for Economic Cooperation and Development (OECD Guidelines for Multinational Enterprises)
- The United Nations Global Compact (the Communication on Progress) International Organization for Standardization (ISO 26000, International Standard for social responsibility)
- Uptake of sustainability reporting is increasing among organizations of all sizes: here are some statistics .

Benefits:

An effective sustainability reporting cycle should benefit all reporting organizations.
Internal benefits for companies and organizations can include:

- Increased understanding of risks and opportunities
- Emphasizing the link between financial and non-financial performance
- Influencing 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
- Avoiding being implicated in publicized environmental, social and governance failures Comparing performance internally, and between organizations and sectors

External benefits of sustainability reporting can include:

- Mitigating - or reversing - negative environmental, social and governance impacts

- Improving reputation and brand loyalty
- Enabling external stakeholders to understand company's true value, and tangible and intangible assets
- Demonstrating how the organization influences, and is influenced by, expectations about sustainable development

GRI and Sustainability Reporting

Since 1999, GRI has provided a comprehensive Sustainability Reporting Framework that is widely used around the world. The cornerstone of the Framework is the Sustainability Reporting Guidelines. As a result of the credibility, consistency and comparability it offers, GRI's Framework has become a de facto standard in sustainability reporting.

Sustainability is a journey. Along the way, organizations need to set goals, measure performance, and integrate a sustainability strategy into their core planning. GRI's Reporting Framework allows all organizations to take the first steps towards a sustainable global economy.

Global Reporting Initiative

The GRI *Guidelines* contain information to assist companies seeking to enhance the credibility of their reports through independent verification and assurance. The *Guidelines* highlight five critical areas for consideration by those companies seeking independent assurance:

Internal information systems and processes - investigation and evaluation of the effectiveness of internal systems and processes to provide accurate and meaningful data.

The assurance process - in order to provide value to the reporting company, the assurance process must provide assurance in relation to subject matter, evidence, control systems, and the usefulness of reported information.

Selection of assurance providers - the assurance provider should be independent, be able to balance stakeholder and company needs, have no conflict of interest, be able to commit sufficient time and appropriate resources.

Director's responsibilities - recognition by the Board of the role of the assurance provider and ensuring that sufficient resources and access is made available to the assurance provider serves to enhance the process.

Assurance statements/reports - the GRI offers guidelines on the minimum requirements for inclusion in assurance statements and reports.

In addition, the *Guidelines* identify several issues that companies and other organisations should consider in choosing an independent assurance provider.

Some of the distinctive elements of GRI's Framework – and the activity that creates it – include:

Multi-stakeholder input. GRI believes that multi-stakeholder engagement is the best way to produce universally applicable reporting guidance that meets the needs of report makers and users. All elements of the Reporting Framework are created and improved using a consensus-seeking approach, and considering the widest possible range of stakeholder interests. Stakeholder input to the Framework comes from business, civil society, labor, accounting, investors, academics, governments and sustainability reporting practitioners.

A record of use and endorsement. Every year, an increasing number of reporters adopt GRI's Guidelines. From 2006 to 2011, the yearly increase in uptake ranged from 22 to 58 percent. New audiences for sustainability information, like investors and regulators, are now calling for more and better performance data. Annual growth in the number of reporters is expected to continue, as GRI works for more reporters and better reporting.

Governmental references and activities. GRI was referenced in the Plan of Implementation of the UN World Summit on Sustainable Development in 2002. Use of GRI's Framework was endorsed for all participating governments. Several governments consider GRI's Framework to be an important part of their sustainable development policy, including Norway, the Netherlands, Sweden and Germany.

Independence. GRI's governance structure helps to maintain its independence; geographically diverse stakeholder input increases the legitimacy of the Reporting Framework. GRI's funding approach also ensures independence. GRI is a stichting – in Dutch, a non-profit foundation – with a business model that aims for a degree of self-sufficiency. Funding is secured from diverse sources; governments, companies, foundations, partner organizations and supporters.

Shared development costs. The expense of developing GRI's reporting guidance is shared among many users and contributors. For companies and organizations, this negates the cost of developing in-house or sector-based reporting frameworks.

Bridge building. GRI's basis in multi-stakeholder engagement contributes to its ability to build bridges between different actors and sectors - like business, the public sector, labor unions and civil society - and to mediate.

GRI Guidelines

G3.1 Guidelines

G3.1 is a finalized update of GRI's most recent generation of Sustainability Reporting Guidelines, and is the most comprehensive sustainability reporting guidance currently available.

The G3.1 Guidelines are an update and completion of the third generation of GRI's Sustainability Reporting Guidelines, G3. The Guidelines are the cornerstone of GRI's Reporting Framework.

G3.1 includes expanded guidance for reporting on human rights, local community impacts, and gender. G3.1 was launched in March 2011 and is the most comprehensive sustainability reporting guidance available today.

The G3.1 Guidelines are made up of two parts. Part 1 features guidance on how to report. Part 2 features guidance on what should be reported, in the form of Disclosures on Management Approach and Performance Indicators.

G3.1's Performance Indicators are organized into categories: Economic, Environment and Social. The Social category is broken down further by Labor, Human Rights, Society and Product Responsibility sub-categories.

Indicator Protocols are the 'recipe' behind the Performance Indicators; they define key terms in the Indicator, compilation methodologies, the intended scope and relevance of the Indicator, and technical references. Indicator Protocols provide guidance on how Disclosures on Management Approach and Performance Indicators should be reported.

Guidelines overview

Part 1 – Reporting Principles and Guidance

- Principles to define report content: Materiality, Stakeholder Inclusiveness, Sustainability Context, and Completeness
- Principles to define report quality: Balance, Comparability, Accuracy, Timeliness, Reliability, and Clarity
- Guidance on how to set the Report Boundary

Part 2 – Standard Disclosures

- Strategy and Profile

- Management Approach
- Performance Indicators

Human Rights and Reporting

HUMAN RIGHT – A CALL TO ACTION

G3.1's improvements to reporting human rights-related performance are the outcome of a joint project that marked the 60th anniversary of the Universal Declaration on Human Rights.

The United Nations Global Compact, Realizing Rights:

The Ethical Globalization Initiative and GRI collaborated on 'Human rights – A call to action'. The project aimed to foster greater integration of human rights principles into corporate sustainability reporting. Subsequently, a multi-stakeholder expert Working Group was assembled to shape greater consensus on what constitutes good human rights practice and measurement for organizations. Recent developments have led to new perspectives on how human rights relate to businesses, with implications for reporting. The revisions proposed by the Working Group took account of these developments. The revisions addressed the policy framework put forward by the United Nations Special Representative of the Secretary General on Business and Human Rights, John Ruggie, and formulated disclosure expectations in the field of human rights due diligence and access to grievance and remedy mechanisms. The project partners also organized three multi-stakeholder workshops in Geneva, Buenos Aires and Seoul. The workshops informed the deliberations of the Working Group.

Reporting on Community Impacts

The Society category features an expanded introduction and new content for Disclosure on Management Approach. In addition, it features an update to an existing Society Performance Indicator and two new Performance Indicators that address the identification, prevention and mitigation measures in place for communities that are significantly affected by an organization's operations.

The improvements featured in the G3.1 Guidelines are the outcome of a working group process and a 2007 joint research project focused on reporting practices. The research project resulted in the publication reporting on Community Impacts.

4.3 INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

Investors and other stakeholders want to know what makes companies tick; at the same time, regulators are increasingly requiring companies to report clearly on their business models. In response, IFAC, with the Chartered Institute of Management Accountants (CIMA) and PwC, and at the request of the International Integrated Reporting Council (IIRC), have released a background paper, which highlights the business model as being at the heart of integrated reporting.

Currently, there is wide variation in how organizations define their business models and approach to disclosure. This highlights the need for a clear, universally applicable, international definition of a business model. The proposed definition and discussion in the paper aim to bridge the varied interpretations by highlighting common areas and ensuring a consistent application across industries and sectors.

The background paper found that, in a complex financial climate that has seen investors demand greater transparency, reporting on business models is currently inconsistent, incomparable, and incomplete because of a lack of consistent guidance.

"Towards Integrated Reporting – Communicating Value in the 21st Century" , where it was identified as one of two "central themes for the future direction of reporting". The Discussion Paper noted that although there "is no single, generally accepted definition of the term 'business model' ... it is often seen as the process by which an organization seeks to create and sustain value."

Integrated Reporting Can Result in Better Governance

- ❖ Integrated reporting needs to reflect an organization's strategy and values, as well as how it is managed in all social, environmental, and economic dimensions of performance;
- ❖ The process of integrated reporting, in turn, is a powerful tool to help drive an organization's strategic agenda, providing management with key drivers of performance; Integrated reporting has to be open and transparent by reflecting both improvements in performance as well as weaknesses; and
- ❖ Pension fund investors, as well as some other institutional investors, are increasingly looking for financial implications of ESG factors to understand how an organization's strategy and operations are affecting the numbers and key measures of performance.

Definition on Capitals:

(1) Financial capital. The pool of funds that is:

- ❖ available to an organization for use in the production of goods or the provision of services
- ❖ obtained through financing, such as debt, equity or grants, or generated through operations or investments.

(2) Manufactured capital. Manufactured physical objects (as distinct from natural physical objects) that are available to an organization for use in the production of goods or the provision of services, including:

- ❖ buildings
- ❖ equipment
- ❖ infrastructure (such as roads, ports, bridges and waste and water treatment plants).

Manufactured capital is often created by one or more other organizations, but also includes assets manufactured by the reporting organization when they are retained for its own use.

(3) **Human capital.** People's competencies, capabilities and experience, and their motivations to innovate, including their:

❖ alignment with and support of an organization's governance framework and risk management approach, and ethical values such as recognition of human rights

❖ ability to understand, develop and implement an organization's strategy

❖ loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.

(4) **Intellectual capital.** Organizational, knowledge-based intangibles, including:

❖ intellectual property, such as patents, copyrights, software, rights and licences

❖ "organizational capital" such as tacit knowledge, systems, procedures and protocols

❖ intangibles associated with the brand and reputation that an organization has developed.

(5) **Natural capital.** All renewable and non-renewable environmental stocks that provide goods and services that support the current and future prosperity of an orpositively or negatively, on natural capital. It includes:

❖ air, water, land, forests and minerals

❖ biodiversity and ecosystem health.

(6) **Social and relationship capital**. The institutions and relationships established within and between each community, group of stakeholders and other networks (and an ability to share information) to enhance individual and collective well-being. Social and relationship capital includes:

❖ shared norms, and common values and behaviours

❖ key relationships, and the trust and willingness to engage that an organization has developed and strives to build and protect with customers, suppliers, business partners, and other external stakeholders

❖ an organization's social licence to operate

Approaches of Business Model Reporting

In reviewing the global examples of business model reporting, it became apparent that they could be broadly allocated into five categories. Common approaches to business model reporting based on a survey of current practices.

Approach	Description
Organizational overview	What the entity does, how it is structured or where it operates
Business strategy	Key aspects of the organization's strategy
Value chain	Place in the value chain and dependencies on key inputs
Financial performance	How the business model drives profitability or revenue generation
Value creation	How the organization's inputs, activities and relationships lead to value and desired outcomes

Divergent approaches need to be reconciled by forming a common, widely-accepted definition of key elements that need to be considered when determining what constitutes a business model. These key elements could usefully encompass inputs, activities, outputs and outcomes. A link to financial performance, in terms of cost, revenue generation and cash flows, represents the value added that accrues to the organization and investors.

The Framework draws a distinction between outputs and outcomes, but recognizes that both are important in presenting a complete picture of a business model. Outputs represent the key products and services that an organization produces. These outputs can then have a range of outcomes, both internally to the organization and externally among a wider set of stakeholders. For example, in the case of a car manufacturer, the output is the car; the outcomes to a consumer may be mobility, safety, reliability, comfort and status. Outcomes that flow beyond the customer include environmental impacts arising from emissions.

Incorporating the key elements of inputs, activities, outputs and outcomes will facilitate report preparers to make the connection to the capitals. This, in turn, will encompass the broader concepts of value creation identified in the Framework, as well as a more complete definition of business model than is traditionally the case.

Linking strategy and business model disclosures is important, but they should be distinct disclosure elements. Building upon an assessment of opportunities, risks and the market environment, an organization's strategy will determine the appropriate mix of products and services (outputs) to achieve the desired outcomes that will generate the greatest benefits to customers and other stakeholders. The aim of the business model is then to deliver on this strategy, and consequently the outputs and desired outcomes, both of which may be expressed quantitatively in terms of targeted key performance indicators. It is also important to avoid describing the business model as merely an organizational overview and description of the business.

A description of the actual outputs and outcomes achieved is therefore fundamental to a proper understanding of the effectiveness of an organization's business model. Disclosure on the achievement of outcomes (ideally presented relative to prior periods), market expectations, strategic goals or other benchmarks can be considered part of the "Performance" Content Element of the Framework. Performance analysis may identify changes necessary to the business model to better achieve the current strategy. Alternatively, this analysis may highlight changes to strategic objectives that affect the current business model.

Positioning the Business Model

It is important to establish where the business model sits within the broader narrative. Based on the literature study and review of current reporting practices, it would be appropriate for the Framework to make a distinction between business model disclosures and other information such as:

- external factors or context
- capitals
- governance
- strategy and resource allocation
- opportunities and risks
- performance
- future outlook.

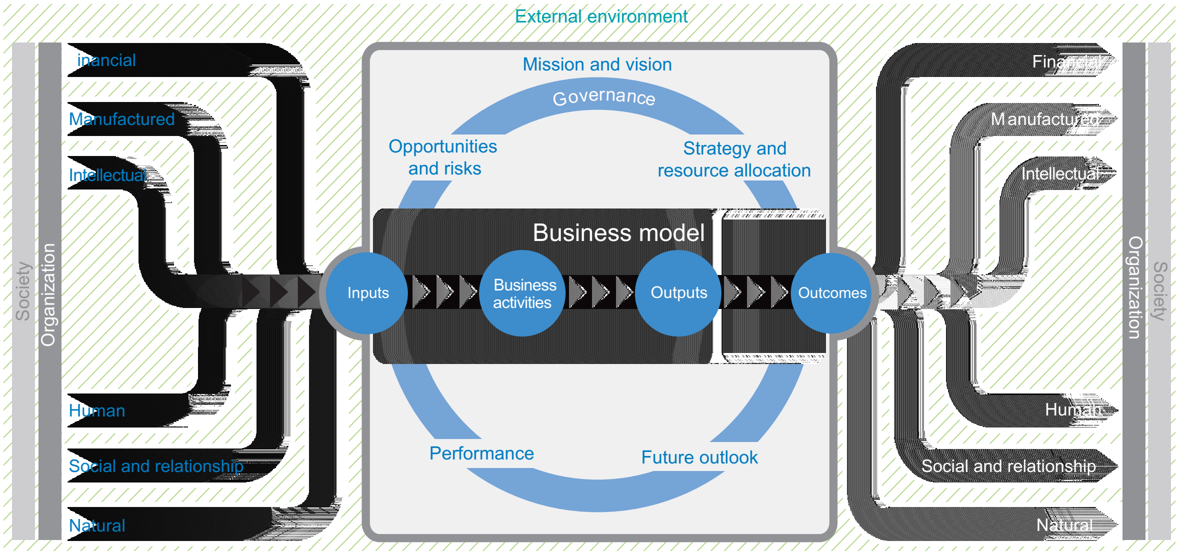


Figure 1: Position of business model relative to other system elements

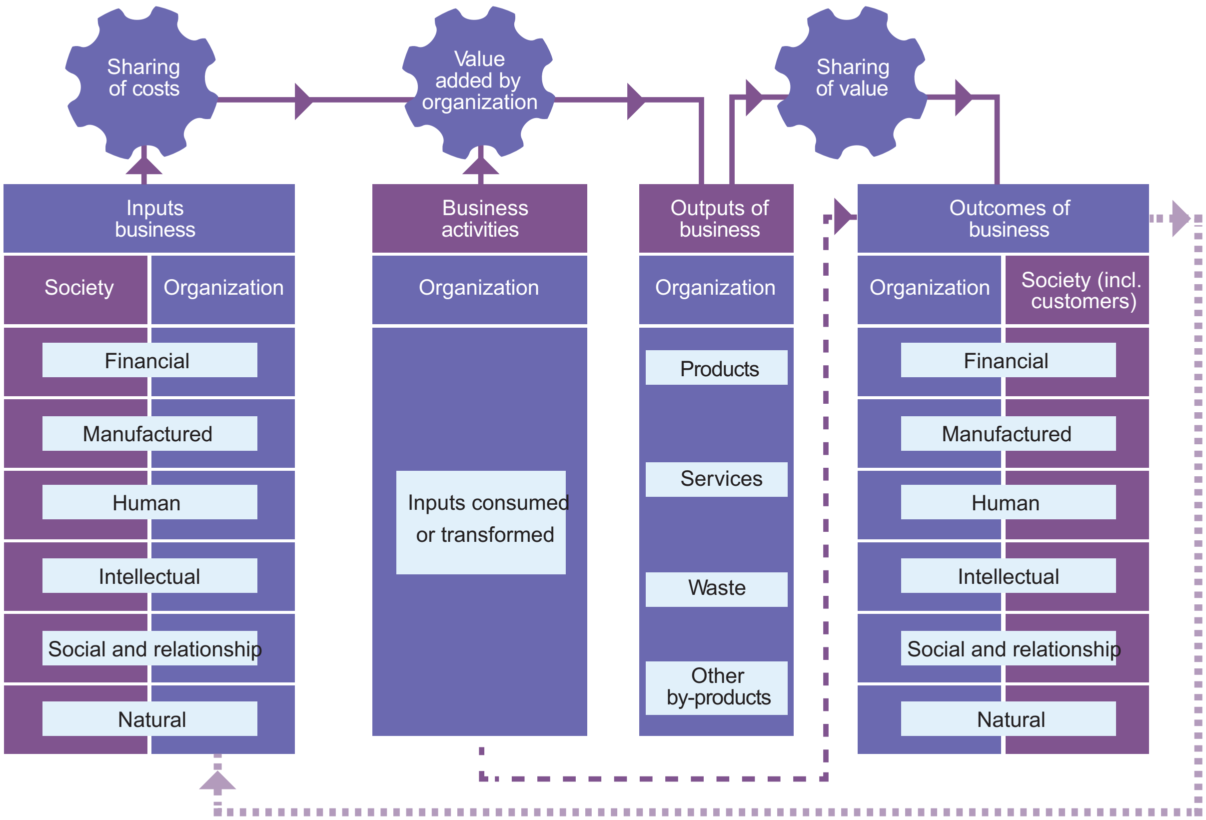


Figure 2: Interaction of business model with internal and external capitals

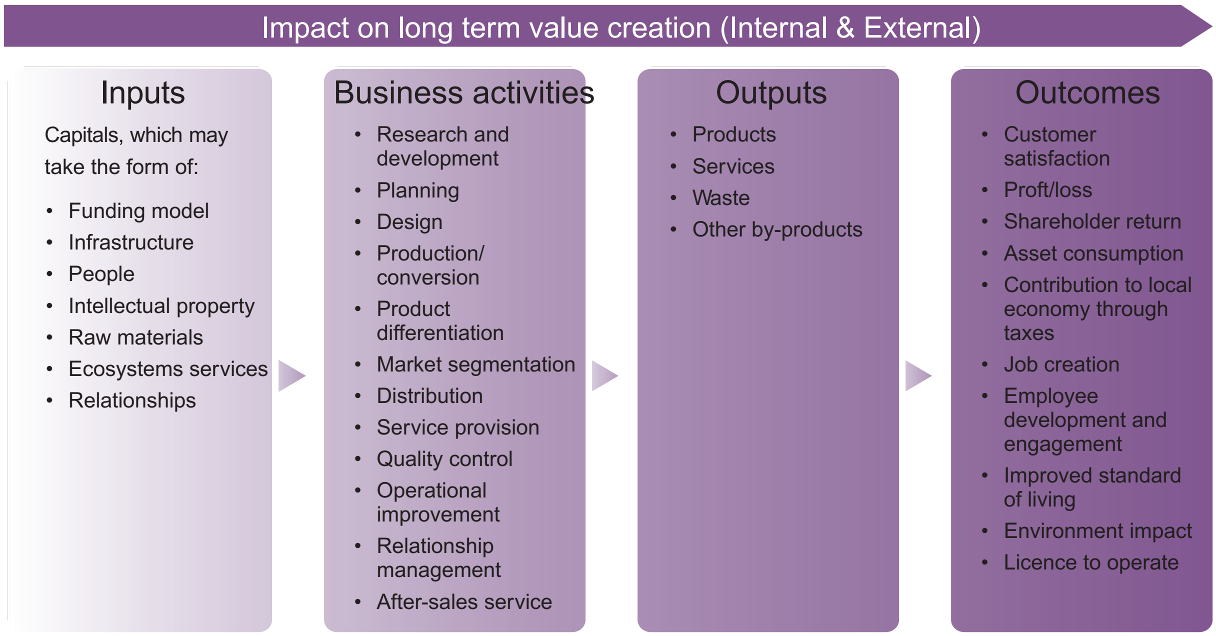


Figure3: Impact on long term value creation (Internal & External) [Business Model disclosure map]

Study Note - 5

ACCOUNTING AND REPORTING OF FINANCIAL INSTRUMENTS AND OTHER EXTERNAL REPORTING

This Study Note includes

5.1 Meaning, Recognition, De-recognition and Offset, Compound Financial Instruments
5.2 Measurement of Financial Instruments
5.3 Hedge Accounting
5.4 External Reporting under Capital Market Regulations & Disclosures
5.5 Annual Reports-Statutory Requirement and External Report, Preparation of Financial Information, Disclosure of Post Balance Sheet Events
5.6 Financial Reporting across the world with Reference to Reporting under US and UK Laws
5.7 AS 30, 31, 32

5.1 MEANING, RECOGNITION, DE-RECOGNITION AND OFFSET, COMPOUND FINANCIAL INSTRUMENTS

FINANCIAL INSTRUMENTS

(i) Applicability: this statement is applicable on enterprises which are Non-SME.

(ii) Definition of Financial Statements:

Financial Instrument is a contract that gives rise to a Financial asset for one enterprise and a Financial Liability or an Equity for another enterprise. The example are investments, debtors, deposits etc.

(iii) Definition of Financial Assets: A Financial asset is an asset that is:

- Cash
- Equity Instruments of other enterprise, eg. Investment in ordinary shares.
- A contractual right to receive cash, or to exchange financial assets or liabilities with other enterprise under conditions that are potentially favourable to the enterprise.

(iv) Definition of Financial Liability: Financial Liability is a contractual obligation to deliver cash or to exchange financial assets or financial liabilities with another enterprise under conditions which are potentially unfavourable to the enterprise.

It also includes contracts which may be settled in the enterprise's equity shares. Eg. Convertible debenture, convertible Preference share.

Fixed assets, stock, pre-paid expenses are not financial assets. Deferred incomes and warranty obligation are not financial liabilities.

(v) Classification of financial assets: A financial assets has four classification

- Held for trading: Financial assets at fair value through Profit & Loss.
- They are held for trading or they are designated as such. It includes derivatives also.
- Held to maturity: Assets with fixed maturity and the entity has a positive intention and ability to hold till maturity.
- Loans & receivables: Assets with fixed payments (determinable and which are not quoted in the market.

- Available for sale: These & those assets which are not classified under the above 3 categories. (residual)

(vi) Classification of Financial Liabilities: They are of two types:-

(a) Financial liability at fair value through profit & loss (Held for trading liabilities.)

(b) Other liabilities

(vii) Regular way of purchase or sale of financial assets: A regular way of purchase or sale is a contract that requires delivery of the assets within the stipulated time fame.

(viii) Trade date accountings & settlement date accounting: A financial asset purchased or sold is accounted for on trade date is called trade date accounting if it is accounted for on settlement date then it is called settlement date accountings.

(ix) Accountings for financial assets at fair value through profit & loss: (held for trading)

(a) On the day of acquisition the asset is recognized at fair values.

(b) The transaction costs are directly charged to the profit & loss account. (This is also applicable for interim financial statement.)

(c) On subsequent reporting dates they are measured at fair values. The difference is transferred to P/L A/c.

(d) On Disposal the assets will be de-recognised and the difference carrying amount & fair value at the date of sale is transfer to P/c A/c.

(e) No impairment test is required.

(f) Any change in the fair value between trade date & settlement date is recognized through profit & loss A/c.

5.2 MEASUREMENT OF FINANCIAL INSTRUMENTS

Example: 28.03.2015 – Purchase 100 share of ₹600 each

31.03.2015 – Fair value ₹632 each

04.04.2015 – Settlement date – Fair value ₹624.

22.04.2015 – Sold ₹690/ share (settled on the same date.)

Use trade date accounting.

Solution:

Journal Entries

Date	Particulars		Debit (₹)	Credit (₹)
28.03.2015	Investment A/c To, Liabilities A/c	Dr.	60,000	 60,000
31.03.2015	Investment A/c To, P/L A/c	Dr.	3,200	 3,200
04.04.2015	P/L A/c To, investment	Dr.	800	 800
	Liabilities A/c To, Bank A/c	Dr.	60,000	 60,000
22.04.2015	Bank A/c To, Investment A/c To, P/L A/c	Dr.	69,000	 62,400 6,600

If the same example is solved using settlement date accounting

Journal Entries

Date	Particulars		Debit ₹	Credit ₹
31.03.2015	Fair value adjustment A/c	Dr.	3,200	
	To, P/L A/c			3,200
04.04.2015	Investment A/c	Dr.	62,400	
	P/L A/c	Dr.	800	
	To, Bank A/c			60,000
	To, Fair value adjustment A/c			3,200
22.04.2015	Bank A/c	Dr.	69,000	
	To, Investment A/c			62,400
	To, P/L A/c			6,600

(x) Accounting For Available For Sale Financial Assets:

(a) On the day of purchase they are measured at acquisition cost plus directly attributable transaction cost.

(b) On each subsequent reporting date they are measured at fair values. The difference is debited or credited to an equity account –

Example: Investment revaluation reserve. (600 - 800 – 320)

(c) Impairment test is required

(d) On disposal the balance in investment revaluation reserve will be transferred to P/L A/c.

Example: Trade date accounting

28.03.2015 Purchase one share ₹700.

31.03.2015 fair value ₹ 736.

04.04.2015 Fair value on settlement date ₹683

22.04.2015 sold ₹622.

Solution:

Date	Particulars		Debit (₹)	Credit (₹)
28.03.2015	Investment A/c	Dr.	700	
	To, Liabilities A/c			700
31.03.2015	Investment A/c	Dr.	36	
	To, Investment Revaluation Resaves A/c			36
04.04.2015	Investment Revaluation Reserve A/c	Dr.	53	
	To, Investment A/c			53
	Liabilities A/c	Dr.	700	
	To, Bank A/c			700
22.04.2015	Bank A/c	Dr.	622	
	P & L A/c	Dr.	78	
	To, Investment A/c			683
	To, Investment A/c			17

If the same example is solved using settlement date accountings

Date	Particulars		Debit ₹	Credit ₹
31.03.2015	Fair value adjustment A/c	Dr.	36	
	To, Investment revaluation reserve			36
04.04.2015	Investment A/c	Dr.	683	
	Investment revaluation reserve A/c	Dr.	53	
	To, Bank A/c			700
	To, Fair value adjustment			36
22.04.2015	Bank A/c	Dr.	622	
	P/L A/c	Dr.	78	
	To, Investment A/c			683
	To, Investment Revaluation Reserve A/c			17

(xi) Accountings for Held to maturity Investment: -

(a) On the day of acquisition they are measured at acquisition cost plus transaction cost.

(b) On he subsequent reporting date they are measured using effective interest rate at amortised cost.

(c) Impairment test is needed.

(d) On maturity no profit or loss will arise.

Example:

Face of the investment = ₹1000.

Interest rate @12%

Cost of acquisition = 1076

Life 5 years

On Maturity ₹1000.

Solution: Using trial & error approach we find that the effective interest rate (IRR) is 10%

Journal Entries

Particular		Debit ₹	Credit ₹
Investment A/c	Dr.	1,076	
To, Bank A/c			1,076

Particulars		1st Year ₹		2nd Year ₹		3rd Year ₹		4th Year ₹		5th Year ₹	
Investment A/c	Dr.	108		106		105		104		101	
To Interest			108		106		105		104		101
Bank A/c	Dr.	120		120		120		120		120	120
To Investment			120		120		120		120		

(xii) Accounting for Loans & receivables :

(a) On the acquisition date they are measured at Debtors invoice amount or at acquisition cost plus transaction cost.

(b) On the subsequent reporting dates they are measured at invoice amount/ amortized cost using effective interest rate.

(c) Impairment test is needed.

(xiii) Impairment of financial assets: -

At each balance sheet date the enterprise will access whether is any objective evidence that a financial assets is impaired, then the assets is tested for impairment and the impairment is accounted.

(xiv) Impairment of Assets carried at amortized cost:

(loans and receivables or held to maturity instruments)

(a) Find the present value of future cash inflows using original effective interest rate

(b) The difference between the carrying amount and this, PV is impairment loss which will be transferred to P/L by either crediting assets or provision for impairment.

(c) If there is objective evidence that reversal of impairment has taken place then accounting for reversal should be done. Subject to the same limitation as discussed in AS – 28.

(xv) Impairment of receivable carried at invoice amount:

(Provision for bad debt)

(a) Find the undiscounted future cash flow.

(b) Provide for the impairment loss either directly or through provision for bad debts by debiting P/L A/c.

(c) If there is objective evidence that impairment less is reverse then accounting for reversal shall be done.

(xvi) Impairment of available for sale financial assets:

(a) Find the present value of expected future cashing flows / Fair value on the date of such impairment consideration .

(b) The difference between carrying amount and this is the impairment loss but the existing balance of investment revaluation reserve should be removed & transferred to the P/L A/c. No reversal is allowed.

Example:

Original Cost = ₹10

Carrying amount on 31.03.2015 = ₹ 6

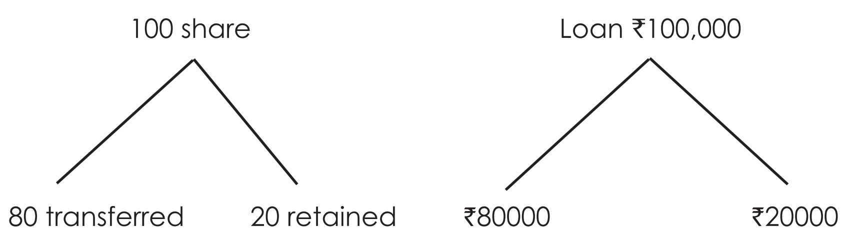
Investment Revaluation reserve = ₹ 4 (Dr. Bal)

Fair value on 31.03.2015 = ₹ 5.3

Solution:

Date	Particulars	Debit ₹	Credit ₹
	P/L A/c Dr. To, IRR A/c To, Investment A/c	4.7	 4.0 0.7

(xvii) Partial transfer:



In case of partial transfer the following steps are to be followed.

- Identify the two parts of the assets
  - (a) Part retained
  - (b) Part transferred
- Determine the value of these parts (either will be given in the question or will be determine using PV technique)
- Ex – carrying amount ₹ 400

Fair 360 Value (Transfer) — 90

Carrying amount 320 — 80 → Retained → B/S

Profit on transfer = 40

Divide the carrying amount of the assets in the ratio of the fair value of the two parts:

- Pass the accounting entry for the part that has been sold the remaining part will automatically be there in the books. The difference between the carrying amount of the part transferred and the proceeds received will be transferred to profit & loss A/c.
- The part retained will continued to be recognised as a financial asset.

Example: Carrying amount of an asset is ₹1,400 lakhs. The fair value of the part transferred is ₹1,280 and the total fair value of the assets is ₹1,600. The company received ₹1,280 lakhs on sale of the part transferred. Pass journal entries.

Solution:

	Fair value	Ratio	Carrying amount
Part transferred	1,280	8	1,120
Part retained	320	2	280
Total	1,600		1,400

Journal Entries

Particular		Debit ₹	Credit ₹
Bank A/c	Dr.	1,280	
To, Assets A/c			1,120
To, P/L A/c			160

But if the partial transfer given some continuous involvement in the assets by selling the assets at a higher values and taking the risk of loss of non receive of cash flows transferred then the extra amount received over fair value will be treated as a liability and not income.

(xviii) Buy – Back of Equity share:

(a) On buying the shares

Particular		Debit ₹	Credit ₹
Equity Share Capital A/c	Dr.	20	
Premium on buy back A/c	Dr.	80	
To, Bank A/c			100

(b) On adjusting the premium

Particular	Debit ₹	Credit ₹
Securities premium A/c Dr.	80	
To, Premium on buy back A/c		80

(c) On crediting CRR

Particular	Debit ₹	Credit ₹
Securities premium A/c Dr.	20	
To, CRR A/c		20

(xix) Accounting for Financial Liabilities: -

	Interest
Debenture issued = 800 Crore	80
Expenses on issue = 140 Crore	80
∴ Net cash inflow = 660 crore	80
	80
	80 + 800

(a) Financial liabilities at fair value through profit & loss (Held for Trading)

I. Initial recognition at fair value

II. Subsequent measurement at each reporting date at fair value the difference will be transferred to P/L.

III. On Settlement of liabilities the difference will be transferred to profit & Loss A/c.

Example: Took ₹4 lakhs from Ankit which was equal to the share of 800 TISCO. i.e. share price ₹500 share. Trade is on the date of redemptions amount received against loan is 800 share of TISCO. On B/S date price per share ₹700 share.

∴. ₹160,000 should be transfer to P/L A/c.

(b) Financial liabilities carried at amortized Cost (Long-term liabilities Loan liabilities)

I. Initial recognition: Fair value (-) acquisition cost.

II. There after use effective interest rate & carry the liabilities at amortized cost.

Example: Mr. A borrow ₹400 loss from B at 12% interest rate Mr. A wants to settle the loan of 80% amount after 1 year but Mr. B wants to settle on maturity date. For that, at that time 80% of the liability i.e. ₹320 lakhs is sold at ₹280 to Mr. C who is required that sum immediately, therefore the company can transfer the profit to P/L A/c.

III. On settlement the difference between carrying amount & payment will be transferred to P/L A/c.

Example: borrow ₹300 & given loans & advance – 200 (a part)

(c) Short term payments

I. Initial payment: At invoice amount.

II. Subsequent measurement: At invoice amount.

III. On settlement: difference is transferred to P/L.

(xx) " Derivatives"

A financial derivative is a financial investment with all the three charactiestics

(a) Its value changes in response to change in the underlying

(b) It requires no initial investment or very small initial investment

(c) It is settled on a future date,

Derivatives are used for following two purposes

(a) Speculative

(b) Hedging

(xxi) Derivatives for speculative purposes

If the derivatives are used for speculative purposes they are accounted for as held for trading instruments. So they are financial assets-liabilities at fair value through Profit & Loss A/c.

Example: RIL future : ₹2000

3rd day: ₹2040

Important note:

The guidance note on accounting for future options is withdrawn but the concept used in the guidance note and in the AS – 30 are same with following exceptions:

(i) The credit balance of MTMM at the end of the year will no longer be trance as a liabilities rather it will be transferred to Profit & Loss A/c.

(ii) Do not create provision for losses rather transfer the balance of MTMM to P/L whether debit or credit.

(xxii) Derivatives as hedging instruments (Headge Accounting)

Hedged Items

Hedging instrument

(i) Portfolio of equity hedged by shorting NIFTY.

(ii) Sugar stock

5.3 HEDGE ACCOUNTING

(a) Hedging: Its an action designated to reduce uncertainty of value of assets, value of liabilities, cash flows, firm commitments

Some of the example of most hedge items are portfolios of equity, foreign currency receivables, foreign currency payables, inventories etc. Instruments used for hedging are forward, future, option, swaps.

(b) Hedging relationship: - There are three hedging relationships

I. Fair value hedge

II. Cash flow hedge

III. Hedge of an net investment in non-integral foreign operation.

(c) Conditions for applying hedge accounting: - Inventory – further hedge – conditions not fulfilled – AS-2

Designation = the option which has chooses

All the following condition must be satisfied

I. At the inception of the hedge there is formal designation and documentation.

II. The effectives of the hedging should be continuously accessed through out the reporting period on an ongoing basis.

(xxiii) Accounting for fair value hedge

Example – Sugar – 500 crore

Future short – 600 crore

(a) The gains losses in re-measuring the hedging instrument at fair value will be transferred to P/L A/c

(b) The changes in the hedged item will be accounted for through profit & loss Account.

(c) The objective is to set off the profits against the losses.

Example: Say, an enterprise has 100 kgs of tea valued at ₹6,00,000. It entered into a sale- future contract of ₹6,00,000 of tea- future. The date was 01.03.2015 on 31.03.2015 the market price of tea & tea future is ₹6,30,000. Pass the journal entries.

Solution:

Date	Particular	Debit ₹	Credit ₹
01.0. 2015	No Entry		
31.03.2015	P & L A/c Dr. To, Liabilities (future)	30,000	 30,000

Re-measuring the inventory

Date	Particular	Debit ₹	Credit ₹
31.03.2015	Inventory A/c Dr. To, P/L A/c	30,000	 30,000

(xxiv) Accounting for cash flow hedge:-

The gains or losses on re-measurement of hedging instrument is dealt as follows

(a) Effective portion = Adjusted against equity Account

(b) In effective portion = Adjusted against P/L account.

Say for example, a foreign currency debtor is hedged through a sale-forward contract. Exchange rate falls down. The loss in foreign currency debtors is ₹1,00,000 where as the profit in forward contract is ₹120,000 so the ineffective portion is ₹20000. The accounting will be as follows:-

Date	Particular	Debit ₹	Credit ₹
31.03.2015	Forward assets A/c Dr. To, Hedging Reserve A/c To, P/L A/c	1,20,000	 1,00,000 20,000
	Hedging Reserve A/c Dr. To, Debtors A/c	1,00,000	 1,00,000

(xxv) Accounting for Net Investments in foreign operation same as above.

(xxvi) Embedded derivatives

(Compound financial instruments)

Important Definition

Convertible debenture → within 3 years → option to convert into equity.

An embedded derivative is a component of a hybrid instrument which also includes a non – derivative host contract.

The embedded derivative should be separated & accounted for as a derivatives if

(a) Economic characteristics of derivative & host are separate.

(b) The derivatives fulfills the conditions mentions in para no. 20.

Derivative – Embedded derivative

Sugar – Host

Saccharine – Embedded derivative

Example: 1000 tonnes coal as per the rate increase the rate of electricity to be settled on future dates.

Let us considered, the issuers point of view in the following example:

Life of Debenture = 5 years

Face Value = ₹ 100 lacs

Interest rate = 12%

Maturity value = ₹ 100 lacs.

Yield = 10%

Conversion option to holder at the end of 3 years. Consideration - ₹122 lacs

Solution : Fair value of debt = 12×3.791 6 + 100 × .621

= 45.49 + 62.10

= 107.59

Now the total consideration will be divided in two parts

Liability = 107.59 issuer prospective

Equity = 14.41

Date	Particular		Debit ₹	Credit ₹
31.03.2015	Bank A/c	Dr.	122	
	To, Liability			107.59
	To, Equity (security premium)			14.41
	In the Books of Investors			
	Investment in debt A/c	Dr.	107.59	
	Investment in Derivative A/c	Dr.	14.41	
	To Bank A/c			122

Important note:- But we are not required to separate the embedded derivatives if the entire instrument is recognised as fair value through P/L instrument.

Example

Future settlement of Sugar price is based on future price of saccharine.

24.03.2015 1 call bought @ ₹60; strike price = ₹500

26.03.2015 2 call bought @ ₹90; strike price = ₹500

28.03.2015 1 call sold @ ₹106

31.03.2015 Quoted premium @ ₹120

Option premium Account

Date	Particular	₹	Date	Particular	₹
24.03.2015	To Bank (1 × 60)	60	28.03.2015	By Bank	106
26.03.2015	To Bank (2 × 90)	180			
28.03.2015	To P/L A/c (106 – 80)	26	31.30.2015	By balance c/d (120 × 2)	240
31.03.2015	To P/L A/c (240 – 80 × 2)	80			
		346			346

Average price = [(1 x 60) + (2 x 90)]/3 = ₹80

5.4 EXTERNAL REPORTING UNDER CAPITAL MARKET REGULATIONS & DISCLOSURES

In India Capital Markets are regulated by the Securities Exchange Board of India (SEBI). In view of enhancing the Corporate Governance in Corporate in India the SEBI introduced the Clause 49 of the Listing Agreement, which deals with the Corporate Governance and its applicability in Listed companies.

CORPORATE GOVERNANCE OF LISTING AGREEMENT IN INDIA

Applicability of Clause 49

The Clause 49 of the Listing Agreement shall be applicable to all companies whose equity shares are listed on a recognized stock exchange. However, compliance with the provisions of Clause 49 shall not be mandatory, for the time being, in respect of the following class of companies:

(a) Companies having paid up equity share capital not exceeding ₹10 crore and Net Worth not exceeding ₹25 crore, as on the last day of the previous financial year;

Provided that where the provisions of Clause 49 becomes applicable to a company at a later date, such company shall comply with the requirements of Clause 49 within six months from the date on which the provisions became applicable to the company.

(b) Companies whose equity share capital is listed exclusively on the SME and SME-ITP Platforms.

The company agrees to comply with the provisions of Clause 49 which shall be implemented in a manner so as to achieve the objectives of the principles as mentioned below. In case of any ambiguity, the said provisions shall be interpreted and applied in alignment with the principles.

A. The Rights of Shareholders

The company should seek to protect and facilitate the exercise of shareholders' rights. The company should provide adequate and timely information to shareholders. The company should ensure equitable treatment of all shareholders, including minority and foreign shareholders.

B. Role of stakeholders in Corporate Governance

The company should recognise the rights of stakeholders and encourage cooperation between company and the stakeholders.

C. Disclosure and transparency

The company should ensure timely and accurate disclosure on all material matters including the financial situation, performance, ownership, and governance of the company.

D. Responsibilities of the Board

Members of the Board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the company.

The Board and top management should conduct themselves so as to meet the expectations of operational transparency to stakeholders while at the same time maintaining confidentiality of information in order to foster a culture for good decision-making.

E. Composition of Board

The Board of Directors of the company shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty percent of the Board of Directors comprising non-executive directors.

Where the Chairman of the Board is a non-executive director, at least one-third of the Board should comprise independent directors and in case the company does not have a regular non-executive Chairman, at least half of the Board should comprise independent directors.

Provided that where the regular non-executive Chairman is a promoter of the company or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the company shall consist of independent directors.

F. Independent Directors

For the purpose of the clause A, the expression 'independent director' shall mean a non-executive director, other than a nominee director of the company:

(a) who, in the opinion of the Board, is a person of integrity and possesses relevant expertise and experience;

(b) (i) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(ii) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

(c) apart from receiving director's remuneration, has or had no material pecuniary relationship with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives has or had pecuniary relationship or transaction with the company, its holding, subsidiary or associate company, or their promoters, or directors, amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

G. Limit on number of directorships

A person shall not serve as an independent director in more than seven listed companies. Further, any person who is serving as a whole time director in any listed company shall serve as an independent director in not more than three listed companies.

H. Maximum tenure of Independent Directors

The maximum tenure of Independent Directors shall be in accordance with the Companies Act, 2013 and clarifications/circulars issued by the Ministry of Corporate Affairs, in this regard, from time to time.

I. Non-executive Directors' compensation and disclosures

All fees / compensation, if any paid to non-executive directors, including independent directors, shall be fixed by the Board of Directors and shall require previous approval of shareholders in general meeting. The shareholders' resolution shall specify the limits for the maximum number of stock options that can be granted to non-executive directors, in any financial year and in aggregate.

Provided that the requirement of obtaining prior approval of shareholders in general meeting shall not apply to payment of sitting fees to non-executive directors, if made within the limits prescribed under the Companies Act, 2013 for payment of sitting fees without approval of the Central Government.

Provided further that independent directors shall not be entitled to any stock option.

J. Audit Committee

(i) Qualified and Independent Audit Committee

A qualified and independent audit committee shall be set up, giving the terms of reference subject to the following:

1. The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors.
2. All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise.
3. The Chairman of the Audit Committee shall be an independent director;
4. The Chairman of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;
5. The Audit Committee may invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor may be present as invitees for the meetings of the audit committee;
6. The Company Secretary shall act as the secretary to the committee.

(ii) Meeting of Audit Committee

The Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent members present.

(iii) Powers of Audit Committee

The Audit Committee shall have powers, which should include the following:

1. To investigate any activity within its terms of reference.
2. To seek information from any employee.
3. To obtain outside legal or other professional advice.
4. To secure attendance of outsiders with relevant expertise, if it considers necessary.

(iv) Role of Audit Committee

The role of the Audit Committee shall include the following:

1. Oversight of the company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
2. Recommendation for appointment, remuneration and terms of appointment of auditors of the company;
3. Approval of payment to statutory auditors for any other services rendered by the statutory auditors;
4. Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the board for approval, with particular reference to:
   (a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (c) of sub-section 3 of section 134 of the Companies Act, 2013
   (b) Changes, if any, in accounting policies and practices and reasons for the same
   (c) Major accounting entries involving estimates based on the exercise of judgment by management
   (d) Significant adjustments made in the financial statements arising out of audit findings
   (e) Compliance with listing and other legal requirements relating to financial statements
   (f) Disclosure of any related party transactions
   (g) Qualifications in the draft audit report
5. Reviewing, with the management, the quarterly financial statements before submission to the board for approval;
6. Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilisation of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter;

K. Nomination and Remuneration Committee

The company through its Board of Directors shall constitute the nomination and remuneration committee which shall comprise at least three directors, all of whom shall be non-executive directors and at least half shall be independent. Chairman of the committee shall be an independent director.

Provided that the chairperson of the company (whether executive or nonexecutive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.

L. Subsidiary Companies

At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non-listed Indian subsidiary company.

The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

M. Related Party Transactions

A related party transaction is a transfer of resources, services or obligations between a company and a related party, regardless of whether a price is charged.

For the purpose of Clause 49 (VII), an entity shall be considered as related to the company if:

(i) such entity is a related party under Section 2(76) of the Companies Act, 2013; or

(ii) such entity is a related party under the applicable accounting standards.

N. Disclosures

Disclosure relating to –

A. Related Party Transactions

B. Disclosure of Accounting Treatment

C. Remuneration of Directors

D. Management

E. Shareholders

F. Proceeds from public issues, rights issue, preferential issues, etc.

O. CEO/CFO certification

The CEO or the Managing Director or manager or in their absence, a Whole Time Director appointed in terms of Companies Act, 2013 and the CFO shall certify to the Board that:

(i) They have reviewed financial statements and the cash flow statement for the year and that to the best of their knowledge and belief :

   1. these statements do not contain any materially untrue statement or omit any material fact or contain statements that might be misleading;

   2. these statements together present a true and fair view of the company's affairs and are in compliance with existing accounting standards, applicable laws and regulations.

(ii) There are, to the best of their knowledge and belief, no transactions entered into by the company during the year which are fraudulent, illegal or violative of the company's code of conduct.

(iii) They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the company pertaining to financial reporting and they have disclosed to the auditors and the Audit Committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies.

(iv) They have indicated to the auditors and the Audit committee:

   1. significant changes in internal control over financial reporting during the year;

   2. significant changes in accounting policies during the year and that the same have been disclosed in the notes to the financial statements; and

   3. instances of significant fraud of which they have become aware and the involvement therein, if any, of the management or an employee having a significant role in the company's internal control system over financial reporting.

P. Report on Corporate Governance

There shall be a separate section on Corporate Governance in the Annual Reports of company, with a detailed compliance report on Corporate Governance. Non- compliance of any mandatory requirement of this clause with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted. The suggested list of items to be included in this report is given in **Annexure - XII to the Listing Agreement** and list of non-mandatory requirements is given in **Annexure - XIII to the Listing Agreement.**

The companies shall submit a quarterly compliance report to the stock exchanges within 15 days from the close of quarter as per the format given in **Annexure – XI to the Listing Agreement**. The report shall be signed either by the Compliance Officer or the Chief Executive Officer of the company.

Q. Compliance

The company shall obtain a certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance as stipulated in this clause and annex the certificate with the directors' report, which is sent annually to all the shareholders of the company. The same certificate shall also be sent to the Stock Exchanges along with the annual report filed by the company.

The non-mandatory requirements given in **Annexure - XIII to the Listing Agreement** may be implemented as per the discretion of the company. However, the disclosures of the compliance with mandatory requirements and adoption (and compliance) / non-adoption of the non-mandatory requirements shall be made in the section on corporate governance of the Annual Report.

5.5 ANNUAL REPORTS-STATUTORY REQUIREMENT AND EXTERNAL REPORT, PREPARATION OF FINANCIAL INFORMATION, DISCLOSURE OF POST BALANCE SHEET EVENTS

The periodic financial statements are prepared on the basis of transactions and events that have occurred during the year. However, in order that the information is complete, information regarding any significant events or material transactions beyond the traditional accounts is essential. Accounting and reporting standards ensure that the information provided in the financial statements is as complete as possible. In this section a brief introduction of the Accounting Standard 4 Contingencies and Events occurring after the Balance Sheet Date, which ensures adequate disclosure of additional evidence of conditions existing at the balance sheet date acquired up to the date of publication of the financial statements.

The preparation of the annual financial statements can be a timely process in practice and usually takes around three or four months. Company law places a maximum time limit for publication of the financial statements Six months after the year end for companies.

During the period after the balance sheet date assets such as stock will be realised into debtors or cash or, alternatively, events may occur that significantiy affect the position of the company and it is only fair to inform external users of the financial statements of any further information relevant to them regarding the items in the balance sheet at the year end. The additional information may relate to actual amounts in the balance sheet or to events that have taken place since the year end. To ensure this information is disclosed, preparers of financial statements must follow the requirements of Accounting Standard 4.

What are Post-Balance Sheet Events

Post-balance sheet events are those events, both favourable and unfavourable, which occur between the balance sheet date and the date on which the financial statements are approved by the board of directors.

Adjusting events are post-balance sheet events which provide additional evidence of conditions existing at the balance sheet date. They include events which because of statutory or conventional requirements are reflected in financial statements.

Non-adjusting events are post-balance sheet events which concern conditions which did not exist at the balance sheet date.

The date on which the financial statements are approved by the board of directors is the date the board of directors formally approves a set of documents as the financial statements.

Accounting treatment

Accounting Standard 4 gives the following accounting treatment in each case.

Adjust the financial statements if events after the balance sheet dale provide material evidence of conditions that existed at the balance sheet dale, adjusting events.

A material post-balance sheet event should be disclosed (by note) where it is a non-adjusting event of such materiality that its non-disclosure would affect the ability of users of financial statements to reach a proper understanding of the financial position.

Disclosure is also required for the reversal or maturity after the year end of a transaction entered into before the year end, the substance of which was primarily to alter the appearance of the company's balance sheet. (If such a transaction has an income effect, adjustment would be required, for example sales returns.)

Certain post-balance sheet events are adjusted for because of statutory requirements to include them in the accounts; for example, proposed dividends, amounts appropriated to reserve, effects of changes in tax and dividends receivable from subsidiary and associated companies.

Examples of adjusting and non-adjusting events

Adjusting	Non-adjusting
Subsequent determination of proceeds of sale of fixed assets purchased or sold before the year end.	Mergers/acquisitions after the year end.
Property valuation that provides evidence of a permanent diminution in value.	Reconstructions after the year end.
Evidence re NRV < cost of stocks.	Issue of shares/debentures after the year end.
Evidence re inaccuracy of attributable profit calculations.	Purchase/sale of fixed assets after the year end.
Insolvency of a debtor	Losses re fire/flood after the year end
Dividends receivable	Extension of activities after the year end
Receipt of information re rates of tax	Significant closure if this was not anticipated at the year end
Amounts received/receivable -re insurance claims that were in the course of negotiation.	Decline in asset values if demonstrated to be after the year end.
Discovery of error or fraud.	Changes in exchange rates after the year end.
	Effect of nationalisation or strikes after the year end.
	Augmentation of pension benefits after the year end.

For a detailed discussion on the Accounting Standard 4, please refer to the earlier section in this chapter.

5.6 FINANCIAL REPORTING ACROSS THE WORLD WITH REFERENCE TO REPORTING UNDER US AND UK LAWS

There are major international differences in accounting practices in reporting across the world. By the term " Accounting system", we mean the set of financial reporting practices used by a particular company for an annual report.

The factor that impact accounting development at the national level also contribute to accounting diversity at the international level.

Environmental factors may be broadly classified as:

1) The type of capital market
2) Diversify taxation and financial reporting

   If the legal framework allows two sets of reporting, one for taxation where profits are understated to minimize taxation, and external reporting is legally allowed to be presented on glossier terms to attract investment.

3) Size of business houses

Larger business houses, consisting of large variety of products, employing thousands of people and operating in many countries, characterize developed countries. Financial reporting in these countries will be detailed and complete since it is needed to capture the economic substance of the entities of these economies. They are therefore very different from financial reporting rules sufficient for smaller and less complex entities.

4) Legal system

The legal system in countries like Rome, Germany, France etc. may be called the code – law type where accounting is regulated mainly through an account code, which tends to be highly detailed, prescriptive, procedural and is generally set by the legislature. The emphasis is on protection of creditors of the company. This is in contrast to the common law countries like United Kingdom, U.S.A. and Australia accounting regulations are set on a procedural basis, typically by a private sector standard setting body, with emphasis on presenting a true and fair picture to shareholders. This type of reporting is more timely and transparent, and regarded as being more adaptive and innovative.

Level of enforcement: Where stringent enforcement prevails, accounting and reporting practices are largely in compliance with regulatory requirements. In some countries, political patronage and proximity to the ruling group enables business entities to circumvent existing financial reporting requirements. Investors who assumed there was compliance when there was actually not, suffered sufficient losses when the true financial position of such flouting companies was disclosed.

Sometimes, countries that adopted accounting standards of other countries do not have the resources to implement and enforce the standards. Business entities need trained personnel to apply these standards, while regulatory agencies need adequate budgets to monitor compliance. When countries lack these resources, there is a gap between the requirements and actual practice.

Inflation Levels:

Countries such as U.K. and U.S. who usually keep inflation under check, tend to use the historic cost model, where as countries like Bolivia and Mexico, have to use inflation – adjusted models of Financial reporting to provide more decision – relevant information.

Political and economic ties:

Where a country was colonized for an extended period of time, it typically adopted the accounting system of the colonial power. Singapore and Malaysia continued with the British system and Philippines, with the U.S system, even after gaining independence, where as Indonesia discarded its pre–independence Dutch system in favour of the U.S. model after independence.

Status of the accounting profession:

In common law countries like the U.S., Canada and U.K, accounting is held in high esteem as a profession. In such countries the accounting profession is largely self regulating and plays a major role in setting accounting and auditing standards, as well as establishing educational and licensing requirements for entering and staying in the profession. In code law countries like France and Germany, the accounting profession has considerably less statute and power, and the Government takes the lead role in regulating the profession. In yet other countries like Russia, accounting has historically been equated with book – keeping a clerical task.

Quality of Accounting Education:

In some countries, there is a long history of including accounting as a very important course, attracting some of the country's best talent. This in turn, produces quality in the accounting practices. Other countries which treat accounting as a clerical vocation get into a vision cycle of non-improvement in the country's accounting/regulatory bodies.

Classification of Financial Accounting and Reporting system:

Classifications should reveal fundamental structures that countries belonging to a group have in common and that distinguish them from countries in other groups. Many groups of researchers have made attempts for a meaningful classification. The best among them in Nobes' Classification of accounting system which is presented below.

Multinational companies are likely to use transnational accounting practices.

Global harmonization:

Having understood the causes for differences and suitably classifying the accounting system across the world, it is necessary to achieve harmony or uniformity in the accounting system. This is the need of the hour, considering the levels of multi-nationalisation and tele-communication, which are really shrinking the world.

Harmony will ensure easy comparability, which is essential in the context of global funding and multi-national companies regulators who monitor capital markets, and the securities industries (including stock exchanges).

Definition:

Harmonisation may be defined as the process aimed at enhancing the comparability of financial statements produced in different countries' accounting regulations.

The following are the main organizations that are involved in global accounting harmonization

i) IASC: The International Accounting Standards Committee is an independent private sector organization that was established in 1973 by professional accounting organizations from 10 countries – Australia, Canada, France, Germany, Ireland, Japan, Mexico, The Netherlands, The U.K and the U.S. Now, more than 140 countries are members of the IASC. The objectives of the IASC are:

   - To formulate and publish in the public interest accounting standards to the observed in the presentation of financial statements and to promote their world wide acceptance and observance.
   - To work generally for the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements.

IAS 1 to 39 for the various accounting standards issued by the IASC.

IASC is supported by international organization of securities commission (IOSCO), which consists of representatives of the securities regulatory organizations in over 60 countries. Where IASC lacks the authority to enforce its standards globally, IOSCO helps by enforcing these standards in its member countries.

The International Federation of Accountants (IFAC):

This is a body of national professional accounting organization that represents accountants employed in public practice, business and industry , the public sector and education as well as some specialized groups that interface frequently with the profession. It was formed in 1997 to develop the profession and harmonise its standards world wide to enable public accountant to provide good services in the public interest. Currently, IFAC has about 150 member organizations in 103 countries, representing 2 million accountants.

IFAC issues International Standards on Auditing (ISA) that are aimed at harmonizing auditing practices globally.

Another initiative of the IFAC is the establishment of international public sector standards applicable to all levels of government. IFAC has also spearheaded the organization of a forum on the development of the accounting profession, bringing together, various development banks and agencies, to determine how best to marshal the combined resources of the accounting profession, local and national governments and development agencies to meet the basic needs for an accounting framework in developing countries.

The IFAC may also be credited with reports to maintain auditor's independence in today's complex and competitive business environment.

International Organisation of Securities Commission (IOSCO)

It was formed in 1983 and is comprised of securities regulators from more than 115 securities regulatory agencies from around the world and about 85% of world's capital markets. Its general secretariat is based in Montreal. IOSCO strives to promote high standards of regulations to maintain just efficient sound markets with integrity by establishing standards and surveillance of international securities transactions and ensuring enforcement of the standards.

IOSCO has already endorsed half the IASC standards, and is in the process of endorsing the remaining, subject to its satisfying itself with a comprehensive core set of high quality accounting standards.

United Nations:

Initially in the 1970's, the UN has its group of experts on ISA and .... produce a list of financial and non-financial disclosures to be provided by multi- national companies. The list was detailed and included requirements for disclosure of transfer pricing policies, segment information, R&D expenditure and employee information. Those being proprietary in nature, the recommendations were rejected by most industrialized countries. More recently, the UN has worked to harmonise the accounting standards by discussing and supporting best practices, including those stipulated by the IASC. It has focused on issues such as environmental disclosures. The UN has provided funding a technical assistance towards a sound financial reporting regime in accordance with international standards, in a number of Communist bloc countries which lacked such initiative.

Organisation For Economic Corpotation And Development (OECD):

The OECD comprises 29 member countries producing two-thirds of the world's goods and services. It has an adhoc working group on accounting standards which supports current efforts on accounting harmonization by international, regional and national bodies and the UN.

Harmonisation scenarios:

Bilateral	MDS (Multi-Jurisdictional disclosure system)
	SEC & Canadian regulatory authorities.

World class issuer:

NYSC promotes criteria eg. Revenue/market capitalisation/Weekly trading volume so that such .... (Global Blue chip companies) enter U.S. market with less risk to U.S. investors. This is not a welcome step.

The G4+1 initiave:

This is one of the several groupings of national standard setting bodies; originally consisted of standard setters in Australia, Canada, UK, US and started as a forum to exchange ideas, information and experiences. IASC joined this and hence the name +1. New Zealand lake joined this group. The G4+1 has supported the IASC, which in turn co-operates with the G4+1.

Major achievements in harmonistaion:

IASC has proved its acceptability with statistically increasing number of standards and countries following them. They remain to be vetted and endorsed by the IOSCO and SFC.

The EU is mainly backed by the EEC (Treaty of Rome, 1957), which was signed by 6 countries – Belgium, France, Germany, Italy, Luxemburg and The Netherlands; and by later admission, Denmark, Republic of Ireland, The UK, Greece, Spain, Portugal, Sweden, Finland and Austria. The objective of the EU is to bring about a common market which allows for free mobility of capital goods, and people between member countries.

The EU company law and directives ensure uniformity in law in the member countries. The fourth directives addresses all aspects of financial statements of individual companies. The seventh directive addresses the issue of consolidated financial statements and generally followed the British American emphasis on legal control, but has not led to a significant level of harmony in consolidated financial reporting due to accounting diversity, capital market structures, code law US. Common law legal systems and macro Vs micro user roles of accounting.

The EU has indicated its support for the IASC and IOSCO initiatives and is aiming at conformity with the IASs. A number of EU member countries including France and Germany have started taking steps to require IASs domestically.

ASEAN – The Association of South-East Asian Nations adopted the global paradigm. ASEAN's principal objective was to create a robust economic alliance among members viz., Indonesia, Malaysia, Philippines, Singapore, Thailand, Brunei, Vietnam, ……… & Myanmar. ASEAN adopts unilaterally the standards issued by IASC. Member countries vary widely due to each one's colonial history and regulatory preferences.

While 60% of world wide experts for members of the EU are within the EU, while this is just 20% for ASEAN. Hence, ASEAN requires a more global approach.

In the emerging situation, a global approach would be more relevant and sustainable. The only hard work is to make it happen in practice with all the diversities overcome, and translate into uniformity.

5.7 AS 30, 31, 32

AS 30 ALREADY DISCUSSED IN DETAILS AT THE BEGINING OF THIS CHAPTER

AS - 31

Financial Instrument: Presentation

1. Applicability: This statements is applicable to non – SMES.
2. Debt – equity classification:-

   An enterprise is required to distinguish a financial liability and an equity. The equity will be presented separately under capital and reserves & surplus. Whereas financial liability will be presented as a liability.

   Any instrument where the issuer is obliged to settle in cash or by issuing another financial instrument is a liability and where no such contractual obligation exists it is an equity.
3. Preference shares:

   Redeemable preference share : Liability

   Irredeemable preference share : Equity
4. Share warrants/ option

   Where no cash obligation exists is an equity. But where such a liability exists is a liability.
5. Compound financial instruments containing both liability and equity:

   To be separated on the basis already explained in AS – 30.
6. Treasury share (Buy back shares):

   (i) Buy bank premium should be adjusted against security premium A/c / other reserves.

   (ii) Capital redemption reserve should be created to the extent of face value of capital bought back from security premium / other free reserves.

   (iii) An enterprise cannot hold its own equity share as a financial assets because they are required to be cancelled.

   (iv) No gain / loss arising in buy – back of equity is taken to the P/L A/c.

   (v) Interest & dividend relating to liabilities: Expenses. And those related to equity: - is an appropriation.

   (vi) Offsetting a financial asset against a financial liability-

   It can only be done

   (a) If there is legally enforceable right and

   (b) The enterprise intends to settle it on a net basis.

AS - 32

Financial Instruments Disclosure

Credit risk

The risk that one party to a financial instrument will cause a financial loss for another party by failing to discharge an obligation.

Currency risk

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Interest rate risk

The risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk

The risk that an entity will encounter difficulty in meeting obligation associated with the financial liabilities.

Market risk

The risk that fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risks: currency risk, interest rate risk and other price risk.

Other price risk

The risk that fair value or future cash flows of a financial instrument will fluctuate because of change in market prices (other than those arising from interest rate or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments trade in the market.

Past due

A financial asset past due when a counterparty has failed to make a payment when contractually due.

Sensitivity analysis

An analysis showing how profit or loss and equity would have been affected by changes in relevant risk variable (interest rate, foreign currency exchange rates and other prices) that were reasonably possible at reporting date.

Financial instruments should be grouped according to its class, for which an entity should consider at a minimum, whether instruments are measured at amortised cost or fair value and whether these are within or outside the scope of this standard. Such classification should render better understanding of the significance, impact, nature and extent of risks associated with the financial instruments to the users of financial statements easier.

Information that enables users of financial statements to understand the significance of financial instruments and its impact on the financial performance of the entity at the reporting date are as follows:

Balance Sheet related

The categories of financial assets classified into (a) financial assets at fair value through P&L ,(b) Held to maturity investments (c) Loans and receivables, (d) Available for Sale, and financial liabilities falling in the categories of (e) at fair value profit or loss, and (f) those liabilities measured at amortised cost.

Where entity has designated a loan or receivable as at fair value through Profit or Loss, maximum exposure to credit risk, and the amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.

Where an entity has designated a financial liability as at fair value through Profit or Loss, the amount of change during the period and cumulatively, in the fair value of such liability that is attributable to changes in the credit risk of that liability.

Where a financial asset has been reclassified, the amount reclassified into and out of each category and the reason for reclassification.

Details of financial assets involving transfer where transfers of part of whole of the assets do not qualify for de-recognition.

Carrying amount of financial assets in respect of which lien or other encumbrances have been created, and the terms and conditions of such a pledge or lien.

A reconciliation of the allowance account for credit losses (where impairment loss is accounted for separately rather than adjusting the carrying amount directly)

Existence of special features in a financial liability, such as multiple embedded derivatives whose values are interdependent.

Default and breaches in loans and receivables are also disclosed.

Profit or loss and equity related

Net Gains or Net Losses on financial assets or financial liabilities at fair value through profit or loss, and in respect of other categories of assets.

Total interest income and expense relating to financial instruments that are not at fair value through profit or loss.

Fee income on financial assets, interest income on impaired financial assets, and impairment loss on each class of financial assets.

Other Disclosures

Accounting Policies relating to Financial Instruments

In the area of hedge accounting, description of each type of hedge, items designated as hedging instruments, nature of risks being hedged, timing of expected cash flows under cash-flow hedges and timing when these are likely to affect profit or loss, gains or losses in respect of hedging instruments and in hedged items for fair value hedges.

Fair value of each class of financial assets and liabilities in a manner that it permits a comparison with carrying amounts; methods and valuation techniques adopted in estimating fair values.

Information that enables users of financial statements to evaluate nature and extent of risks arising from financial instruments to which the entity is exposed at the reporting date fall broadly under two groups, namely qualitative disclosures and quantitative disclosures.

Qualitative Disclosures

Qualitative disclosure helps user understand the entity’s exposure to risk, concentration of risk and risk management and mitigation activities. Such disclosures are presented in the form of a narrative description of entity’s exposure to risks describing both gross and net of any risk transfer and other risk mitigating activities and how they arose. The description shall also include the entity’s policies and processes for accepting, measuring, monitoring and controlling risks.

These disclosures can be presented as part of financial statements of cross referenced to any statement that is presented on the same terms and same time as that of financial statements (Director’s Report, corporate Governance report, etc).

Quantitative Disclosures

Quantitative disclosures help user understand the impact of narrative description, with the numerical explanations. The various methods used for managing risk should be disclosed as part of the accounting policy. The quantitative information disclosed should be based on the information provided internally to key management personnel.

An entity should disclose its concentrations of risk associated with financial instruments. Concentrations of risk arise from financial instruments having similar characteristics and are affected similarly by changes in economic and other conditions. Disclosure should include how concentration is determined, shared characteristics and the amount of exposure associated to shared characteristics. Examples of shared/ similar characteristics are counter parties, geographical area, and currency market.

When the information presented as at the reporting date is not representative of the entity's exposure, an entity should further provide additional information that is representative. For this purpose, the highest, lowest, and average amount of exposure during the period shall be representative.

Credit Risk

Disclosure relating to credit risk is the exposure analysis of financial assets of an entity. Such exposure analysis requires disclosure of maximum exposure to credit risk at the reporting date without taking accounting of any collateral held or other credit enhancements, description of collateral held of other credit enhancements, credit quality of financial assets that are nor impaired and not past due, carrying amount of financial assets whose terms have been renegotiated which otherwise have been impaired or past due.

For financial assets that are past due or impaired , an analysis of age of financial assets that are past due and not impaired on reporting date, an analysis of financial assets that are individually determined to be impaired and the factors that led to such conclusions and details of any collateral held or other credit enhancements at fair values.

During the period if any collateral or other credit enhancements are obtained, nature and carrying amount of such financial or non-financial assets and whether they are readily convertible to cash, as also the policy for disposing it should be disclosed.

Activities that give rise to credit risk and maximum credit exposure may result in cases where the maximum exposure is the carrying amount of the instrument itself or may be higher or lower than the carrying amount of the instrument.

Maximum exposure is restricted to carrying amount in cases of loans and receivables, placing deposits, entering into derivatives contracts when reported at fair values. Maximum exposure may be higher or lower than the carrying amount in cases of financial guarantees.

Liquidity Risk

Disclosure relating to liquidity risk is contractual maturity analysis of financial liabilities of an entity. A contractual maturity analysis showing remaining contractual maturities and description on management of liquidity risk should be disclosed. The time bands for preparing contractual maturity analysis shall be at the discretion of the entity.

If a choice exists on the time of settlement of liability, then the earliest date on which the entity can be required to pay. In instalments payment, each instalment is allocated to the earliest period in which the entity is required to pay.

The amount disclosed in contractual maturity analysis should be undiscounted , though the relevant liabilities may be presented on a discounted basis in the financial statements (exception being the requirement under the Standard on Leases, namely, reconciliation between Gross MLP and PV of MLP)

Market Risk

Disclosure relating to market includes sensitivity analysis of financial instruments for various types of market risk to which the entity is exposed. Impact on the profit or loss and equity if there is a change in the relevant risk variable is interest rates, foreign exchange rate risks and other price risks. The method and assumptions that were used in preparation of sensitivity analysis, changes from previous period and the reasons for such changes should also be disclosed.

If an entity prepares any alternative sensitivity analysis that reflects the interdependencies between risk variables such as value-at-risk and uses it to manage financial risks, such analysis can be used in place of the sensitivity analysis mentioned above . However, explanation of method used as main parameters and assumptions underlying the data, explanation of objective of method used and limitation for not disclosing the fair value of assets and liabilities.

Study Note - 6

SHARE BASED PAYMENTS IN IND AS

This Study Note includes

6.1 Meaning, Equity settled transactions, Transaction with employees and non-employees

6.2 Determination of fair value of Equity Instruments

6.3 Vesting conditions, Modification, Cancellation and Settlement & Disclosures

6.1 MEANING, EQUITY SETTLED TRANSACTIONS, TRANSACTION WITH EMPLOYEES AND NON-EMPLOYEES

Introduction

Share plans and share option plans have become a common feature of remuneration packages for directors, senior executives and other employees in many countries. Shares and share options may also be used to pay suppliers (e.g. for professional services). IFRS 2 "Share-based Payments" fills a gap in accounting for the recognition and measurement of such transactions under IFRS.

Definitions

Share-based payment arrangement

An agreement between an entity (or another group entity or a shareholder of a group entity) and another party (including an employee) which entitles the other party to receive:

- Equity instruments (including shares or share options) of the entity (or another group entity); or
- Cash (or other assets) for amounts based on the price (or value) of equity instruments of the entity (or another group entity),

Provided specified vesting conditions (if any) are met.

"Vest" means to become an entitlement. A party's right to shares of an entity may be free or at a pre-arranged exercise price.

Share-based payment transaction

A transaction in a share based payment arrangement in which the entity:

- Receives goods or services from a supplier (including an employee); or
- incurs an obligation (to the supplier) when another group entity receives those goods or services.

Equity instrument: A contract that gives a residual interest in the assets of an entity after deducting all its liabilities.

Share option: A contract that gives the holder the right, but not the obligation, to subscribe to the entity's shares at a fixed (or determinable) price for a specified period of time.

Vesting conditions: The conditions that must be satisfied for a person to become entitled to receive cash, other assets or equity instruments under a share-based payment arrangement.

Examples of vesting conditions include completion of a specified service period and meeting performance targets (e.g. a specified increase in revenue over a specified period of time).

Types of Transactions

The Standard identifies three types of share-based payment transactions:

- Equity-settled share-based payment transactions;
- Cash-settled share-based payment transactions; and
- Share-based payment transactions with cash alternatives

Equity-settled

The entity receives services:

- As consideration for its own equity instruments; or
- Has **no obligation** to settle the transaction with the supplier.

Cash settled

The entity acquires services by incurring liabilities for amounts that are based on the price (or value) of equity instruments of the entity or another group entity.

Share-based payment transactions with cash alternatives

Where an entity has a choice of issuing shares or paying cash then the entity shall recognize a liability if it determines that it has an obligation to settle the liability in cash. If on settlement the entity issues shares rather than paying cash then the value of the liability should be transferred to equity.

6.2 DETERMINATION OF FAIR VALUE OF EQUITY INSTRUMENTS

Employee share-based payments

Employee share-based payments are incentive payments to employees in form of shares. The expression employee share-based payments also include cash incentives to employees, the size of which is linked with value of shares. The payment in form of shares generally involve grant of options to employees to subscribe shares of employer's enterprise at a concessional price, called the exercise price.

The employees gain the excess of market price of share at the time of exercise over the specified exercise price. In case of employee share-based payments in form of cash incentive, the excess of market price on specified future date and a stated price is paid in cash. In either case, the value of incentive depends on increase in share value, which is the generally accepted indicator financial success of a business. By linking incentives with value of shares, the employee share-based payment plans effectively integrate personal goals of employees with that of the enterprise.

The day a share-based payment plan is announced and accepted by employees is called the grant date and the day, when the employees become entitled to such payments, is called the vesting date. The period between these two dates is called the vesting period. To qualify for the incentives, the employees put in their efforts during the vesting period to fulfill specified vesting conditions, e.g. reaching a specified sales/profit target. Exercise date is the date when an option is exercised by paying the exercise price.

The value of share-based payment depends on the market value of shares on vesting date/exercise date and hence cannot be known with certainty before these dates. Nevertheless, since the share-based payments are payments for services rendered by employees during the vesting period, the value of share-based payments should be recognized 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.

The International Accounting Standards Board (IASB) has issued the International Financial Reporting Standard (IFRS) 2, on share-based payments. This chapter is however based on the Guidance Note on Accounting for Employee Share-based Payments, issued by the Institute of Chartered Accountants of India.

Employee share based payment plans

Employee share-based payment plans generally take the form of Employee Stock Option Plans (ESOP), Employee Stock Purchase Plans (ESPP) and Stock Appreciation Rights (SAR).

The Employee Stock Option Plan (ESOP) 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.

The Employee Stock Purchase Plan (ESPP), is a plan under which the enterprise offers shares to its employees at a discounted price as part of public issue or otherwise.

The Stock Appreciation Rights (SAR) are 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.

The date when a share-based payment plan is announced and agreed, is called the grant date.

For accounting purposes, employee share-based payment plans are classified into the following categories:

(a) Equity- settled: Under these plans, the employees receive shares, e.g. ESOP

(b) Cash-settled: Under these plans, the employees receive cash based on the price (or value) of the enterprise's shares, e.g. Stock Appreciation Rights (SAR)

(c) Employee share- based payment plans with cash alternatives: Under these plans, either the enterprise or the employee has a choice of whether the enterprise settles the payment in cash or by issue of shares.

The entitlements to share-based payments are based on satisfaction of specified conditions. The specified conditions are vesting conditions and the period taken to satisfy the vesting conditions is the vesting period. The share-based payments are incentives for services rendered by employees over the vesting period and hence are recognized as Employees' Compensation Expense over the vesting period.

The examples of vesting condition include, a sales target, a profit target, a target market price of shares or service conditions such as continuous employment during the vesting period. Market condition is a vesting condition related to market price of shares of the enterprise, e.g. a condition that the payments will be made provided the market price of shares increases by at least 40% over that on grant date, within a period of three years.

Equity settled employee share-based payment plans

Payments under these plans are made in form of shares. Under these plans, the enterprise offers new shares issued by it to its employees. The issue price for the shares issued under these plans is the exercise price. At their option, the employees may pay the exercise price and become shareholders of the enterprise. The options are granted subject to fulfillment of specified vesting conditions. This form of plan is commonly called Employees Stock Option Plans (ESOP).

Under an ESOP, the employees gain the excess of market price of underlying share on exercise date over the exercise price. The option is not exercised if market price of underlying share on exercise date falls below the exercise price. For example, consider an option at exercise ₹60. If market price per share on exercise date is ₹60, an employee gains ₹5, by purchasing the share at exercise price is ₹60. The option is not exercised if market price falls below ₹60. Clearly, the ESOP is a call option held by the employees, which is settled by actual delivery of underlying shares. The employer is the writer of the option, but does not charge any option premium. The employer recognizes the premium sacrificed, i.e. the value of call, as expense over the vesting period. The value of call for the purpose of accounting for share-based payments can be either the intrinsic value or fair value.

The fair value of an option is defined as the amount for which stock option granted can be exchanged between knowledgeable, willing parties in an arm's length transaction. This should be present value of expected gain of employees on exercise of the option. The expected gain is excess of expected market price at the time of exercise of option over the exercise price. The fair values of options depend on factors like, exercise price, current market price of underlying shares, expected volatility of return from the shares, risk-free rate of return, expected dividends, time allowed to exercise the option after vesting (i.e. life of option) and so on. Standard option pricing models, like Back-Scholes-Merton formula are modified suitably to ascertain fair value the options granted to employees.

Intrinsic value of an option is the excess of market price of the underlying share on the grant date over the exercise price. For example, if market price per share on grant date is ₹60 and the exercise of the option is 56, the intrinsic value of option on grant date is ₹4.

The value of an Employees Stock Option plan is initially based on fair value/intrinsic value per share on grant date. This is the minimum value of ESOP an enterprise must recognize as expense over vesting period. Where, after the grant date, the terms of an option are modified in a manner to increase its value, e.g. reduction of exercise price, the enterprise must also recognize the increased value of option as expense over vesting period remaining at the time of modification.

The aggregate value of option granted depends on the number of employees satisfying the vesting conditions and the number of options granted to each employee.

Suppose fair value of an option is ₹20 per share. If one option is granted per employee and if each option consists of 100 shares, the value of option granted to each employee is ₹2,000 (₹20 ×100). If the enterprise expects 200 employees to satisfy the vesting conditions at the end of vesting period, the fair value of option to be recognized as expense is ₹4 lakh (₹ 2,000 × 200). If vesting period is 5 years, the enterprise should recognize ₹80,000 (₹4 lakh/ 5) as expense per year for 5 years.

Example

Ajanta grants 120 share options to each of its 230 employees. Each grant is conditional on the employee working for Ajanta over the next three years. Ajanta has estimated that the fair value of each share option is ₹24.

Ajanta estimates that 25% of employees will leave during the three-year period and so forfeit their rights to the share options.

Everything turns out exactly as expected.

Required:

Calculate the amounts to be recognized as expense during the vesting period.

Solution:

Year	Calculation	Expense for Period ₹	Cumulative expense ₹
1	27,600 options × 75% × ₹24 × 1/3 years	1,65,600	1,65,600
2	(27,600 options × 75% × ₹24 × 2/3 years)- ₹1,65,600	1,65,600	3,31,200
3	(27,600 options × 75% × ₹24 × 3/3 years) - ₹3,31,200	1,65,600	4,96,800

An enterprise should review all estimates taken in consideration for valuation of option. The value of options recognized as expense in an accounting period is the excess of cumulative expense as per latest estimates upto the current accounting period over total expense recognized upto the previous accounting period.

Accounting procedure for ESOP

The amount recognized as expense in a period is debited to 'Employees' Compensation A/c' with a corresponding credit to an equity account called Stock Options Outstanding A/c'. The amount recognized as expense can be either the intrinsic value or fair value. The Stock Options Outstanding A/c' is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve at the time of settlement. Till such transfer, the credit balance of Stock Options Outstanding A/c is shown in balance sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus'.

The balance of Employees' Compensation A/c is transferred to the Profit & Loss A/c of the period. In case capitalization is justified, the balance of Employees' Compensation A/c is transferred to the concerned Asset A/c instead of the Profit & Loss A/c.

On exercise of the option, the enterprise issues shares on receipt of the exercise price. The consideration for such shares comprises of the exercise price and the aggregate value of option recognized as expense, standing to the credit of Stock Options Outstanding A/c. In a situation where the right to obtain shares or stock options expires unexercised, the balance standing to the credit of the relevant equity account should be transferred to General Reserve.

Illustration 1

The following particulars in respect of stock options granted by a company are available:

Grant date	April1, 2014
Employees covered (Nos.)	525
Options granted per employee (Nos.)	100
Vesting condition: Continuous employment for 3 years	
Nominal value per share (₹)	100
Exercise price per share (₹)	125
Market price per share on grant date (₹)	149
Date of Vesting	March 31, 2017
Date of Exercise	March 31, 2018
Fair value of option per share on grant date (₹)	30

Position on 31/03/15

(a) Estimated annual rate of departure 2%

(b) Number of employees left = 15

Position on 31/03/16

(a) Estimated annual rate of departure 3%

(b) Number of employees left = 10

Position on 31/03/17

(a) Number of employees left = 8

(b) Number of employees entitled to exercise option = 492

Position on 31/3/18

(a) Number of employees exercising the option = 480

(b) Number of employees not exercising the option = 12

Compute expenses to recognize in each year by (i) fair value method (ii) intrinsic value method and show important accounts in books of the company by both of the methods.

Solution:

As per Fair Value Method

Year 2014-15

Fair value of option per share = ₹30

Number of shares expected to be vested = (525 × 0.98 × 0.98 × 0.98) × 100 = 49,400

Fair value = 49,400 x ₹30 = ₹14,82,000

Vesting period = 3 years

Value of option recognized as expense in 2014-15 = ₹14,82,000/3 = ₹4,94,000

Year 2015-16

Fair value of option per share = ₹30

Number of shares expected to be vested =(525 – 15) × 0.97 × 0.97) × 100 = 47,986

Fair value =47,986× ₹30 = ₹14,39,580

Vesting period = 3 years

Number of years expired = 2 years

Cumulative value of option to recognize as expense in 2014-15 and 2015-16

= (₹14,39,580/3)×2 = ₹9,59,720

Value of option recognized as expense in 2015-16

= ₹9,59,720 – ₹4,94,000 = ₹4,65,720

Year 2016-17

Fair value of option per share = ₹30

Number of shares actually vested under the scheme = 492 ×100 = 49,200

Fair value = 49,200 x ₹30 = ₹14,76,000

Cumulative value of option to recognize as expense in 3 years = ₹14,76,000

Value of option recognized as expense in 2016-17 = ₹14,76,000 – ₹9,59,720 = ₹5,16,280

Year 2017-18

Fair value of option per share = ₹30

Number of shares not subscribed = (492 – 480) × 100 = 1,200

Value of option forfeited = 1,200 × 30 = ₹36,000

Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To, ESOP Outstanding A/c	4,94,000	2014-15	By ,Profit & Loss A/c	4,94,000
		4,94,000			4,94,000
2015-16	To ESOP Outstanding A/C	4,65,720	2015-16	By, Profit & Loss A/c	4,65,720
		4,65,720			4,65,720
2016-17	To ESOP Outstanding A/c	5,16,280	2016-17	By Profit & Loss A/c	5,16,280
		5,16,280			5,16,280

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	4,94,000	2014-15	By Employees' Compensation A/c	4,94,000
		4,94,000			4,94,000
2015-16	To Balance c/d	9,59,720	2015-16	By Balance b/d	4,94,000
				By Employees Compensation A/c	4,65,720
		9,59,720			9,59,720
2016-17	To Balance c/d	14,76,000	2016-17	By Balance b/d	9,59,720
				By Employees Compensation A/c	5,16,280
		14,76,000			14,76,000
2017-18	To General Reserve (1,200x30)	36,000	2017-18	By Balance b/d (49,200x30)	14,76,000
	To Share Capital (48,000x100)	48,00,000		By Bank (48,000x125)	60,00,000
	To Securities Premium (48,000x55)	26,40,000			
		74,76,000			74,76,000

Note: Securities Premium

	₹
Exercise price received per share	125
Value of service received per share	30
Consideration received per share	155
Less: Nominal value per share	(100)
Securities premium per share	55

As per Intrinsic Value Method

Year 2014-15

Intrinsic value of option per share = ₹149 – ₹125 = ₹24

Number of shares expected to be vested = (525 × 0.98 × 0.98 × 0.98) x 100 = 49,400

Intrinsic value = 49,400 × ₹24 = ₹11,85,600

Vesting period = 3 years

Value of option recognized as expense on 2014-15 = ₹11,85,600/3 = ₹3,95,200

Year 2015-16

Intrinsic value of option per share = ₹149 – ₹125= ₹24

Number of shares expected to be vested = (525 – 15) × 0.97 × 0.97) × 100 = 47,986

Intrinsic value = 47,986 × ₹24 = ₹11,51,664

Vesting period = 3 years

Number of years expired = 2 years

Cumulative value of option to recognise as expense in 2014-15 and 2015-16

= (₹11,51,664/3) × 2 = ₹7,67,776

Value of option recognized as expense in 2015-16

= ₹7,67,776 – ₹3,95,200 = ₹3,72,576

Year 2016-17

Intrinsic value of option per share = ₹149 – ₹125 =₹24

Number of shares actually vested = 492 x 100 = 49,200

Intrinsic value =49,200 × ₹24 = ₹11,80,800

Cumulative value of option to recognize as expense in 3 years = ₹11,80,800

Value of option recognized as expense in 2016-17

= ₹11,80,800 – ₹7,67,776 = ₹4,13,024

Year 2017-18

Intrinsic value of option per share = ₹149 – ₹125 = ₹24

Number of shares not subscribed = (492 – 480) x 100 =1,200

Value of option forfeited = 1,200 x 24 = ₹28,800

Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To ESOP Outstanding A/c	3,95,200	2014-15	By Profit & Loss A/c	3,95,200
		3,95,200			3,95,200
2015-16	To ESOP Outstanding A/c	3,72,576	2015-16	By Profit & Loss A/c	3,72,576
		3,72,576			3,72,576
2016-17	To ESOP Outstanding A/c	4,13,024	2016-17	By Profit & Loss A/c	4,13,024
		4,13,024			4,13,024

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	3,95,200	2014-15	By Employees' Compensation A/c	3,95,200
		3,95,200			3,95,200
2015-16	To Balance c/d	7,67,776	2015-16	By Balance b/d	3,95,200
				By Employees' Compensation A/c	3,72,576
		7,67,776			7,67,776
2016-17	To Balance c/d	11,80,800	2016-17	By Balance b/d	7,67,776
				By Employees Compensation A/c	4,13,024
		11,80,800			11,80,800
2017-18	To General Reserve A/c (1,200x24)	28,800	2017-18	By Balance b/d (49,200x24)	11,80,800
	To Share Capital A/c (48,000x100)	48,00,000		By Bank A/c (48,000x125)	60,00,000
	To Securities Premium A/c (48,000x49)	23,52,000			
		71,80,800			71,80,800

Note: Computation of Securities Premium per share

	₹
Exercise price received per share	125
Value of service received per share	24
Consideration received per share	149
Less: Nominal value per share	(100)
Securities premium per share	49

6.3 VESTING CONDITIONS, MODIFICATION, CANCELLATION AND SETTLEMENT & DISCLOSURES

Variation in Vesting Period

The vesting period, i.e. the time taken to satisfy the vesting conditions can be uncertain. For example, if employees are granted ESOP subject condition that the enterprise achieves a 50% market share, the vesting period can be known only when the market share of the company actually reaches the specified 50% level. In these cases, allocation of option value for recognition as expense in a particular accounting period should be based on estimated vesting period. The initial estimate of vesting period on grant date should be reviewed and revised if necessary, at the end of each accounting period. In case of revision of vesting period, the basis of allocation of option value to a particular accounting period should be based on revised estimate of vesting period.

Where the vesting condition is a market condition, e.g. when an option is granted subject to condition that the market price of the share reaches a specified level, the fair value of option is reduced due to the possibility that the vesting condition may not be satisfied. Such fair values are recognized as expense whether or not the market condition is satisfied, over the vesting period estimated on grant date. The estimates of vesting periods are not revised subsequently in these cases.

Illustration 2.

The following particulars in respect of stock options granted by a company are available:

Grant date	April 1, 2014
Number of employees covered	1000
Number options granted per employee	200
Fair Value of option per share on grant date (₹)	50

The vesting period shall be determined as below:

(a) If the company earns ₹240 crore or above after taxes in 2014-15, the options will vest on 31/03/15.

(b) If condition (a) is not satisfied but the company earns ₹500 crores or above after taxes in aggregate in 2014-15 and 2015-16, the options will vest on 31/0 3/16.

(c) If conditions (a) and (b) are not satisfied but the company earns ₹800 crores or above after taxes in aggregate in 2014-15, 2015-16 and 2016-17, the options will vest on 31/03/17.

Position on the date : 31.03.15

(a) The company earned ₹230 crore after taxes in 2014-15

(b) The company expects to earn ₹280 crores in 2015-16 after taxes

(c) Expected vesting date: March 31, 2016

(d) Number of employees expected to be entitled to option = 948

Position on the date : 31.03.16

(a) The company earned ₹260 crores after taxes in 2015-16

(b) The company expects to earn ₹320 crores in 2016-17 after taxes

(c) Expected vesting date: March 31, 2017

(d) Number of employees expected to be entitled to option = 930

Position on the date : 31.03.17

(a) The company earned ₹330 crore after taxes in 2016-17

(b) Number of employees on whom the option actually vested = 900

Compute expenses to recognize in each year.

Solution:

Year 2014-15

Fair value of option per share = ₹50

Number of shares expected to vest under the scheme = 948 × 100 = 94,800

Fair value = 94,800 × ₹50 = ₹47,40,000

Expected vesting period = 2 years

Value of option recognized as expense in 2014-15 = ₹47,40,000/2 = ₹23,70,000

Year 2015-16

Fair value of option per share = ₹50

Number of shares expected to vest under the scheme = 930 × 100 = 93,000

Fair value = 93,000 × ₹50 = ₹46,50,000

Expected vesting period = 3 years

Cumulative value of option to recognize as expense in 2014-15 and 2015-16

= (₹46,50,000/3) × 2 = ₹31,00,000

Value of option recognized as expense in 2014-15 = ₹23,70,000

Value of option recognized as expense in 2015-16

= ₹31,00,000 – ₹23,70,000 = ₹7,30,000

Year 2016-17

Fair value of option per share = ₹50

Number of shares actually vested under the scheme = 900 × 100 = 90,000

Fair value = 90,000 × ₹50 = ₹45,00,000

Vesting period = 3 years

Cumulative value of option to recognize as expense in 2014-15, 2015-16 and 2016-17

= ₹45,00,000

Value of option recognized as expense in 2014-15 and 2015-16 = ₹31,00,000

Value of option recognized as expense in 2016-17

= ₹45,00,000 - ₹31,00,000 = ₹14,00,000

Illustration 3.

The following particulars in respect of stock options granted by a company are available:

Grant date is	April 1, 2014
Employees covered (Nos.)	10
Options granted per employee (Nos.)	1,000
Fair value of option per share on grant date (₹)	9

The options will vest to employees serving continuously for 3 years from vesting date, provided the share price is ₹70 or above at the end of 2016-17.

The estimates of number employees satisfying the condition of continuous employment were 96 on 31/03/15, 94 on 31/03/16. The number of employees actually satisfying the condition of continuous employment was 90.

The share price at the end of 2016-17 was ₹68

Compute expenses to recognize in each year and show important accounts in books of the company.

Solution:

The vesting of options is subject to satisfaction of two conditions viz. service condition of continuous employment for 3 years and market condition that the share price at the end of 2016-17 is not less than ₹70.

Since the share price on 31/03/17 was ₹68, the actual vesting as nil. Despite this, the company should recognize value of option over 3-year vesting period from 2014-15 to 2016-17.

Year 2014-15

Fair value of option per share = ₹ 9

Number of shares expected to vest under the scheme = 96 × 1,000 = 96,000 Fair value = 96,000 × ₹9 = ₹8,64,000

Expected vesting period = 3 years

Value of option recognized as expense in 2014-15 = ₹8,64,000/3 = ₹2,88,000

Year 2015-16

Fair value of option per share = ₹9

Number of shares expected to vest under the scheme = 94 × 1,000 = 94,000 Fair value = 94,000 × ₹9 = ₹8,46,000

Expected vesting period = 3 years

Cumulative value of option to recognize as expense in 2014-15 and 2015-16 = (₹8,46,000/3) × 2 = ₹5,64,000

Value of option recognized as expense in 2014-15 = ₹2,88,000

Value of option recognized as expense in 2015-16

= ₹5,64,000 - ₹2,88,000 = ₹2,76,000

Year 2016-17

Fair value of option per share = ₹9

Number of shares actually vested under the scheme = 90 × 1,000 = 90,000 Fair value = 90,000 × ₹9 = ₹8,10,000

Vesting period = 3 years

Cumulative value of option to recognize as expense in 2014-15, 2015-16 and 2016-17

= ₹8,10,000

Value of option recognized as expense in 2014-15 and 2015-16 = ₹5,64,000 Value of option recognized as expense in 2016-17

= ₹8,10,000 – ₹5,64,000 = ₹2,46,000

Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To ESOP Outstanding A/c	2,88,000	2014-15	By Profit & Loss A/c	2,88,000
		2,88,000			2,88,000
2015-16	To ESOP Outstanding A/c	2,76,000	2015-16	By Profit & Loss A/c	2,76,000
		2,76,000			2,76,000
2016-17	To ESOP Outstanding A/c	2,46,000	2016-17	By Profit & Loss A/c	2,46,000
		2,46,000			2,46,000

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	2,88,000	2014-15	By Employees' Compensation A/c	2,88,000
		2,88,000			2,88,000
2015-16	To Balance c/d	5,64,000	2015-16	By Balance b/d	2,88,000

				By Employees' Compensation A/c	2,76,000
		5,64,000			5,64,000
2016-17	To General Reserve	8,10,000	2016-17	By Balance b/d	5,64,000
				By Employees' Compensation A/c	2,46,000
		8,10,000			8,10,000

Graded Vesting

Graded vesting refers to a situation where options under a plan vest on different dates. For example, a plan may provide that shares offered to an employee shall vest in proportion of 2:3:5 in three years commencing from fourth year. Thus if an employee is offered 200 shares under the plan, 40 shares shall vest in year 4, 60 shares shall vest in year 5 and 100 shares shall vest in year 6. In these cases, based on vesting dates, the plan is segregated in into different groups. Each of these groups is then treated as a separate plan with specific vesting period and expected life.

Since one of the factors affecting fair value of an option is expected life, the fair value for each group should be computed separately. Fair value of a group is then allocated to accounting periods and recognized as expense for the period with reference to vesting period for the group.

Intrinsic value of an option does not depend on its expected life. Intrinsic value of option per share shall therefore be same for each group. In the same way as fair value, intrinsic value of a group is allocated to accounting periods and recognized as expense for the period with reference to vesting period for the group.

Illustration 4

The following particulars in respect of stock options granted by a company are available:

Grant date	April 1, 2014
Employees covered (Nos.)	400
Options granted per employee (Nos.)	60
Nominal value per share (₹)	100
Exercise price per share (₹)	125

Shares offered were put in three groups. Group I was for 20% of shares offered with vesting period one-year. Group II was for 40% of shares offered with vesting period two-years. Group III was for 40% of shares offered with vesting period three-years. Fair value of option per share on grant date was ₹10 for Group I, ₹12.50 for Group II and ₹14 for Group III.

Position on 31/03/15

(a) Number of employees left = 40

(b) Estimate of number of employees to leave in 2015-16 = 36

(c) Estimate of number of employees to leave in 2016-17 = 34

(d) Number of employees exercising options in Group I = 350

Position on 31/03/16

(a) Number of employees left = 35

(b) Estimate of number of employees to leave in 2016-17 = 30

(c) Number of employees exercising options in Group II = 319

Position on 31.03.17

(a) Number of employees left = 28

(b) Number of employees at the end of last vesting period = 297

(c) Number of employees exercising options in Group III = 295

Options not exercised immediately on vesting, were forfeited.

Compute expenses to recognize in each year and show important accounts in books of the company by both of the methods.

Solution:

Expected vesting

Year	Group	Number of employees expected to qualify	Number of shares vested to each employee	Total number of shares expected to vest	Fair value of option per share	Fair value of option
2014-15	I	360	12	4,320	10.00	43,200
	II	324	24	7,776	12.50	97,200
	III	290	24	6,960	14.00	97,440
2015-16	II	325	24	7,800	12.50	97,500
	III	295	24	7,080	14.00	99,120
2016-17	III	297	24	7,128	14.00	99,792

Expense recognized in year 2014-15

	₹	
Group I	43,200	
Group II	48,600	97,200/2
Group III	32,480	97,440/3
	1,24,280	

Expense recognized in year 2015-16

	₹	
Group I	43,200	
Group II	97,500	
Group III	66,080	(99,120/3)×2×1
Cumulative expenses for 2014-15 and 2015-16	2,06,780	
Less: Expenses recognized in 2014-15	(1,24,280)	
Expenses recognized in 2015-16	82,500	

Expense recognized in year 2016-17

	₹
Group I	43,200
Group II	97,500
Group III	99,792
Cumulative expenses for 2014-15 to 2016-17	2,40,492
Less: Expenses recognized in 2014-15 and 2015-16	(2,06,780)
Expenses recognized in 2015-16	33,712

Options Forfeited

	Group I 2014-15	Group II 2015-16	Group III 2016-17
Number of employees qualifying	360	325	297
Less: Number of employees exercising	(350)	(319)	(295)
Number of employees not exercising	10	6	2
Number of options per employee	12	24	24
Number of options forfeited	120	144	48

Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To ESOP Outstanding A/c	1,24,280	2014-15	By Profit & Loss A/c	1,24,280
		1,24,280			1,24,280
2015-16	To ESOP Outstanding A/c	82,500	2015-16	By Profit & Loss A/c	82,500
		82,500			82,500
2016-17	To ESOP Outstanding A/c	33,712	2016-17	By Profit & Loss A/c	33,712
		33,712			33,712

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To General Reserve (120x10)	1,200	2014-15	By Employees' Compensation A/c	1,24,280
	To Share Capital (4,200x100)	4,20,000		By Bank (4,200x125)	5,25,000
	To Securities Premium (4,200x35)	1,47,000			
	To Balance c/d	81,080			
		6,49,280			6,49,280
2015-16	To General Reserve (144x12.50)	1,800	2015-16	By Balance b/d	81,080
	To Share Capital (7,656x100)	7,65,600		By Employees' Compensation A/c	82,500
	To Securities Premium (7,656x37.50)	2,87,100		By Bank (7,656x125)	9,57,000
	To Balance c/d	66,080			
		11,20,580			11,20,580
2016-17	To General Reserve (48x14)	672	2016-17	By Balance b/d	66,080
	To Share Capital (7,080x100)	7,08,000		By Employees' Compensation A/c	33,712
	To Securities Premium (7,080x39)	2,76,120		By Bank (7,080x125)	8,85,000
		9,84,792			9,84,792

Securities Premium

	Group I 2014-15	Group II 2015-16	Group III 2016-17
Exercise price received per share	125.00	125.00	125.00
Value of service received per share	10.00	12.50	14.00
Consideration received per share	135.00	137.50	139.00
Less: Nominal value per share	(100.00)	(100.00)	(100.00)
Securities premium per share	35.00	37.50	39.00

Employees' Stock Purchase Plans (ESPP)

Under these plans, 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. For example, a company may offer specified number of shares to its employees at 20% discount on market price on grant date. ESPP with option features is treated as ESOP. For example, consider a case where shares are offered to employees at 80% of market price. If employees have the option to pay either 80% of market price of shares on grant date or to pay 80% of market price on date of purchase, the plan is treated as ESOP rather than ESPP. The fair value of ESPP can be less than the discount due to post-vesting restrictions on transfers and similar other factors. The fair value of ESPP is recognized over the vesting period in the same way as ESOP.

Illustration 5.

On April 1, 2014, a company Sky Blue Ltd. offered 100 shares to each of its 1,500 employees at ₹40 per share. The employees are given a month to decide whether or not to accept the offer. The shares issued under the plan shall be subject to lock-in on transfers for three years from grant date. The market price of shares of the company on the grant date is ₹50 per share. Due to post-vesting restrictions on transfer, the fair value of shares issued under the plan is estimated at ₹48 per share.

On April 30, 2014, 1,200 employees accepted the offer and paid ₹40 per share purchased. Nominal value of each share is ₹10.

Record the issue of shares in book of the Sky Blue Ltd. under the aforesaid plan.

Solution:

Fair value of ESPP per share = ₹48 – ₹40 = ₹8

Number of share issued = 1,200 × 100 = 1,20,000

Fair value of ESPP = 1,20,000 × ₹8 = ₹9,60,000

Vesting period = One month

Expense recognized in 2014-15 = ₹9,60,000

		₹	₹	
April 30, 2014	Bank	48,00,000		1,20,000x40
	Employees' Compensation A/c	9,60,000		1,20,000x8
	To Share Capital		12,00,000	1,20,000x10
	To Securities premium		45,60,000	1,20,000x38

Modifications

If the modification reduces the fair value of the options granted, the modification should be ignored. If the modification increases the fair value of the options granted (e.g., when exercise price is reduced), the incremental fair value is recognized as expense over the remaining vesting period. The incremental fair value is the difference between (i) fair value of the modified option estimated on the date of the modification and (ii) fair value of the original option estimated on the date of modification. If the modification occurs after the vesting date, the incremental fair value is recognized immediately, or over the additional vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to the options.

Illustration 6.

The following particulars in respect of stock options granted by Welcome Ltd. are available:

Grant date	April 1, 2014
Employees covered (Nos.)	600
Options granted per employee (Nos.)	60
Vesting condition: Continuous employment for 3 years	
Nominal value per share (₹)	100
Exercise price per share (₹)	125
Vesting date	March 31,2012
Exercise date	March 31,2013
Fair value of options per share on grant date (₹)	14

Position on 31/03/15

(a) Number of employees left = 30

(b) Estimate of number of employees to leave in 2015-16 and 2016-17 = 70

(c) Exercise price was reduced to ₹120

(d) Fair value of original option on 31/03/15 = ₹13

(e) Fair value of option at reduced exercise price on 31/03/15 = ₹15

(f) Vesting date for modified option was March 31, 2017

Position on 31/03/16

(a) Number of employees left = 35

(b) Estimate of number of employees to leave in 2016-17 = 30

Position on 31/03/17

(a) Number of employees left = 28

(b) Number of employees entitled to exercise option = 507

Position on 31/03/18

(a) Number of employees exercising the option = 500

(b) Number of employees not exercising the option = 7

Compute the amount of expense Welcome Ltd. should recognize in each of the years 2014-15, 2015-16 and 2016-17 and show important accounts in books of Welcome Ltd.

Solution:

Year 2014-15

Fair value of option per share = ₹15

Number of shares expected to vest under the scheme = (600 – 100) × 60 = 30,000

Fair value = 30,000 × ₹14 = ₹4,20,000

Vesting period = 3 years

Value of option recognized as expense in 2014-15 = ₹4,20,000/3 = ₹1,40,000

Year 2015-16

Fair value of option per share = ₹14

Incremental fair value of option per share = ₹15 – ₹13 = ₹2

Number of shares expected to vest under the scheme = (600 – 95) × 60 = 30,300

Fair value of option = 30,300 × ₹14 = ₹4,24,200

Incremental fair value = 30,300 × ₹2 = ₹60,600

Vesting period = 3 years;

Remaining vesting period = 2 years (including current year)

Cumulative value of option to recognize as expense in 2014-15 and 2015-16

= (₹4,24,200/3) × 2 + ₹60,600/2 = ₹3,13,100

Value of option recognized as expense in 2014-15 = ₹1,40,000

Value of option recognized as expense in 2015-16

= ₹3,13,100 – ₹1,40,000 = ₹1,73,100

Year 2016-17

Fair value of option per share = ₹14

Number of shares actually vested under the scheme = 507 × 60 = 30,420

Fair value of option = 30,420 × ₹14 = ₹4,25,880

Incremental fair value = 30,420 x ₹60,840

Cumulative value of option to recognize as expense in 3 years

= ₹4,25,880 + ₹60,840 = ₹4,86,720

Value of option recognized as expense in 2014-15 and 2015-16 = ₹3,13,100

Value of option recognized as expense in 2016-17= ₹4,86,720 – ₹3,13,100 = ₹1,73,620

In the books of Welcome Ltd.

Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To ESOP Outstanding A/c	1,40,000	2014-15	By Profit & Loss A/c	1,40,000
		1,40,000			1,40,000
2015-16	To ESOP Outstanding A/c	1,73,,100	2015-16	By Profit & Loss A/c	1,73,100
		1,73,100			1,73,100
2016-17	To ESOP Outstanding A/c	1,73,620	2016-17	By Profit & Loss A/c	1,73,620
		1,73,620			1,73,620

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	1,40,000	2014-15	By Employees' Compensation A/c	1,40,000
		1,40,000			1,40,000
2015-16	To Balance c/d	3,13,100	2015-16	By Balance b/d	1,40,000
				By Employees Compensation A/c	1,73,100
		3,13,100			3,13,100
2016-17	To Balance c/d	4,86,720	2016-17	By Balance b/d	3,13,100
				By Employees' Compensation A/c	1,73,620
		4,86,720			4,86,720
2017-18	To General Reserve A/c (420x16)	6,720	2017-18	By Balance b/d (30,420x16)	4,86,720
	To Share Capital A/c (30,000x100)	30,00,000		By Bank A/c (30,000x120)	36,00,000
	To Securities Premium A/c (30,000x36)	10,80,000			
		40,86,720			40.86,720

Note: Computation of Securities Premium per share

	₹
Exercise price received per share	120
Value of service received per share	16
Consideration received per share	136
Less: Nominal value per share	(100)
Securities premium per share	36

Cancellation and Settlements during Vesting Period

If an enterprise cancels or settles a grant of shares or stock options during the vesting period (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) The entire amount of unamortized value of option should be recognized immediately.

(b) Payments made to the employees on cancellation or settlement should be debited to ESOP Outstanding A/c to the maximum extent of fair value of options granted, measured at the cancellation / settlement date. Any payment in excess of the fair value is recognized as an expense.

(c) If new options are granted to the employees in replacement for the cancelled options, the replacement is regarded as modification. The incremental fair value for the purpose is the difference between the fair value of replaced option and net fair value of cancelled option, as on the date of replacement. The net fair value of the cancelled option is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation that is debited to ESOP Outstanding A/c, in accordance with (b) above.

Dilution of Earning Per Share (EPS) due to ESOP Granted

Dilution of EPS is anticipated fall in EPS. Dilution occurs when expected proportionate increase in number of shares is more than expected proportionate increase in profit available to equity shareholders. For example, if number of shares increases from 10,000 to 11,000 (10% increase) and profit available to equity shareholders increases from ₹50,000 to ₹52,500 (5% increase) the EPS falls from ₹5 to ₹4.77. The Accounting Standard (AS) 20, Earning per Share, requires disclosure of basic and diluted EPS.

One factor contributing to dilution of EPS is issue of shares at less than fair value. This happens because issue of shares at less than fair value implies issue of certain number of shares for no consideration. For example, consider the case of a share warrant for 4,000 shares at exercise price ₹40. On exercise of the warrant, the issuer collects ₹1,60,000. If fair of the shares is ₹50, the issue proceed is equivalent of price of 3,200. The issuer, by setting the exercise price at ₹40, instead of ₹50, allows the warrant holder to have 800 shares for no consideration. The shares issued for no consideration increase number of shares but does not increase resources available to the issuer and consequently, no increase in profit can be anticipated. These shares are taken in computation of diluted EPS as potential equity.

$$\text{Number of shares issued for consideration} = \frac{\text{Expected issue proceeds}}{\text{Fair value per share}}$$

Number of shares issued for no consideration

= Number of shares issued – Number of shares issued for consideration

Issue of shares under a scheme of share-based payment, increases the number of shares outstanding. Since the shares are issued at exercise price, which is lower than the fair value of shares issued, in the same way as share warrants, an ESOP gives rise to situation of dilution of EPS. In calculating the number of shares issued for no consideration, the expected proceeds from the exercise of option is taken as sum of (i) Exercise Price (ii) Value of services to be rendered by employees in future upto the vesting date. This value of services is measured as unamortized value of option.

Illustration 7.

The following particulars in respect of stock options granted by a company Gambhir Ltd. are available:

Number of share	4,00,000
Grant date	April 1, 2014
Number of employees covered	600
Number options granted per employee	100
Vesting condition: Continuous employment for 3 years	
Nominal value per share (₹)	10
Exercise price per share (₹)	45
Vesting date	March 31, 2017
Exercise date	May 31, 2018
Fair value of option per share on grant date (₹)	15

Position on 31/03/15

(a) Number of employees expected to satisfy service condition = 540

(b) Number of employees left = 15

(c) Profit before amortization of ESOP cost = ₹11.90 lakh

(d) Fair value per share = ₹60

Position on 31/03/16

(a) Number of employees expected to satisfy service condition = 552

(b) Number of employees left = 20

(c) Profit before amortization of ESOP cost = ₹12.62 lakh

(d) Fair value per share = ₹66

Position on 31/3/17

(i) Number of employees left = 11

(ii) Number of employees entitled to exercise option = 554

(iii) Profit before amortization of ESOP cost = ₹13.79 lakh

(iv) Fair value per share = ₹72

Position on 31/05/18

(a) Number of employees exercising the option = 550

(b) Number of employees not exercising the option = 4

(c) Show Employees Compensation A/c, ESOP Outstanding A/c from 2014-15 to 2017-18.

(d) Compute basic and diluted EPS for the years 2014-15 to 2016-17

Solution:

Year 2014-15

Fair value of option per share = ₹15

Number of shares expected to vest under the scheme = 540 × 100 = 54,000

Fair value = 54,000 × ₹15 = ₹8,10,000

Vesting period = 3 years

Value of option recognized as expense in 2014-15 = ₹8,10,000/3 = ₹2,70,000

Year 2015-16

Fair value of option per share = ₹15

Number of shares expected to vest under the scheme = 552 × 100 = 55,200

Fair value = 55,200 × ₹15 = ₹8,28,000

Vesting period = 3 years

Number of years expired = 2 years

Cumulative value of option to recognize as expense in 2014-15 and 2015-16

= (₹ 8,28,000/3) × 2 = ₹5,52,000

Value of option recognized as expense in 2015-16

= ₹ 5,52,000 – ₹2,70,000 = ₹2,82,000

Year 2016-17

Fair value of option per share = ₹15

Number of shares actually vested under the scheme = 554 × 100 = 55,400

Fair value = 55,400 × ₹15 = ₹8,31,000

Cumulative value of option to recognize as expense in 3 years = ₹8,31,000

Value of option recognized as expense in 2014-15

= ₹8,31,000 – ₹5,52,000 = ₹2,79,000

Year 2017-18

Fair value of option per share = ₹15

Number of shares not subscribed = (554 – 550) × 100 = 400

Value of option forfeited = 400 × ₹15 = ₹6,000

In the books of Gambhir Ltd.

Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To ESOP Outstanding	2,70,000	2014-15	By Profit & Loss A/c	2,70,000
		2,70,000			2,70,000
2015-16	To ESOP Outstanding A/c	2,82,000	2015-16	By Profit & Loss A/c	2,82,000
		2,82,000			2,82,000
2016-17	To ESOP Outstanding A/c	2,79,000	2016-17	By Profit & Loss A/c	2,79,000
		2,79,000			2,79,000

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	2,70,000	2014-15	By Employees' Compensation A/c	2,70,000
		2,70,000			2,70,000
2015-16	To Balance c/d	5,52,000	2015-16	By Balance b/d	2,70,000
				By Employees Compensation A/c	2,82,000
		5,52,000			5,52,000
2016-17	To Balance c/d	8,31,000	2016-17	By Balance b/d	5,52,000
				By Employees Compensation A/c	2,79,000
		8,31,000			8,31,000
2017-18	To General Reserve A/c (400 x15)	6,000	2017-18	By Balance b/d (55,400x15)	8,31,000
	To Share Capital A/c (55,000 x10)	5,50,000		By Bank A/c (55,000x45)	24,75,000
	To Securities Premium A/c (55,000x50)	27,50,000			
		33,06,000			33,06,000

Note: Securities Premium

	₹
Exercise price received per share	45
Value of service received per share	15
Consideration received per share	60
Less: Nominal value per share	(10)
Securities premium per share	50

Computation of Basic EPS

	2014-15 ₹ 000	2015-16 ₹ 000	2016-17 ₹ 000
Profit before amortization of ESOP costs	1,190	1,262	1,379
Less: ESOP cost amortised	(270)	(282)	(279)
Net Profit for shareholders	920	980	1,100
Number of shares Outstanding ('000)	400	400	400
Basic EPS	2.30	2.45	2.75

Computation of Potential Equity

	2014-15	2015-16	2016-17
A.Actual number of employees	585	565	554
B. Option granted per employee	100	100	100
C. Number of options outstanding	58,500	56,500	55,400
D. Unamortised ESOP cost per option (₹)	10	5	Nil
E. Exercise price (₹ 45)	45	45	45
F. Expected exercise price to be received (c x e);₹ 000	2,632.5	2,542.5	2,493.0
G. Unamorised ESOP cost (c x d); ₹ 000	585.0	282.5	Nil
H. Total proceeds: ₹ 000	3,217.5	2,825.0	2,493.0
I. Fair value per share (₹)	60	66	72
J. Number of shares issued for consideration (H/I)	53,625	42,803	34,625
K. Potential equity (C-J)	4,875	13,697	20,775

Computation of Diluted EPS

	2014-15 ₹	2015-16 ₹	2016-17 ₹
Net profit for shareholders	9,20,000	9,80,000	11,00,000
Number of shares outstanding	4,00,000	4,00,000	4,00,000
Potential equity	4,875	13,697	20,775
Total number of share	4,04,875	4,13,697	4,20,775
Diluted EPS	2.27	2.37	2.61

Stock Appreciation Rights (SAR)

Stock Appreciation Rights (SAR) entitle the employees to claim cash payment to the extent of excess of market price of underlying shares on exercise date over the exercise price. Stock Appreciation Rights are not exercised if market price of underlying shares on exercise date is less than the exercise price. SAR is therefore a call option held by employees. The employer recognizes the value of call as expense over the vesting period.

The accounting procedures for ESOP and SAR are similar except that: (i) The liability for SAR is recognized as Provision instead of ESOP Outstanding and (ii) value per option is reassessed at each reporting date.

Illustration 8.

A company Amrit Ltd. announced a Stock Appreciation Right on 01/04/14 for each of its 525 employees. The scheme gives the employees the right to claim cash payment equivalent to excess on market price of company's shares on exercise date over the exercise price ₹125 per share in respect of 100 shares, subject to condition of continuous employment for 3 years. The SAR is exercisable after 31/03/17 but before 30/06/17. The fair value of SAR was ₹21 in 2014-15, ₹23 in 2015-16 and ₹24 in 2016-17. In 2014-15 the company estimates that 2% of the employees shall leave the company annually. This was revised to 3% in 2015-16. Actually, 10 employees left the company in 2014-15, 5 left in 2015-16 and 3 left in 2016-17. The SAR therefore actually vested to 482 employees. On 30/06/17, when the SAR was exercised, the intrinsic value was ₹25 per share.

Show Provision for SAR A/c by fair value method.

Solution:

Provision of SARs Account (For 2014-15)

Dr. **Cr.**

Particulars	₹	Particulars	₹
To Balance c/d	3,29,700	By Employees Compensation Expense	3,29,700
	3,29,700		3,29,700
Provision of SARs Account (For 2015-16)			
To Balance c/d	7,06,867	By Balance b/d	3,29,700
		By Employee Compensation Expenses	3,77,167
	7,06,867		7,06,867
Provision of SARs Account (For 2016-17)			
To Balance c/d	11,56,800	By Balance b/d	7,06,867
		By Employee Compensation Expenses	4,49,933
	11,56,800		11,56,800
Provision of SARs Account (For 2017-18)			
To Bank (48,200x25)	12,05,000	By Balance b/d	11,56,800
		By Employee Expenses	48,200
	12,05,000		12,05,000

The Provision for SAR is a liability as settlement of SAR is through cash payment equivalent to an excess of market price of company's shares on exercise date over the exercise price.

Working Notes:

Year 2014-15

A. Number of employees to whom SARs were announced (482+10+5+3) = 500 employees.

B. Total number of employees after three years, on the basis of the estimation in 2014-15 = (500 x 0.98 x 0.98 x0.98) = 471 employees.

C. No. of SARs expected to vest = 471 employees x 100 = 47,100 SAR

D. Fair value of SARs = 47,100 SARs × ₹21 = ₹9,89,100

E. Vesting period = 3 years

F. Recognized as expense in 2014-15 = ₹9,89,100/3 years = ₹3,29,700

Year 2015-16

G. Total number of employees after three years, on the basis of the estimation in 2015-16 = [(500-10) x 0.97 x 0.97) = 461 employees

H. No. of SARs expected to vest =461 employees × 100 = 46,100 SARs

I. Fair value of SARs = 46,100 SARs × ₹23 = ₹10,60,300

J. Vesting period = 3 years

K. No. of years expired = 2 years

L. Cumulative value of SARs to recognized as expense = 10,60,300/3 x 2 = ₹7,06,867

M. SARs recognize as expense in 2015-16 = ₹7,06,867 - ₹3,29,700 = ₹3,77,167

Year 2016-17

N. Fair value of SARs = ₹24

O. SARs actually vested = 482 employees x 100 = 48,200 SARs

P. Fair value = 48,200 SARs x ₹24 = ₹11,56,800

Q. Cumulative value to be recognized = ₹11,56,800

R. Value of SARs to be recognized as an expense = ₹11,56,800 – ₹7,06,867 = ₹4,49,933

Year 2017-18

S Cash payment of SARs = 48,200 SARs ¥ ₹ 25 = ₹ 12,05,000

T Value of SARs to be recognized as an expense in 2017-18 = ₹12,05,000 - ₹11,56,800 = ₹48,200

Employee Share-based Payment Plans with Cash Alternatives

These plans consist of two components viz., (i) liability, i.e., the employer's obligation to pay price differential in cash and (ii) equity, i.e., the employer's obligation to issue shares at exercise price. The company should first measure, on the grant date, fair value of the plan on the assumption that all employees will exercise their options in favour of (i) cash settlement (ii) equity settlement. The fair value of plan for cash settlement is the fair value of the liability component. The excess, if any, of fair value of plan for equity settlement over the liability component is the fair value of equity component. The accounting procedure for equity component is same as that for ESOP. The accounting procedure for liability component is same as that for SAR.

On the date of settlement, the company should remeasure the liability to its fair value. If the employees opt for shares, the amount of liability should be treated as the consideration for the shares issued. If the employees opt for cash settlement, the balance in ESOP Outstanding A/c should be transferred to general reserve.

Illustration 9.

A company Happy Ltd. announced a share-based payment plan for its employees on 01/04/14, subject to a vesting period of 3 years. By the plan, the employees can (i) either claim difference between exercise price ₹150 per share and market price of those shares on vesting date in respect of 10,000 shares or (ii) can subscribe to 12,000 shares at exercise price ₹150 per share, subject to lock in period of 5 years. On 01/04/14, fair value of the option, without considering restrictions on transfers was ₹30 and that after considering restrictions on transfer was ₹27. The fair value estimates, without considering transfer restrictions were ₹31.50, ₹32.70 and ₹34 respectively, at the end of 2014-15, 2015-16 and 2016-17.

Show important accounts in books of Happy Ltd. if employees opt for (i) cash settlement (ii) equity settlement.

Solution:

Fair Value under equity settlement = 12,000 x ₹27	3,24,000	
Less: Fair value under cash settlement = 10,000 x ₹30	(3,00,000)	Liability component
	24,000	Equity component

Vesting period = 3 years

Expense to be recognized each year for equity component = ₹24,000/3 = ₹8,000

Expense recognized for liability component

2014-15

Number of shares = 10,000

Fair value = ₹31.50 per share

Fair value of liability component = 10,000 × ₹31.50 = ₹3,15,000

Vesting period = 3 years

Expense recognized = ₹3,15,000/3 = ₹1,05,000

2015-16

Number of shares = 10,000

Fair value = ₹32.70 per share

Fair value of liability component = 10,000 × ₹ 32.70 = ₹ 3,27,000

Vesting period = 3 years

Number of years expired = 2 years

Cumulative expense to be recognized upto 2014-15

= (₹3,27,000/3) × 2 = ₹2,18,000

Expense recognized in 2014-15 = ₹1,05,000

Expense recognized in 2015-16 = ₹2,18,000 – ₹1,05,000 = ₹1,13,000

2016-17

Number of shares = 10,000

Fair value = ₹34 per share

Fair value of liability component = 10,000 × ₹34 = ₹3,40,000

Vesting period = 3 years

Number of years expired = 3 years

Cumulative expense to be recognized upto 2016-17 = ₹3,40,000

Cumulative expense to be recognized upto 2015-16 = ₹2,18,000

Expense recognized in 2016-17 = ₹3,40,000 – ₹2,18,000 = ₹1,22,000

In the books of Happy Ltd.
Employees' Compensation Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To provision for liability	1,05,000	2014-15	By profit & Loss A/c	1,13,000
	To ESOP Outstanding	8,000			
		1,13,000			1,13,000
2015-16	To Provision for Liability	1,13,000	2015-16	By Profit & Loss A/c	1,21,000
	To ESOP Outstanding	8,000			
		1,21,000			1,21,000
2016-17	To Provision for liability	1,22,000	2016-17	By Profit & Loss A/c	1,30,000
	To ESOP Outstanding	8,000			
		1,30,000			1,30,000

Provision for Liability Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	1,05,000	2014-15	By Employees' Compensation A/c	1,05,000
		1,05,000			1,05,000
2015-16	To Balance c/d	2,18,000	2015-16	By Balance b/d	1,05,000
				By Employees' Compensation A/c	1,13,000
		2,18,000			2,18,000
2016-17	To Balance c/d	3,40,000	2016-17	By Balance b/d	2,18,000
				By Employees' Compensation A/c	1,22,000
		3,40,000			3,40,000

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2014-15	To Balance c/d	8,000	2014-15	By Employees' Compensation A/c	8,000
		8,000			8,000
2015-16	To Balance c/d	16,000	2015-16	By Balance b/d	8,000
				By Employees' Compensation A/c	8,000
		16,000			16,000
2016-17	To Balance c/d	24,000	2016-17	By Balance b/d	16,000
				By Employees' Compensation A/c	8,000
		24,000			24,000

Cash Settlement

Provision for Liability Component Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2017-18	To Bank	3,40,000	2017-18	By Balance b/d	3,40,000
		3,40,000			3,40,000

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2017-18	To General Reserve	24,000	2017-18	By Balance b/d	24,000
		24,000			24,000

Equity Settlement

Provision for Liability Component Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2017-18	To ESOP Outstanding A/c	3,40,000	2017-18	By Balance b/d	3,40,000
		3,40,000			3,40,000

ESOP Outstanding Account

Dr. **Cr.**

Year	Particulars	₹	Year	Particulars	₹
2017-18	To Share Capital	12,00,000	2017-18	By Balance b/d	24,000
	To Securities Premium	9,64,000		By Provision for Liability Component	3,40,000
				By Bank	18,00,000
		21,64,000			21,64,000

Disclosures

The Guidance Note on Accounting for Employee Share-based Payments issued by The Institute of Chartered Accountants of India requires enterprises to disclose the following in respect of such payments:

1. Method used to account for the employee share-based payment plans. Where an enterprise uses the intrinsic value method, it should also disclose the impact on the net results and EPS- both basic and diluted –for the accounting period, had the fair value method been used.
2. Information that enables users of the financial statements to understand the nature and extent of employee share-based payment plans that existed during the period. In particular, it should disclose:
   (a) A description of each type of employee share-based payment plan that existed at any time during the period, including the general terms and conditions of each plan, such as vesting requirement, the maximum term of options granted, and the method of settlement (e.g., whether in cash or equity).
   (b) The number and weighted average exercise prices of stock options for each of the following groups of options:
      (i) Outstanding at the beginning of the period:
      (ii) Granted during the period;
      (iii) Forfeited during the period;
      (iv) Exercised during the period;
      (v) Expired during the period;
      (vi) Outstanding at the end of the period; and
      (vii) Exercisable at the end of the period
   (c) For stock options exercised during the period, the weighted average share price at the date of exercise. If options were exercised on a regular basis throughout the period, the enterprise may instead disclose the weighted average share price during the period.
   (d) For stock options outstanding at the end of the period, the range of exercise prices and weighted average remaining contractual life (comprising the vesting period and the exercise

period). If the range of exercise prices is wide, the outstanding options should be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received upon exercise of those options.

1. An enterprise should disclose the following information to enable users of the financial statements to understand how the fair value of shares or stock options granted, during the period, was determined:

   (a) For stock options granted during the period, the weighted average fair value of those options at the grant date and information on how that fair value was measured, including:

      (i) The option pricing model used and the inputs to that model, including the weighted average share price, exercise price, expected volatility, option life (comprising the vesting period and the exercise period), expected dividends, the risk-free interest rate and any other inputs to the model, including the method used and the assumptions made to incorporate the effects of expected early exercise;

      (ii) How expected volatility was determined, including an explanation of the extent to which expected volatility; and

      (iii) Whether and how any other features of the option grant were incorporated into the measurement of fair value, such as a market condition.

   (b) For other instrument granted during the period (i.e., other than stock options), the number and weighted average fair value of those instruments at the granted date, and information on how that fair value was measured, including:

      (i) If fair value was not measured on the basis of an observable market price, how it was determined;

      (ii) Whether and how expected dividends were incorporated into the measured of fair value; and

      (iii) Whether and how any other features of the instruments granted were incorporated into the measurement of fair value.

   (c) For the employee share-based payment plants that were modified during the period:

      (i) An explanation of those modifications;

      (ii) The incremental fair value granted (as a result of those modifications); and

   (iii) Information on how the incremental fair value granted was measured, consistently with the requirements set out in (a) and (b) above, where applicable.

2. An enterprise should disclose the following information to enable users of the financial statement to understand the effect of employee share-based payment plans on the profit or loss of the enterprise for the period and on its financial position:

   (a) The total expense recognized for the period arising from employee share-based payment plans in which the services received did not qualify for recognition as a part of the cost of an asset and hence were recognized immediately as an expense, including separate disclosure s of that portion of the total expense that arises from transactions accounted for as equity-settled employee share-based payment plans;

   (b) For liability arising from employee share-based payment plans;

   (i) The total carrying amount at the end of the period; and

   (ii) The total intrinsic value at the end of the period of liabilities for which the right of the employee to cash or other assets had vested by the end of the period (e.g., vested stock appreciated rights).

Illustration 10.

The following particulars in respect of stock options granted by Upkar Ltd. are available:

Grant date	April 1, 2014
Number of employees covered	300
Vesting condition: Continuous employment upto 31/03/17	100
Nominal value per share (₹)	10
Exercise price per share (₹)	40
Fair value of option per share on grant date (₹)	20
Exercise date	July 31, 2017

The number options to vest per employee shall depend on company's average annual earnings after tax during vesting period as per the table below:

Average annual earning after tax	Number of options per employee
Less than ₹ 100 crores	Nil
₹100 crores to less than ₹ 120 crores	30
₹ 120 crores to less than ₹150 crores	45
Above ₹150 crores	60

Position on 31/3/15

(a) The company expects to earn ₹ 115 crores after tax on average per year during vesting period.

(b) Number of employees expected to be entitled to option = 280

Position on 31/03/16

(a) The company expects to earn ₹ 130 crores after tax on average per year during vesting period.

(b) Number of employees expected to be entitled to option = 270

Position on 31/03/17

(a) The company earned ₹ 128 crores after tax on average per year during vesting period.

(b) Number of employees entitled to option = 275

Position on July 31, 2017

Number of employees exercising option = 265

Compute expenses to recognize in each year and show important accounts in books of the company.

Solution:

Expense recognized in year 2014-15 = ₹56,000

Expense recognized in year 2015-16 = ₹1,06,000

Expense recognized in year 2016-17 = ₹85,500

Value of options forfeited = ₹9,000

Study Note - 7

VOLUNTARY DISCLOSURES

This Study Note includes

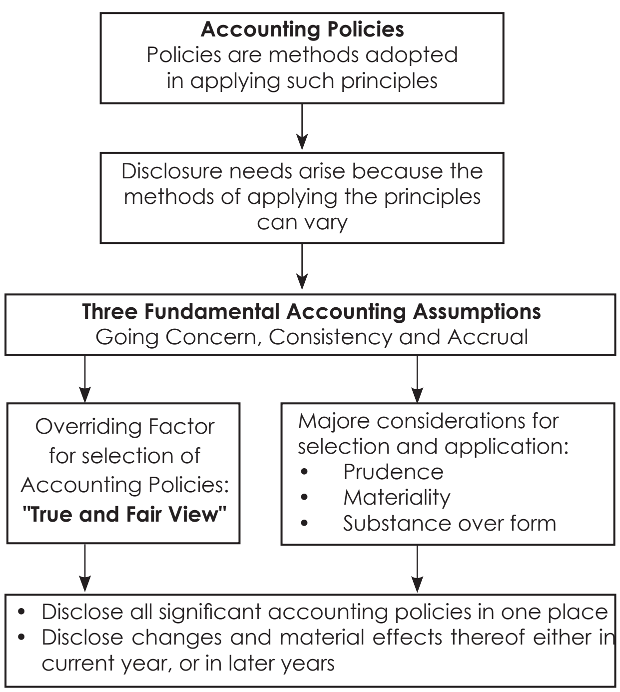
7.1 Disclosure Issues
7.2 Value Added Statement
7.3 Economic Value Added, Market Value Added, Shareholder's Value Added
7.4 Human Resource Accounting
7.5 Environmental Accounting
7.6 Guidance Notes on Accounting for Tax Matters
7.7 Financial Reporting by Mutual Funds, Merchant Bankers, Non Banking Finance Companies, Stock and Commodity Market Intermediaries
7.8 Guidance Notes on Derivatives
7.9 Guidance Notes for Special Business/Reports
7.10 Management Discussion and Analysis

7.1 DISCLOSURE ISSUES

AS – 1 DISCLOSURE OF ACCOUNTING POLICIES

Accounting Policies refer to specific accounting principles and the method of applying those principles adopted by the enterprises in preparation and presentation of the financial statements.

DIAGRAMMATIC REPRESENTATION



AS – 2 VALUATION OF INVENTORIES

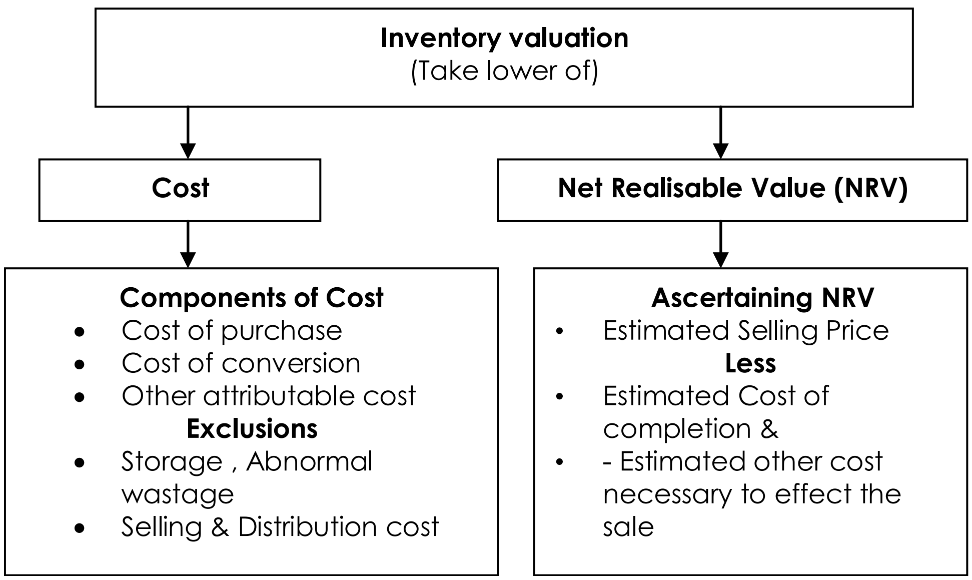
The objective of this standard is to formulate the method of computation of cost of inventories / stock, determine the value of closing stock / inventory at which the inventory is to be shown in balance sheet till it is not sold and recognized as revenue.

DISCLOSURE:

The financial statement should disclose the following:

- Accounting policy adopted in measuring inventories.
- Cost formula used.
- Classification of inventories – like finished goods, WIP, raw material, spare parts and its carrying amount.

DIAGRAMMATIC REPRESENTATION



Cost Aspects

NRV Aspects

Cost of Purchase

- Purchase price
- Duties and taxes on purchases (net of refund if any)
- Freight inward
- Other acquisition cost in simple, the landed cost
- ED net of cenvat credit availed

Estimated NRV

- Reliable evidence
- Price Fluctuations
- Events occuring after balance sheet date

Ascertainment based on estimation

Conversion costs

- Direct labour
- Variable production overhead
- Fixed costs (relatively constant for Normal capacity)

Estimating NRV

- Firm sales - Contract price
- Excess inventory beyond contract requirement - General selling price

Provide for –
Contingent losses as per AS 29

Other costs

- Directly attributable to bring items to their present location and condition

Joint costs to be allocated on a consistant and rational basis

Ascertain and reduce NRV of small value by-products etc. from cost of main product

For Materials and other supplies used in production (WIP):
Examine and relate the sale value of FG
Consider replacement cost for decline in price of materials

Select and apply appropriate Cost Formula FIFO, Weighted Average, Specific identification method Techniques

Standard Cost or Retail Inventory Method Review Annually

Valuation can be Individual item method

In select areas , Valuation can be Group (or Global) method

Disclose:

- Inventory valuation policy
- Changes of policy,if any
- Impact of such changes

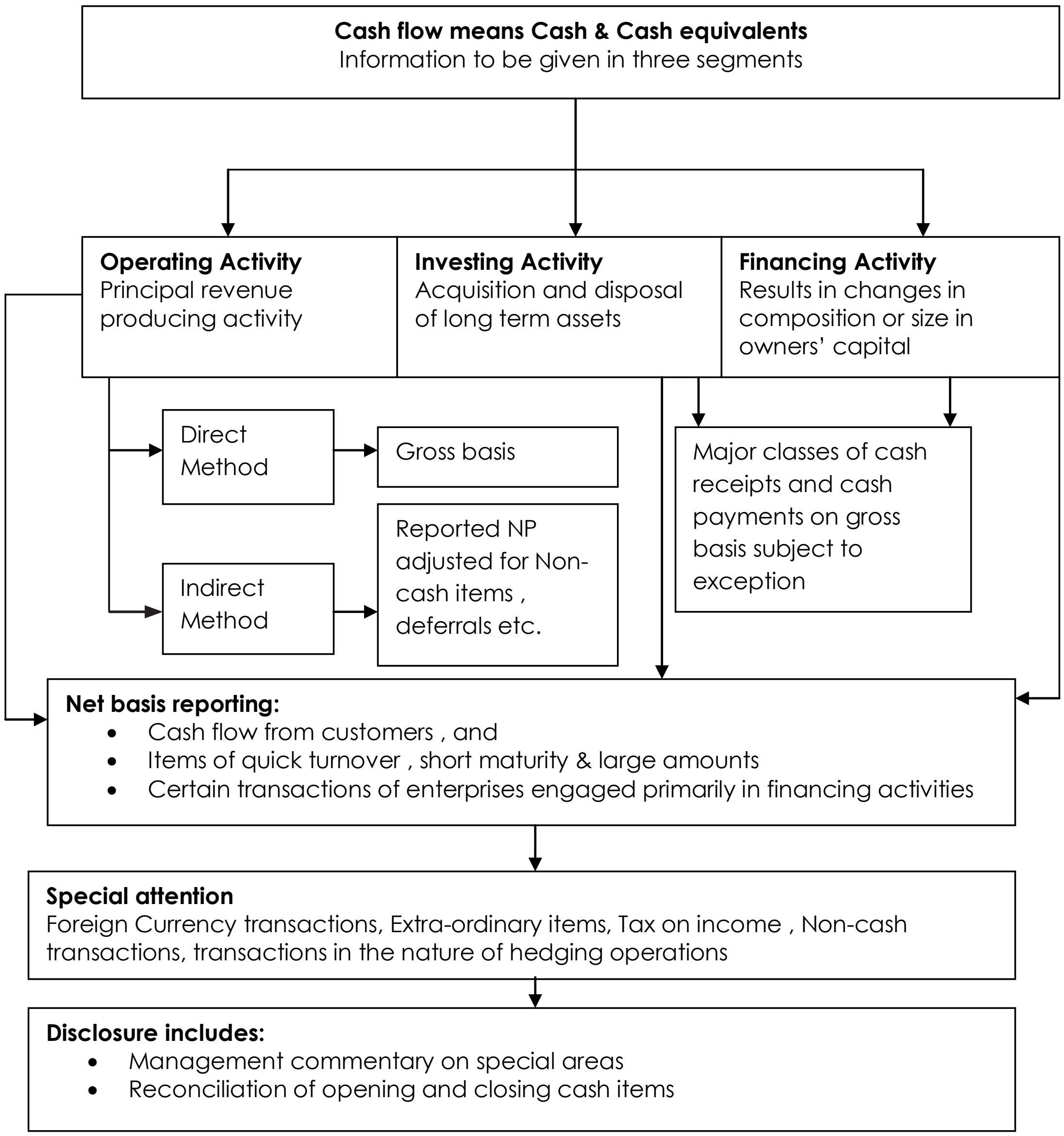
AS – 3 CASH FLOW STATEMENTS

Cash flow statement is additional information to user of financial statement. This statement exhibits the flow of incoming and outgoing cash. This statement assesses the ability of the enterprise to generate cash and to utilize the cash. This statement is one of the tools for assessing the liquidity and solvency of the enterprise.

DISCLOSURE OF CASH AND CASH EQUIVALENTS

- An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amount in the cash flow statement with the equivalent items reported in the balance sheet.
- An enterprise should disclose the amount of significant cash and cash equivalent balance held by the enterprises that are not available for use by it with explanation of Management.

DIAGRAMMATIC REPRESENTATION



AS – 4 CONTIGENCIES AND EVENTS OCCURING AFTER THE BALANCE SHEET DATE

In preparing financial statement of a particular enterprise, accounting is done by following accrual basis of accounting and prudent accounting policies to calculate the profit or loss for the year and to recognize assets and liabilities in balance sheet. While following the prudent accounting policies, the provision is made for all known liabilities and losses even for those liabilities / events, which are probable. Professional judgement is required to classify the likehood of the future events occuring and, therefore, the question of contingencies and their accounting arises.

Objective of this standard is to prescribe the accounting of contigencies and the events, which take place after the balance sheet date but before approval of balance sheet by Board of Directors. The Accounting Standard deals with Contingencies and Events occuring after the balance sheet date.

DISCLOSURE:

If material contingent loss is not provided for, its nature and an estimate of financial effect should be disclosed by way of note.

If estimate of financial effect cannot be made, the fact should be disclosed.

DIAGRAMATIC REPRESENTATION

Post Balance Sheet Events

Events that occur

After the Balance Sheet date | **Before** approval of accounts by the Governing

Two possibilities
- Adjusting events – requiring adjustments of assets or liabilities
- Non Adjusting events

Adjusting events
- That provides additional evidence and
- Assist in estimation of amount
- Going Concern assumption rendered invalid
- Proposed Dividends

Non Adjusting Events
- Events that do not affect B/S figures
- Disclose in report of approving authorities (say Board)

Disclosure
- Nature of event
- An estimate of financial effect, or a statement that such an estimate cannot be made

AS – 5 NET PROFIT OR LOSS FOR THE PERIOD, PRIOR PERIOD ITEMS AND CHANGE IN ACCOUNTING POLICIES

The objective of this accounting standard is to prescribe the criteria for certain items in the profit and loss account so that comparability of the financial statement can be enhanced. Profit and loss account being a period statement covers the items of the income and expenditure of the particular period. This accounting standard also deals with change in accounting policy, accounting estimates and extraordinary items.

DISCLOSURE:

DISCLOSURE OF PRIOR PERIOD ITEMS:

The nature and amount of prior period items should be separately disclosed in the statement of profit and loss in a manner that their impact on current profit or loss can be perceived.

DISCLOSURE OF ACCOUNTING ESTIMATE:

- The effect of a change in accounting estimate disclosed in net profit or loss
- The period of change, if the change affects the period only
- The period of change and future periods, if the change affects both

DISCLOSURE OF CHANGE IN ACCOUNTING POLICIES:

- Material effect should be shown in financial statement to reflect the effect of such change
- This effect should be disclosed in the year of change
- If the effect of change is not ascertainable , the fact should be disclosed
- If the effect of change is not material for current period, but it is material effect for the later period, then fact should be disclosed in the period of change.

DIAGRAMMATIC REPRESENTATION

Net profit or loss for the period

Include all items of income and expenses recognized for the period

Disclose separately-
- Ordinary activities
- Extraordinary items- so that impact on Current year result can be perceived

Prior period items

Result of errors or omission in the preparation or presentation of FS of one or more prior periods

Disclose separately-
- Nature and amount of such items so that impact on CY result can be perceived
- Can be either above the line , or below the line

Change in Accounting Policies

Make change only if –
- Required by statute or standard
- Leads to better presentation to enhance

Disclose separately-
- Material effect of change:
  - Current period
  - Later periods
- Also state if impact of change is not ascertainable

Change in Accounting Estimates - CAE

- Neither a prior period item nor an extraordinary item
- Determine impact of CAE , include in the determination of P&L of relevant period(s)
- Use the same classification as earlier adopted
- Consider materiality disclosed separately
- Also state clearly if the impact of CAE cannot be quantified in monetary terms

AS – 6 DEPRECIATION ACCOUNTING

It is a measure of wearing out, consumption or other loss of value of a depreciable asset arising from use, passage of time. Depreciation is nothing but distribution of total cost of asset over its useful life.

DISCLOSURE:

- Total cost of each class of assets – historical cost or revalued cost.
- Total depreciation for the period of each class of assets.
- Accumulated depreciation of each class of assets.
- Depreciation method.
- Depreciation rates or the useful life of asset, if they are different than the rates specified in governing statute.
- A change in method of depreciation is treated as a change in accounting policy and is disclosed separately.
- Effect of the revaluation of the fixed asset on the amount of depreciation.

DIAGRAMMATIC REPRESENTATION

Basic principle
Understand the nature of Fixed asset and adopt Matching

Three basic elements of measuring depreciation

Historical Cost or Substituted value

Estimated useful economic life

Estimated Residual Value

Estimation in these areas involves **"subjectivity"**

Based on estimates , determine the depreciable amount and amortise the same over the useful life , on a systematic and rational basis

Apply appropriate method based on type of asset , nature of use and economic

Change method only for compliance with Stature of Standard or for better presentation of financial information

- The change is equivalent to a change in accounting policy – quantify and make adequate disclosure
- Depreciation is to be recomputed and charged retrospectively

- Conduct periodical review of 3 basic elements
- Modify and amend depreciation charge on a prospective basis covering the unamortized amount over residual life of asset
- Make appropriate disclosure

Disclose

- Historical cost
- Total depreciation for each class of assets
- Method applied
- Rates, if different from Schedule II rates
- Surplus or deficiency on disposal, if material & Schedule III requirement

AS – 7 CONSTRUCTION CONTRACTS

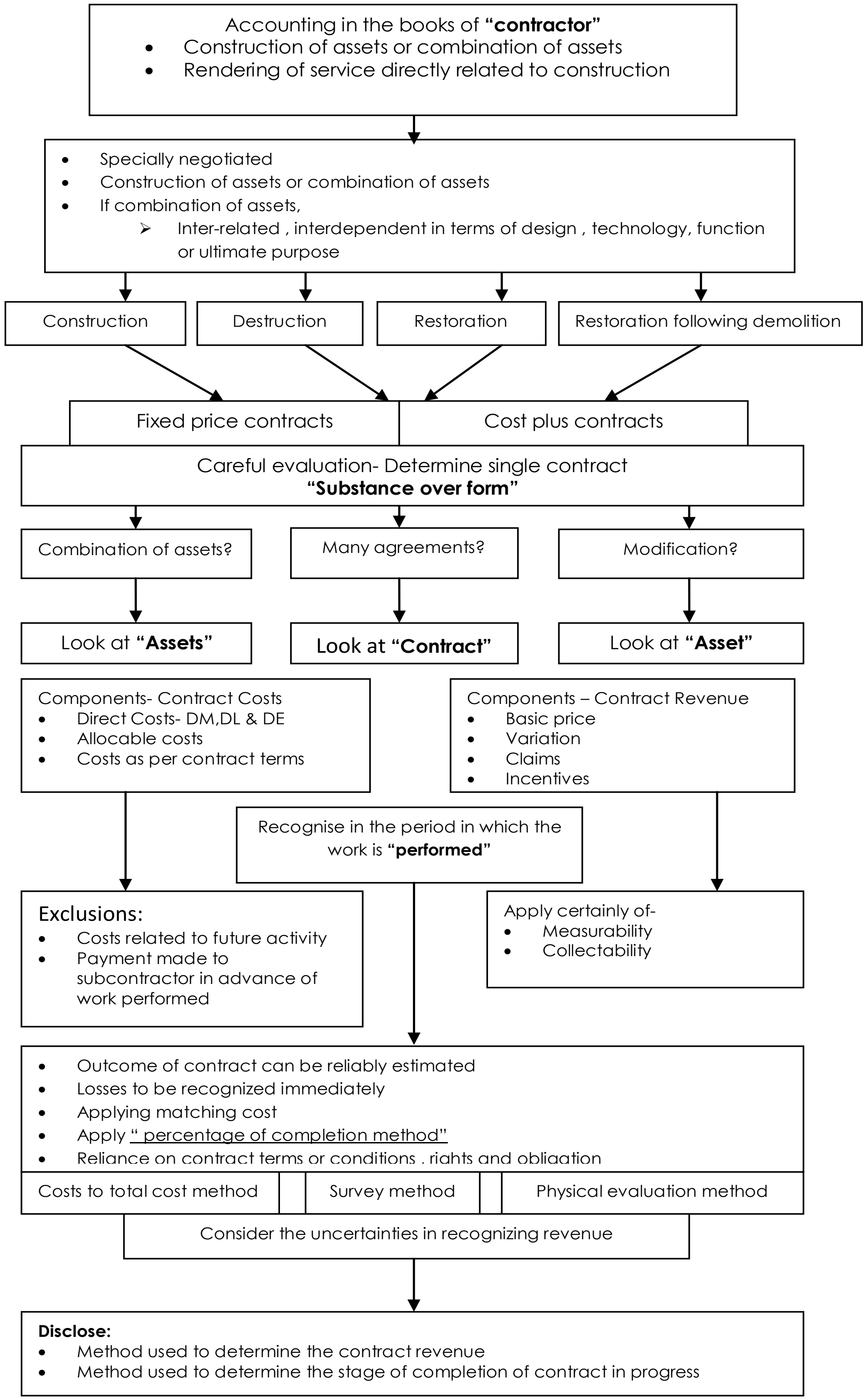
Accounting for long term construction contracts involves question as to when revenue should be recognized and how to measure the revenue in the books of contractor. As the period of construction contract is long, work of construction starts in one year and is completed in another year or after 4-5 years or so. Therefore question arises how the profit or loss of construction contract by contractor should be determined. There may be following two ways to determine profit or loss: on year-to-year basis based on percentage of completion or on completion of the contract.

DISCLOSURE:

An enterprise should disclose the following policies:-

- The method used to determine the stage of completion of contract in progress
- The method used to determine the contract revenue recognised
- The amount of contract revenue recognized in the period
- Contract cost incurred and recognized profit (less recognized losses) up to the reporting period
- Advance received
- Gross amount due from customers for contract work [(cost incurred + recognized profit) – (some of recognized losses + progress billing)]
- Gross amount due to customer for contract work [(some of recognized losses + progress billing) – (cost incurred + recognized profit)]

DIAGRAMMATIC REPRESENTATION



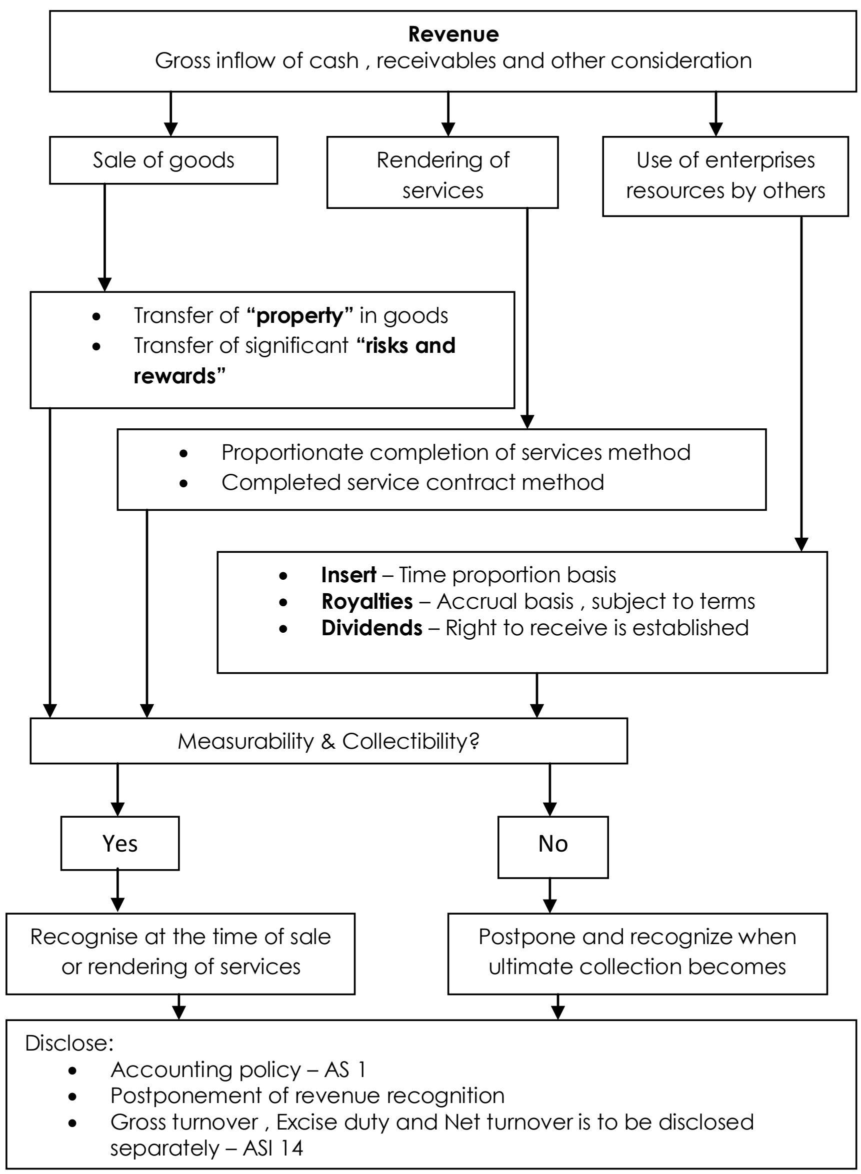
AS – 9 REVENUE RECOGNITION

The standard explains as to when the revenue should be recognized in profit and loss account and also states the circumstances in which revenue recognition can be postponed. Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as: - The sale of goods, Rendering of Services, and Use of enterprises resources by other yielding interest, dividend and royalties. In other words, revenue is a charge made to customers / clients for goods supplied and services rendered.

DISCLOSURE:

In addition to the disclosures required by Accounting Standard 1 on 'Disclosure of Accounting Policies' (AS-1), an enterprise should also disclose the circumstances in which revenue recognition has been postponed pending the resolution of significant uncertainties.

DIAGRAMMATIC REPRESENTATION



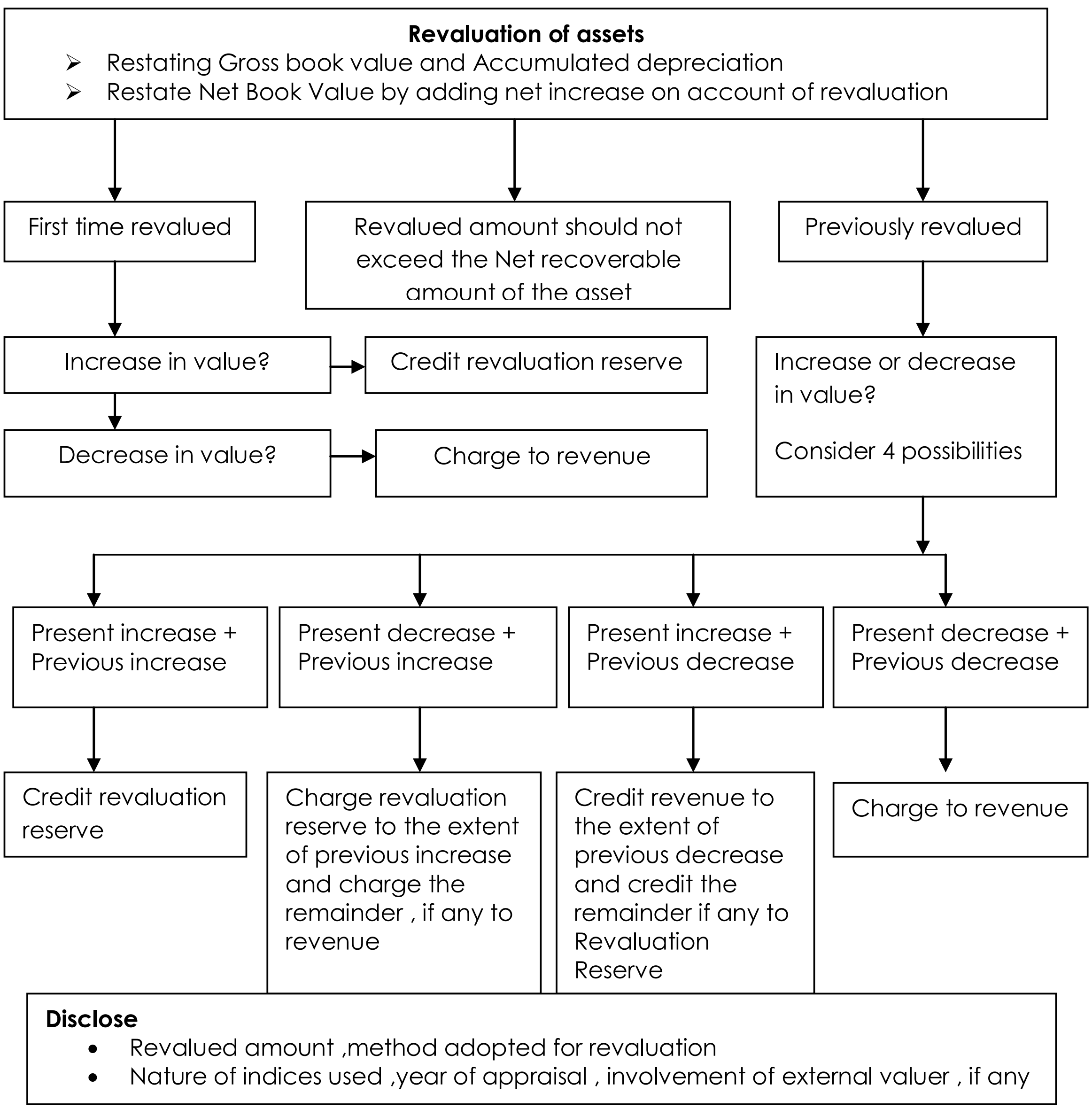
AS – 10 ACCOUNTING FOR FIXED ASSETS

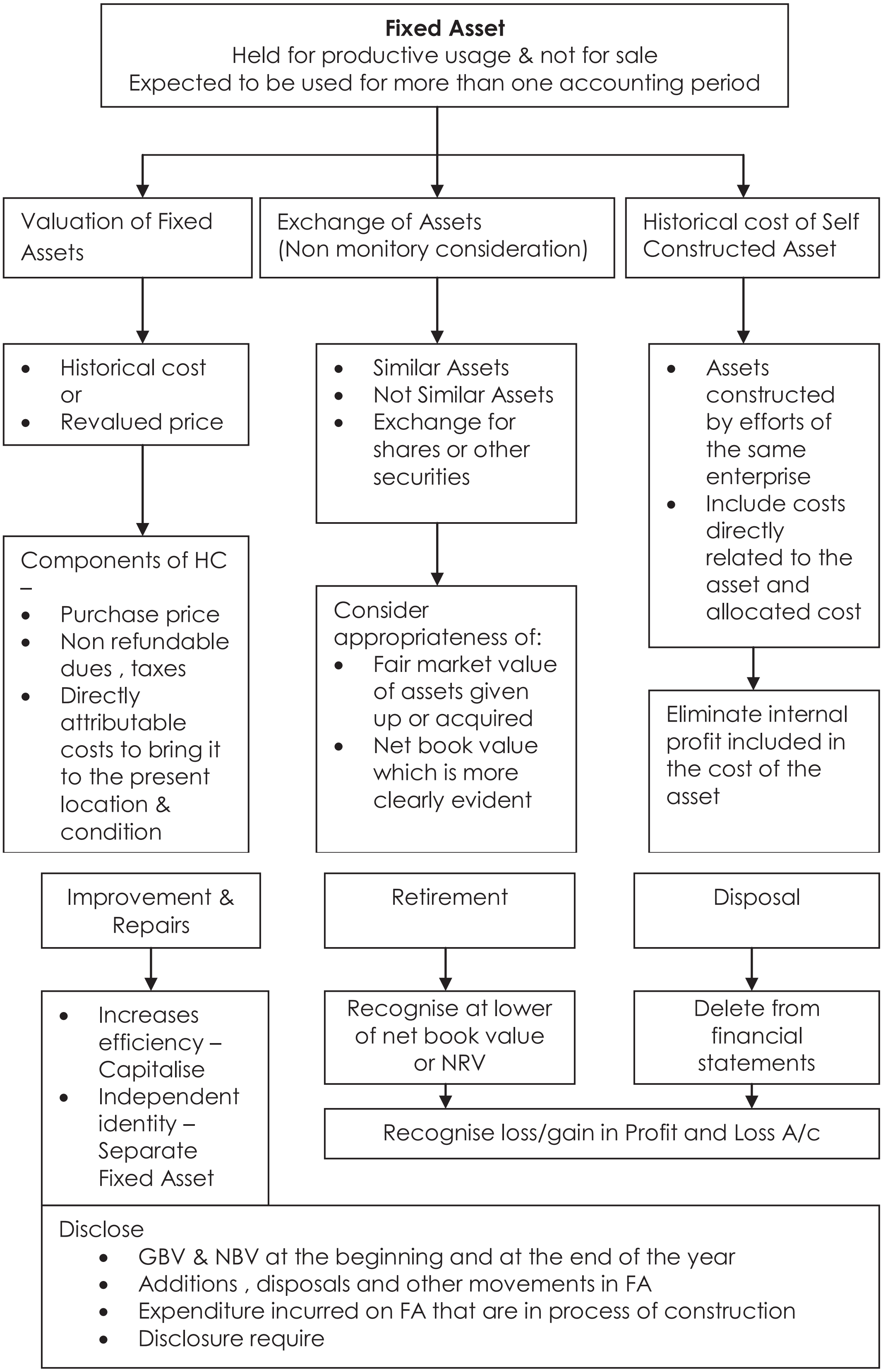
It is an asset, which is held with intention of being used for the purpose of producing or providing goods and services. Not held for sale in the normal course of business. Expected to be used for more than one accounting period.

DISCLOSURE:

- Gross and net book values of fixed assets at the beginning and at the end of accounting period showing additions, disposal, acquisition and other movements.
- Expenditure incurred on account of fixed assets in the course of construction or acquisition.
- Revalued amount substituted for historical cost of fixed assets, the method adopted to compute the revalued amount, and whether an external valuer has valued the fixed assets, in case where fixed assets are stated at revalued amount.

DIAGRAMMATIC REPRESENTATION




Fixed Asset
Held for productive usage & not for sale
Expected to be used for more than one accounting period
Valuation of Fixed Assets
Exchange of Assets (Non monitory consideration)
Historical cost of Self Constructed Asset
• Historical cost or
• Revalued price
• Similar Assets
• Not Similar Assets
• Exchange for shares or other securities
• Assets constructed by efforts of the same enterprise
• Include costs directly related to the asset and allocated cost
Components of HC –
• Purchase price
• Non refundable dues , taxes
• Directly attributable costs to bring it to the present location & condition
Consider appropriateness of:
• Fair market value of assets given up or acquired
• Net book value which is more clearly evident
Eliminate internal profit included in the cost of the asset
Improvement & Repairs
Retirement
Disposal
• Increases efficiency – Capitalise
• Independent identity – Separate Fixed Asset
Recognise at lower of net book value or NRV
Delete from financial statements
Recognise loss/gain in Profit and Loss A/c
Disclose
• GBV & NBV at the beginning and at the end of the year
• Additions , disposals and other movements in FA
• Expenditure incurred on FA that are in process of construction
• Disclosure require

AS – 11 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Effect of Changes in Foreign Exchange Rate shall be applicable in Respect of Accounting Period commencing on or after 01-04-2004 and is mandatory in nature. This accounting Standard applicable to accounting for transaction in Foreign currencies in translating in the Financial Statement of foreign operation Integral as well as non- integral and also accounting for forward exchange. Effect of Changes in Foreign Exchange Rate, enterprises should disclose following aspects:

Amount Exchange Difference included in Net profit or Loss;

Amount accumulated in Foreign Exchange Translation Reserve;

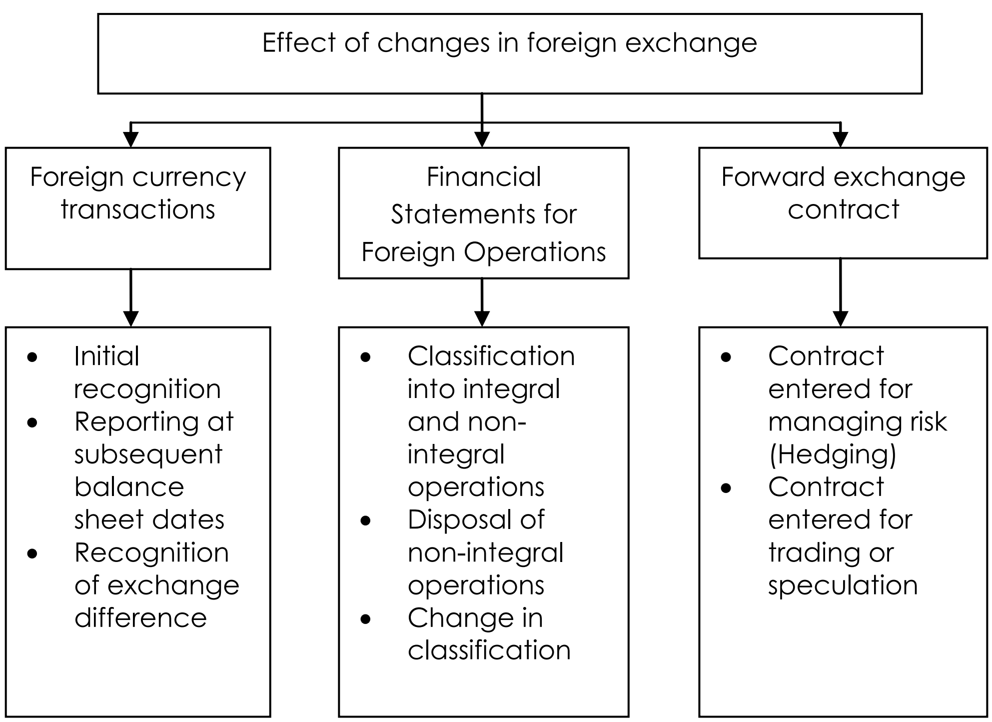
Reconciliation of opening and closing balance of Foreign Exchange Translation Reserve;

DISCLOSURES:

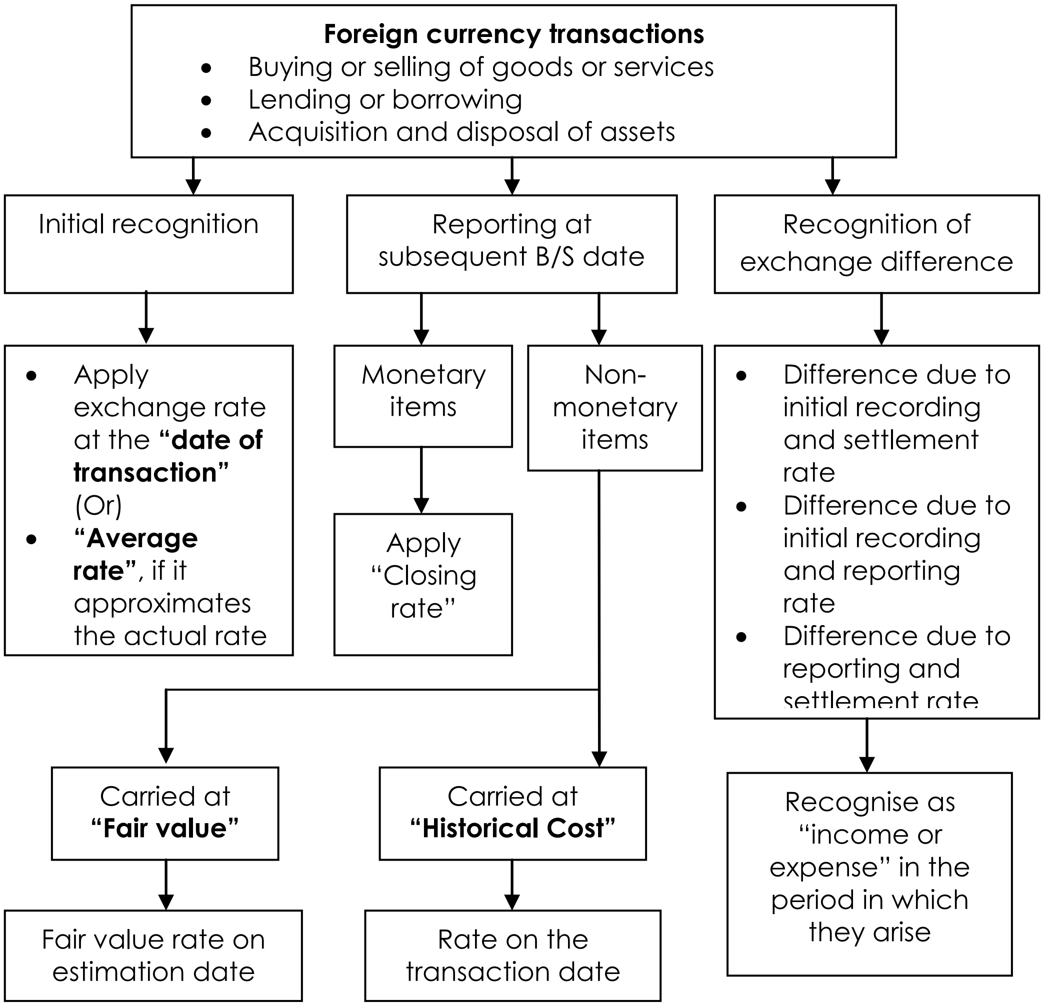
An enterprise should disclose-

- Amount of exchange difference included in the net profit or loss
- Amount accumulated in foreign exchange translation reserve
- Reconciliation of opening and closing balance of foreign exchange translation reserve
- If the reporting currency is different from the currency of the country in which entity is domiciled, the reason for such difference.
- A change in classification of significant foreign operation needs following disclosures-
    - Nature of change in classification
    - The reason for the change
    - Effect of such change on shareholders fund
    - Impact of change on net profit or loss for each prior period presented
    - The disclosure is also encouraged of an enterprise's foreign currency risk management policy.

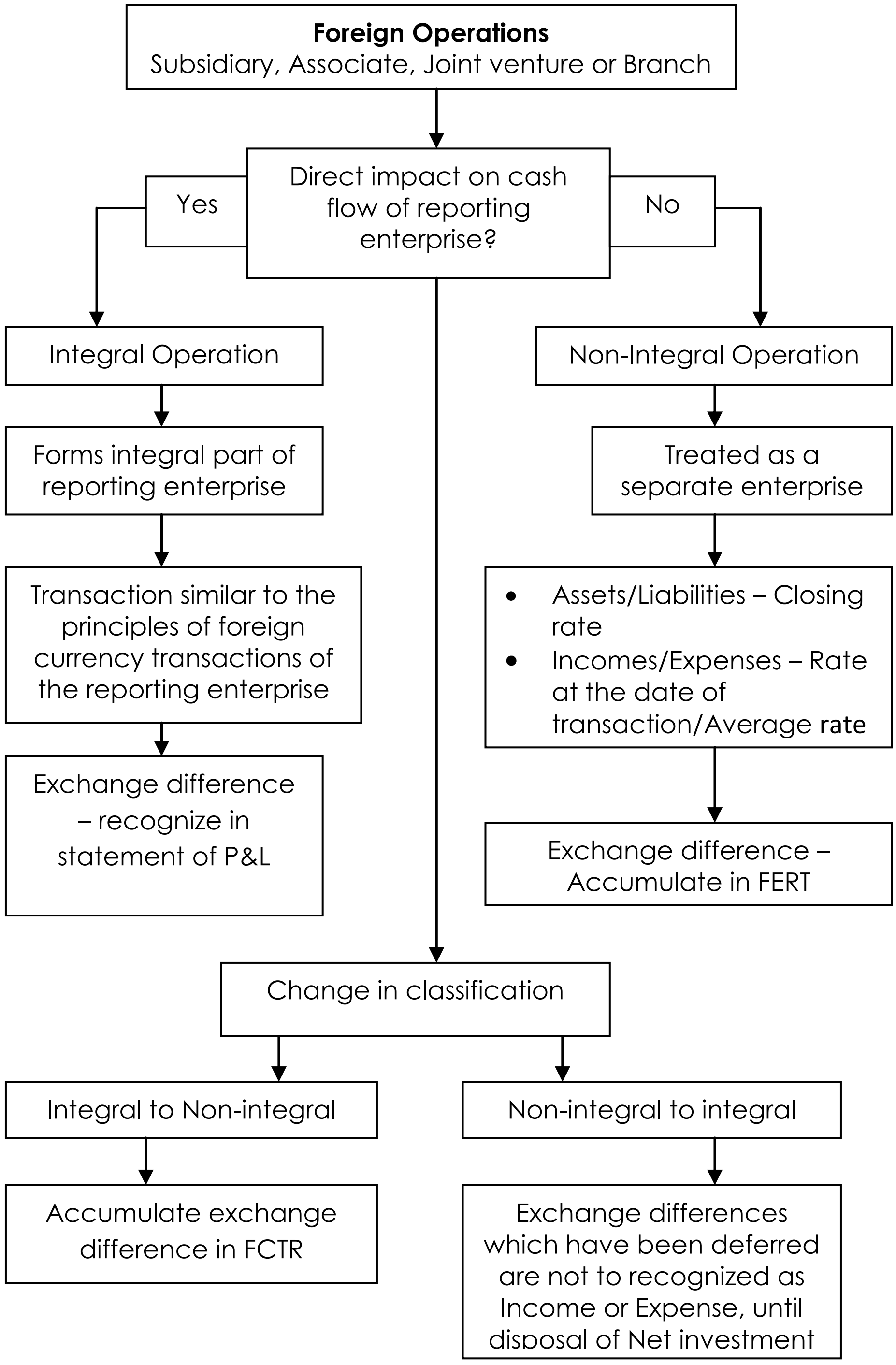
DIAGRAMMATIC REPRESENTATION



Segment I

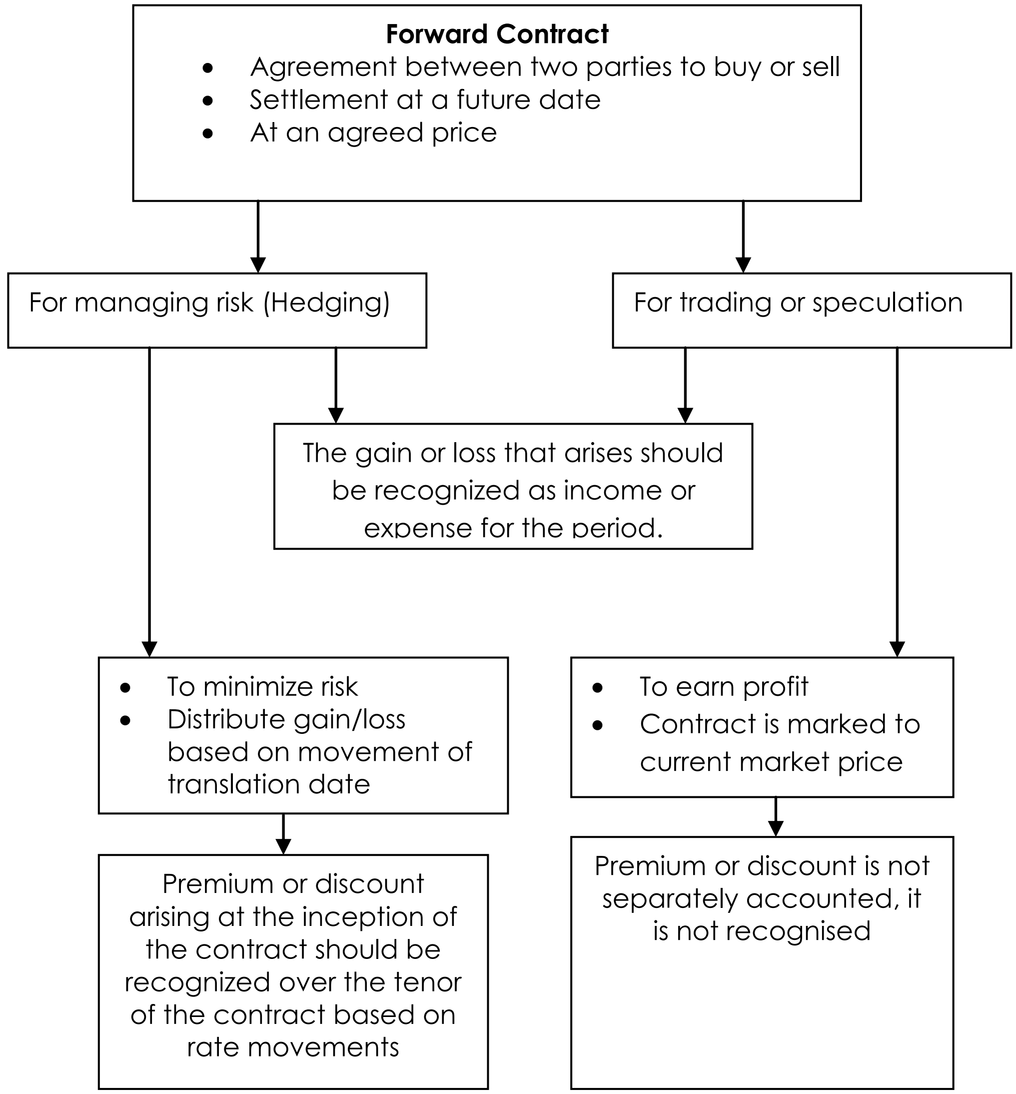

Foreign currency transactions
Buying or selling of goods or services
Lending or borrowing
Acquisition and disposal of assets
Initial recognition
Reporting at subsequent B/S date
Recognition of exchange difference
Apply exchange rate at the "date of transaction" (Or) "Average rate", if it approximates the actual rate
Monetary items
Non-monetary items
Difference due to initial recording and settlement rate
Difference due to initial recording and reporting rate
Difference due to reporting and settlement rate
Apply "Closing rate"
Carried at "Fair value"
Carried at "Historical Cost"
Recognise as "income or expense" in the period in which they arise
Fair value rate on estimation date
Rate on the transaction date

Segment II



Foreign Operations
Subsidiary, Associate, Joint venture or Branch
Direct impact on cash flow of reporting enterprise?
Yes
No
Integral Operation
Forms integral part of reporting enterprise
Transaction similar to the principles of foreign currency transactions of the reporting enterprise
Exchange difference – recognize in statement of P&L
Non-Integral Operation
Treated as a separate enterprise
• Assets/Liabilities – Closing rate
• Incomes/Expenses – Rate at the date of transaction/Average rate
Exchange difference – Accumulate in FERT
Change in classification
Integral to Non-integral
Accumulate exchange difference in FCTR
Non-integral to integral
Exchange differences which have been deferred are not to recognized as Income or Expense, until disposal of Net investment

Segment III


Forward Contract
• Agreement between two parties to buy or sell
• Settlement at a future date
• At an agreed price
For managing risk (Hedging)
For trading or speculation
The gain or loss that arises should be recognized as income or expense for the period.
• To minimize risk
• Distribute gain/loss based on movement of translation date
• To earn profit
• Contract is marked to current market price
Premium or discount arising at the inception of the contract should be recognized over the tenor of the contract based on rate movements
Premium or discount is not separately accounted, it is not recognised

AS – 12 ACCOUNTING FOR GOVERNMENT GRANTS

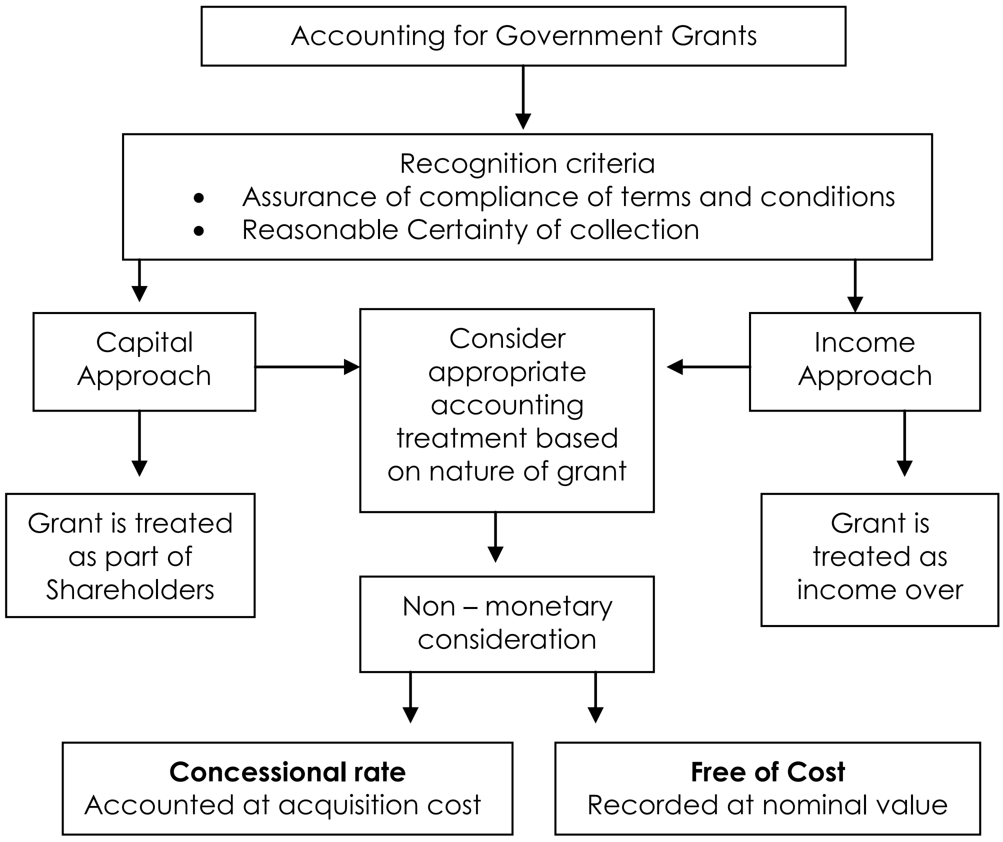
Government Grants are assistance by the Govt. in the form of cash or kind to an enterprise in return for past or future compliance with certain conditions. Government assistance, which cannot be valued reasonably, is excluded from Govt. grants. Those transactions with Government, which cannot be distinguished from the normal trading transactions of the enterprise, are not considered as Government grants.

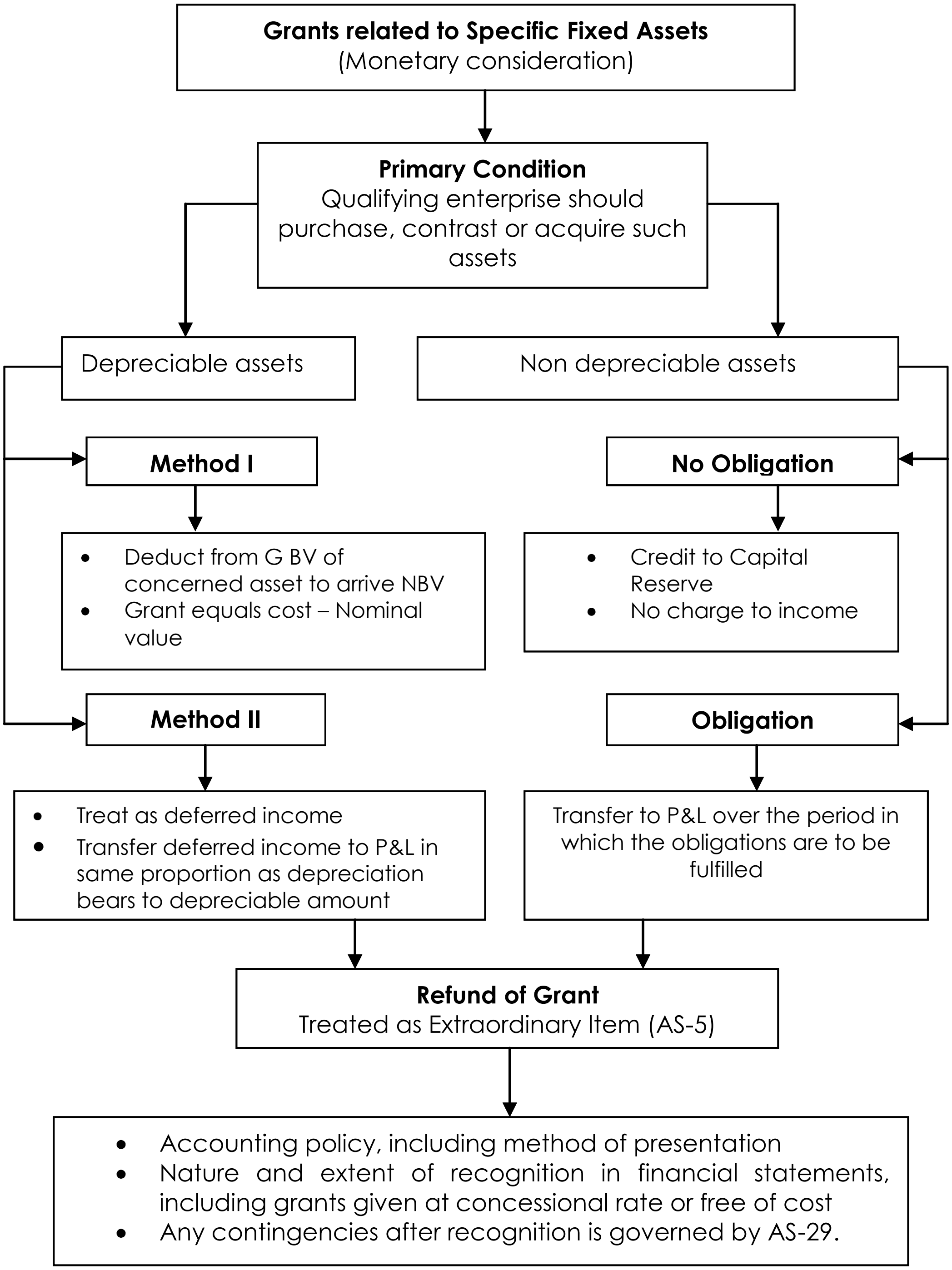
DISCLOSURE:

The following disclosure are appropriate:

- The accounting policy adopted for Government grants including the methods of presentation in the financial statement.
- The nature and extent of Govt. grants recognized in the financial statements including grants of non-monetary assets given at a concessional rate or free of cost.

DIAGRAMMATIC REPRESENTATION




Grants related to Specific Fixed Assets
(Monetary consideration)
Primary Condition
Qualifying enterprise should purchase, contrast or acquire such assets
Depreciable assets
Non depreciable assets
Method I
Deduct from G BV of concerned asset to arrive NBV
Grant equals cost – Nominal value
No Obligation
Credit to Capital Reserve
No charge to income
Method II
Treat as deferred income
Transfer deferred income to P&L in same proportion as depreciation bears to depreciable amount
Obligation
Transfer to P&L over the period in which the obligations are to be fulfilled
Refund of Grant
Treated as Extraordinary Item (AS-5)
Accounting policy, including method of presentation
Nature and extent of recognition in financial statements, including grants given at concessional rate or free of cost
Any contingencies after recognition is governed by AS-29.

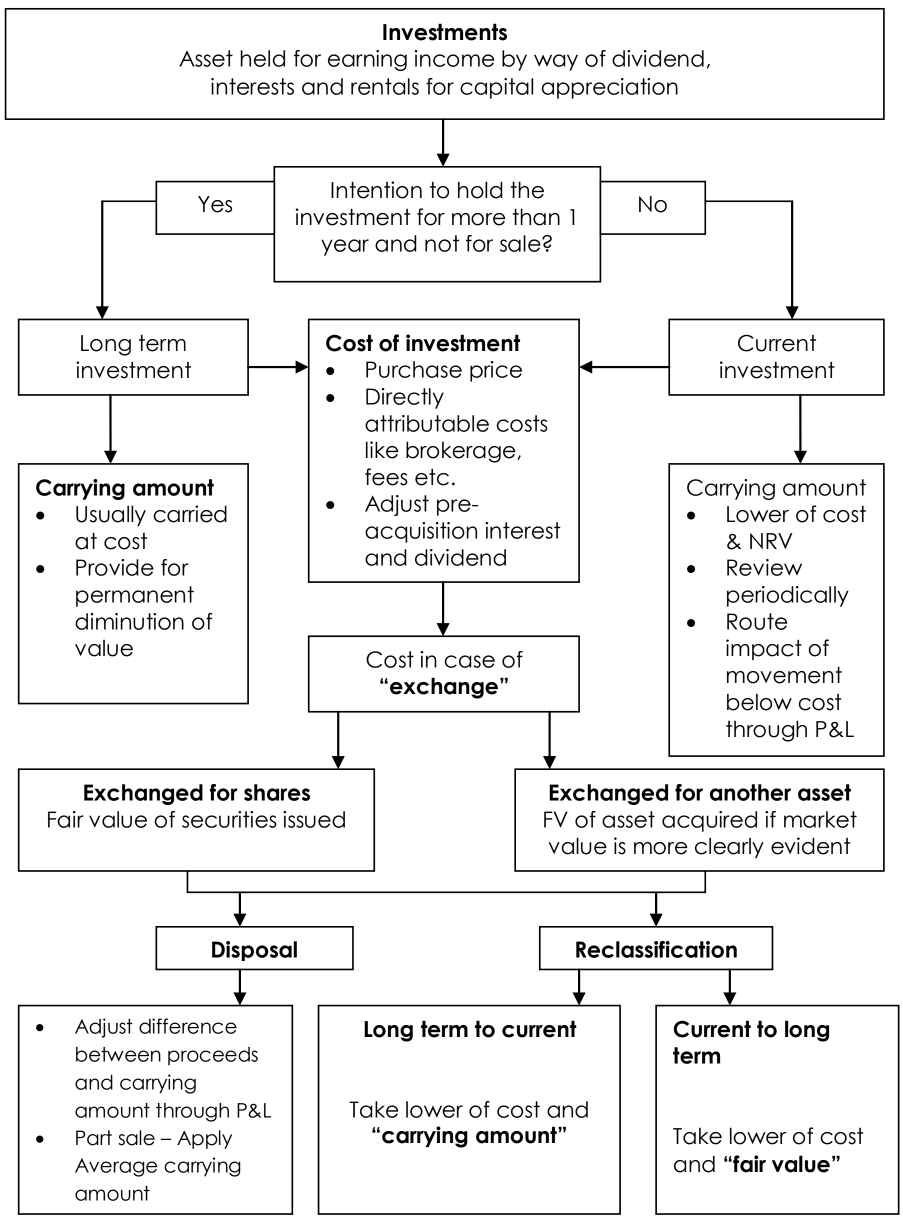
AS – 13 ACCOUNTING FOR INVESTMENTS

It is the assets held for earning income by way of dividend, interest and rentals, for capital appreciation or for other benefits.

DISCLOSURE:

- Accounting policies followed for valuation of investment.
- Classification of investment into current and long term in addition to classification as per Schedule III of Companies Act in case of companies.
- Aggregate amount of quoted & unquoted securities separately.
- Any significant restriction on investment like minimum holding period for sale/disposal, utilization of sale proceeds, or non-remittance of sale proceeds of investment held outside India.

DIAGRAMMATIC REPRESENTATION



AS – 14 ACCOUNTING FOR AMALGAMATION

This accounting standard deals with accounting to be made in books of Transferee company in case of amalgamation. This accounting standard is not applicable to cases of acquisition of shares when one company acquires / purchases the share of another company and the acquired company is not dissolved and its separate entity continues to exist. The standard is applicable when acquired company is dissolved and separate entity ceased exist and purchasing company continues with the business of acquired company.

DISCLOSURE:

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

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

DIAGRAMMATIC REPRESENTATION

Amalgamation – "to unite"
Accounting in the books of purchasing company only

CONDITIONS

Assets & Liabilities

- All asset/liabilities of SC should be taken over
- All asset/liabilities should be recorded at same values that existed in SC books.

Shareholders

- Atleast 90% of shareholders of SC become shareholders of PC
- Consideration to be paid only in form of equity shares of PC. (cash for fractional shares)

Business

PC should intend to carry on existing business of SC.

All five conditions satisfied?

YES

Amalgamation in the nature of **"Merger"**

Pooling of interest method
- All asset/liabilities recorded at book values
- Difference between purchase consideration and share capital – adjust with P&L, reserves
- If purchase consideration > Share capital – debit difference to reserve (Credit to reserve if vice versa)

NO

Amalgamation in the nature of **"Purchase"**

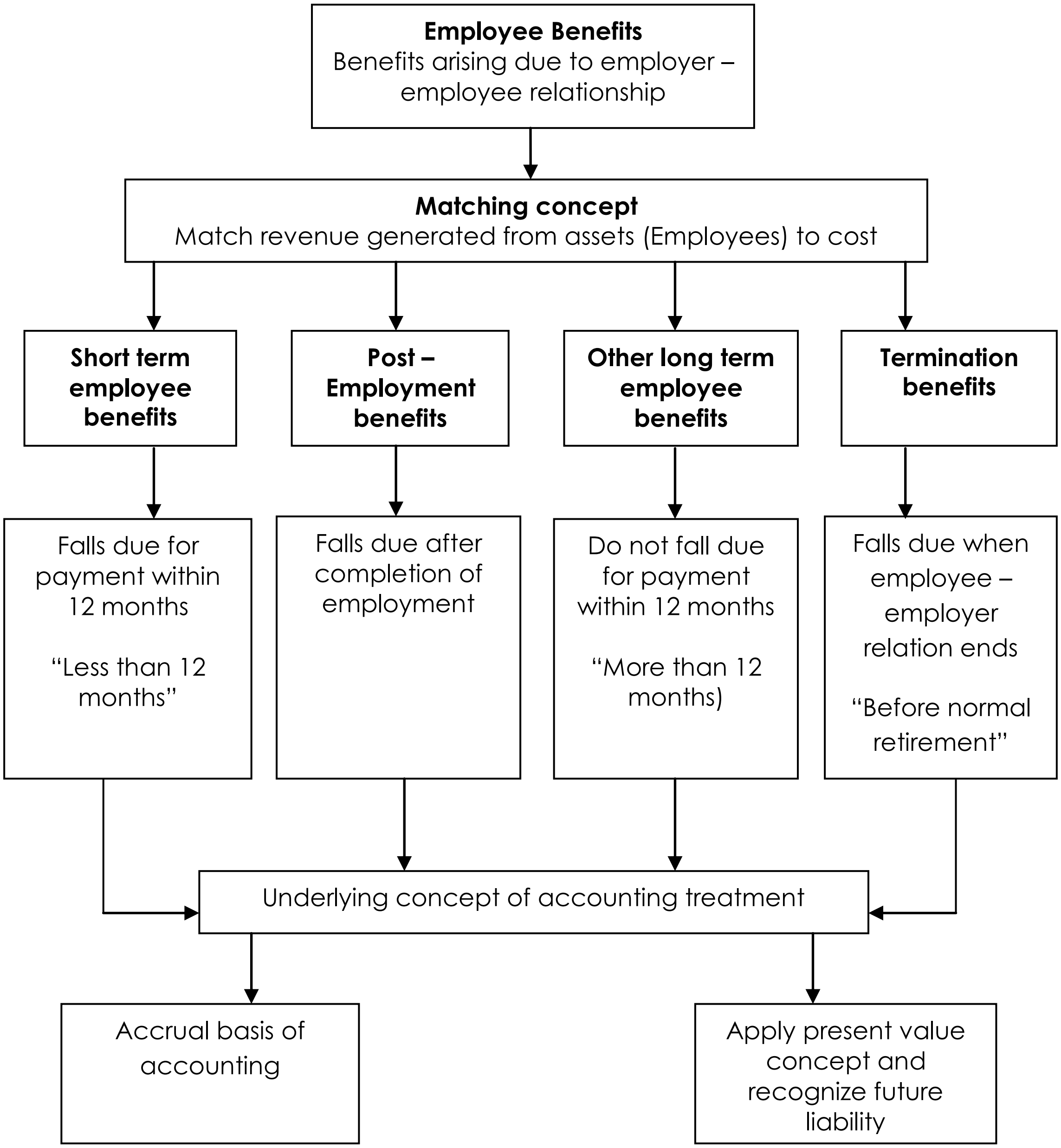
Purchase method
- All assets/liabilities recorded at fair values
- PC > Net assets – debit Goodwill
- PC < Net assets – Credit Capital reserve
(Net assets = Assets at fair values **less** liabilities at agreed values)

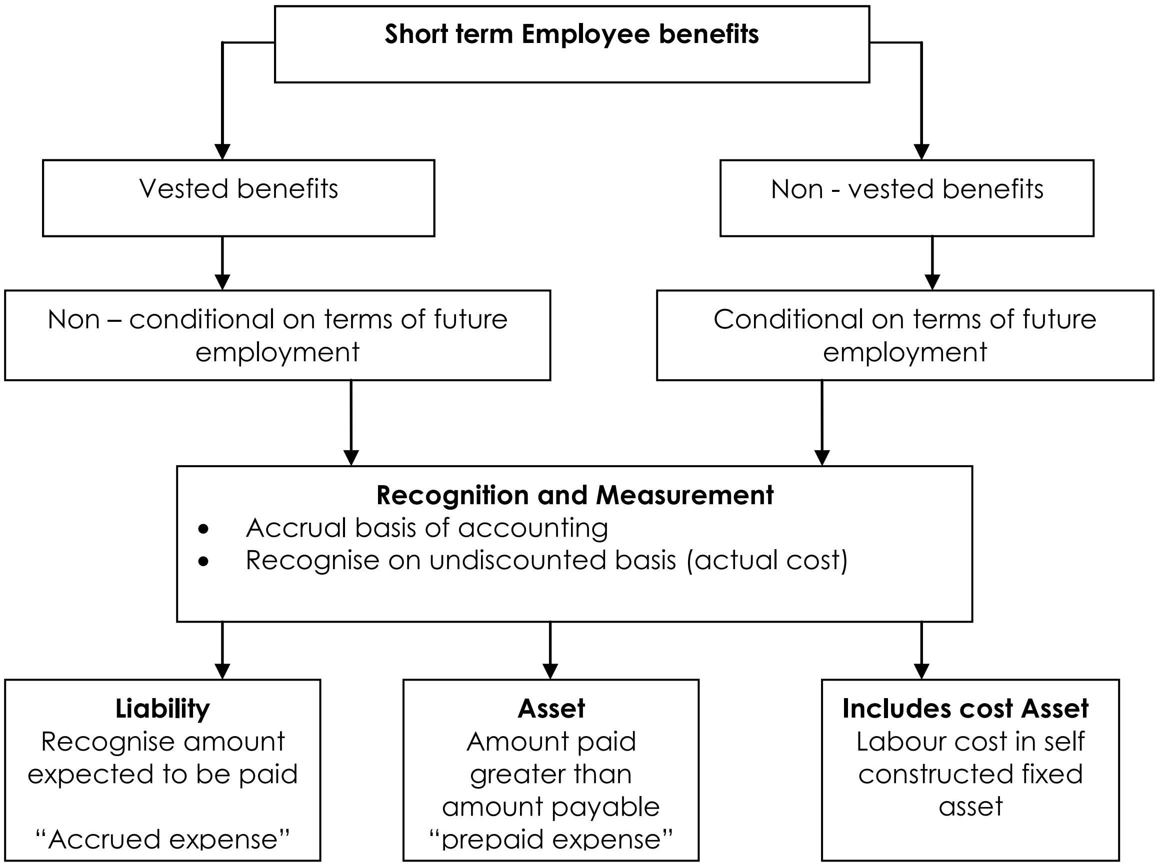
- Non-cash consideration less Record at Fair values
- Adjustment of consideration if conditional , upon one or more future uncertain events materializing
- Amalgamation after the balance sheet date – AS 4
- Separate accounting adjustment entry is not required for statutory reserves in case of mergers
- In case of purchase statutory norms to be complied with
- Disclosure covers three distinct areas – All amalgamations, Pooling of Interest and Purchase method.

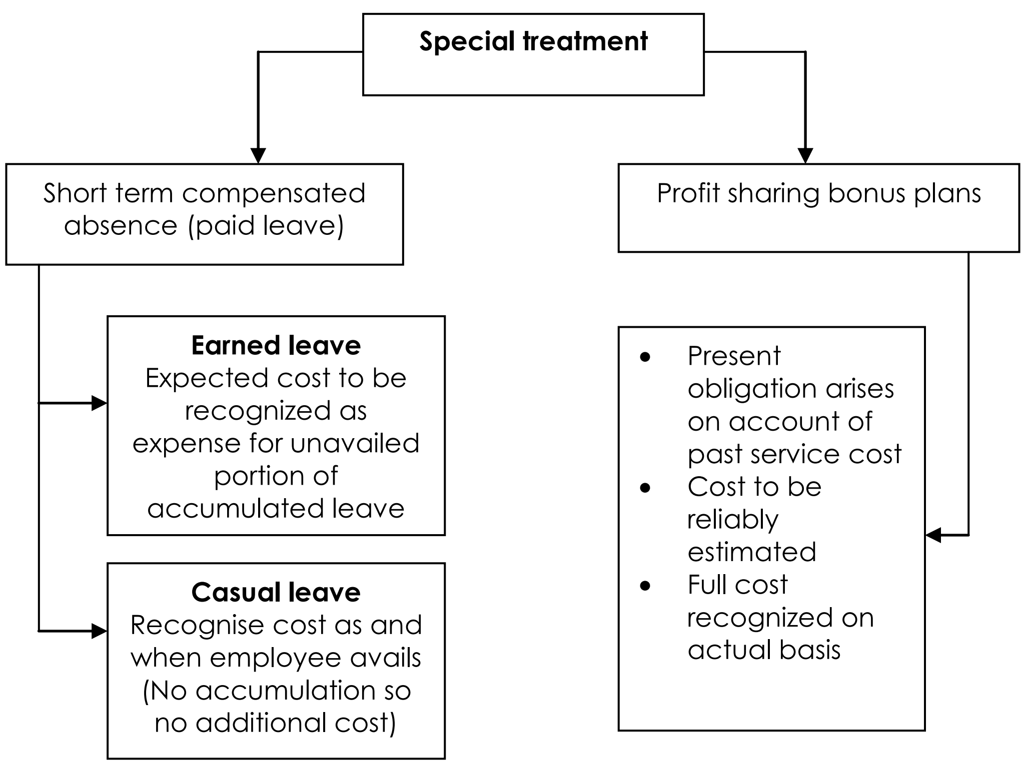
AS – 15 EMPLOYEE BENEFITS

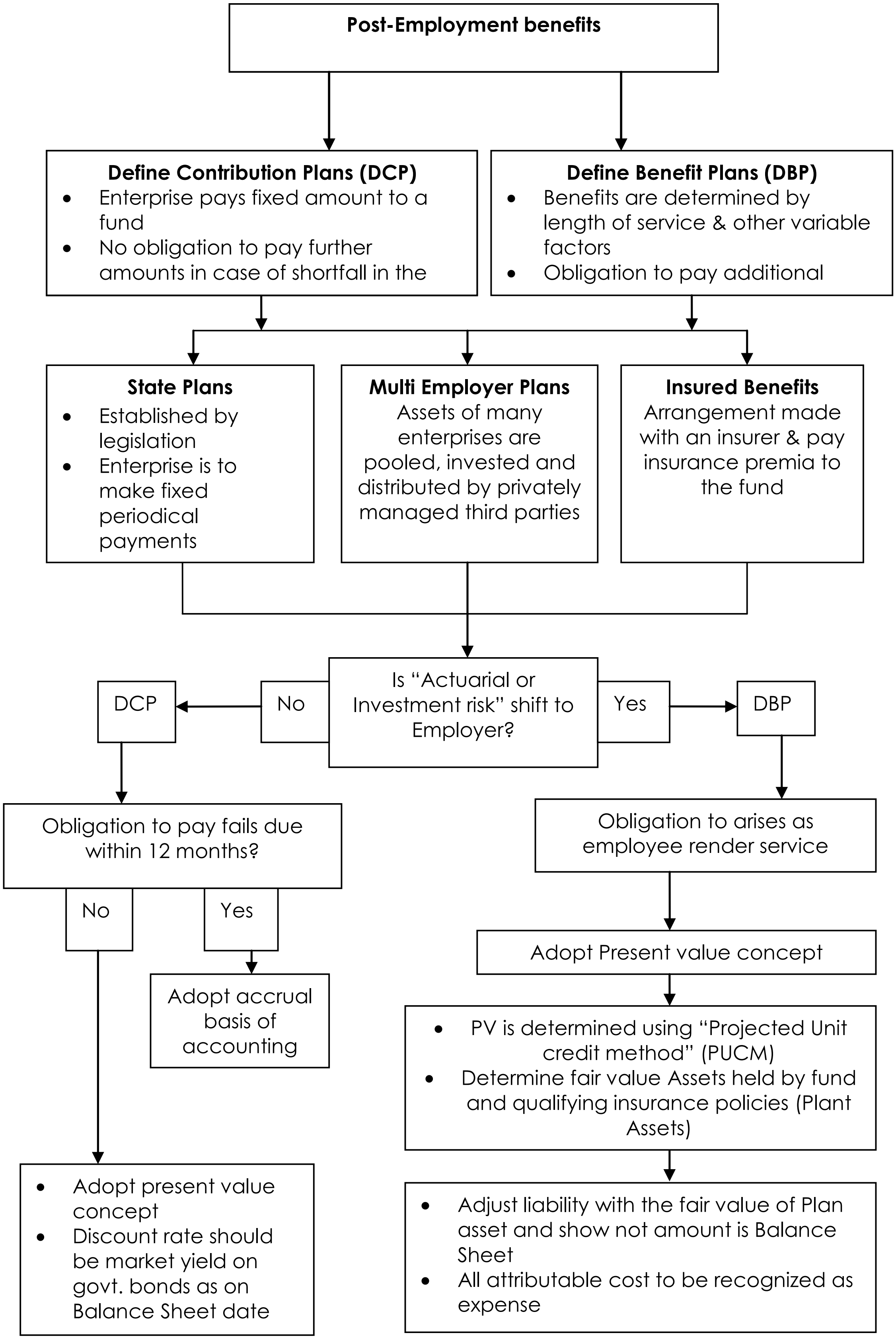
Accounting Standard has been revised by ICAI and is applicable in respect of accounting periods commencing on or after 1st April 2006. The scope of the accounting standard has been enlarged, to include accounting for short-term employee benefits and termination benefits.

DIAGRAMMATIC REPRESENTATION




Short term Employee benefits
Vested benefits
Non - vested benefits
Non – conditional on terms of future employment
Conditional on terms of future employment
Recognition and Measurement
• Accrual basis of accounting
• Recognise on undiscounted basis (actual cost)
Liability
Recognise amount expected to be paid
"Accrued expense"
Asset
Amount paid greater than amount payable
"prepaid expense"
Includes cost Asset
Labour cost in self constructed fixed asset


Special treatment
Short term compensated absence (paid leave)
Profit sharing bonus plans
Earned leave
Expected cost to be recognized as expense for unavailed portion of accumulated leave
Casual leave
Recognise cost as and when employee avails (No accumulation so no additional cost)
• Present obligation arises on account of past service cost
• Cost to be reliably estimated
• Full cost recognized on actual basis


Post-Employment benefits
Define Contribution Plans (DCP)
• Enterprise pays fixed amount to a fund
• No obligation to pay further amounts in case of shortfall in the
Define Benefit Plans (DBP)
• Benefits are determined by length of service & other variable factors
• Obligation to pay additional
State Plans
• Established by legislation
• Enterprise is to make fixed periodical payments
Multi Employer Plans
Assets of many enterprises are pooled, invested and distributed by privately managed third parties
Insured Benefits
Arrangement made with an insurer & pay insurance premia to the fund
Is “Actuarial or Investment risk” shift to Employer?
No
DCP
Yes
DBP
Obligation to pay fails due within 12 months?
No
Yes
Adopt accrual basis of accounting
• Adopt present value concept
• Discount rate should be market yield on govt. bonds as on Balance Sheet date
Obligation to arises as employee render service
Adopt Present value concept
• PV is determined using “Projected Unit credit method” (PUCM)
• Determine fair value Assets held by fund and qualifying insurance policies (Plant Assets)
• Adjust liability with the fair value of Plan asset and show not amount is Balance Sheet
• All attributable cost to be recognized as expense

Termination benefits

When does obligation arise?

Employer's decision
Terminate employment before normal retirement date

Employee's decision
Accept voluntary redundancy in exchange for benefits (VRS)

- Occurrence of obligation is uncertain
- If obligation is not met it becomes a liability

- Enterprise has present obligation as a result of past events
- Provision is to be created (AS 29)

If benefit falls due for payment more than 12 month after Balance Sheet date, benefits to be discount using **PV concept**

AS – 16 BORROWING COSTS

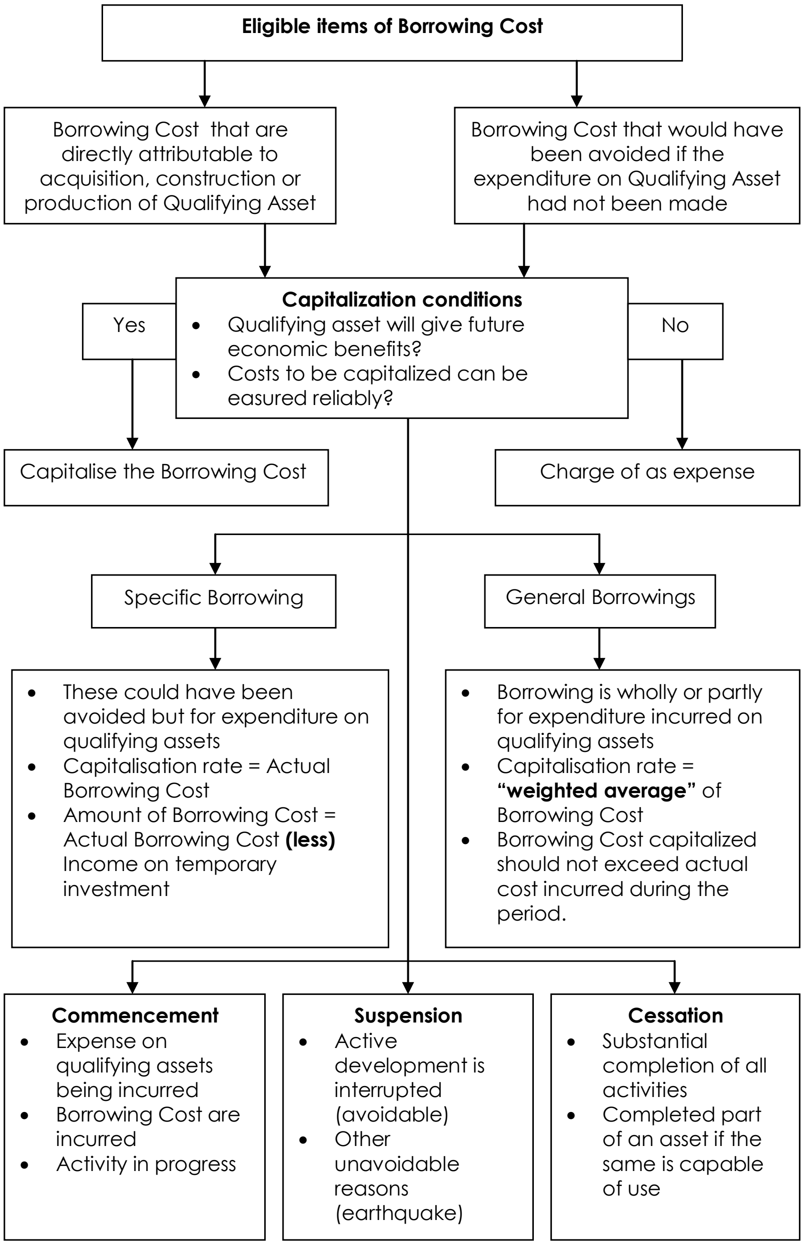
Enterprises are borrowing the funds to acquire, build and install the fixed assets and other assets, these assets take time to make them useable or saleable, therefore the enterprises incur the interest (cost on borrowing) to acquire and build these assets. The objective of the Accounting Standard is to prescribe the treatment of borrowing cost (interest + other cost) in accounting, whether the cost of borrowing should be included in the cost of assets or not.

DISCLOSURE:

The financial statement should disclose-

- The accounting policy adopted for borrowing cost.
- The amount of borrowing cost capitalised during the period.

DIAGRAMMATIC REPRESENTATION



Eligible items of Borrowing Cost

Borrowing Cost that are directly attributable to acquisition, construction or production of Qualifying Asset

Borrowing Cost that would have been avoided if the expenditure on Qualifying Asset had not been made

Capitalization conditions

- Qualifying asset will give future economic benefits?
- Costs to be capitalized can be easured reliably?

Yes → Capitalise the Borrowing Cost

No → Charge of as expense

Specific Borrowing

- These could have been avoided but for expenditure on qualifying assets
- Capitalisation rate = Actual Borrowing Cost
- Amount of Borrowing Cost = Actual Borrowing Cost **(less)** Income on temporary investment

General Borrowings

- Borrowing is wholly or partly for expenditure incurred on qualifying assets
- Capitalisation rate = **"weighted average"** of Borrowing Cost
- Borrowing Cost capitalized should not exceed actual cost incurred during the period.

Commencement

- Expense on qualifying assets being incurred
- Borrowing Cost are incurred
- Activity in progress

Suspension

- Active development is interrupted (avoidable)
- Other unavoidable reasons (earthquake)

Cessation

- Substantial completion of all activities
- Completed part of an asset if the same is capable of use

AS – 17 SEGMENT REPORTING

An enterprise needs in multiple products/services and operates in different geographical areas. Multiple products / services and their operations in different geographical areas are exposed to different risks and returns. Information about multiple products / services and their operation in different geographical areas are called segment information. Such information is used to assess the risk and return of multiple products/services and their operation in different geographical areas. Disclosure of such information is called segment reporting.

Disclosure:

The disclosure requirements of primary segments are as under:

- Revenue from external customers.
- Revenue from transactions with other segments.
- Segment result.
- Cost to acquire tangible and intangible fixed assets.
- Depreciation and amortization expenses.
- Carrying amount of segment assets.
- Segment liabilities.
- Non- cash expenses other than depreciation and amortisation.
- Reconciliation of revenue, result, assets and liabilities.

Summary of Required Disclosure of secondary segments:

PRIMARY FORMAT IS BUSINESS SEGMENT	PRIMARY FORMAT IS GEOGRAPHICAL SEGMENT BY LOCATION OF ASSETS	PRIMARY FORMAT IS GEOGRAPHICAL SEGMENT BY LOCATION OF CUSTOMERS
Required Secondary Disclosure	**Required Secondary Disclosure**	**Required Secondary Disclosure**
Revenue from external customers by location of customers	Revenue from external customers by business segment	Revenue from external customers by business segment
Carrying amount of segment assets by location of assets	Carrying amount of segment assets by business segment	Carrying amount of segment assets by business segment
Cost to acquire tangible and intangible fixed assets by location of assets	Cost to acquire tangible and intangible fixed assets by business segment	Cost to acquire tangible and intangible fixed assets by business segment
	Revenue from external customers by geographical customers if different from location of assets	
		Carrying amount of segment assets by location of assets if different from location of customers
		Cost to acquire tangible and intangible fixed assets by location of assets if different from location of customers
Other Required Disclosure	**Other Required Disclosure**	**Other Required Disclosure**
Basis of pricing inter-segment transfer and any change therein	Basis of pricing inter-segment transfers and any change therein	Basis of pricing inter-segment transfers and any change therein
Changes in segment accounting policies	Changes in segment accounting policies	Changes in segment accounting policies
Types of products and services in each business segment	Types of products and services in each business segment	Types of products and services in each business segment
Composition of each geographical segment	Composition of each geographical segment	Composition of each geographical segment

DIAGRAMMATIC REPRESENTATION

Segment reporting

Reporting based on multiple products/services and operations in different geographical areas

Business segment

Distinguishable component

Geographical segment

Segment based on **"Products or services"** or related products that are phone to different risks and returns

Segment based on operations in different **"geographical areas"** that are phone to different risks and returns

Factors for identification

- Nature of product or service
- Nature of production process
- Type or class of customer
- Marketing or distribution techniques
- Nature of regulatory environment

Factors for identification

- Similarity of economic & political conditions
- Relationship between operation in different geographical areas
- Proximity and risk of operations
- Exchange regulations & currency risk

Basis

- Location of assets
- Location of customers

Segment revenue

- Revenue directly attributable to the segment
- Income allocable to the segment
- Inter segment income

Segment expense

- Expense directly attributable to the segment
- Expense allocable to segment
- Expense on transacting with other segment

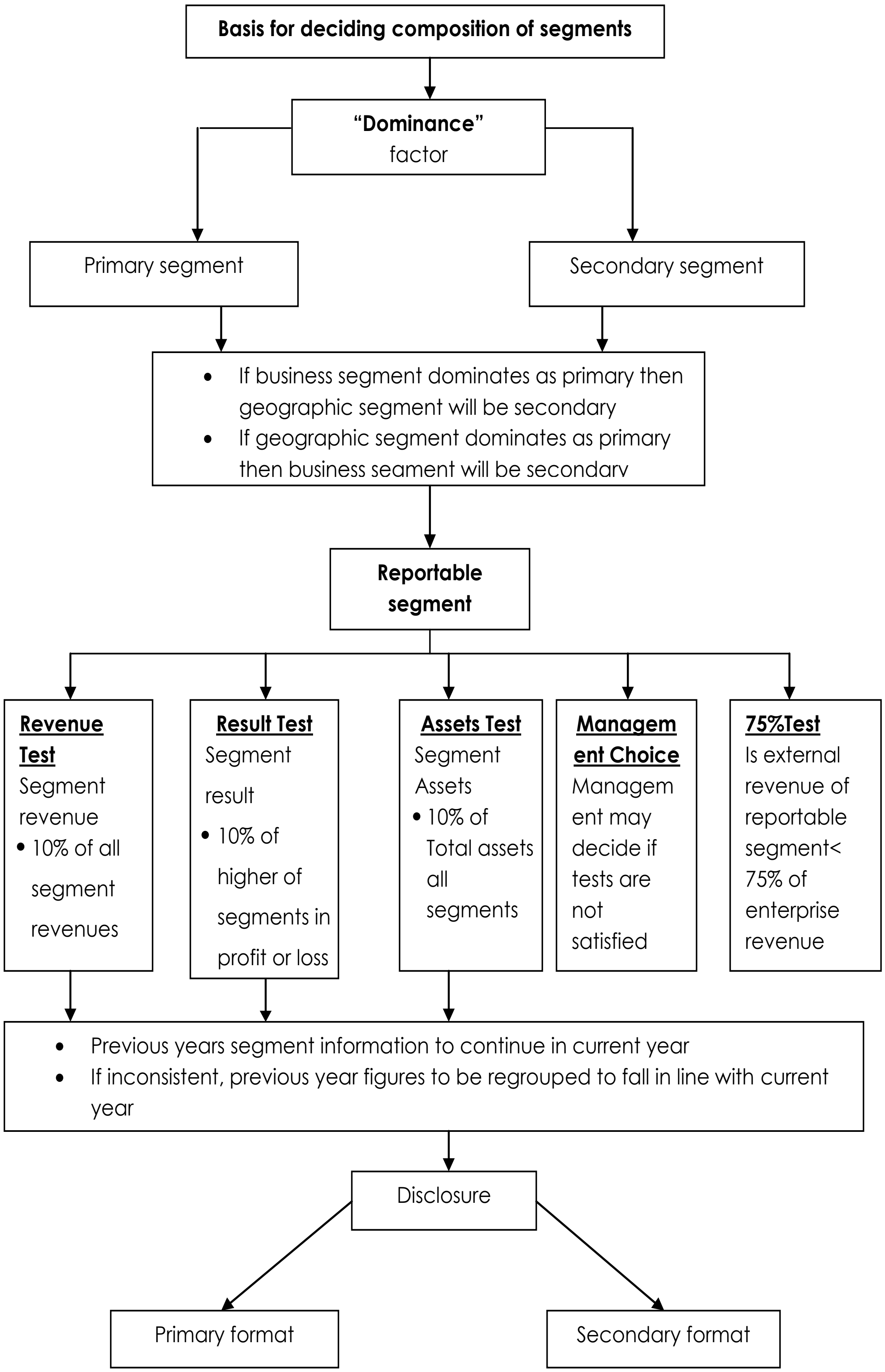
Segment result=segment revenue-segment expense

Segment Assets

- Operating assets directly attributable
- Operating assets allocated on reasonable basis
- Goodwill, if directly attributable or if reasonably allocated

Segment Liabilities

- Operating liabilities directly attributable
- Operating liabilities allocated on reasonable basis


Basis for deciding composition of segments
"Dominance" factor
Primary segment
Secondary segment
• If business segment dominates as primary then geographic segment will be secondary
• If geographic segment dominates as primary then business seament will be secondarv
Reportable segment
Revenue Test
Segment revenue
• 10% of all segment revenues
Result Test
Segment result
• 10% of higher of segments in profit or loss
Assets Test
Segment Assets
• 10% of Total assets all segments
Management Choice
Management may decide if tests are not satisfied
75%Test
Is external revenue of reportable segment< 75% of enterprise revenue
• Previous years segment information to continue in current year
• If inconsistent, previous year figures to be regrouped to fall in line with current year
Disclosure
Primary format
Secondary format

AS – 18 RELATED PATY DISCLOSURE

Sometimes business transactions between related parties lose the feature and character of the arms length transactions. Related party relationship affects the volume and decision of business of one enterprise for the benefit of the other enterprise. Hence disclosure of related party transaction is essential for proper understanding of financial performance and financial position of enterprise.

DISCLOSE:

The statutes governing an enterprise often require disclosure in financial statements of transactions with certain categories of related parties. In particular, attention is focussed on transactions with the directors or similar key management personnel of an enterprise, especially their remuneration and borrowings, because of the fiduciary nature of their relationship with the enterprise.

Name of the related party and nature of the related party relationship where control exists should be disclosed irrespective of whether or not there have been transactions between the related parties.

Where the reporting enterprise controls, or is controlled by, another party, this information is relevant to the users of financial statements irrespective of whether or not transactions have taken place with that party. This is because the existence of control relationship may prevent the reporting enterprise from being independent in making its financial and/or operating decisions. The disclosure of the name of the related party and the nature of the related party relationship where control exists may sometimes be at least as relevant in appraising an enterprise's prospects as are the operating results and the financial position presented in its financial statements. Such a related party may establish the enterprise's credit standing, determine the source and price of its raw materials, and determine to whom and at what price the product is sold.

If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise should disclose the following:

(i) the name of the transacting related party;

(ii) a description of the relationship between the parties;

(iii) a description of the nature of transactions;

(iv) volume of the transactions either as an amount or as an appropriate proportion;

(v) any other elements of the related party transactions necessary for an understanding of the financial statements;

(vi) the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date;and

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

The following are examples of the related party transactions in respect of which disclosures may be made by a reporting enterprise:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of fixed assets;

(c) rendering or receiving of services;

(d) agency arrangements;

(e) leasing or hire purchase arrangements;

(f) transfer of research and development;

(g) license agreements;

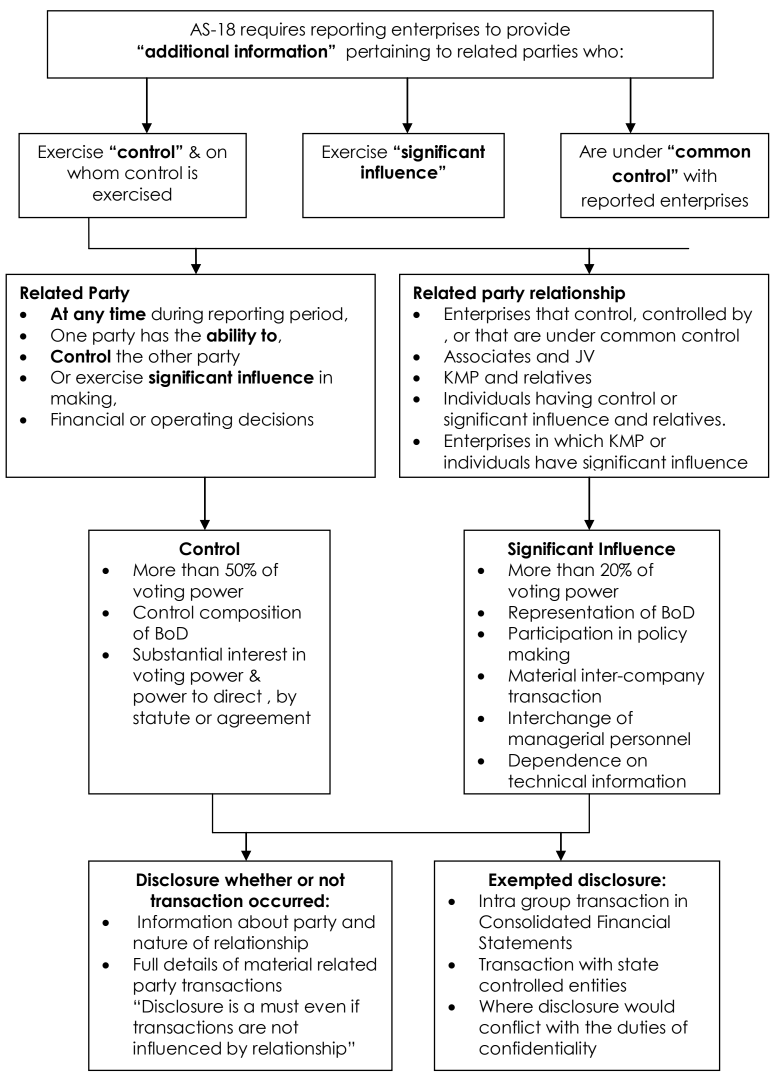
(h) finance (including loans and equity contributions in cash or in kind);
(i) guarantees and collaterals; and
(j) management contracts including for deputation of employees.

Paragraph 23 (v) requires disclosure of 'any other elements of the related party transactions necessary for an understanding of the financial statements'. An example of such a disclosure would be an indication that the transfer of a major asset had taken place at an amount materially different from that obtainable on normal commercial terms.

Items of a similar nature may be disclosed in aggregate by type of related party except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the reporting enterprise.

Disclosure of details of particular transactions with individual related parties would frequently be too voluminous to be easily understood. Accordingly, items of a similar nature may be disclosed in aggregate by type of related party. However, this is not done in such a way as to obscure the importance of significant transactions. Hence, purchases or sales of goods are not aggregated with purchases or sales of fixed assets. Nor a material related party transaction with an individual party is clubbed in an aggregated disclosure.

DIAGRAMMATIC REPRESENTATION



AS – 19 ACCOUNTING FOR LEASES

Lease is an arrangement by which the lesser gives the right to use an asset for given period of time to the lessee on rent. It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor who owns the asset agrees to allow the lessee to use it for a specified period of time in return of periodic rent payments.

DISCLOSURE:

The following disclosure in the books of the lessee and lessor should be made as regards lease:

Disclosure in Operating Lease by lessor -

- General description of significant leasing arrangements
- Accounting policy for initial direct payment
- Future lease payments in aggregate classified as:
  - Not later than one year:
  - Later than one year and not later than five years;
  - Later than five years.

Disclosure in Operating Lease by lessee –

- General description of significant leasing arrangements
- Total of future minimum lease payments in following period:
  - Not later than one year;
  - Later than one year and not later than five years;
  - Later than five years.
- Lease payment recognized in Profit and Loss a/c for the period.

Disclosure in Finance Lease by lessor –

- General description of significant leasing arrangements
- Accounting policy for initial direct cost
- Reconciliation of total gross investment in lease and present value of MLP receivable at balance sheet date.
- Minimum lease payment (MLP) receivable in following categories:
  - Not later than one year;
  - Later than one year and not later than five years;
  - Later than five years.

Disclosure in finance lease by the lessee –

- Asset under finance lease segregated from the asset owned.
- Reconciliation of total MLP with its present value on balance sheet date.
- MLP in following categories on balance sheet date –
  - Not later than one year;
  - Later than one year and not later than five years;
  - Later than five years.

DIAGRAMMATIC REPRESENTATION

Lease
- Convey right to use an asset
- In return for payment or series of payments
- For an agreed period of time
- Includes **Hire purchase agreements**

Classify **"at the inception"** of the lease as -

Finance Lease
- Consider "substance over form"
- Substantially transfer all risks and rewards incident to ownership

Operating Lease
- Other than finance lease
- Negative definition

Minimum Lease Payment (MLP)
- Total lease rent + Guaranteed residual value, (or)
- Total lease rent + Payment on purchase option

In the books of lessee
- Recognise as asset and liability
- Initial recognition of asset at lower of FV and PV of MLP
- Charge lease payment to P&L
- Provide depreciation as per AS 6

In the books of lessee
- Recognise lease payment in P&L
- Pattern – straight line basis over the lease term

In the books of lessor
- Recognise as "Receivable at an amount equal to net investment in the lease
- Recognise lease income in P&L
- Pattern – constant periodic return

In the books of lessor
- Recognise as asset
- Recognise lease income in P&L using straight line method
- Charge depreciation as per AS 6

Disclosure
- Details of leasing agreement
- Accounting policy for initial direct cost
- Age wise break up of Gross Investment , PV of MLP
    - Upto 1 year
    - >1 year upto 5 years
    - > 5 years

AS – 20 EARNING PER SHARE

Earning per share (EPS) is a financial ratio that gives the information regarding earning available to each equity share. It is very important financial ratio for assessing the state of market price of share. This accounting standard gives computational methodology for the determination and presentation of earning per share, which will improve the comparison of EPS. The statement is applicable to the enterprise whose equity shares or potential equity shares are listed in stock exchange.

DISCLOSURE:

An enterprise should disclose the following:

– The amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to the net profit or loss for the period;

– The weighted average number of equity shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other; and

– The nominal value of shares along with the earnings per share figures.

Additionally, if applicable the enterprise shall disclose

– The Fact that Restatement has been made for events after Balance sheet date

– If a component of net profit is used which is not reported as a line item in the statement of profit and loss, a reconciliation should be provided between the component used and a line item which is reported in the statement of profit and loss.

DIAGRAMMATIC REPRESENTATION

ESP
Profit avail to Equity shareholders (PAES) + Weighted average no. of Equity shares (WANES)

Earnings (Numerator)
- Profit after tax less preference dividend and corporate dividend tax thereon
- In case of more than one class of equity shares – distribute earnings in proportion on dividend right for each class

Preference Dividend
- Non-cumulative = deduct if declared of provided
- Cumulative = deduct whether provided or not (Areas not to be deducted)

Participating preference shares – treatment of fixed and variable element of dividend

WANES (Denominator)
- No. of shares (after adjustments for additions and deletion during the period)
- Weight = no. of days shares were outstanding during the period (Timing)

Timing – shares issued are included:
- For cash – Cash is receivable
- Conversion of debt – date of conversion
- Settlement of liability – date of settlement
- Acquisition of asset –recognition
- Amalgamation –
  Purchase -date of acquisition
  Merger – Begning of reporting period

Potential Equity Shares

Dilutive shares
- Option exercised at price less than FV
- Leads to reduction in EPS

Non-Dilutive shares
- New shares issued at fair price
- Does not lead to reduction in EPS

Diluted EPS

<u>Diluted earnings</u>
(Numerator)
PAES + Preference dividend + Interest recognized on dilutive potential shares adjusted for tax expenses +/- after tax amount of any change in Expense or Income

Revised WANES
(Denominator)
WANES + Weighted average of additional equity shares outstanding assuming conversion

- Take cognizance of implications under Bonus issue, Rights issue, Split or consolidation of shares
- Contingently issuable shares –
  If already existing – Start of the period
  If issued during the period – Date of issue

AS – 21 CONSOLIDATED FINANCIAL STATEMENTS

The objective of this statement is to present financial statements of a parent and its subsidiary (ies) as a single economic entity. In other words the holding company and its subsidiary (ies) are treated as one entity for the preparation of these consolidated financial statements. Consolidated profit/loss account and consolidated balance sheet are prepared for disclosing the total profit/loss of the group and total assets and liabilities of the group. As per this accounting standard, the consolidated balance sheet if prepared should be prepared in the manner prescribed by this statement.

DISCLOSURE:

Following disclosure should be made in consolidated financial statements:

- List of all subsidiaries;
- Proportion of ownership interest;
- Nature of relationship between parent and subsidiary whether direct control or control through subsidiaries;
- Name of subsidiary of which reporting date are different;
- The fact for different accounting policies applied for preparation of consolidated financial statements;
- If consolidation of particular subsidiary has not been made as per the grounds allowed in accounting standards the reason for not consolidating should be disclosed.

DIAGRAMMATIC REPRESENTATION

Consolidation
Parent + Subsidiary + One single economic entity

Preparation
- Combine “on line by line“ basis
- Should prepared even if activities of both are dissimilar

Exception
- Control is intended to be temporary
- Subsidiary operates under severe long term restrictions

Control
- <50% of voting power
- Control of composition of BoD

Elimination
Cost of parents investment in subsidiary with that of parents portion of Equity on date of investment

Goodwill
(Asset)
Cost of parents investment in subsidiary > parents portion of Equity on date of investment

Capital Reserve
(Liability)
Cost of parents investment in subsidiary < parents portion of Equity on date of investment

Minority Interest
- Consolidated profit – Minority’s share = profit share of parent
- Adjust Outstanding cumulative preference dividend of subsidiary whether provided or not

Minority interest in Net asset
- Amount of equity attributed to minorities
- Share of movements in equity from date of relationship

Negative minority interest
- Adjust against majority interest
- Subsequent profit by subsidiary is allocated to majority until previous loss is recovered

Intra group balances
- Eliminate along with unrealized profit in full
- Eliminate unrealized loss if recoverable amount is more than cost of transaction

Same reporting date
- CFS to be drawn on same reporting date
- If not practicable , adjustments to be made
- Differences between dates not to exceed 6 months

Uniform Accounting policies
- CFS to be prepared using uniform accounting policies
- If not practicable, disclose the fact.

AS – 22 ACCOUNTING FOR TAXES ON INCOME

This accounting standard prescribes the accounting treatment for taxes on income. Traditionally, amount of tax payable is determined on the profit/loss computed as per income tax laws. According to this accounting standard, tax on income is determined on the principle of accrual concept. According to this concept, tax should be accounted in the period in which corresponding revenue and expenses are accounted. In simple words tax shall be accounted on accrual basis; not on liability to pay basis.

DISCLOSURE:

– Current tax asset and Liability to be netted off only if

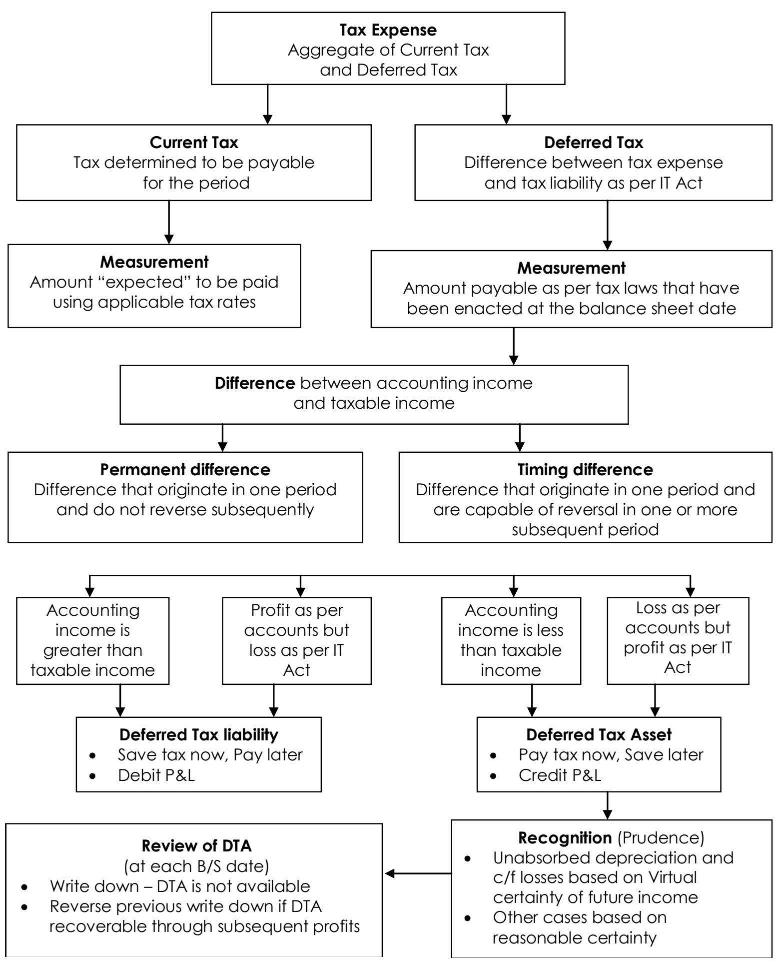
- only if legally enforceable claim exists to net off and
- Enterprise intends to Set-off

– Deferred tax asset and Liability to be netted off only if

- legally enforceable claim exists to net off and
- Assets and liabilities are governed by same tax laws

- DTA/ DTL separately in the balance sheet
- Break up DTA/ DTL to be shown separately
- Current and deferred tax - separate disclosure
- Nature of evidence indicating recognition of DTA to be disclosed

DIAGRAMMATIC REPRESENTATION



AS – 23 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

The accounting standard was formulated with the objective to set out the principles and procedures for recognizing the investment in associates in the consolidated financial statements of the investor, so that the effect of investment in associates on the financial position of the group is indicated.

DISCLOSURE:

Appropriate listing and description of associates including proportion of ownership interest and proportion of voting power held, if different from ownership interest.

Investments in associates accounted by using Equity Method should be disclosed as Long Term Investments in the consolidated Balance sheet.

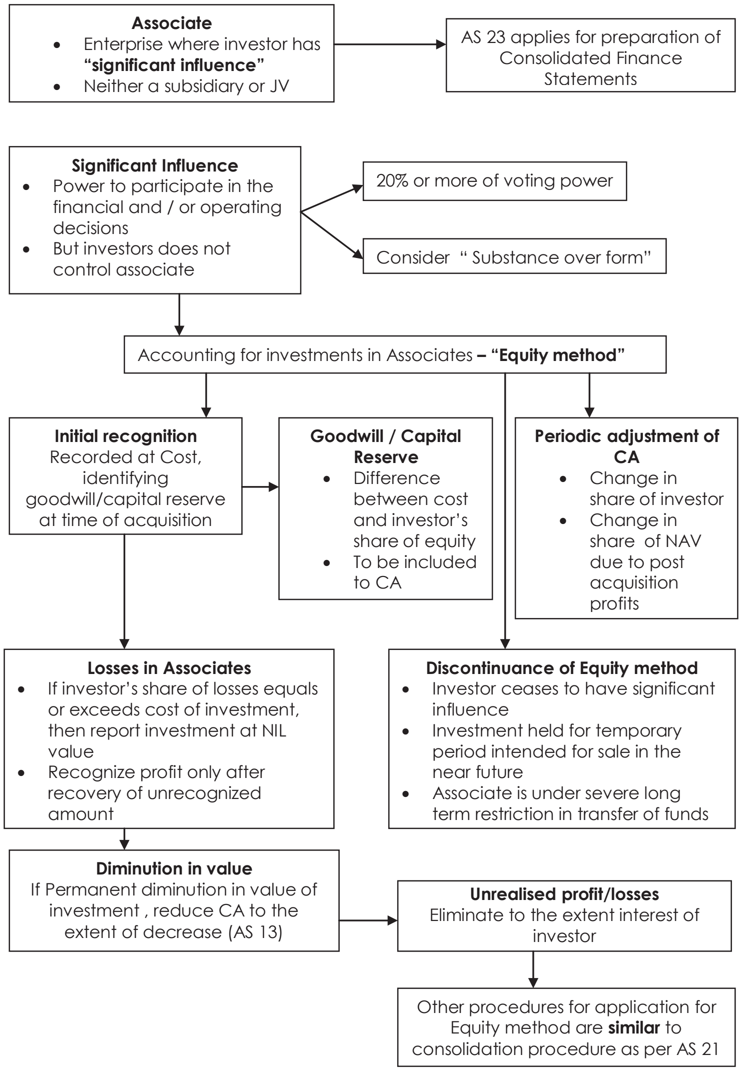
Investor's share in Profit or Loss of such investments should be disclosed separately in the consolidated Profit & Loss Account.

Investor's share in extraordinary items to be disclosed separately.

The names of the associates of which reporting date is different and differences in the reporting dates.

In case different accounting policies are adopted for like transactions and it is not practicable to make appropriate adjustment to associate's financial statements, the fact should be disclosed.

DIAGRAMMATIC REPRESENTATION



AS – 24 DISCONTINUING OPERATIONS

The objective of this standard is to establish principles for reporting information about discontinuing operations. This standard covers "discontinuing operations" rather than "discontinued operation". The focus of the disclosure of the Information is about the operations which the enterprise plans to discontinue rather than disclosing on the operations which are already discontinued. However, the disclosure about discontinued operation is also covered by this standard.

INITIAL DISCLOSURE EVENT

Information about planned discontinuance must be disclosed in the first set of financial statement immediately after the "initial disclosure event", initial disclosure event is the event out of these two and whichever occurs earlier –

- Entering into an agreement to sell substantially all the assets of the discontinuing operation.
- Approving and announcing of the discontinuance plan.

PRESENTATION AND DISCLOSURE

- Initial disclosure: First disclosure after initial disclosure event occurs about the discontinuing operations.
- Description of the discontinuing operation.
- Business or geographical segments in which it is reported.
- Date and nature of initial disclosure event.
- Timing of expected completion of discontinuance.
- Carrying amount of total assets and liabilities to be disposed of.
- Amount of revenue and expense attributable to discontinuing operation.
- Amount of pre-tax profit or loss and tax expense attributable to discontinuing operation.
- Net cash flows after initial disclosure event occurs about the discontinuing operations.
- Other disclosure:

When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation, the following other informations are also disclosed.

- Amount of gain or loss recognized on the disposal of assets or settlement of liabilities and related income-tax.
- Net selling price from the sale of those net assets for which the enterprise has entered into binding sale agreements and the expected timing thereof and carrying amount of those assets.

MANNER OF DISCLOSURE

The disclosure of amount of pre-tax profit or loss and tax expense and amount of gain or loss recognized on the disposal of assets and settlement of liabilities should be disclosed on the face of statement of profit/loss accounts, other information should be disclosed in the notes to accounts.

UPDATING THE DISCLOSURE

The disclosure required for discontinuing operation should continue in financial statements for the period up to and including the period in which the discontinuance is completed, the disclosure required should be updated.

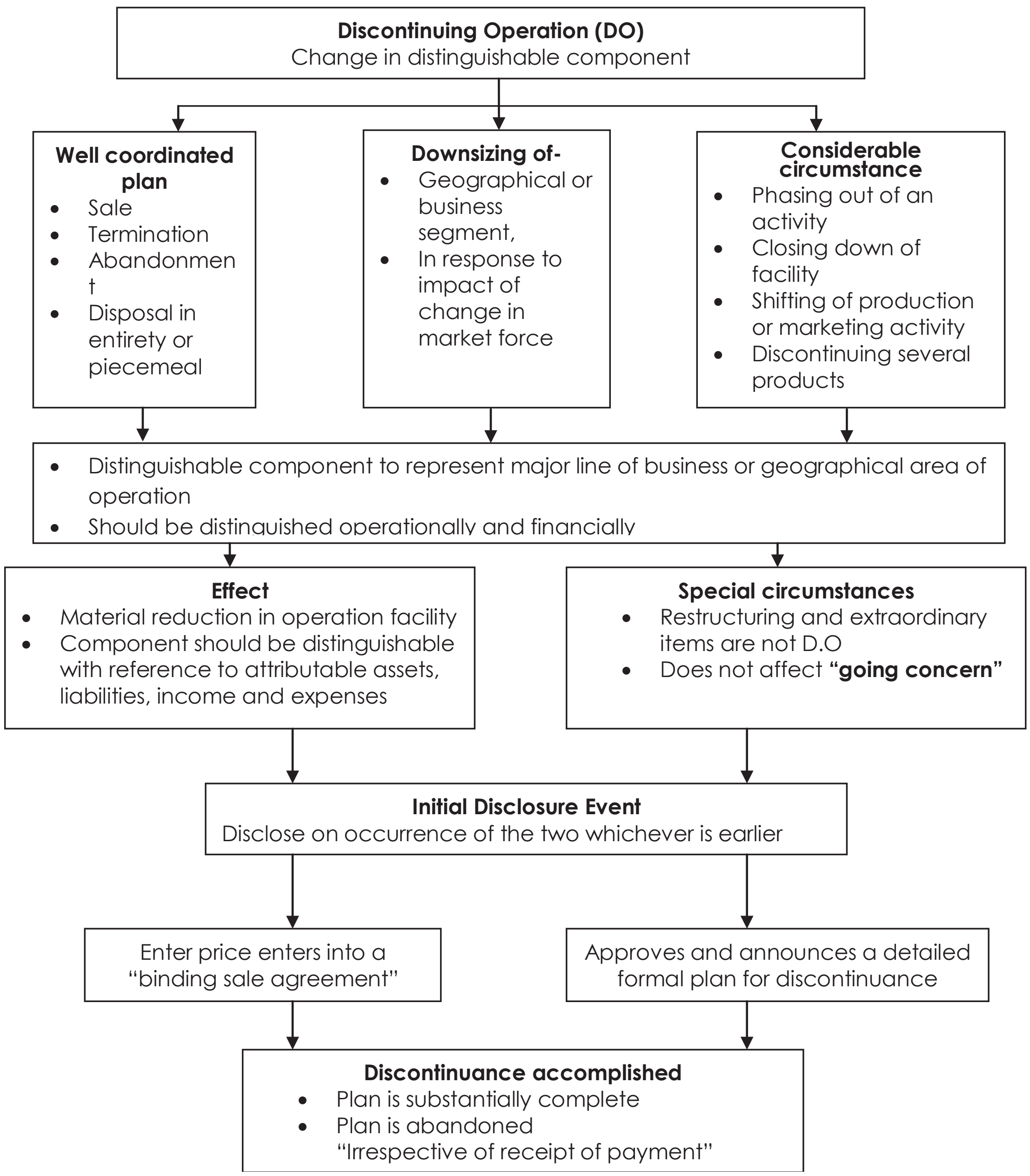
RECOGNITION AND MEASUREMENT

Standard prescribes that an enterprise should comply with the principles of recognition and measurement that are set out in other accounting standards for the purpose of deciding how and when to recognize and measure the changes un assets and liabilities and the income and expense and cash flow of discontinuing operation.

INTERIM FINANCIAL REPORTS

Interim financial reports should disclose in its notes any significant activity or event since the end of the most recent annual reporting relating to discontinuing operation and any significant change in the amount or timing of cash flows relating to assets and liabilities to be disposed/settled.

DIAGRAMMATIC REPRESENTATION



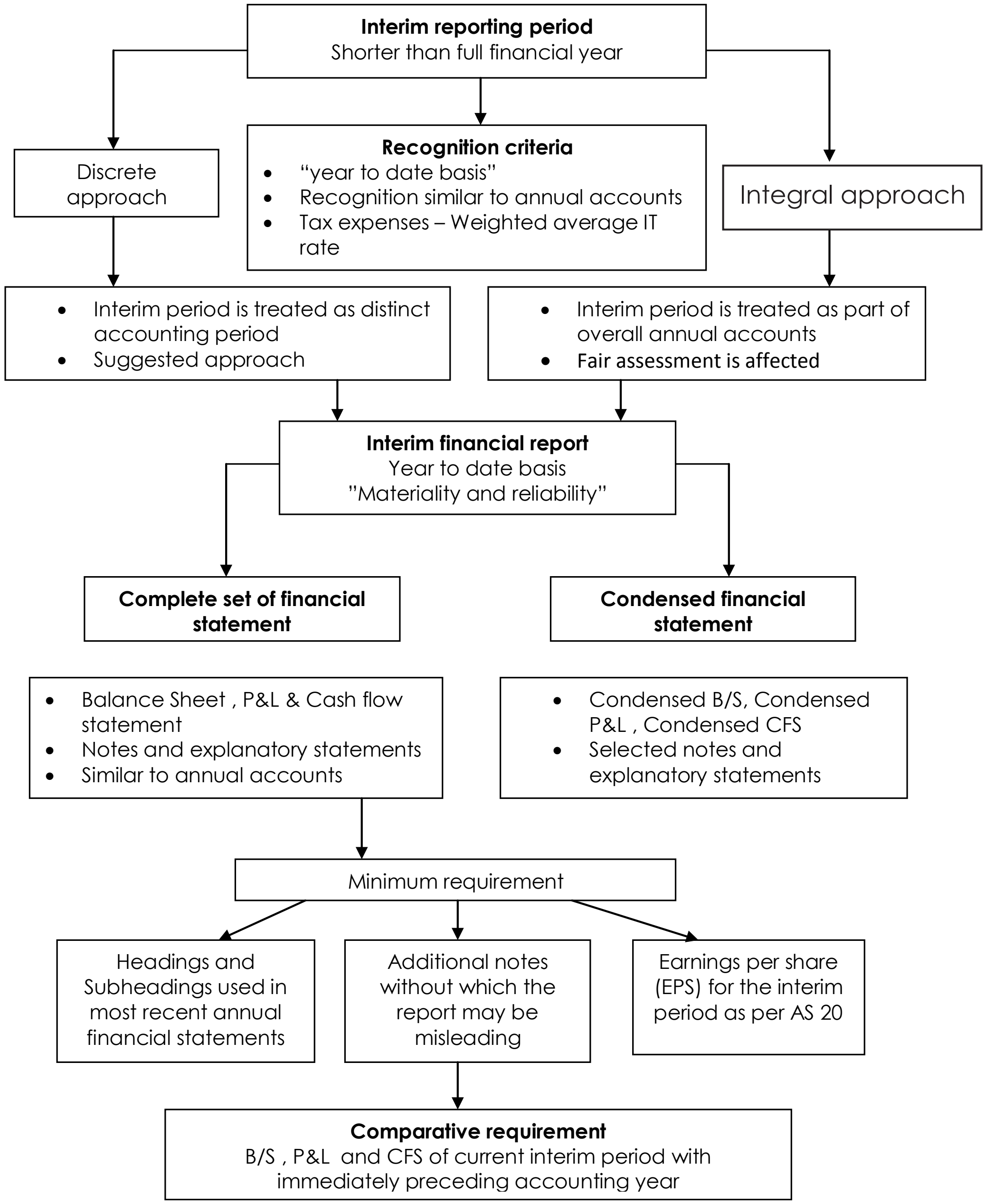
AS – 25 INTERIM FINANCIAL REPORTING (IFR)

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

DISCLOSURE:

- Enterprise may not prepare and present separate financial report for final interim period as annual financial statements are presented.
- If estimate of an amount reported in interim period is changed significantly during final interim period, nature and amount of the change in estimate should be disclosed as note to annual financial statements.

DIAGRAMMATIC REPRESENTATION



AS – 26 INTANGIBLE ASSETS

An Intangible Asset is an Identifiable non-monetary Asset without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.

DISCLOSURE:

The financial statement should disclose the following in respect of intangible asset:

- Useful life or amortization rate.
- Amortisation method
- Gross carrying amount, accumulated amortization and impairment loss at the beginning and at the end of the period.
- Reconciliation of carrying amount at the beginning and at the end of the period.

FURTHER DISCLOSURE

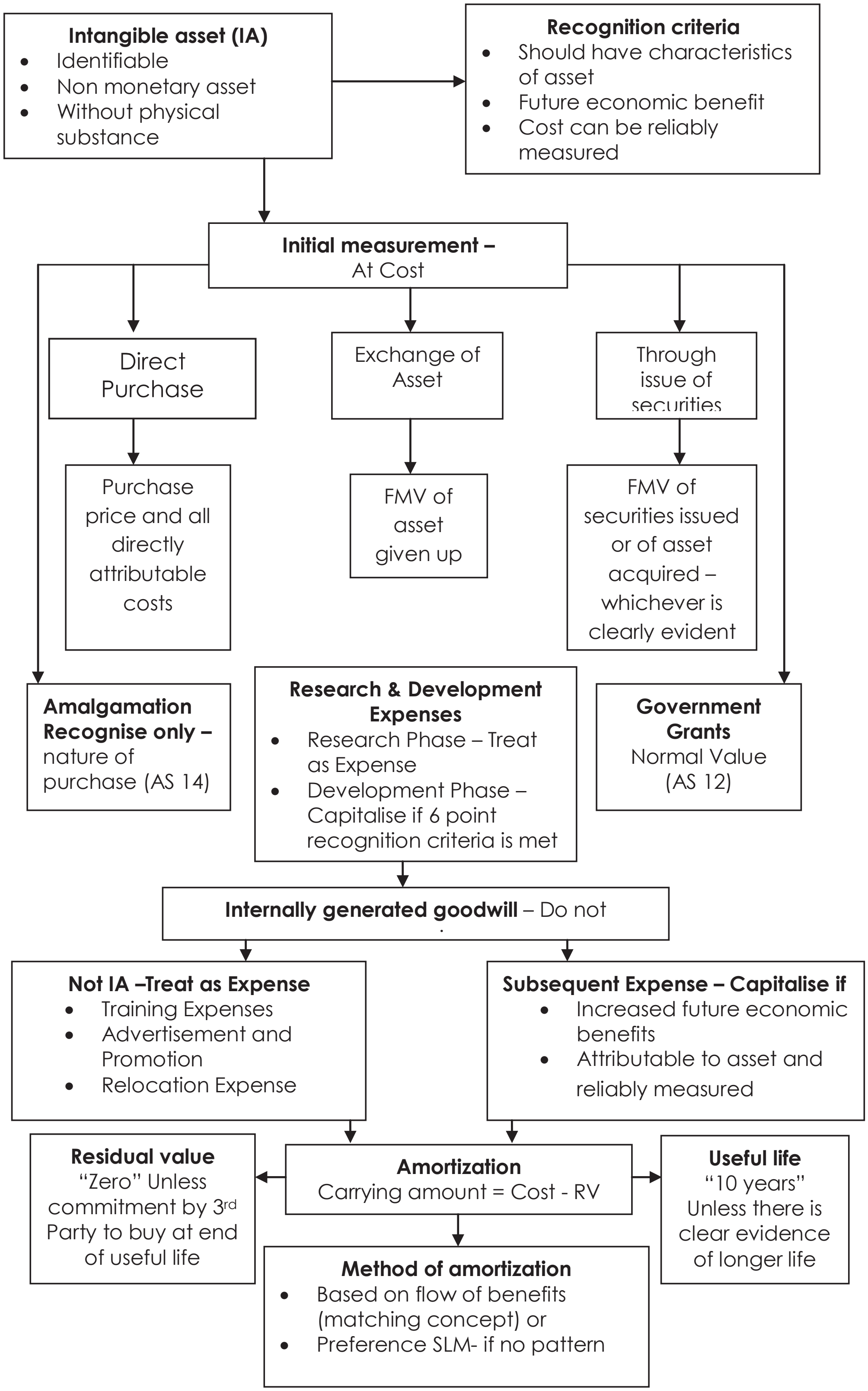
- If amortization period is more than ten years, the reason why the useful life is estimated for more than 10 years.
- Carrying amount of intangible whose life is restricted, pledged on security.
- Research and development expenses recognized as expenses during the period.

TRANSITIONAL PROVISIONS

This Accounting Standard is coming into force for the accounting period commencing on or after 1-4-2003 for the enterprises whose shares are quoted or turnover exceeding 50 crores. For the other enterprises it shall be applicable for the accounting period commencing from 1-4-2004.

If the enterprise has intangible asset in books when this accounting standard comes into force, the enterprise is already following some policy for amortization of intangible, which may or may not be as per this Standard. The transitional provision prescribes the treatment as provided as per this standard.

DIAGRAMMATIC REPRESENTATION



AS – 27 FINANCIAL REPORTING OF INTEREST IN JOINT VENTURES

Joint Venture is defined as a contractual arrangement whereby two or more parties carry on an economic activity under 'joint control'. Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefit from it. 'Joint control' is the contractually agreed sharing of control over economic activity.

DISCLOSURE:

In separate Financial Statements and CFS

- aggregate amount of contingent liability of the venturer in relation to its interest in the joint venture and share of the venturer in each contingent liability incurred jointly with other venturers.
- Contingent liability that has arisen on account of contingent liability of other venturers.
- Share in contingent liabilities of the joint ventures themselves.
- Aggregate amount of any capital commitment of the venturer and share of the venturer in the capital commitment incurred jointly with other venturers.
- Venturers share of capital commitments of the joint ventures themselves.
- The list of all joint ventures and description of interest in significant joint ventures.
- In its separate financial statements the venturer should disclose the aggregate amount of each assets, liabilities, income and expenses related to interest in jointly controlled entities.

DIAGRAMMATIC REPRESENTATION

Joint Venture (JV)

- Contractual agreement
- Two or more parties
- Undertake an economic activity
- Jointly controlled

Investor

- Part of JV
- No control

Control

"Power to given"
operating & financial policies
of economic entity

Venturer

- Part of JV
- Has control

Interest in JV

Jointly controlled operation

- No separate legal entity
- Assets are fully owned
- Sale – as per contract
- No separate accounting records

Books of Venturer & CFS

Recognise

- Asset it controls
- Expenses and liabilities it incurs
- Share of income from JCO

Books of "investor"

Apply AS 13

Jointly controlled entity

- Separate legal entity
- Separate contract to determine "control"
- Benefit – shared as per agreement

Separate Financial Statement

Interest – Investment (AS 13)

CFS

Report interest as per "Proportionate consolidation method"

Proportionate completion method

Account & report venturer's share a "separate line item"

Jointly controlled assets

- No separate legal entity
- Assets are jointly owned
- Asset used to derive benefit separately
- Expenses are shared

Books of Venturer & CFS

Recognise

- Share of Asset in JCA's
- Direct Liabilities , expenses incurred
- Jointly incurred liabilities
- Share of income from JCA

Books of "operator"

- Fee income is revenue
- Recognise as per AS 9

AS – 28 IMPAIRMENT OF ASSETS

The dictionary meaning of 'impairment of asset' is weakening in value of asset. In other words when the value of asset decreases, it may be called impairment of an asset. As per AS-28 asset is said to be impaired when carrying amount of asset is more than its recoverable amount.

DISCLOSURE:

Disclosure requirement as per paras 117,120 to122 of AS – 28 can be categorized in four major categories:

- Basic requirements for each class of assets
- Requirement for segment reporting
- Requirement for cash generating unit
- Requirement for reversal of impairment loss.

Basic requirements for each class of Assets: These are as under:

If the:

- Amount of impairment loss debited in profit and loss statement is not separately disclosed, item of profit and loss statement within which included.
- Amount of reversal of impairment loss credited to profit /loss account as income and if separately not shown in profit / loss account, item in which included.
- Amount of impairment loss set off against revaluation reserve during the period.
- Amount of reversal of impairment loss credited to revaluation reserve during the period.

Requirement for segment reporting: Enterprise where AS – 17 segment reporting is applicable, the following should be disclosed for impairment loss and reversal thereof for each reportable segment:

- The amount of impairment loss recognized in profit and loss statement and directly in revaluation reserve during the period.
- The amount of reversal of impairment losses recognized in profit and loss statement and directly to revaluation reserve during the period.

Requirement for cash generating unit - If impairment loss or reversal thereof during the period is material for the reporting enterprises as a whole an enterprise should disclose:

- The events and circumstances that led to the recognition of impairment loss and reversal thereof.
- Amount of impairment loss recognized or reversed.
- Nature of the individual assets and reportable segment to which it belongs.
- Description of cash generating unit (product line, business operation, a plant or geographical area).
- Amount of impairment loss recocnised or reversal thereof for primary reportable segment.
- Any change in identifying the cash-generating unit as compared to previous estimate of the cash-generating unit.
- Whether recoverable amount is "net selling price" or "value in use".
- If recoverable amount is net selling price basis of determining the net selling price.
- If recoverable amount is 'value in use', the discount rate used.
- Assumption used to determine the recoverable amount. This disclosure of assumption is not mandatory but encouraged to disclose.

TRANSITIONAL PROVISION

On the date this accounting standard becomes applicable , the enterprise should assess whether there are any indication (internal or external) that an asset may be impaired. If yes, the enterprise should determine the impairment loss in accordance with this standard as described in paras 28.8 and 28.9.

The impairment loss so calculated should be treated as under:

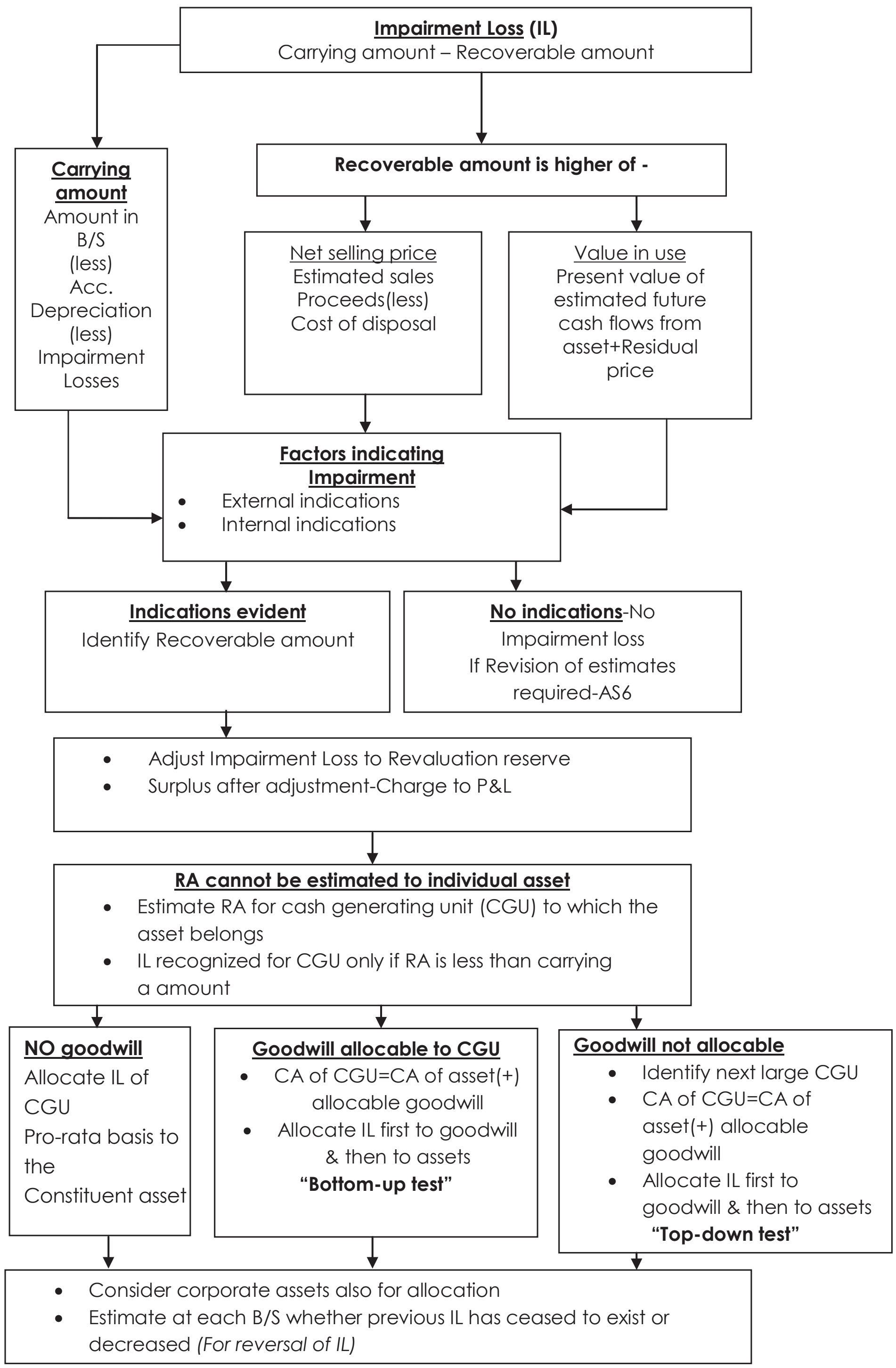
- If assets impaired are not carried at revalued price

Impairment loss should be debited to opening balance of revenue reserve.

- If assets impaired are carried at revalued cost

The impairment loss should be debited to revaluation reserve for that same asset. If impairment loss exceeds the revaluation reserve of that asset, excess should be debited to opening revenue reserve.

DIAGRAMMATIC REPRESENTATION



AS – 29 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Objective of this standard is to prescribe the accounting for Provisions, Contingent Liabilitites, Contingent Assets, Provision for restructuring cost.

Provision: It is a liability, which can be measured only by using a substantial degree of estimation.

Liability: A liability is present obligation of the enterprise arising from past events the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

DISCLOSURE:

Disclosure of provisions in financial statements

Enterprise should disclose for each class of provision the following:

- Opening balance
- Addition to and use of the provision
- Unused amount written back
- Closing balance of the provision

Besides these the following other disclosures are required:

- A brief description of provision.
- Major assumption about future events made while measuring the provision and indication of uncertain items.
- The expected reimbursement recognized as an asset.

Disclosure of contingent liability : An enterprise should disclose for each class of contingent liability at the balance sheet date-

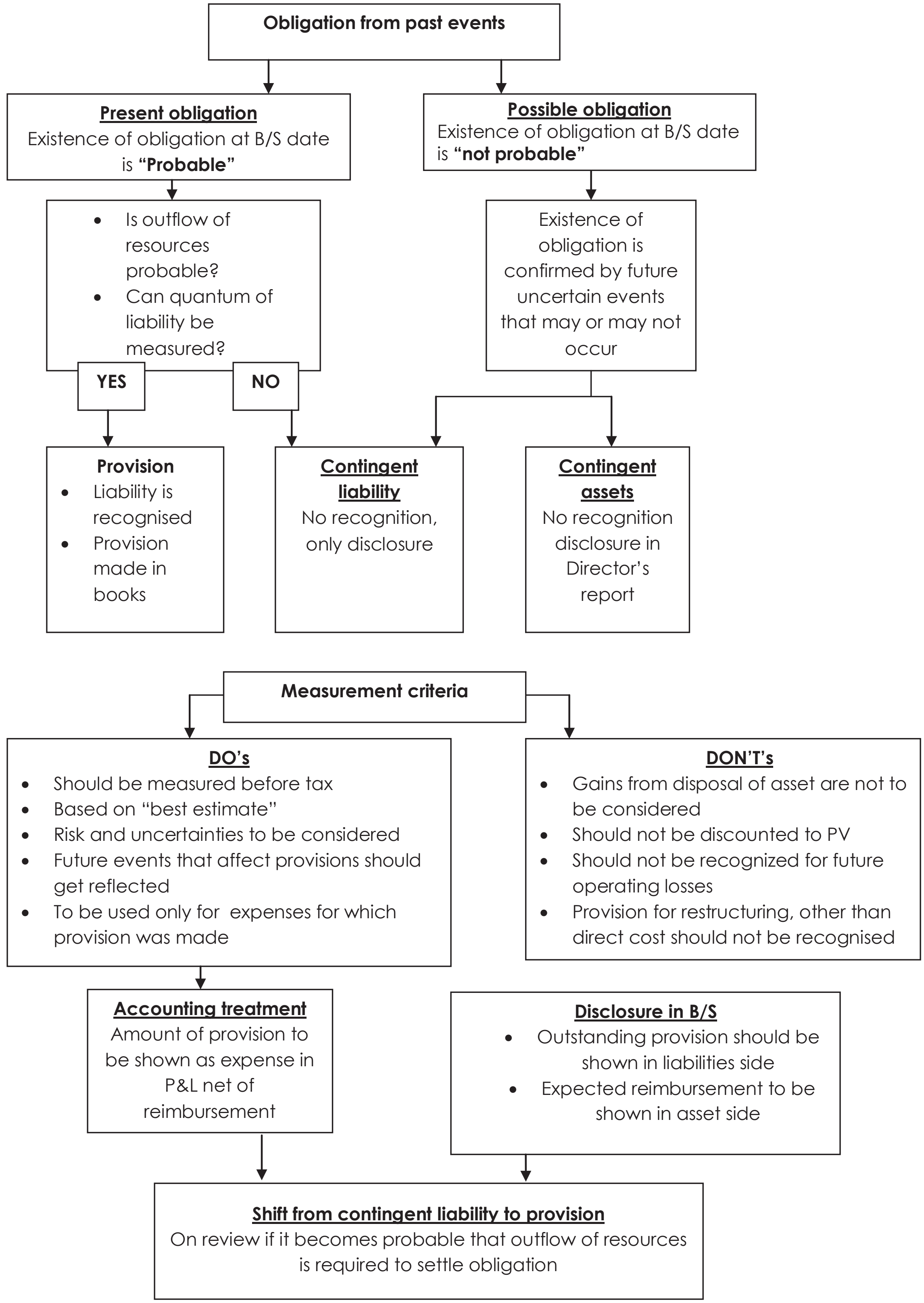
- A brief description of the nature of the contingent liability where practicable.
- An estimate of the amount as per measurement principles as prescribed for provision.
- Indications of the uncertainties relating to outflow.
- The possibility of any reimbursement.
- Where any of the information required as above is not disclosed because it is not practicable to do so, that fact should be stated.

An enterprise need not disclose of the disclosure requirement if disclosure of any of this information is expected to prejudice seriously the case of the enterprise in disputes with other party. However, it should be extremely rare case.

DISCLOSURE OF CONTINGENT ASSETS;

Contingent assets are not required to disclosed in financial statement, generally Board of Directors report discloses such contingent assets.

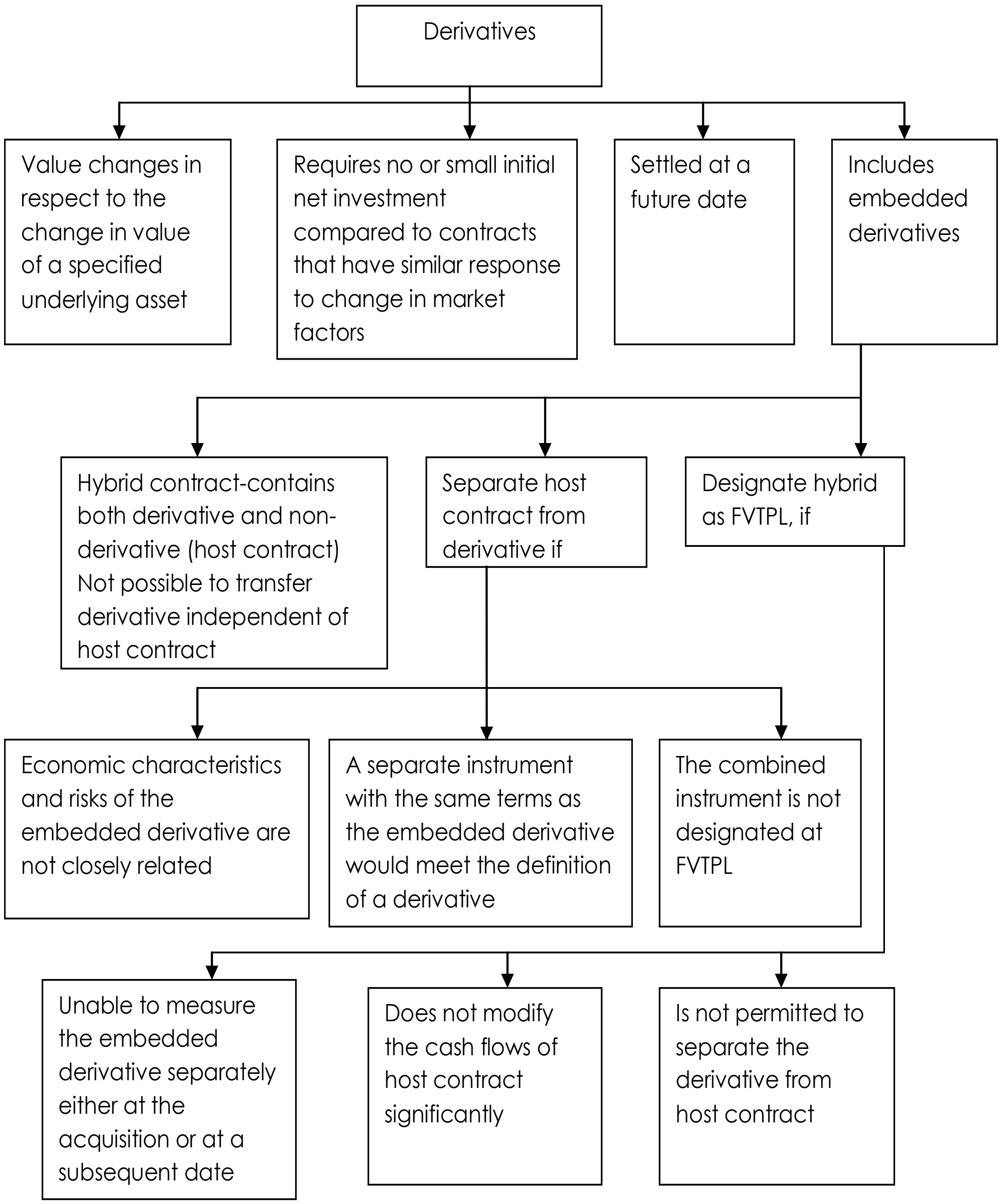
DIAGRAMMATIC REPRESENTATION

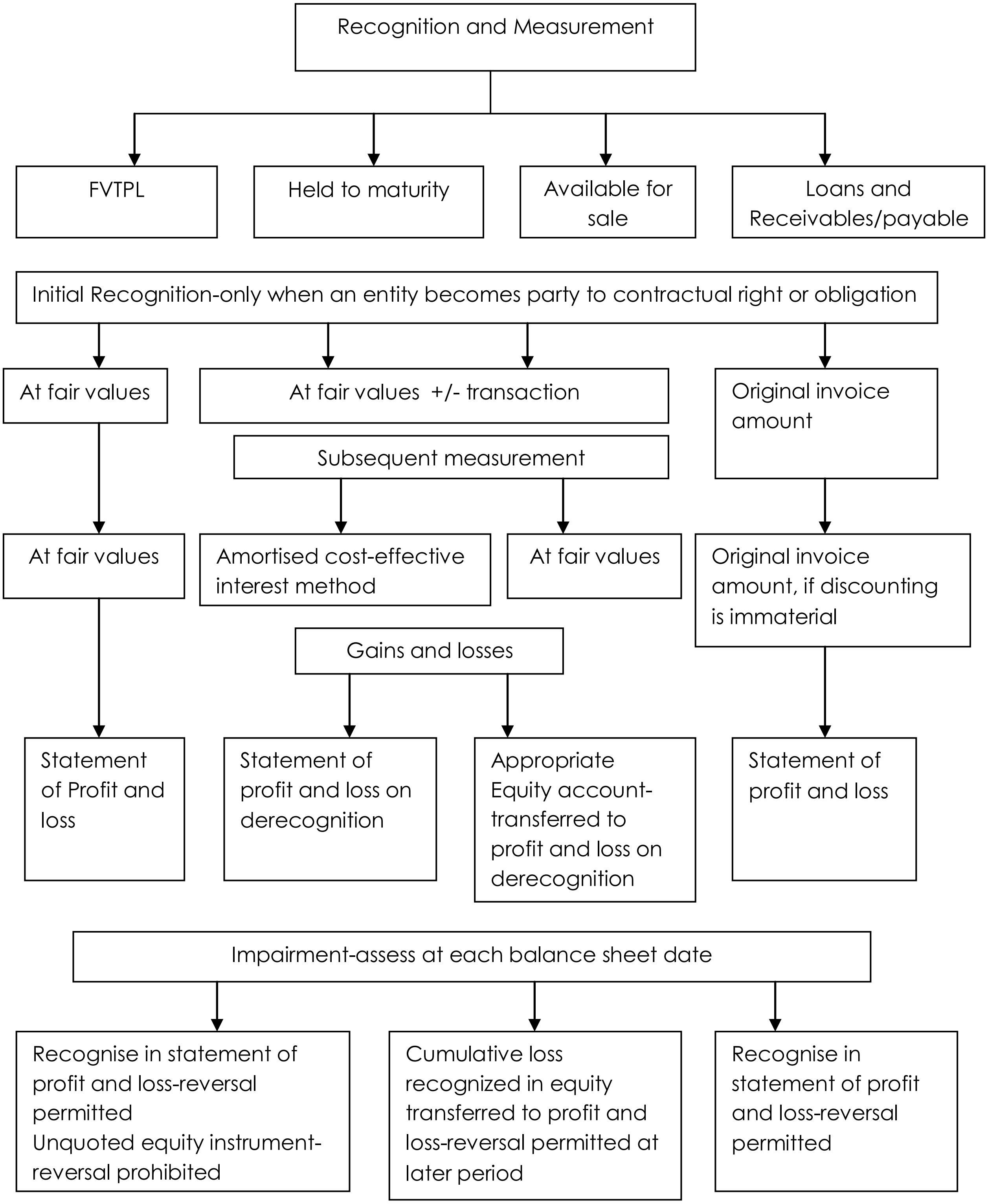


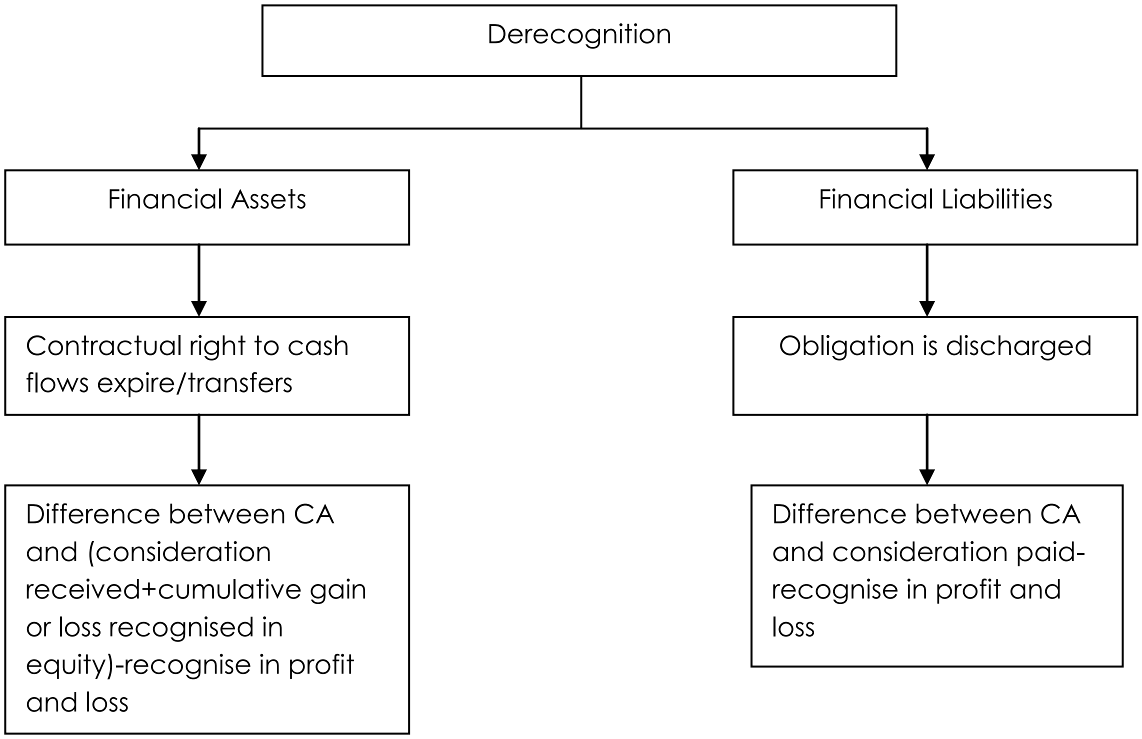
AS – 30 FINANCIAL INSTRUMENT

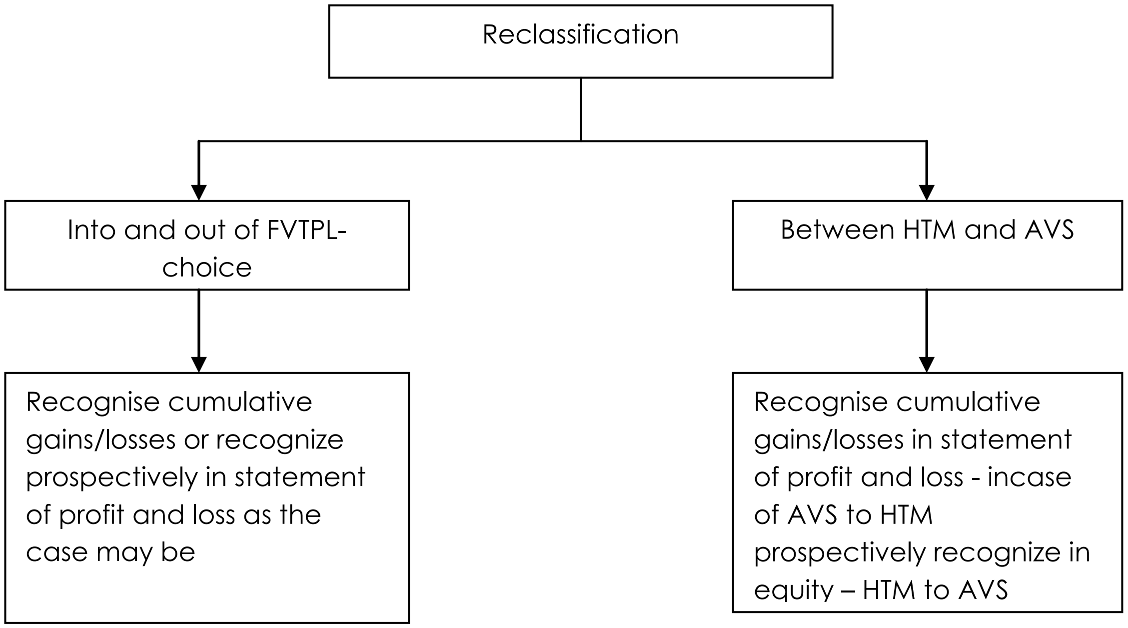
Recognition and Measurement, issued by The Council of the Institute of Chartered Accountants of India, comes into effect in respect of accounting periods commencing on or after 1-4-2009 and will be recommendatory in nature for an initial period of two years. This Accounting Standard will become mandatory in respect of accounting periods commencing on or after 1-4-2011 for all Commercial, Industrial and Business Entities except to a Small and Medium-sized Entity. The objective of this standard is to establish principles for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in Accounting Standard.

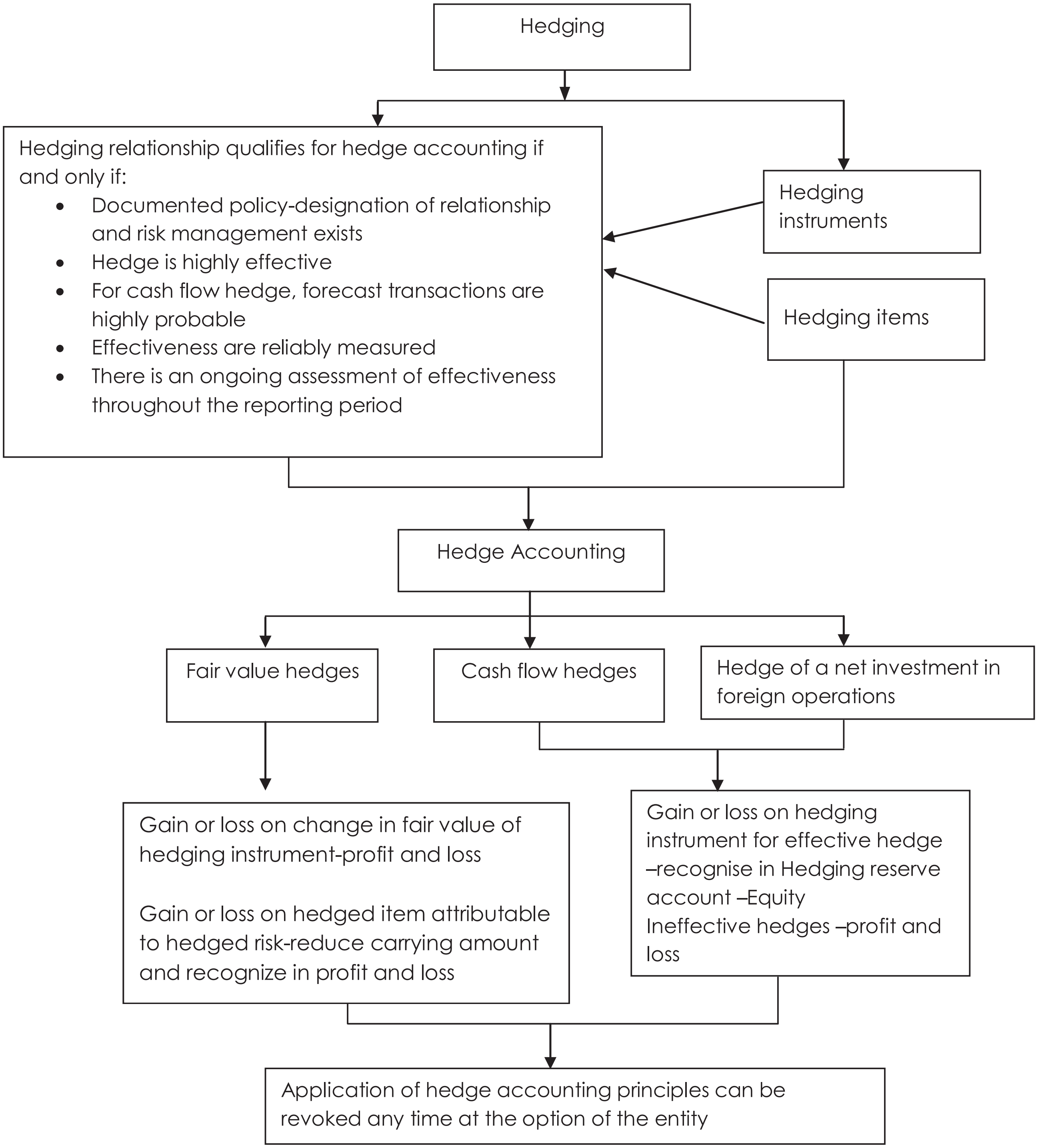
DIAGRAMMATIC REPRESENTATION




Recognition and Measurement
FVTPL
Held to maturity
Available for sale
Loans and Receivables/payable
Initial Recognition-only when an entity becomes party to contractual right or obligation
At fair values
At fair values +/- transaction
Original invoice amount
Subsequent measurement
At fair values
Amortised cost-effective interest method
At fair values
Original invoice amount, if discounting is immaterial
Gains and losses
Statement of Profit and loss
Statement of profit and loss on derecognition
Appropriate Equity account-transferred to profit and loss on derecognition
Statement of profit and loss
Impairment-assess at each balance sheet date
Recognise in statement of profit and loss-reversal permitted
Unquoted equity instrument-reversal prohibited
Cumulative loss recognized in equity transferred to profit and loss-reversal permitted at later period
Recognise in statement of profit and loss-reversal permitted


Derecognition
Financial Assets
Financial Liabilities
Contractual right to cash flows expire/transfers
Obligation is discharged
Difference between CA and (consideration received+cumulative gain or loss recognised in equity)-recognise in profit and loss
Difference between CA and consideration paid-recognise in profit and loss

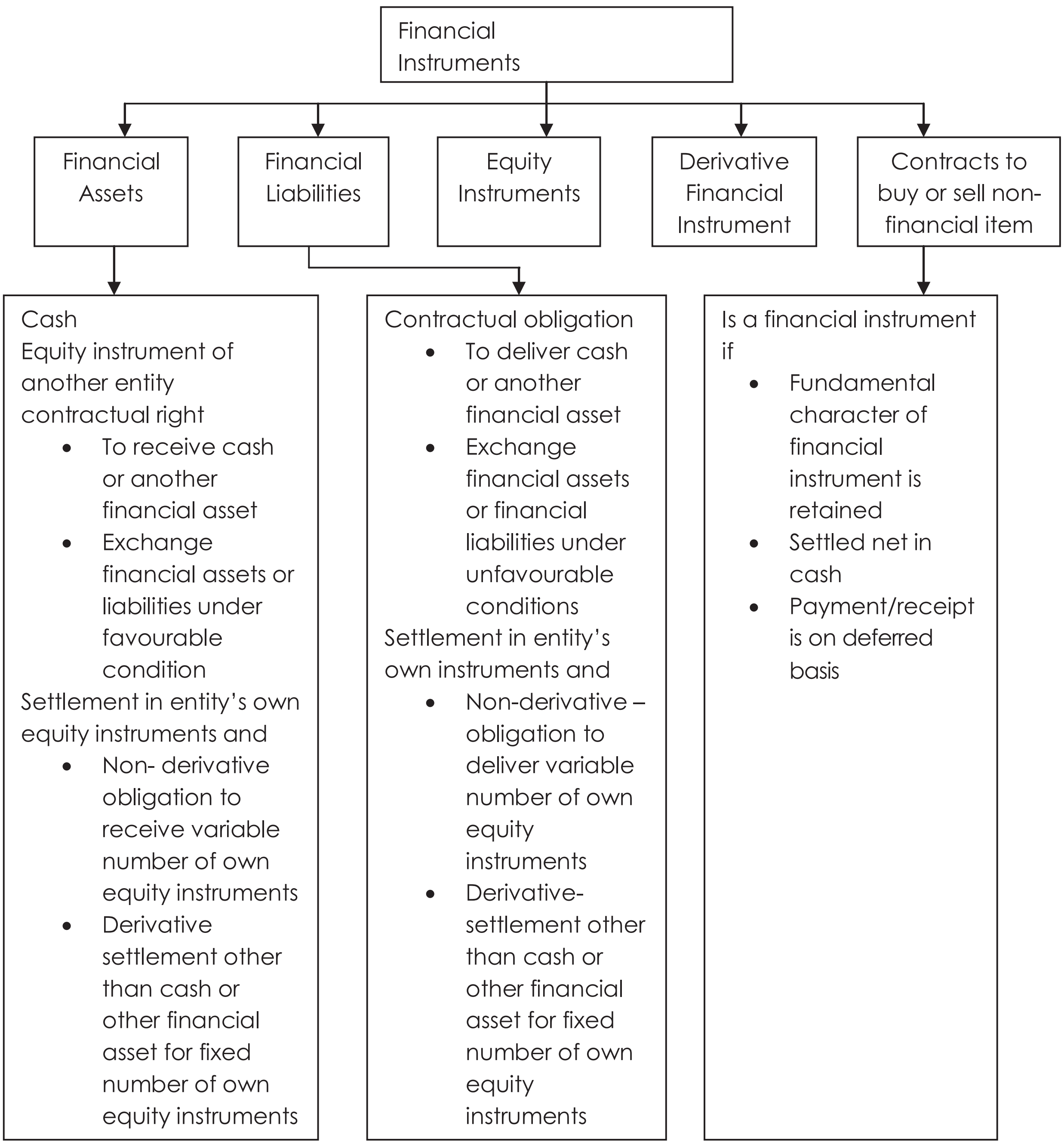

Reclassification
Into and out of FVTPL-choice
Between HTM and AVS
Recognise cumulative gains/losses or recognize prospectively in statement of profit and loss as the case may be
Recognise cumulative gains/losses in statement of profit and loss - incase of AVS to HTM prospectively recognize in equity – HTM to AVS


Hedging
Hedging relationship qualifies for hedge accounting if and only if:
• Documented policy-designation of relationship and risk management exists
• Hedge is highly effective
• For cash flow hedge, forecast transactions are highly probable
• Effectiveness are reliably measured
• There is an ongoing assessment of effectiveness throughout the reporting period
Hedging instruments
Hedging items
Hedge Accounting
Fair value hedges
Cash flow hedges
Hedge of a net investment in foreign operations
Gain or loss on change in fair value of hedging instrument-profit and loss
Gain or loss on hedged item attributable to hedged risk-reduce carrying amount and recognize in profit and loss
Gain or loss on hedging instrument for effective hedge –recognise in Hedging reserve account –Equity
Ineffective hedges –profit and loss
Application of hedge accounting principles can be revoked any time at the option of the entity

AS – 31 FINANCIAL INSTRUMENT: PRESENTATION

The objective of this standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset. The principles in this standard complement the principles for recognising and measuring financial assets and financial liabilities in Accounting Standard Financial Instruments.

DIAGRAMMATIC REPRESENTATION



- Presentation
  - Liabilities and Equity
    - Explicit redeemable feature
      - FL
    - No explicit redeemable feature
      - Classified as FL or equity based on terms and conditions
    - Settlement in entity's own equity instruments
      - Variable number-FL fixed number-equity
    - Contingent settlement
      - FL- Generally Equity- if less likely to happen
    - Settlement options
      - FL
  - Compound financial instruments
    - Recognise liability and equity component separately
    - On conversion at maturity- derecognise FL and recognize equity
  - Treasury shares
    - Deduct from equity in the FS
    - Recognise gains/losses relating to entity's own shares in equity
    - Disclose amount of treasury shares on the face of BS
  - Interests, dividends, losses and
    - FA and FL and liability component of compound financial instrument recognise in settlement of profit and loss
    - Equity component of compound financial instruments recognized as separate component in equity
  - Offsetting a FA and a FL
    - There is a legally enforceable right to set off
    - Intends either to settle on a net basis of set off simultaneously

AS – 32 FINANCIAL INSTRUMENTS, DISCLOSURES AND LIMITED REVISION TO ACCOUNTING STANDARDS

The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

the significance of financial instruments for the entity's financial position and performance; and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the reporting date, and how the entity manages those risks.

DISCLOSURE:

PRESCRIBES THE DISCLOSURES REQUIREMENTS FOR:

(a) Different categories of financial assets

(b) Different categories of financial liabilities

(c) Re-classifications of financial assets

(d) De-recognition of financial assets and financial liabilities

(e) Financial assets pledged or held as collateral

(f) Allowances for credit losses

(g) Compound financial instruments with multiple embedded derivatives

(h) Defaults and breaches for loan payable

(i) Income, expense, gain or losses recognized in profit and loss account

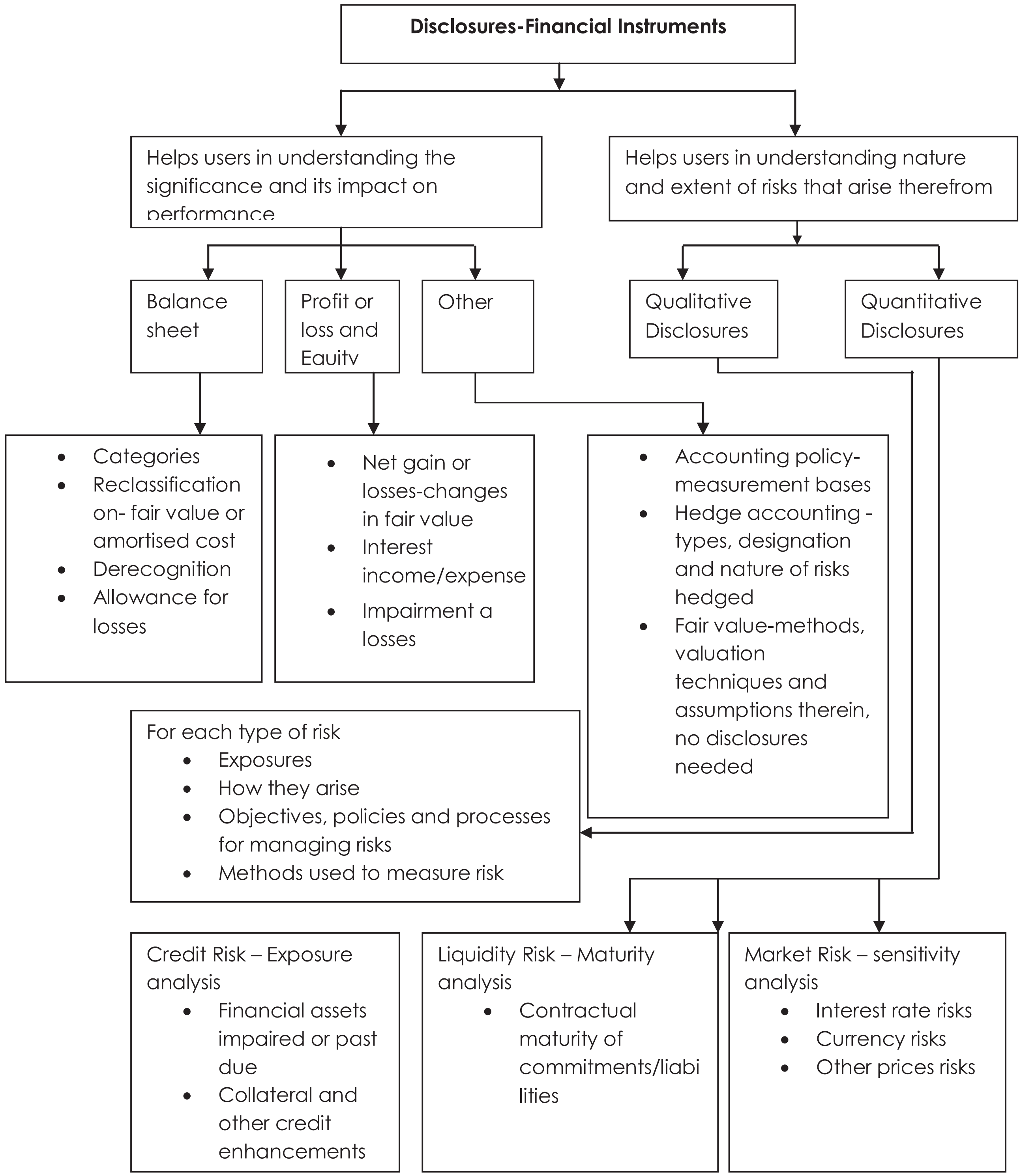
(j) Accounting policies followed

(k) Hedge accounting

(l) Fair value determination for financial assets and financial liabilities

(m) Risk disclosures

DIAGRAMMATIC REPRESENTATION

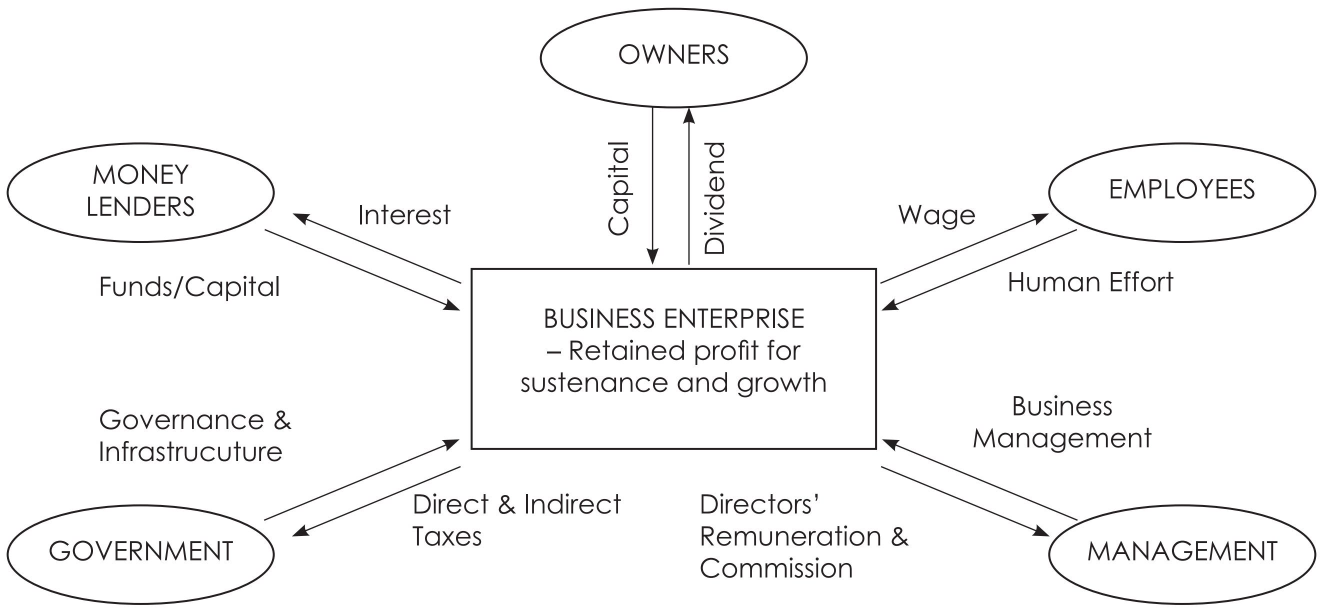


7.2 VALUE ADDED STATEMENT

(A) Value Added

Value Added is the wealth created by a Firm, through the combined effort of (1) Capital (2) Management and (3) Employees. This wealth concept arises due to the input- output exchange between a Firm and components of its external environment.

Value Added = Sale Value of Outputs **Less:** Cost of Bought in goods and services.



(B) Gross Value Added (GVA)

Retained Profits Sales Revenue - Materials Cost - Wages Cost - Expenses Cost - Managerial Remuneration - Depreciation Expenses - Interest paid - Taxes paid - Dividends paid.

Transposing the same, we have the following equation –

Sales Revenue - Materials Cost - Expenses Cost = Retained Profits + Wages paid + Managerial Remuneration + Interest, paid + Taxes paid + Dividends paid + Depreciation Expense.

After adjusting for other Direct Incomes, Non-operating incomes and expenditure, we have —

Sales Revenue + Direct Incomes - Materials Cost - Expenses Cost ± Non-Operating Income/Expenditure ± Extra-Ordinary Income/Expenditure	=	Wages paid to Employees + Interest paid to Providers of Loan Funds + Taxes paid to Government + Dividends paid to owners and investors + Retained Profits + Depreciation (for maintenance & expansion)

This equation represents to the concept of Gross Value Added, i.e. the wealth or surplus created by the firm on the LHS (Sources) and the beneficiaries of this wealth on the RHS (Applications).

(C) Net Value Added (NAV)

Net Value Added = Gross Value Added — Depreciation

Rewriting the equation for Gross Value Added as indicated above, we have —

Sales Revenue + Direct Incomes - Materials Cost - Expenses Cost ± Non-Operating Income/Expenditure ± Extra-Ordinary Income/Expenditure - Depreciation (for maintenance & expansion)	=	Wages paid to Employees + Interest paid to Providers of Loan Funds + Taxes paid to Government + Dividends paid to owners and investors + Retained Profits

(D) Value Added Statement for a Manufacturing Firm.

The Value Added Statement shows the Value Added of a business for a particular period. It also reveals how it is arrived at and apportioned to the stakeholders like employees, management, loan providers, Government and also to the business itself.

The Value Added Statements has two parts — the first part showing how the GVA is arrived at and the second part showing the application / distribution of Value Added to various beneficiaries.

GROSS VALUE ADDED OF A MANUFACTURING COMPANY

for the year ended 31st March, 200X

Particulars	₹	Percentage
Sales	XXX	
Less: Materials and Services Used	XX	
Add: Royalties and Other Direct Income	XX	
Value Added by Trading Activities	**XXX**	
Add: Investment Income	XX	
Add/Less: Extra-Ordinary Items	XX	
Gross Value Added	**XXXX**	**100%**
Applied as follows -		
1. To Employees Salaries, Wages, etc.	XXX	x%
2. To Government as Taxes, Duties, etc.	XXX	x%
3. To Financiers as Interest on borrowings	XXX	x%
4. To Shareholders as Dividends	XXX	x%
5. To Retained Earnings, including Depreciation	XXX	x%
Total	**XXXX**	**100%**

(E) Utility of GVA reporting than NVA reporting.

(i) **Realistic meaning of Retained profits:** There is no cash outflow from a firm to the extent of depreciation charged. Hence, GVA reporting, which includes depreciation as part of retained profits, properly reflects the amount retained for business purposes.

(ii) **Objectivity:** Depreciation charged in the accounts depends on the firm's policy and also on the estimates of the asset's useful life, scrap value, etc. Since the cost of bought in materials and services are deducted to compute GVA, it is derived in an objective manner than NVA.

(iii) **Macro level analysis:** At the macro level, Gross Domestic Product (GDP) is commonly used as an indicator of economic trends. GVA reporting will make aggregation of data easier for macro level analysis.

(F) Advantages of NVA over GVA.

(i) **Matching:** NVA reporting properly deducts depreciation, which represents a write off of the capital cost of the asset due to wear and tear. This results in proper matching of the period's revenues with costs.

(ii) **Asset Life Disparity:** Under GVA, cost of tools, jigs, etc. having a life of one year would be deducted whereas depreciation on assets having a longer useful life will not be deducted. NVA recognises both types of assets and properly records depreciation on the assets utilised.

(iii) **Calculation of Wealth:** Wealth or Surplus created by an entity will be overstated if no allowance is made towards wear and tear or loss of value of fixed assets used by the entity.

(iv) **Impact on Productivity Bonus:** When a Productivity Bonus is paid to employees based on Value Added, NVA is more appropriate since it recognises the effect of mechanization, etc. by charging depreciation.

(G) (a) Proprietary Theory; (b) Entity Theory; and (c) Enterprise Theory.

(a) **Proprietary Theory:** This theory is based on the principle that the proprietor is the centre of interest. This theory propounds that all assets belong to the Proprietor and all liabilities are the Proprietor's obligations. This theory holds good only for a Sole Proprietorship or a Partnership.

(b) **Entity Theory:** This theory is suitable for corporate form of business enterprises. The theory suggests that the **Net Income** of the Reporting Entity is generally expressed in terms of the **Net Change** in the Stockholders' Equity. It represents the residual change in equity position after deducting all outsiders' claims. The Reporting Entity is considered as a separate economic unit operating only for the benefit of its Equity Shareholders.

(c) **Enterprise Theory:** In this theory, the Reporting Entity is a Social Institution, operating for the benefit of many interested groups like Shareholders, Bondholders, Management, Employees, etc. The Value Added is an important concept in this theory. When the income is defined as the reward of a larger group of people than just shareholders, the concept and its understanding is better.

(H) The relevance of Value Added Statements in Corporate Financial Reporting.

(i) **Company Ranking:** The Value Added is a very good index to measure the size and importance of a Company. It also overcomes the distortion in ranking caused by the use of inflated sales.

(ii) **Systems Concept:** The Value Added Statement reflects the Company's objectives and responsibilities in a better fashion. It establishes the fact that the business entity is part of a larger system interacting with other components in the environment.

(iii) Employee Incentives: The Value Added Statement paves way for introduction of productivity linked bonus schemes for the employees. Calculation also becomes easier.

(iv) Macro level analysis: The Value Added Statement links the Company's financial accounts to the national income by indicating the Company's Contribution to National Income.

(v) Ratio Analysis: The Value Added Statement helps in ratio analysis. The Value Added to Payroll, Taxes to Value Added and Value Added to Sales ratios are used as predictive tools for analysis of different firms. It also provides for adjustments in respect of inflation, to facilitate comparison between periods.

(vi) Concepts: The Value Added Statement is based on fundamental concepts that are accepted in financial statements like the going concern concept, matching concept, consistency and substance over form, etc.

(vii) Performance Measure: Value Added is a better measure of performance of business entity than the profit. It explains the input-output relationship. Once the value added is ascertained, it is possible to establish a linkage with value to be used —

- For the work force – for Wages, Salaries and related expenses
- For the Business – for retention
- For the Government – for Corporation Tax
- For the Financiers – for Interest on loans and for Dividends on Share Capital

(viii) Budgeting: Value Application is a pre-condition for value generation. So insufficiency of value added can be understood beforehand. This may be good test for Business Budgeting than Financial Reporting.

(I) What information can we gather from Value Added Statements?

(i) Wealth Creation: The Value Added Statement specifies the wealth accumulated by the Company. It states in monetary terms the wealth accumulated by the Company.

(ii) Beneficiaries/participants of wealth: The Value Added Statement states the application of Value Added to shareholders, bondholders, employees, etc. This identifies the participants/ beneficiaries of the wealth generated by the Company and their interest in the Company in terms of value and percentage.

(iii) Value Added based ratios: The following ratios can be computed – Value Added to Sales, Value Added to payroll, Taxes to Value Added, etc. This facilitates comparison of ratios between periods as well as comparison between Companies.

(iv) Value Added Interpretation: Value Added facilitates interpretation of operating results or contribution of variou Companies. The real wealth of Companies can be understood only from the Value Added Statement, as the comparison of Sales Turnover may not give a real picture. Many Companies can have the same turnover also.

(J) Disadvantages of Value Added Reporting.

(i) Risk: Employees, Government and Fund Providers are interested only in getting their share of Value Added. The entire business risk is borne only by the Shareholders. The residual profits after meeting the obligations of the outside groups should be shown as the Value Added accruing to the shareholders.

(ii) Non-uniformity: Value Added Statements are non-standardised in areas like inclusion or exclusion of Depreciation, Taxation on Profits, etc. This can however be overcome by defining an Accounting Standard on Value Added.

ILLUSTRATIONS

Illustration 1: Gross Value Added Statement – Treatment of Deferred Taxes

From the following details, calculate the Gross Value Added and Net Value Added of Amareshwar Ltd.

Profit and Loss Account for the year ended 31st March 200X

Particulars		₹ 000s	Notes	₹ 000s
	Sales			8,540
	Trading Profit		A	766
Less:	Depreciation	121		
	Interest	56	B	(177)
Add:	Rent from let out properties			33
	Profit Before Tax			622
Less:	Provision for tax		C	(275)
	Profit After Tax			347
Less:	Extra-Ordinary Items		D	(7)
				340
Less:	Dividend Paid and Payable			(136)
	Retained Profit			204

Notes:

A. Trading Profit is arrived at after charging - (₹ 000s) • Salaries, Wages, etc. to employees 1,475 • Directors' Remuneration 145 • Audit Fees 90 • Hire of Equipment 115	B. Interest figure is ascertained as under: (₹ 000s) Interest paid on Bank Loans and Overdrafts 65 Interest received (9) Net Interest 56
C. Provision of Taxes includes a transfer of ₹ 57(000s) to the credit of Deferred Tax Account.	D. Extra-ordinary items - (₹ 000s) Surplus on Sale and Lease back of properties 8 Loss of Cash by theft (15)

Solution:

Expenditure debited in deriving Trading Profit (as per Note A) = 1,475 + 145 + 90 + 115 = 1,825.

Cost of Bought Out Materials = Sales - Exps as per Note A - Trading Profit = 8,540 - 1,825 - 766 = 5,949.

Value Added Statement of Amareshwar Ltd. for the year ended 31.03.200X.

	Particulars	₹ 000s	₹ 000s
	Sales/Turnover		8,540
Less:	Bought in Materials	5,949	
	Manufacturing and Other Expenses (90 +115)	205	6,154
	Value Added by Trading Activities		2,386
Add:	Other Income (Rent = + 33; Interest Received = + 9)	42	
	Extra-Ordinary Items (as per Note D)	(7)	35
	TOTAL VALUE ADDED		**2,421**
Applied as follows -			%
	1. To Employees Salaries, Wages, etc.	1,475	61%
	2. To Management as Directors' Remuneration	145	6%
	3. To Government as Taxes, Duties, etc. (Tax Provn 275 - Deferred Tax 57)	218	9%
	4. To Financiers as Interest on borrowings	65	3%
	5. To Shareholders as Dividends	136	6%
	6. To Retained Earnings as — (a) Depreciation	121	5%
	(b) General Reserves	204	8%
	(c) Deferred Taxation	57	2%
	TOTAL APPLICATION	**2,421**	**100%**

Illustration 2: Value Added Statement – Treatment of Value Deficit

From the following data, prepare a Value Added Statemen of Bhadreshwar Ltd., for the year-ended 31.03.200X.

Particulars	₹	Particulars	₹
Decrease in Stock	24,000	Sales	40,19,000
Purchases	20,20,000	Other income	55,000
Wages & Salaries	10,00,000		
Manufacturing & Other Expenses	2,30,000		
Finance Charges	4,69,000		
Depreciation	2,44,000		
Profit Before Taxation	87,000		
Total	**40,74,000**	**Total**	**40,74,000**

	Particulars	₹
	Profit Before Taxation	87,000
Less:	Tax Provisions	(40,000)
	Income Tax Payments (for earlier years)	(3,000)
Add:	Earlier Year Profit brought forward	38,000
	Profit After Taxation	82,000
Appropriations of PAT		
	Debenture Redemption Reserve	10,000
	General Reserve	10,000
	Proposed Dividend	35,000
	Balance carried to Balance Sheet	27,000
	Total	**82,000**

Solution:

Value Added Statement of Bhadreshwar Ltd. for the year ended 31.03.200X

Particulars	₹	₹
Sales/Turnover		40,19,000
Less: Bought in Materials		
• Decrease in Stock	24,000	
• Purchases	20,20,000	20,44,000
Value Added by Trading Activities		19,75,000
Add: Other Income		55,000
GROSS VALUE ADDED		**20,30,000**
Applied as follows -		
1. To Employees Salaries, Wages, etc.	10,00,000	
2. To Other Service Providers as Manufacturing & Other expenses	2,30,000	
3. To Government as Taxes, Duties, etc. (40,000 + 3,000)	43,000	
4. To Financiers as Interest on borrowings	4,69,000	
5. To "Shareholders as Dividends	35,000	
6. To Retained Earnings as –		
• Depreciation	2,44,000	
• Debenture Redemption Reserve	10,000	
• General Reserve	10,000	
TOTAL APPLICATION		**20,41,000**
VALUE DEFICIT (Reduction in P & L A/c balance = 38,000 - 27,000)		(11,000)

Note: Alternatively, the reduction in Retained Profits (38,000 - 27,000) may be considered as an adjustment / reduction against the entry "To Retained Earnings" and the Value Deficit need not be shown.

Illustration 3: Value Added Statement – Percentage Analysis of VA

Following is an extract of Profit & Loss A/c of Chakreshwar Ltd. for the year ended 31st March.

Particulars	₹ 000s
Sales (including Excise Duty Recoveries)	727
Other Income	13
Total	740
Materials	530
Excise Duty	62
Salaries, Wages & Employee Benefits	19
Other Expenses	47
Interest & Finance Charges	–
Depreciation	5
Provision for Taxation	31
Preliminary Expenses written off	
Transfer to Debenture Redemption Reserve	5
Proposed Dividend	5
Transfer to General Reserve	24
Total	**740**

- Other Expenses include Fees & Commissions to Whole-Time Directors amounting to ₹ 9,000 and Loss on Sale of Fixed Assets of ₹ 3,000.
- Interest and Finance Charges include interest on Long Term Loans of ₹ 4,000; and the balance being on Short-Term Borrowings.

Prepare a Value Added Statement for the year ended 31st March.

Solution: Value Added Statement of Chakreshwar Ltd for the year ended 31st March

	Particulars		₹ 000s	% of Sales
A:	**VALUE ADDED**			
	Sales		727	100.0
Less:	Materials		(530)	72.9
	Other Expenses (47 - 9 - 3)		(35)	4.8
	Short-Term Interest		(3)	0.4
	Value Added from own operations		159	21.9
Add:	Other Income		13	
	TOTAL VALUE ADDED		172	

B:	**VALUE APPLIED**		**₹ 000s**	**%**
B.1	To Employees: Salaries, Wages and Benefits		**28**	**16.3**
B.2	To Government:	Excise Duty	62	36.0
		Income-Tax	31	18.1
			93	**54.1**
B.3	To Finance Providers:	Interest on Long Term Loans	4	2.0
		Dividend on Equity	5	3.0
			9	**5.2**
B.4	To Entity's needs -			
	Meeting Loss on Sale of Fixed Assets		3	1.7
	Preliminary Expenses w/off		5	3.0
	Depreciation		5	3.0
	Transfer to Reserves (Deb. Redemption & General Reserve)		29	16.9
			42	**24.4**
	TOTAL APPLICATION		**172**	**100.0**

Illustration 4: VA Statement and Reconciliation of GVA with PAT

Prepare a Gross Value Statement from the following Profit and Loss Account of Dakshineshwar Ltd. Show also the Reconciliation between Gross Value Added and Profit before Taxation.

Profit & Loss Account for the year ended 31.03.200X

	Particulars	(₹ Lakhs)	(₹ Lakhs)
Income:	Sales Other Income		610 25
Total Income			635
Expenditure:	Production & Operational Expenses Administration Expenses Interest and Other Charges Depreciation	465 19 27 14	525
Less:	Profit Before Taxes Provision for Taxes		110 16
Add:	Profit After Taxes Balance as per last Balance Sheet		94 7
			101
Transferred to:	General Reserve Proposed Dividend Surplus carried to Balance Sheet	60 11	 71 30
	Total		**101**

Notes:

1. Production & Operational Expenses

	(₹ Lakhs)
Increase in Stock	**112**
Consumption of Raw Materials	**185**
Consumption of Stores	**22**
Salaries, Wages, Bonus & other benefits	**41**
Cess and Local Taxes	**11**
Other Manufacturing Expenses	94
	465

2. Administration Expenses include inter-alia Audit Fees of ₹4.80 Lakhs, Salaries & Commission to Directors ₹5 Lakhs and Provision for Doubtful Debts ₹5.20 Lakhs.

3. **Interest and Other Charges:**

	(₹ Lakhs)
On Working Capital Loans from Bank	**8**
On Fixed Loans from IDBI	12
On Debentures	**7**
	27

Solution:

Value Added Statement of DakshinjShwar Ltd for the year-ended 31.03.200X

		₹ Lakhs	₹ Lakhs	%
	Sales		610	
Less:	Cost of Bought In Material and Services:			
	Production & Operational Expenses (112 + 185 + 22 + 94)	413		
	Administration Expenses (19 - 5)	14		
	Interest on Working Capital Loans	8	435	
	Value Added by Manufacturing and Trading activities		175	
Add:	Oilier Incomes	-	25	
	TOTAL VALUE ADDED		**200**	

Application of Value Added:		₹ Lakhs	₹ Lakhs	%
1. To pay Employees:	Salaries, Wages, Bonus and other benefits		41	20.50
2. To pay Directors:	Salaries and Commission		5	2.50
3. To pay Government:	Cess and Local Taxes	11		
	Income Tax	16	27	13.50
4. To pay providers of Capital:	Interest on Debentures	7		
	Interest on Fixed Loans	12		
	Dividend	11	30	15.00
5. To provide for maintenance and expansion of the Company:				
	Depreciation	14		
	General Reserve	60		
	Retained Profit (30 - 7)	23	97	48.50
TOTAL APPLICATION			**200**	**100.00**

Reconciliation between Total Value Added and Profit before Taxation

	Particulars	₹ Lakhs	₹ Lakhs
	Profit before Tax		110
Add back:	Depreciation	14	
	Salaries, Wages, Bonus and other benefits	41	
	Directors Remuneration	5	
	Cess and Local Taxes	11	
	Interest on Debentures	7	
	Interest on Fixed Loans	12	90
	Total Value Added		**200**

Illustration 5: GrossValue Added Statement and Reconciliation ofJ&VA with PAT

The following is the Profit and Loss Account of F Ltd., from which you are required to prepare a Gross Value Added Statement and reconcile the same with Profit before Taxation.

	Particulars	₹ 000s	₹ 000s
Income:	Sales	28,500	
	Other Income	750	29,250
Expenditure:	Operating Cost	25,600	
	Excise Duty	1,700	
	Interest on Bank Overdraft	100	
	Interest on 12% Debentures	1.150	28.550
Less:	Profit before Depreciation		700
	Depreciation		250
	Profit Before Tax		450
Less:	Tax Provision		270
	Net Profit After Tax		180
Less:	Transfer to Replacement Reserve		30
	Balance Profit		150
Less:	Dividend		50
	Retained Profit		**100**

Note:

(a) Sales are net after deducting Discounts, Returns, and Sales Tax.
(b) Operating Cost includes ₹(000s) 10,200 as Wages, Salaries and other benefits to Employees.
(c) Bank Overdraft is a temporary source of finance.
(d) Provision for Tax includes ₹ (000s) 70 for Deferred Tax.

Solution: **Value Added Statement of F Ltd.**

Particulars			₹ 000s	₹ 000s	%
	Sales			28,500	
Less:	Cost of Materials and Services				
	Operating Cost (25,600 - 10,200)		15,400		
	Excise Duty		1,700		
	Interest on Overdraft **(See Note 1)**		100	17,200	
	Value Added by manufacturing and trading activities			**11,300**	
Add:	Other Income			750	
TOTAL VALUE ADDED				**12,050**	
Application of Total Value Added:					
1.	To pay Employees:	Wages, Salaries and other benefits		10,200	84.65
2.	To pay Government:	Corporation Tax		200	1.65
3.	To pay Providers of Capital:	Interest on 12% Debentures	1,150		
		Dividend	50	1,200	9.95
4.	To Provide for maintenance and expansion of Company:				
		Depreciation	250		
		Replacement Reserve	30		
		Deferred Tax (See Note 2)	70		
		Retained Profit	100	450	3.75
	TOTAL APPLICATION			**12,050**	**100.00**

Note:

1. Bank Overdraft is a temporary source of finance. It has been considered as provision of a banking service rather than provision of Capital. Hence, Interest on Bank OD has been shown as deduction from Sales and as part of "Cost of Bought In Materials & Services".
2. Deferred Taxation can also be shown as "To Pay Government".

Illustration 6: Gross Value Added Statement and Reconciliation of GVA with PAT

On the basis of the following Income Statement of G Ltd., prepare - (a) Gross Value Added Statement; and (b) Statement showing reconciliation of Gross Value Added with Profit Before Taxation. (₹ 000')

Particulars	₹ 000s	₹ 000s
Income:		
Sales Less Returns		15,27,956
Dividends and Interest		130
Miscellaneous Income		474
Total Income (A)		**15,28,560**

Expenditure:		
1. Production & Operational Expenses:		
Decrease in Inventory of Finished Goods	26,054	
Consumption of Raw Materials	7,40,821	
Power & Lighting	1,20,030	
Wages, Salaries and Bonus	3,81,760	
Staff Welfare Expenses	26,240	
Excise Duty	14,540	
Other Manufacturing Expenses	32,565	13,42,010
2. Administration Expenses:		
Directors' Remuneration	7,810	
Other Administration Expenses	32,640	40,450
3. Interest on:		
9% Mortgage debentures	14,400	
Long-Term loan from Financial Institutions	10,000	
Bank Overdraft	100	24,500
4. Depreciation on Fixed Assets:		50,600
Total Expenditure (B)		**14,57,560**

	Profit before Taxation (A) - (B)		71,000
Less:	Provision for Income Tax		25,470
	Profit after Taxation		45,530
	Balance of P & L A/c as per last Balance Sheet		6,300
	Total available for appropriation		51,830
Transferred to:			
	General Reserve 40% of ₹45,530	18,212	
	Proposed Dividend at 22%	22,000	
	Tax on Distributed Profits at 12.81%	2,818	43,030
Surplus carried to Balance Sheet			8,800

Solution:

Value Added Statement of G Ltd.

	Particulars	₹ 000s	₹ 000s	%
	Sales less Returns		15,27,956	
Less:	Bought In Materials & Services (13,42,010 - 3,81,760 - 26,240)	9,34,010		
	Administration Expenses	32,640		
	Interest on Bank Overdraft	100	9,66,750	
	Value Added by Manufacturing and Trading Activities		5,61,206	
Add:	Dividend & Interest Received		130	
	Miscellaneous Income		474	
	TOTAL VALUE ADDED (See Note below)		**5,61,810**	

APPLICATION OF VALUE ADDED	₹ 000s	₹ 000s	%
1. To Pay Employees: Wages, Salaries & Bonus	3,81,760		
Staff Welfare Expenses	26,240	4,08,000	72.62
2. To Pay Directors: Directors Remuneration		7,810	1.39
3. To Pay Government: Income Tax	25,470		
Tax on Distributed Profits	2,818	28,288	5.04
4. To Pay to providers of Capital: Interest on 9% Debentures	14,400		
Interest on long-term loan from financial institution	10,000		
Dividend to Shareholders	22,000	46,400	8.26
5. To provide for maintenance and expansion of the Company:			
Depreciation on Fixed Assets	50,600		
Transfer to General Reserve	18,212		
Retained Profits (8,800 - 6,300)	2,500	71,312	12.69
TOTAL APPLICATION		**5,61,810**	**100.00**

Reconciliation of Total Value Added with Profit before Taxation

	Particulars	₹ 000s	₹ 000s
	Profit Before Taxation		71,000
Add back:	Wages, Salaries & Bonus	3,81,760	
	Staff Welfare Expenses	26,240	
	Directors Remuneration	7,810	
	Interest on 9% Mortgage Debentures	14,400	
	Interest on Long-Term loan from Financial Institution	10,000	
	Depreciation on Fixed Assets	50,600	4,90,810
	Total Value Added		**5,61,810**

Note: *Excise Duty may alternatively be shown as an application of Value Added under "To pay Government".*

Illustration 7: GVA Statement – Calculation of Excise Duty

The following is the Profit and Loss Account of Haalaasi Ltd. for the year ended 31st March. Prepare a GVA Statement of K Ltd., and show also the reconciliation between Gross Value Added and Profit before Taxation.

Profit and Loss Account for the year ended 31st March

Particulars		₹ Lakhs	₹ Lakhs
Income:	Sales	890	945
	Other Income	55	
Expenditure:	Production and operational expenses	641	
	Administration expenses (Factory)	33	
	Interest	29	
	Depreciation	17	720
	Profit Before Taxes		225
Less:	Provision for Taxes		30
	Profit After Tax		195
Add:	Balance as per Balance Sheet		10
			205
Less:	Transferred to General Reserve	45	
	Dividend Paid	95	140
	Surplus carried to Balance Sheet		**65**

1.	Production and Operational Expenses consists of Consumption of Raw materials	293	2.	Interest Charges Consists of Interest on loan from ICICI Bank for working capital	9
				Interest on loan from ICICI Bank for fixed loan	10
	Consumption of stores	59			
	Salaries, Wages, Gratuities etc. (Admn.)	82		Interest on loan from IFCI for fixed loan	8
	Cess and Local taxes	98		Interest on Debentures	2
	Other manufacturing expenses	109			
3.	Administration Expenses include Salaries to Directors ₹ 9 lakhs. Provision for doubtful debts ₹ 6.30 lakhs.		4.	The charges for taxation Include a transfer of ₹ 3 lakhs to the credit of Deferred Tax Account.	
5.	Cess and Local Taxes include Excise Duty, which is equal to 10% of cost of bought-in material.				

Solution:

Value Added Statement of K Ltd. for year ending 31st March

	Particulars			₹ Lakhs
	Sales			890.00
Less:	Cost of Bought in Materials & Services	(Note 1)		461.00
	Administrative Expenses	(Note 2)		17.70
	Interest	(Note 3)		9.00
	Excise Duty	(₹461 x	10%)	46.10
	Value Added from Manufacturing and Trading Activities			356.20
Add:	Other Income			55.00
	TOTAL VALUE ADDED			**411.20**
Application of Value Added			%	**₹ Lakhs**
	To Pay Employees	(Note 4)	20%	82.00
	To Pay Directors	(Note 5)	2%	9.00
	To Pay Government	(Note 6)	20%	81.90
	To Pay Providers of Capital	(Note 7)	28%	115.00
	To Provide for Maintenance & Expansion of the Company	(Note 8)	30%	123.30
	TOTAL APPLICATION		**100%**	**411.20**

Working Notes:

1. **Cost of bought in materials and services** includes Raw materials, stores and other manufacturing expenses, i.e., 293 + 59 + 109 = ₹461 Lakhs.
2. **Administrative Expenses** excludes Commission to Directors and Provision for debts i.e., [₹33 - (₹9 + ₹6.3)] which is ₹ 17.70 Lakhs.
3. **Interest** on Working Capital - ICICI Bank is ₹ 9 Lakhs.
4. **Employees:** Salaries, Wages, Gratuities etc. is ₹ 82 Lakhs.
5. **Directors** - Salaries and Commission to Directors is ₹ 9 Lakhs.
6. Payment to **Government** includes Cess and Local Taxes (₹98 Lakhs **Less** ₹461 Lakhs x 10%), Deferred Taxes and Provision for taxation i.e., (₹51.9 + ₹3 + ₹27 = ₹ 81.9 Lakhs.
7. Payment to **Providers of Capital** includes interest on Fixed Loan (₹ 10 Lakhs + ₹ 8 Lakhs), Interest on Debentures and pividend i.e., ₹ 18 + ₹ 2 + ₹ 95 = ₹ 115 Lakhs.
8. **Retained earnings and Depreciation** includes depreciation, Transfer to General Reserve, Retained Profit and Provision for doubtful debts i.e., ₹17 + ₹45 + ₹55 + ₹6.3 = ₹ 123.30 Lakhs.

7.3 ECONOMIC VALUE ADDED, MARKET VALUE ADDED, SHAREHOLDER'S VALUE ADDED

A. ECONOMIC VALUE ADDED

(i) What is Economic Value Added (EVA)? How is it calculated?

- **Meaning:** Economic Value Added (EVA) is ths surplus generated by an entity after meeting an equitable charge towards the providers of Capital.

EVA = Operating Profit-Taxes paid-(Capital Employed x WACC)

- **Significance:** Economic Value Added is an index to measure the financial performance. It takes into account the Profit, Loss, Balance Sheet efficiency and Opportunity Cost of Capital.
- **Uses:** EVA helps to –

(a) measure business performance,

(b) take important managerial decisions,

(c) equate managerial incentives with Shareholders' interest, and

(d) improve financial and business literacy throughout the Firm.

(ii) Differentiate between VA (Value Added) and Economic Value Added (EVA) concepts.

Particulars	Value Added	Economic Value Added
Meaning	VA is the **wealth** that a Firm has been able to create through the collective effort of Capital, Management and Employees.	EVA is the **surplus** generated by an entity after meeting an equitable charge towards the providers of Capital.
Computation	**VA** = Market Price of a Firm's Output — Cost of Bought in Materials and Services	**EVA** = Operating Profit - Taxes paid - (Capital Employed x WACC)
Purpose	VA provides a useful measure in **analysing the performance** and activity of the reporting entity.	EVA is a management tool to help managers take **decisions** which increase the shareholders' wealth.
Focus	VA focusses on the Firm's performance and contribution towards **various groups**.	EVA focusses on Firm's ability to create surplus above **shareholders' expectations.**
Information	VA reporting is based on the P & L Account information, which is primarily **internal** data.	EVA reporting uses **market information** and estimates like Cost of Capital, Beta, Risk Free Rate of Return etc.
Time Value of Money	VA reporting does not recognise time value of money, since it deals with the wealth created by the Firm during a specified period of time e.g. a financial year.	Time Value of Money is recognised in EVA reporting through the use of WACC. The Weighted Average Cost of Capital is based on the PV of future interest/ dividend outflows.

(iii) List the concepts in Economic Value Added (EVA).

- **Cost of Debt** (K_d): It is the Discount Rate that equates the Present Value of After Tax Interest Payment Cash Outflows to the current Market Value of Debt Capital. *[**Note:** Debt = Long Term Borrowings only]*

- K_d (for Irredeemable Debt) = [Interest (100% - Tax Rate)] ÷ Long Term Debt
- K_d (for Redeemable Debt) = {[Interest (100% - Tax Rate)I + [RV - NP1 ÷ *n)* / [RV + NP] ÷ 2

Where RV = Redemption Value of Debt; NR = Net Proceeds of Debt Issue; n = Number of years after which Debt becomes redeemable.

- **Cost of Preference Capital** (K_p): It is the Discount Rate that equates the Present Value of Preference Dividend Cash Outflows to the current Market Value of Preference Share Capital.
  - K_p (for Irredeemable PSC) = Preference Dividend * Preference Share Capital
  - K_d (for Redeemable PSC) = (Preference Dividend + TRV - NP] ^ n) / [RV + NP] - 2

  Where RV = Redemption Value of PSC; NP = Net Proceeds of PSC Issue; n = Number of years after which PSC becomes redeemable.
- **Cost of Equity** (K_e) is the expected Market Rate Return on Equity Capital. This is,generally derived from the Capital Asset Pricing.Model (CAPM), in the following manner –

Cost of Equity Capital = Risk Free Rate + (Beta x **Equity Risk Premium)**
Where Equity Risk Premium = Market Rate of Return ***Less*** Risk Free Rate of Return

- **Cost of Retained Earnings** (K_r): Reserves and Surplus are created out of appropriation of profit, i.e. by retention of profit attributable to Equity Shareholders. So, the expectation of the shareholders to have value appreciation on this money will be same as in case of Equity Share Capital. Accumulated Reserves and Surplus which are free to Equity Shareholders carry the same cost as Equity Share Capital.
- **Beta:**

  (a) Beta is a relative measure of volatility that is determined by comparing the return on a share to the return on the stock market. Thus, Beta is a measure of non-diversifiable risk.

  (b) The greater the volatility, the more risky the Share and hence, the higher the **Beta.** A Company having a Beta of 1.2 implies that, if the Stock Market increases by 10%, the Company's Share Price will increase by 12% (i.e. 10% x 1.2). Also, if the Stock Market decreases by 10% the Company's Share Price will decrease by 12%.

  (c) It is the basis of explaining the relationship between the Return of a particular security (e.g. Shares of a particular Company) and the return of the Stock Market as a whole (i.e. Market Risk Premium). Beta is the responsiveness of Stock Return or Portfolio Return (of a Company) to Market Return (as a whole).

  (d) Beta is a statistical measure of volatility. For Listed Companies, Beta is calculated as the co-variance of daily return on stock market indices and the return on daily share prices of a particular Company divided by the Variance of the return on daily Stock Market indices. Generally, maximum of yearly Beta of the Company should be taken for calculations.

  (e) For Unlisted Companies, Beta of similar firms in the industry may be considered after transforming it to un-geared beta and then re-gearing it according to the Debt Equity Ratio of the unlisted Company.
- **Equity Risk Premium:** Equity Risk Premium is the excess return above tbe RisltFree Rate that investors demand for holding risky securities (i.e. Shares of the given Company). Equity Risk Premium = Market rate of Return (MRR) **Less** Risk Free Rate.

- **Market Rate of Return:** It may be calculated from the movement of share market indices over a period of an economic cycle based on moving average, to smooth out abnormalities, if any. Market Rate of Return may be calculated as under —

$$\frac{\text{Stock Exchange Index at the end of the year} - \text{Stock Exchange Index at the beginning of the year}}{\text{Stock Exchange Index at the beginning of the year}}$$

- Overall Cost of Capital (K_r): The Overall Cost of Capital of a Firm is the weighted average cost of the individual components of Capital i.e. Debt, Preference and Equity. Thus WACC or (K_r) is equal to -

$$K_d \times \frac{\text{Debt}}{\text{Total Funds}} + K_p \times \frac{\text{PSC}}{\text{Total Funds}} + K_e * \frac{\text{Equity}}{\text{Total Funds}}$$

Where Total Funds = Debt + Preference Capital + Equity Funds.

ILLUSTRATIONS

Illustration 8: EVA Computation

Compute EVA'of Sarin Ltd. for 3 years from the information given – (in ₹ Lakhs)

Particulars	Year 1	Year 2	Year 3
Average Capital Employed	3,000.00	3,500.00	4,000.00
Operating Profit before Interest (adjusted for tax Effect)	850.00	1250.00	1600.00
Corporate Income Taxes	80.00	70.00	120.00
Average Debt+Total Capital Employed (In %)	40.00	35.00	13.00
Beta Variant	1.10	1.20	1.30
Risk Free Rate (%)	12.50	12.50	12.50
Equity Risk Premium (%)	10.00	10.00	10.00
Cost of Debt (Post Tax) (%)	19.00	19.00	20.00

Solution: **EVA Statement of Sarin Ltd.**

Particulars	Year 1	Year 2	Year 3
1. Cost of Equity (K^e) = Risk Free Rate+ (Beta x Equity Risk Premium)	12.5+(1.1 x 10) = 23.50%	12.5 + (1.2 x 10) = 24.50%	12.5 +(1.3 x 10) = 25.50%
2. Cost of Debt (K^d) (given)	19.00%	19.00%	20.00%
3. Debt – Equity Ratio (Debt = given; Equity is bal. fig)	40% & 60%	35% & 65%	13% & 87%
4. WACC = [(K^d) x Debt % + (K^e) x Equity%]	**21.70%** (23.50x60% + 19x40%)	**22.58%** (24.50 x 65% + 19 x 35%)	**24.79%** (25.50 x 87% + 20 x 13%)
5. Average Capital Employed (given)	3,000.00	3,500.00	4,000.00
6. Capital Charge (Fair Return to Providers of Capital i.e. Average Capital Employed x WACC) (4 x 5)	3,000x21.70% = 651.00	3,500 x 22.58% = 790.30	4,000 x 24.79% = 991.60
7. Operating Profit before Taxes & Interest	**850.00**	**1,250.00**	**1,600.00**
8. **Less:** Taxes Paid	80.00	70.00	120.00
9. Operating Profit after Taxes (This is the return to the Providers of Capital i.e. Debt and Equity)	770.00	1,180.00	1,480.00
10. Capital Charge (computed in 6 above)	651.00	790.30	991.60

11. Economic Value Added (9 - 10)	**119.00**	**389.70**	**488.40**
12. EVA as a % of Average Capital Employed	**3.96%**	**11.13%**	**12.21%**

Illustration 9: EVA Computation using WACC, Equity Risk Premium etc.

The Capital Structure of Himesh Ltd. is as under:

- 80,00,000 Equity Shares of ₹10 each = ₹800 Lakhs
- 1,00,000 12% Preference Shares of ₹250 each = ₹250 Lakhs
- 1,00,00010% Debentures of ₹500 each = ₹500 Lakhs
- Term Loan from Bank (at 10%) = ₹450 Lakhs.

The Company's Profit and Loss Account for the year showed a balance PAT of ₹100 lakhs, after appropriating Equity Dividend at 20%. The Company is in the 40% tax bracket. Treasury Bonds carry 6.5% interest afid beta factor for the Company may be taken at 1.5. The long run market rate of return may be taken at 16.5%. Calculate EVA.

Solution:

1. Profit and Loss Statement

	Particulars	Commutation	₹ Lakhs
	Profit before Interest and Taxes	Balancing figure	**578.33**
Less:	Interest on Debentures	10% x ₹500 Lakhs	50.00
	Interest on Bank Term Loan	10% x ₹450 Lakhs (₹290.00 - 60%)	45.00
	Profit before Tax		483.33
Less:	Tax at 40%	(₹290.00 ÷ 60%) x 40%	193.33
	Profit after Tax	Reverse working	290.00
Less:	Preference Dividend	12% x ₹250 Lakhs	30.00
	Residual Earnings for Equity Shareholders	Reverse working	260.00
Less:	Equity Dividend	20% x ₹800 Lakhs	160.00
	Net Balance in P & L Account	Given	100.00

2. Computation of Cost of Equity: K^e = Risk Free Rate + Beta x (Market Rate - Risk Free Rate)

= 6.5% + 1.5 (16.5% - 6.5%) = **21.5%.**

3. Computation of WACC:

Component	Amount	Ratio	Individual Cost	WACC
Equity	₹ 800 Lakhs	800 ÷ 2000 - 40.0%	K^e=21.5%	8.60%
Preference	₹ 250 Lakhs	250 ÷ 2000= 12.5%	K^p= 12%	1.50%
Debt	₹ 950 Lakhs	950 ÷ 2000 = 47.5%	K^d = Interest x (100 - Tax Rate) = 10% x (100% - 40%) = 6%	2.85%
Total	**₹2,000 Lakhs**		K_o =	12.95%

4. Computation of EVA:

	Particulars	₹ Lakhs
	Profit before Interest and Taxes (from WN 1)	578.33
Less:	Taxes	193.33
	Net Operating Profit After Taxes i.e. Return to Providers of Capital	385.00
Less:	Capital Charge (Fair Return to providers of Capital) = WACC x Cap Emp	2,000 x 12.95% = 259.00
	Economic Value Added	**126.00**

Illustration 10: EVA using Financial Leverage, PE Ratio

From the following information, compute EVA of Auto Ltd. (Assume 35% tax rate)

• Equity Share Capital = ₹1,000 Lakhs	• PE Ratio = 5 times
• 12% Debentures = ₹500 Lakhs	• Financial Leverage = 1.5 times

Solution:

1. Profit and Loss Statement

	Particulars	%	₹ Lakhs
	Profit before Interest and Taxes	150%	**18.00**
Less:	Interest on Debentures ₹500 x 12%	50%	60.00
	Profit before Tax	100%	120.00
Less:	Tax at 35%	35%	42.00
	Profit after Tax	**65%**	**78.00**

Note: *Financial Leverage = PBIT + PBT = 1.5. Let PBT = 100%), then PBIT = 150%), hence, Interest = 50%.*

2. Computation of WACC

Component	Amount	Ratio	Individual Cost	WACC
Equity	₹ 1,000 Lakhs	2/3	K^e = 1 ÷ PE Ratio = 20%	13.33%
Debt	₹ 500 Lakhs	1/3	K^d = Interest x (100 - Tax Rate) = 12% x (100% - 35%) = 7.8%	2.60%
Total	**₹ 1,500 Lakhs**		**K_o =**	**15.93%**

3. Computation of EVA

	Particulars	₹ Lakhs
	Profit before Interest and Taxes (from WN 1)	180.00
Less:	Taxes	42.00
	Net Operating Profit After Taxes i.e. Return to Providers of Capital	138.00
Less: Emp	Capital Charge (Fair Return to providers of Capital) = WACC x Cap.	1,500 x 15.93% = 238.95
	Economic Value Added	**Nil**

Note: *The Company does not generate sufficient profits to meet the requirements of providers of Capital.*

Illustration 11: Present Value of EVA

B & Co. has existing assets in which it has capital invested of ₹100 Crores. The After Tax Operating Income on assets-in-place is ₹15 Crores. The Return on Capital Employed of 15% is expected to be sustained in perpetuity, and Company has a Cost of Capital of 10%. Estimate the Present Value of Economic Value Added (EVA) to the Firm from its assets-in-place.

Solution:

Operating Profit after Tax = ₹ 15 Crores

Return on Capital Employed = 15%, but Cost of Capital = 10%

Present Value of Economic Value Added (EVA) = Operating Profit after Taxes ÷ Cost of Capital

= ₹15 Crores ÷ 10% = ₹**150 Crores.**

Market Value Added (MVA)

Market value Added (MVA) is the difference between the current market value of a firm and the capital contributed by investors. If MVA is positive, the firm has added value. If it is negative the firm has destroyed value.

To find out whether management has created or destroyed value since its inception, the firm's MVA can be used:

MVA=Market value of capital – capital employed

This calculation shows the difference between the market value of a company and the capital contributed by investors (both bondholders and shareholders). In other words, it is the sum of all capital claims held against the company plus the market value of debt and equity. Calculated as:

The higher the MVA, the bette. . A high MVA indicates the company has created substantial wealth for the shareholders. A negative MVA means that the value of the actions and investments of management is less than the value of the capital contributed to the company by the capital markets, meaning wealth or value has been destroyed.

The aim of the company should be to maximize MVA. The aim should not be to maximize the value of the firm, since this can be easily accomplished by investing ever-increasing amounts of capital.

Shareholder Value Added (SVA)

Shareholder Value Added (SVA) represents the economic profits generated by a business above and beyond the minimum return required by all providers of capital. "Value" is added when the overall net economic cash flow of the business exceeds the economic cost of all the capital employed to produce the operating profit. Therefore, SVA integrates financial statements of the business (profit and loss, balance sheet and cash flow) into one meaningful measure.

The SVA approach is a methodology which recognizes that equity holders as well as debt financiers need to be compensated for the bearing of investment risk in Government businesses. Historically, it has been apparent that debt financiers have been explicitly compensated, however, this has not been the norm for providers of equity capital. Such inequalities can lead to inefficiencies in the allocation and use of capital.

The SVA methodology is a highly flexible approach to assist management in the decision making process. Its applications include performance monitoring, capital budgeting, output pricing and market valuation of the entity.

Comparison With Conventional Performance Measures

Conventional ratio analysis based on accounting data, has historically been regarded as more useful to the management of a business rather than to the investors of the business.

Whereas accounting measures focus on residual profits after tax equivalents measured against the total asset base, the value-based income statement concentrates on the operating performance of the firm by adjusting net operating revenue (NOPAT) by the allocation of a capital charge incorporating the economic operations of the business.

As such, SVA takes into consideration one important variable that most traditional accounting measures do not – how much capital is being employed in the business. SVA combines income statement and balance sheet data to determine the excess returns available to all capital holders, Additionally, through the use of a weighted average cost of capital (WACC), SVA implicitly address the concepts of risk and shareholder expectations

Calculation of SVA

SVA = Net Operating Profit After Taxes (NOPAT) – (Capital WACC)

The first step in calculating SVA is to calculate NOPAT; the second step is to estimate capital employed; the third is to estimate the appropriate WACC; the fourth step is to calculate the capital charges; and the fifth step is to calculate SVA.

NOPAT is operating performance measure after taking account of taxation, but before any financing costs. Interest is totally excluded from NOPAT as it appears implicitly in capital charge. NOPAT also requires further equity-equivalent adjustments.

Capital costs include both the cost of debt finance and the cost of equity finance. The cost of these sources of finance is reflected by the return required by the funds provider, be they a lender or a shareholder. These capital cost is referred to as Weighted Average Cost of Capital (WACC) and is determined having regard to the related capital structure of the business. The WACC is used in SVA as the minimum hurdle rate of return the GBE needs to exceed for value to be added.

SVA is a useful concept as it enables both actual results and forecasts to be used to assess whether value has been added in the past and/or whether the financial forecasts and investment decisions will lead to value being added in future. If forecasted balance sheet and income statements indicate that value will be diminished, the strategic decisions which underpin the forecasts will of course need to be reviewed. As such, SVA provides a further basis for evaluating the potential 'investor value impact' of forecasts and capital projects contained in corporate plans

RELATIONSHIP BETWEEN EVA AND MVA

- The relationship between EVA and Market Value Added is more complicated than the one between EVA and Firm Value
- The market value of a firm reflects not only the Expected EVA of Assets in place but also the Expected EVA from future projects
- To the extent that the actual economic value added is smaller than the expected EVA the market value can decrease even though the EVA is higher.

This does not imply that increasing EVA is bad from a corporate finance stand point. In fact, given a choice between delivering a "below-expectation" EVA and no EVA at all, the firm should deliver the "below- expectation" EVA. It does suggest that the correlation between increasing year-to-year EVA and market value will be weaker for firms with high anticipated growth (and excess returns) than for firms with low or no anticipated growth. It does suggest also that "investment strategies" based upon EVA have to be carefully constructed, especially for firms where there is an expectation built into prices of "high" surplus returns.

MVA is presented below:

Total market capitalization:	₹500 million
(minus) Investor's capital + retained earnings:	₹400 million
Sample firm's MVA:	₹100 million

At a particular point in time, a firm's MVA is equal to the discounted present value of the annual EVA it is expected to generate. Thus, a firm's MVA communicates the market's evaluation on the net present value of that firm's current and expected capital investment projects.

7.4 HUMAN RESOURCE ACCOUNTING

(a) Human Resource Accounting is a **recent phenomenon** in India. Leading Public Sector Units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information.

(b) Companies in India have basically adopted the model of Human Resource Valuation as advocated by **Lev and Schwartz.** Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Lev and Schwartz model has been suitably modified to suit the Company's individual circumstances.

A. Growing scope of Human Capital Reporting:

(i) **Recent Reporting Trends:** In the recent years, there is a growing trend of shift from the traditional focus on financial reporting of quantifiable resources (i.e. which can be measured in monetary terms) to a more comprehensive approach of reporting under which Human Resources are also considered as Measurable Assets of a Going Concern.

(ii) **Relevance:** An organization is a dynamic entity and operates through the effort of its human resources. The ratio of human to non-human capital indicates the degree of labour intensity of an organisation. Comparison of the specific values of human capital based on the organisation's scales of wages and salaries with the general industry standards can provide inputs on the Firm's HR policies.

(iii) **Purpose:** Human Capital Reporting provides scope for planning and decision-making in relation to proper manpower planning. Such reporting can also bring out the effect of various rules, procedure and incentives relating to work force. This can even act as an eye opener for modifications of existing statutes, laws etc.

(iv) **Accounting:** Business entities account for Fixed Assets on Historical Cost basis. Similarly, employee-related costs like cost of recruitment, training and orientation of employees, etc. can be considered for the purpose of capitalization. An appropriate portion of such capitalized costs can be amortised each year over the estimated years of effect of such costs.

(v) **Standards:** Currently, there is no standard format for Human Capital Reporting. Generally, the Human Capital Report contains data pertaining to number of employees, employment and training policies, collective bargaining arrangements, industrial disputes, pension and pay arrangement and number of disabled employees.

B. Models of Human Resource Accounting (HRA):

1. Cost Based Models	2. Economic Value Models
(a) Likert's Model - Historical Costs (b) Flamholtz's Model - Replacement Costs	(a) Hekimian & Jones Model - Opportunity Cost (b) Lev & Schwartz Model - Discounted Wages & Salaries (c) Flamholtz's Model - Stochastic Process & Service Rewards (d) Jaggi & Lau Model - Group Valuation

C. Likert's model of valuing Human Resources:

(i) **Capitalisation:** Likert's Model capitalises all costs related with the making of an employee fit for providing service to the organisation like recruitment, training, development, etc. The costs incurred for each employee is taken into account.

(ii) **Value of Human Resources:** The total of the capitalised costs for all the employees of the organisation constitutes the value of Human Resources. Value of Human Resources to the organisation = Sum of Capitalised costs of each individual employee in the organisation.

(iii) **Amortisation:** The Value of Human Resources (as capitalised above) is amortised annually over the expected length of service of individual employees. The unamortised balance costs are shown as Investment in Human Assets.

(iv) **Charge to Revenue:** When an employee leaves the organisation before his expected length of service, the Net Asset Value of Human Resources to that extent is charged as an expense, to Current Revenue.

D. Likert's model of valuing Human Resources – limitations:

(i) **Sunk Costs:** Likert's Model for valuation of Human Resources makes use of Historical Costs, which are already incurred. However, these are **sunk costs** that are irrelevant for decision-making purposes.

(ii) **Unrealistic:** This model fails to provide a **reasonable value** to the Human Assets.

(iii) **Ignores future costs:** Only training and development costs are capitalised under this model. The **Future Costs** of maintenance are ignored for the purpose of valuation of Human Resources.

(iv) **Skilled vs. Unskilled Employees:** This model does **not distinguish** between a skilled and unskilled employee. Skilled employees are valued at lower cost, as they require only less training, while in reality, they are invaluable to the organisation.

E. Features of Flamhottz's Replacement Cost Model of HR valuation:

I. **Meaning:** Replacement Cost refers to the value of sacrifice made by an organisation to replace its human resource with an identical another. Flamholtz's model indicates two types of Replacement Costs viz. -

(a) **Individual Replacement Cost -** Cost that would have been incurred to replace **an employee** by another individual for providing the same set of services.

(b) **Positional Replacement Cost -** Cost *of* replacing the set of services required of **any incumbent** in a defined position. This takes into account the present and the future position of an employee in the Firm.

II. **Subjective:** The method is not preferred because -

(a) Replacement Cost of an employee is highly subjective and cannot be easily quantified and measured.

(b) Valuation on the basis *of* Replacement Cost will constitute recognition of notional costs.

F. Hekimian & Janes Opportunity Cost Model of HR Valuation:

(i) **Opportunity Costs:** This method uses the Opportunity Cost, i.e. value of the employee in his alternative use, as a basis *for* estimating the value of Human Resources.

(ii) **Scarce Resource:** A Human Asset has value only if it is a scarce resource, i.e. when its employment in one department denies its use to another department of the organisation. Hence the Managers in the organisation should bid for scarce employee for their department.

(iii) **Internal Bidding:** Under this Model, the Opportunity Cost Value is determined by competitive bidding within the organisation.

(iv) **Disadvantages:** The drawbacks of this Model are -

(a) It does not take into account persons who can be readily **hired** from outside.

(b) It is concerned with only **one section** of the organisation's human resources, having special skills or available in the labour market.

(c) Situations in which Managers bid for an employee are **rare.**

(d) The amount of bid for an employee by a Manager is very **subjective.**

G. Discounted Wages & Salaries Model developed by Lev and Schwartz:

(a) **Present Value of Future Earnings:** Under this model, the Value of Human Resources is determined by the Present Value of Estimated Future Earnings i.e. salaries, wages, etc. of the employees, **discounted** by the rate of return on investment i.e. Cost of Capital.

(b) **Valuation:** The Value of Human Capital of a person aged **"n"** years is the Present Value of his remaining Future Earnings from employment.

(c) **Valuation at the point of retirement:** The Valuation Model for a discrete income stream is given by –

$V_n = \sum_{t=n}^{T} \frac{I(t)}{(1+r)^{t-n}}$	Where – V_n = Human Capital Value of a person n years old. I (t) = Person's **Estimated Annual Earnings upto retirement**. r = Discount Rate specific to the person. T = Retirement Age of the person.

(d) Valuation during services: The **I(t)** in the above formula can be known only when the person retires. Hence to find out the estimated value of human capital of "n" years old, the following formula is used -

$V_n = \sum_{t=n}^{T} \frac{In(t)}{(1+r)^{t-n}}$	Where – V_n = Human Capital Value of a person n years old. In (t) = Person's **Estimated Future Earnings per annum**. r = Discount Rate specific to the person. T = Retirement Age of the person.

(e) **Probability of death before retirement:** The Expected Value of a person's human value considering the possibility of death prior to retirement is calculated using the following –

$Va_n = \sum_{i=n}^{T} P_n(t+1) \sum_{i=n}^{t} \frac{Ii}{(1+r)^{t-n}}$	Where – Va_n = Expected Human Capital Value of a person n years old. Pn (t) = Probability of a person dying at age "t" I_i = Person's **Estimated Future Earnings per annum** r = Discount Rate specific to the person. T = Retirement Age of the person.

H. Procedure for computation of Human Resource Capital under the Discounted Wages & Salaries Model developed by Lev and Schwartz:

Step	Procedure
1	Classify employees based on – (1) Age Groups and (2) Skills Sets i.e. skilled, semi-skilled and unskilled.
2	Determine the number of employees under each category determined above and determine the average annual
3	Choose an appropriate Cost of Capital i.e. Discount Factor, for each category.
4	Compute Present Value of Future Annual Earnings of each employee, upto the age of retirement.
5	Total Human Resource Capital = Total PV of Future Annual Earnings of all employees.

I. Disadvantages of Discounted Wages & Salaries Model of Lev and Schwartz:

(a) **Uses Surrogate Values:** The Value of an asset to a Company lies in the rate of return to be derived by the organisation from its employment. This model substitutes wages and salaries of the employees for the income to be derived from their employment and provides a measure of future estimate costs.

(b) **Ignores promotions:** This method ignores the probability that organisation personnel take role changes or get promoted during their careers, e.g. a person appointed as Assistant Manager may become Manager and may even reach the Board level during his expected service life in the Company.

(c) **Ignores individual contribution:** An employee's value to a Company is determined by his personal characteristics and also the organisational role in which he is utilised. His knowledge and skill is valuable only when it is expected to serve as a means to given organisational goals. The model ignores the role played by the individual in different positions.

(d) **Ignores separation:** The model's Expected Value of Human Capital is actually a measure of the expected conditional value that the person will remain in the organisation till his death or retirement. This method ignores the fact that an employee may leave the organisation, (say, employment in another organisation) prior to his period of retirement or death.

(e) **Ignores Group aspect:** The analysis under this model is limited to individuals. It does not consider the added value element of individuals operating as groups or as a team.

Note: Inspite of the above disadvantages, Companies in India generally adopt the Lev and Schwartz model with suitable modifications.

J. Stochastic Process with Service Rewards propounded by Flamholtz:

(a) **Employees Role:** This model is based on the underlying fact that an employee plays many roles and that he is rewarded by promotions and role changes during his tenure in the organisation.

(b) **Probability Analysis:** It assumes that change of roles within the organisation is mutually exclusive and the change of employee role can be determined probabilistically.

(c) **Formula:** Under this model, the expected service to be derived from an individual is given by-

$E(S) = \sum_{i=1}^{n} S_i P(Si)$	Where – S_i = Quantity of services expected to be derived in each role of employee. P (S_i) = Probability of obtaining such services from the employee n = Year upto which the employee is expected to serve the organisation.

(d) **Monetary Equivalent :** The services of individuals should be represented in monetary terms. It is derived –

(i) Either by **determining** the product of their quantity and price ;

(ii) Or by **calculating** the income expected to be derived from their use.

(e) **Discounting:** The Present Value of Human Resources is calculated by discounting the monetary value of expected future services at a specified rate, say, Interest Rate or Cost of Capital.

K. Drawbacks of the Stochastic Process with Service Rewards:

(a) **Estimation problems:** The probabilities of likely service roles and promotions of employees within the organisation are difficult to estimate.

(b) **Time-consuming and costly:** Determination of monetary equivalent for the services of individuals takes much time and also involves high costs.

(c) **Narrow view:** The model considers the positions of employees within the organisation only. It ignores the concept of employee leaving the organisation.

(d) **Ignores Group aspect:** This model takes only the services of individuals and not for employees working as a team or as groups.

L. "Jaggi & Lau Model" on valuation on group basis of Human Resources:

(i) **Recognition of Group Aspect:** This model is based on the group aspect i.e. the fact that humans work as group in an organisation. Here, a Group refers to a set of homogenous employees working in the same department or in different departments.

(ii) **Procedure:** This model calculated the Present Values of all existing employees in each rank as under –

Step	Procedure
1	Ascertain the number of employees in each rank / hierarchy.
2	Estimate the probability that an employee will be in his rank within the organisation or terminated/ promoted in the next period. Estimate this probability for a specified time period.
3	Ascertain the Economic Value of an employee in a specified rank during each time period.
4	Multiply the above three factors and apply an appropriate discount rate to arrive at the Present Value of existing employees.

(iii) **Advantages:** The appreciation for this model stems from the following –

(a) It recognises the Group concept since an organisation consists of people working together.

(b) It is easier to estimate the percentage of people in a group likely to continue or leave the organisation, rather than on an individual basis.

(c) Having the group of employees as a valuation base simplifies the process of valuing human resources.

(iv) **Disadvantages:** The **disadvantage** of the Group Valuation Model that it ignores the special skills and qualities of employees in specific ranks. The exit of a single important person in a certain group may affect the valuation of that entire group.

M. Effects / uses of valuation of Human Resources and its reporting:

In Human Resource Accounting and Reporting, the following aspects may be highlighted -

(i) **Employee Strength** by major Categories or Ranks:

Particulars	This Year	Last Year
Executive Staff	xxx	xxx
Supervisory Staff	xxx	xxx
Technical Staff	xxx	xxx
Artisans and Craftsmen	xxx	xxx
Supporting Technical Staff	xxx	xxx
Clerks and Office Support Staff	xxx	xxx
Unskilled and Semi-skilled Staff	xxx	xxx
Total	**xxx**	**xxx**

(ii) **Payments / Compensation:** Payments made to employees by way of monetary and non-monetary benefits should be disclosed. Cost to Company for Labour Welfare measures should also be disclosed in the usual manner e.g. Staff Salary and Wages, PF and Other Welfare Fund Contributions, Staff Welfare Expenses, other payments made to workers etc.

(iii) **Training & Development:** The details of training programmes (in-house and external) organised for employees, and related expenses should be disclosed. Recognition and promotion of employees who have undergone training should also be disclosed.

(iv) **Value of Human Asset:** An appropriate method (e.g. Lev and Schwartz Model) may be applied to arrive at the value of Human Resources. Suitable assumptions should be made, wherever necessary.

(v) **Assets / Wealth Analysis:** The following data may be presented in respect of Human Capital -

Particulars	This Year	Last Year
a. Value of Human Resources (as per Valuation Model) b. Value of Physical Resources at Current Cost (as per Balance Sheet)	xxx xxx	xxx xxx
Total Value of Resources employed / Wealth enjoyed by the entity	**xxx**	**xxx**

(vi) **Ratio Analysis:** The following ratios may be used for evaluation -

Ratio	Significance
a. Human Resources ÷ Total Resources (i.e. Human + Physical)	This shows the degree of labour intensity of the Company's operations.
b. (Turnover ÷ Human Resources) and (Turnover ÷ Total Resources)	This shows the rate of utilisation of human resources and total resources at the company's disposal.
c. (Value Added ÷ Human Resources) and (Value Added ÷ Total Resources)	This shows the value addition from human resources and total resources.
d. Specific Value of Human Capital based on Firm's Wage Scale. General Value of Human Capital based on Industry's Wage	The difference between these is the Firm's wage scale compared with the industry wage scale.
e. Labour Turnover Rate (using appropriate method) and Costs associated with Labour Turnover e.g. Settlement, Recruitment, Selection, Training etc.	This signifies the rate of change in labour force of a Firm during a certain period.

N. Shortcomings / problems of Human Resource Valuation ; and

Why Human Resources are not recognized as an asset in the Balance Sheet?

Human Resource is generally not recognized in the Balance Sheet due to the following reasons -

(i) **Difficulty in Measurement:** An asset to be recognized in the Balance Sheet should be measured first. An asset is generally valued / measured based on cost of acquisition or expected future benefits. Generally human resources are not bought, but only hired. Future benefits can be measured tangibly for machineries, furniture as their performance follows predictable lines. However, human nature and performance is generally not on predictable lines.

(ii) **Subjectivity:** The various models of Human Resources Valuation deal with capitalisation of Historical Costs, Replacement Costs, Estimated Future Earnings etc. The amounts associated with such costs, and also the determination of various probabilities and discount rates are subjective in nature.

(iii) **Timing:** Unlike the owned physical resources (Fixed Assets), the Company does not "own" the human resources as such. Hence, the timing as to when such resources should be recognised in financial reporting, is an issue to be addressed.

(iv) **Human vs. Non-Human Capital:** Traditional Accounting focusses on recognition of non-human capital i.e. physical resources. Entries in the P&L Account on Salaries and Wages are the only reference to Human Capital. The concept of capitalisation of Human Resources is not recognised in the accounting framework.

(v) **Sensitive:** Unlike physical resources, human assets are highly sensitive to the values placed on them.

(vi) **Useful Life:** Physical Resources have a defined Useful Life or Economic Life, which can be reasonably estimated by the Company. However, the duration of an individual serving the Company can only be determined probabilistically.

(vii) **Qualitative Factors:** All models of HR Valuation attempt to fix a monetary value on the Human Resources. Qualitative factors like attitude, morale, loyalty, commitment, job satisfaction, work culture, behavioural factors etc. are ignored.

O. Progress made by India so far in the field of HR Accounting.

(i) Human Resource Accounting is a **recent phenomenon** in India. Leading Public Sector Units like OIL, BHEL, NTPC, MMTC and SAIL etc. have started reporting Human Resources in their annual reports as additional information.

(ii) Companies in India have basically adopted the model of Human Resource Valuation as advocated by **Lev and Schwartz.** Indian Companies focused their attention on the present value of employee earning as a measure of their human capital. However the Lev and Schwartz model has been suitably modified to suit the Company's individual circumstances.

ILLUSTRATION

Valuation of Human Resources – Lev and Schwartz Model

Illustration 12.

From the following information in respect of L&S Ltd., calculate the Total Value of Human Capital by following Lav and Schwartz Model. The Company uses 15% Cost of Capital for discounting purposes. Retirement Age is 55 years. Distribution of Employees is –

	Unskilled		Semi skilled		Skilled	
Age	**No.**	**Average Annual Earnings**	**No.**	**Average Annual Earnings**	**No.**	**Average Annual Earnings**
30-39	**70**	**₹ 6,00,000**	**50**	**₹ 7,00,000**	**30**	**₹10,00,000**
40-49	**20**	**₹ 8,00,000**	**15**	**₹ 10,00,000**	**15**	**₹ 12,00,000**
50-54	**10**	**₹ 10,00,000**	**10**	**₹ 12,00,000**	**5**	**₹ 14,00,000**

Solution:

VALUATION IN RESPECT OF UNSKILLED EMPLOYEES

1. Age Group 30-39: (assuming that all 70 employees are just 30 years old)

Particulars	Computation	Present Value
₹ 6,00,000 p.a. for next 10 years ₹ 8,00,000 p.a. from 11 to 20 ₹ 10,00,000 p.a. from 21 to 25	(6,00,000 x 5.0188) (8,00,000 x 6.2593) – (8,00,000 x 5.0188) (10,00,000 x 6.4641) – (10,00,000 x 6.2593)	30,11,280 9,92,400 2,04,800
	Total	**42,08,480**

2. Age Group 40-49: (assuming that all 20 employees are just 40 years old)

Particulars	Computation	Present Value
₹ 8,00,000 p.a. for next 10 years ₹ 10,00,000 p.a. from 11 to 15	(8,00,000 x 5.0188) (10,00,000 x 5.8474) – (10,00,000 x 5.0188)	40,15,040 8,28,600
	Total	**48,43,640**

3. Age Group 50-54: (assuming that all 20 employees are just 50 years old)

Particulars	Computation	Present Value
₹ 10,00,000 p.a. for next 5 years	(10,00,000 x 3.3522)	**33,52,200**

VALUATION IN RESPECT OF SEMI-SKILLED EMPLOYEES

1. **Age Group 30-39:** (assuming that all 50 employees are just 30 years old)

Particulars	Computation	Present Value
₹ 7,00,000 p.a. for next 10 years ₹ 10,00,000 p.a. from 11 to 20 ₹ 12,00,000 p.a. from 21 to 25	(7,00,000 x 5.0188) (10,00,000 x 6.2593) – (10,00,000 x 5.0188) (12,00,000 x 6.4641) – (12,00,000 x 6.2593)	35,13,160 12,40,500 2,45,760
	Total	**49,99,420**

2. **Age Group 40-49:** (assuming that all 15 employees are just 40 years old)

Particulars	Computation	Present Value
₹ 10,00,000 p.a. for next 10 years ₹ 12,00,000 p.a. from 11 to 15	(10,00,000 x 5.0188) (12,00,000 x 5.8474) – (12,00,000 x 5.0188)	50,18,800 9,94,320
	Total	**60,13,120**

3. **Age Group 50-54:** (assuming that all 10 employees are just 50 years old)

Particulars	Computation	Present Value
₹ 12,00,000 p.a. for next 5 years	(12,00,000 x 3.3522)	**40,22,640**

VALUATION IN RESPECT OF SKILLED EMPLOYEES

1. **Age Group 30-39:** (assuming that all 30 employees are just 30 years old)

Particulars	Computation	Present Value
₹10,00,000 p.a. for next 10 years ₹ 12,00,000 p.a. from 11 to 20 ₹ 14,00,000 p.a. from 21 to 25	(10,00,000 x 5.0188) (12,00,000 x 6.2593) – (12,00,000 x 5.0188) (14,00,000 x 6.4641) – (14,00,000 x 6.2593)	50,18,800 14,88,600 2,86,720
	Total	**67,94,120**

2. **Age Group 40-49:** (assuming that all 15 employees are just 40 years old)

Particulars	Computation	Present Value
₹ 12,00,000 p.a. for next 10 years ₹ 14,00,000 p.a. from 11 to 15	(12,00,000 x 5.0188) (14,00,000 x 5.8474) – (14,00,000 x 5.0188)	60,22,560 11,60,040
	Total	**71,82,600**

3. Age Group 50-54: (assuming that all 5 employees are just 50 years old)

Particulars	Computation	Present Value
₹ 14,00,000 p.a. for next 5 years	(14,00,000 x 3.3522)	**46,93,080**

TOTAL VALUE OF HUMAN CAPITAL

	Unskilled		Semi-skilled		Skilled		Total	
Age	**No.**	**PV of future earnings**	**No.**	**PV of future earnings**	**No.**	**PV of future earnings**	**No.**	**PV of future earnings**
30-39	70	29,45,93,600 (42,08,480 x 70)	50	24,99,71,000 (49,99,420 x 50)	30	20,38,23,600 (67,94,120 x 30)	150	74,83,88,200
40-49	20	4,84,36,400 (4,84,240 x 20)	15	9,01,96,800 (60,13,120 x 15)	15	10,77,39,000 (71,82,600 x 15)	50	29,48,08,600
50-54	10	3,35,22,000 (33,52,200 x 10)	10	40,22,64,000 (4,02,26,400 x 10)	5	2,34,65,400 (46,93,080 x 5)	25	9,72,13,800
Total	100	42,49,88,400	75	38,03,94,200	50	33,50,28,000	225	**1,14,04,10,600**

Note: Students may work out the above value of Human Capital using 18% Discount Factor, for practice

7.5 ENVIRONMENTAL ACCOUNTING

Introduction:

Environmental Accounting is a faithful attempt to identify and bring to light the resources consumed and the costs rendered reciprocally to the environment by a business enterprise.

It is a method of recording environmental elements and includes -

(a) valuation of natural resources,

(b) measuring the income therefrom,

(c) keeping records of the related costs,

(d) estimating their quantities and providing depreciation on them.

A. Need and significance of Environmental Accounting.

(i) Resource Utilisation: Natural Resources (water, air, minerals, forests etc.) are required to carry on the business activities of every firm. Also, the functioning of an enterprise has some favourable and some adverse effects on the environment. Hence, there is a need for maintaining accounts of the effects of the activities of a business entity on the environment and on natural resources.

(ii) Resource Availability: Environmental Accounting is useful for disclosing how much natural resources are available in the country, their incomes and the costs incurred to use them and their depreciation, values etc.

(iii) Social Responsibility: Environmental Accounting is helpful for measuring industrial development and social welfare and the fulfilment of social responsibilities by Companies. Companies are urged to be accountable to both Shareholders and wider society. Profit Making is not considered as the sole corporate objective.

(iv) Qualitative Study: Traditional Accounting System is restricted to quantitative and monetary aspects only. Hence, Environmental Accounting is necessary to analyse the effect of environmental resources in the entire business functions of a firm.

(v) Environmental Protection: Environmental Accounting will help in evaluating the problem of environment protection. The business activities of the enterprise should be recognised as society (environment) centred and not only profit-centred.

(vi) Going Concern: Environmental pollution and the substantial costs associated with clean-up activities, fines, compensation, and bad publicity etc. can even significantly affect the share prices and even the stability of a Company. Hence, environmental accounting awareness is required.

(vii) Social Accounting: Social Accounting has been the precursor of Environmental Accounting. Social Costs also include the use of natural resources and pollution of environments. Also preservation of the environment is a critical factor for sustainable development. So, Environmental Accounting deserves special attention of manager, investors, society, different branches of Government and other stakeholders.

B. Areas of Environmental Accounting

National Level Environmental Accounting	Corporate Environmental Reporting
• This denotes modification of National Income accounts to include environmental aspects.	• This denotes Voluntary and Involuntary disclosures by Corporate Entities on the impact of its activities on environment.
• This provides only a macro viewpoint of the environmental aspects of development.	• This provides Corporate Environmental Accounting and may also include Social Cost Benefit Analysis of projects affecting environment.

C. National Level Environmental Accounting.

(i) Rational Level Environmental Accounting, denotes a set of aggregate national data linking the environment to the economy which will have a long-term impact on the economic and environmental policy making.

(ii) This requires necessary amendments to the System of National Accounts (SNA) to incorporate the use or depletion of national resources. SNA is a set of accounts which every national Government compiles routinely to track the activities of the economy.

(iii) SNA data are used to calculate major economic indicators including GDP, GNP, Savings Rate and Balance Of Trade figures. The accounts are prepared by all countries in a standardised form, using a framework developed by the United Nations Statistical Division. It helps international comparison and thus allows to place individual countries in the context of world trends.

D. Drawbacks of National Level Environmental Accounting

In its present format, the SNA does not include full economic value of environmental resources. SNA has to be amended in view of the following problems with the present system of national accounts.

(i) Non-recognition of Environmental Expenditure: Expenditure to protect the environment from damage or to mitigate the environmental degradation cannot be identified and segregated from the SNA data.

(ii) Non-marketed Goods and Services: The environment provides certain goods which are not sold but which are of high value e.g. fuel-wood and building materials generated in forests, medicinal plants etc. However, some countries do not include these in their annual income accounts, estimating total consumption and then using market prices of comparable products as an alternative method to calculate the value of non-marketed goods and services.

(iii) **Consumption of Natural Capital:** The SNA treats gradual depletion of Physical Capital (plant and machinery etc.) as depreciation rather than income. However, the depletion of Natural Capital, forests in particular is accounted as income. Most experts of environmental accounting agree that depletion of natural capital should be accounted for in the same manner as in case of other physical assets.

E. Aspects covered in Corporate Environmental Accounting system.

Environmental Accounting System should include aspects such as –

(i) Concept of National Income arising out of the use of Natural Resources;

(ii) Concept of Costs incurred to make use of such Resources;

(iii) Depreciation of Natural Resources;

(iv) Valuation of Natural Resources;

(v) Disclosing the value of Natural Resources in the Balance Sheet;

(vi) Contribution of Natural Resources to Industrial Development;

(vii) Contribution of Industries to the Environment; and

(viii) Extent to which changes in the environment due to business activities has affected social well-being.

Environmental Reporting can be classified into two parts, namely –

(a) **Management Note / Discussion in Director's Report:** Broad Environment Protection Policy adopted and pursued by the Company and material proceedings under environmental laws should be disclosed here.

(b) **Accounting Treatment and Reporting:** Financial effect of environmental protection measures on capital expenditures and earnings should be covered in the Notes forming part of Financial Statements.

F. Reporting Requirements of Environmental Accounting.

Under a comprehensive Corporate Accounting Framework on environmental issues the Board of Directors in their Report or Management Discussions should disclose the following –

(i) Type of **environmental issues** that are pertinent to the enterprise and its industry;

(ii) **Policy and programmes** that have been adopted by the Company with respect to Environmental Protection Measures; or where there is no policy or programmes, such fact should be disclosed;

(iii) **Improvements made** by the Company in key areas, since the introduction of the policy, or over the past five years, whichever is shorter;

(iv) **Environmental Emission Targets** that the Company has set for itself, and how the Company is performing relative to those targets;

(v) Extent to which Environmental Protection Measures have been undertaken as per **Government Legislation,** and the extent to which Government Requirements (e.g. time table for reduction of emissions) are achieved;

(vi) Where any **material proceedings** under environmental laws have been taken, a disclosure of the known and potentially significant environmental problem shall be disclosed, unless it can be objectively concluded that the problem is not likely to occur, or if it does, the effect is not likely to be material;

(vii) **Financial or Operational Effect** of Environmental Protection Measures on the Capital Expenditure and Earnings of the Enterprise for the current period and any specific impact on future periods;

(viii) **Actual Amount charged to operations** in the current period, together with a description of the relative environmental measures.

(ix) **Sub-classification** of the above actual amounts into the following – (a) Liquid Effluent Treatment; (b) Waste Gas and Air Treatment; (c) Solid Waste Treatment; (d) Analysis Control and Compliance; (e) Remediation; (f) Recycling; and (g) Others (e.g. accidents, safety, etc.). Where it is not possible to segregate the amount that relates to Environmental Protection Measures, disclosure of such fact is essential.

(x) When material, the **actual amount capitalised** during the current period, the accumulated amount capitalised to date, and the period for amortising, or writing off, such amounts, together with a description of the environmental measures to whieh they relate. This amount might be sub-divided into categories stated above. Where it is not possible to segregate the amount that relates to environmental measures, this fact could be stated.

G. Disclosure of environment-related Accounting Policies.

The following environment-related Accounting Policies may be disclosed in the Notes to Accounts –

(i) Recording Liabilities and Provisions;

(ii) Setting up of Catastrophe Reserves (though appropriations of retained earnings);

(iii) Disclosure of Contingent Liabilities.

The following environment-related items could be included in Contingent Liabilities, if material –

(a) Liabilities, Provisions and Reserves that have been set / made for the current period, and amounts accumulated to date,

(b) Contingent Liabilities, with an estimate of the amount involved, unless the event is not likely to occur. Also, the possible loss could be quantified to the extent reasonably practicable. If the possible loss cannot be reasonably calculated, a description of the Contingent Liability could be given along with the reason why an estimate of the amount of the loss cannot be made. Completion of a feasibility study of remediation costs may be normally considered as the earliest date at which a reasonable estimate of the liability is possible.

H. Major issues in Environment Accounting.

Major Accounting Issues in Environmental Accounting are –

(i) Environmental Expenditure vs. Normal Business Expenditure: Many machines may have state-of-the-art environmental technology. Hence, a portion of such capital costs and also the running and maintenance expenditure may be treated as environment related expenditure. There should be proper guidelines for allocating the capital and revenue expenditures between Environmental Expenditure and Normal Business Expenditure.

(ii) Capitalisation vs. Charging Off of Environmental Expenditure: Environmental protection costs relating to prior periods and current period are generally very high. If these are expensed off in one year, EPS may be adversely affected. Some Companies may capitalise such expenditure and amortise the same over say 10 years. Uniformity is required for comparative analysis of Financial Statements.

(iii) Recognition of Environment related Contingent Liabilities: Environmental Contingent Liabilities are a matter of increasing concern. Recognizing a liability for hazardous waste remediation frequently depends on the ability to estimate remediation costs reasonably. Developing a reliable estimate requires evaluation of technological, regulatory and legal factors, each of which calls for exercise of management judgement to reach a supportable accounting conclusions.

I. Reporting requirements as to Environmental Statement in the Directors' Report of Companies.

1. **Disclosure Requirements under Companies Act, 2013:** Section 134 requires the Board of Directors to include in their Annual Report, inter-alia, the prescribed particulars in respect of – (i) conservation of energy and (ii) technology absorption. Under the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988, every Company is required to disclose particulars relating to –

   (a) Energy conservation measures taken;

   (b) Additional investments and proposals, if any, being implemented for conservation of energy;

   (c) Impact of the measures at (a) and (b) above, for reduction of energy consumption and consequent impact on the cost of production of goods;

   (d) Total energy consumption and energy consumption per unit of production as per Form A (in respect of 21 specified industry groups e.g. Textiles, Fertilisers, Aluminium, Steel, Sugar, Tea, Paper etc.)

   (e) Efforts made in technology absorption, adaptation and innovation as per Form B.

2. **Notification by Ministry of Environment and Forests:**

   (a) **A Gazette Notification** on Environmental Audit had been issued by the Ministry of Environment and Forests on 3.3.1992, since amended vide Notification GSR 386(E), dated 22.4.1993.

   (b) **Applicability:** The Notification is applicable to any person carrying on an industry, operations or process which requires -

   - Consent to operate by or under Section 25 of the Water (Prevention and Control of Pollution) Act, 1974 or under Section 211 of the Air (Prevention and Control of Pollution) Act, 1981 or both; or
   - Authorisation under the Hazardous Wastes (Management and Handling) Rules, 1989 issued under the Environment (Protection) Act, 1986.

   (c) **Reporting Requirements:** As per the Notification, an Environmental Statement shall be submitted to the Pollution Control Board.

   (d) **Contents:** The Environment Statement of the concerned industry should provide information on –

   - Water and Raw Material Consumption,
   - Pollution Generated,
   - Nature of Hazardous Wastes, Solid Wastes and Disposal Practices, and
   - Impact of Pollution Control Measures on conservation of natural resources.

3. **Conclusion:** The disclosures required under the Companies Act have a minimum scope but constitute a starting point for voluntary disclosure by Companies. However, considering the inadequate level of environment related disclosures in the Corporate Annual Reports, the possibility and constraints of inclusion of the Environmental Statement in the Directors Report should be judged by the user.

7.6 GUIDANCE NOTES ON ACCOUNTING FOR TAX MATTERS

A. Minimum Alternate Tax (MAT)

The accounting treatment of MAT is based on the Guidance Note on Accounting for Taxes on Income, which has been withdrawn (AS - 22 is now applicable). Accordingly, Tax Charge for the period should be determined on the basis of "Tax Effect Accounting Method". The principles laid down in AS - 22 will apply.

B. Corporate Dividend Tax (CDT)

(i) Features of CDT:

(a) CDT is in addition to Income-Tax chargeable in respect of the Total Income of a Domestic Company. CDT shall be payable even if no Income-Tax is payable by the Domestic Company on its Total Income.

(b) CDT is chargeable on any amount declared, distributed or paid by such Company by way of dividends (whether interim or otherwise) on or after 1st June, 1997. The dividends chargeable to CDT may be out of the Current Profits or Accumulated Profits.

(c) The rate of CDT is as given by the Finance Act for the relevant previous year.

(d) CDT is payable to the credit of the Central Government within 14 days of – (i) declaration of any dividend; (ii) distribution of any dividend, or (iii) payment of any dividend, whichever is the earliest.

(e) CDT paid shall be treated as the final payment of tax on the dividends and no further credit therefor shall be claimed by the Company or by any person in respect of the tax so paid.

(ii) Recognition of CDT: Provision for Dividend is recognised in the Financial Statements of the year to which the dividend relates. Hence, CDT on dividend, being directly linked to the amount of the dividend concerned, should also be recognized/reflected in the accounts of the same financial year (in which the dividend is recognized) even though the actual tax liability in respect thereof may arise in a different year.

(iii) Presentation and Disclosure:

(a) P&L Account: CDT liability should be disclosed separately in the P & L A/c, 'below the line', as under-

Dividends	XXX	
Add: Corporate Dividend Tax thereon	XXX	XXX

(b) Balance Sheet: Provision for CDT should be disclosed separately under the head 'Provisions' in the Balance Sheet.

C. Excise Duty

(i) Features of Excise Duty:

(a) Excise Duty is an indirect tax, arising as a consequence of manufacture of excisable goods, irrespective of the manner of use/disposal of goods thereafter i#; sale, destruction or captive consumption.

(b) No sale or further utilization of excisable goods can take place, unless the duty is paid. Hence, Excise Duty is a necessary expense to be incurred if the goods are to be put in the location and condition in which they can be sold or further used in the manufacturing process.

(ii) Accounting Treatment: The accounting treatment of Excise Duty is as under –

(a) Excise Duty should be considered as a manufacturing expense and be considered as an element of cost for Inventory Valuation.

(b) Where Excise Duty is paid on excisable goods (inputs) and such goods are subsequently utilized in the manufacturing process, the duty paid on such goods (inputs), if the same is **not recoverable from taxing authorities,** becomes a manufacturing cost, and must be **included in the valuation of WIP** or **Finished Goods** arising from the subsequent processing of such goods.

(c) Where the liability for excise duty has been incurred but its collection is deferred, provision for the unpaid liability should be made.

(d) Excise Duty **cannot** be treated as a Period Cost.

Excise Duty Treatment

Illustration 13.

Ram Ltd. is manufacturing goods for local sale and exports. As on 31st March, it has the following finished stocks in the factory warehouse –

(a) Goods meant for local sale ₹100 Lakhs (Cost ₹75 Lakhs).

(b) Goods meant for exports ₹ 50 Lakhs (Cost ₹20 Lakhs).

Excise duty is payable at the rate of 16%. The Company's Managing Director says that Excise Duty is payable only on clearance of goods and hence is not a cost. Advise the Company on the proper treatment of Excise Duty.

Solution:

1. Excise Duty is an indirect tax, arising as a consequence of manufacture of excisable gobds irrespective of the manner of use / disposal of goods thereafter i.e. sale, destruction or captive consumption.

2. Levy of excise duty is and remains upon the manufacture or production alone. Only collection part of it is shifted to the stage of removal.' Hence, the Managing Director's contention that "Excise Duty is payable only on clearance of goods and hence is not a cost" is **incorrect.**

3. As per the Guidance Note on Accounting Treatment for Excise Duty, Excise Duty should be considered as a **manufacturing expense** and like other manufacturing expenses be considered as an element of cost for inventory valuation.

4. The Guidance Note also requires that where the liability for excise duty has been incurred but its collection is deferred, **provision** for the unpaid liability should be made. Therefore, in the above case, excise duty on the goods meant for **local sales** should be provided for at the rate of 16% on the Selling Price, of ₹100 Lakhs for valuation of stock.

5. Assuming that all the conditions specified in the Central Excise Rules, regarding export of excisable goods without paymentrfif duty are fulfilled by the Company, Excise Duty may not be provided for the goods meant for exports, even though the manufacture there of is completed.

E. Modvat/Cenvat

(i) CENVAT Scheme:

(a) Central Valued Added Tax (CENVAT) scheme is applicable w.e.f. 01.04.2000, (replacing the erstwhile MODVAT Scheme).

(b) The Scheme allows instant credit of duties paid on inputs (Raw Materials) and specified Capital Goods, used in relation to manufacture of specified final excisable goods, to be utilized for payment of excise duties in respect of such goods. Hence, duty credit taken (on inputs) is in the nature of set-off against the payment of duty on the final products.

(c) In respect of Capital Goods received in a factory at any point of time in a given financial year, credit can be taken only for an amount not exceeding 50% of the duty paid on such capital goods in such financial year. The balance credit can be taken in any subsequent financial year, provided the Capital Goods are still in the possession and use of the manufacture of final products, in such subsequent year(s).

(ii) CENVAT Credit on Inputs used in manufacture of final products: The journal entries are given below-

S.No.	Transaction and Entry	Debit	Credit
1	**Purchase of Inputs (with Duty thereon)** Purchases A/c Dr. CENVAT Credit Receivable (Inputs) A/c Dr. To Suppliers / Sundry Creditors / Bank A/c	Pure Price net of ED ED on Purchases	Pure Price incl. ED
2	**Sale of dutiable goods** Bank/Sundry Debtors A/c Dr. To Sales A/c	FG Price incl. ED on Sales	FG Price incl. ED on Sales
3	**Set-off of CENVAT Credit** Excise Duty A/c Dr. To CENVAT Credit Receivable (Inputs)	Credit available or EO payable, whichever is less	
4	**Payment of balance ED (if credit recble is less)** Excise Duty A/c Dr. To Bank A/c	To the extent of ED actually paid in cash i.e. when Credit Receivable < ED Payable on Sales	

Note:

- **Disclosure in Balance Sheet:** Debit balance in CENVAT Credit Receivable (Inputs) i.e. balance Credit Available for use in subsequent periods, will be shown on the Assets Side of the Balance Sheet under the head **"Loans and Advances".**
- **Changeover from Inclusive Method:** An enterprise which had been following the **Inclusive Method** (under the previous Guidance Note on Accounting for MODVAT) should changeover to the above method. Appropriate disclosures are required under AS - 5 are to be made.

(iii) Accounting Treatment in case of Job Work:

Job Work

Inputs sent outside the factory to a job-worker, for further processing

Debit requirement is not applicable under CENVAT Scheme.

Inputs received inside the factory for further processing on job-work basis; FG is cleared by the enterprise; and ED burden is borne by –

The Enterprise itself

(a) For taking CENVAT credit:
CENVAT Cr. Rec'ble A/c Dr.
To Excise Duty A/c

(b) For set-off of Duty on FG:
Excise Duty A/c Dr.
To CENVAT Cr. Rec'ble

(c) For pymt of bal. ED if any:
Excise Duty A/c Dr.
To Bank A/c

The Principal

(a) For taking CENVAT credit:
CENVAT Cr. Rec'ble A/c Dr.
To Principal Co. A/c

(b) For set-off of Duty on FG:
Principal Co. A/c Dr.
To CENVAT Cr. Rec'ble

(c) For pymt of bal. ED if any:
Principal Co. A/c Dr.
To Bank A/c

(iv) CENVAT Credit on Capital Goods used in manufacture of specified goods:

(a) CENVAT credit in respect of Capital Goods should be recognized in the books of account only if – (1) the enterprise is entitled to CENVAT Credit as per Rules; and (ii) there is a reasonable certainty that the CENVAT Credit would be utilized.

(b) The Journal Entries are given below —

S.No.	Transaction and Entry	Debit	Credit
1	**Purchase of Capital Goods (with Duty thereon)**		
	Fixed Assets A/c Dr.	Pure Price net of ED	
	CENVAT Credit Rec'ble (Capital Goods) A/c Dr.	Credittakenduringtheyear (i.e. maximum 50%)	
	CENVAT Credit Deferred (Capital Goods) A/c Dr.	Balance credit to be availed in subsequent yrs	
	To Asset Vendor / Bank A/c		Pure Price incl. ED
2	**Set-off of CENVAT Credit during the year** Excise Duty A/c Dr. To CENVAT Credit Recble(Capital Goods)	Credit available during the year or ED payable, whichever is less	
3	**Tfr of balance Credit available in subsequent yrs** CENVAT Credit Rec'ble (Capital Goods) A/c Dr. To CENVAT Credit Deferred (Cap. Goods)	Balance Credit Available for set-off in subsequent financial years.	

Note :

- Debit balance in CENVAT Credit Receivable (Capital Goods) A/c and CENVAT Credit Deferred (Capital Goods) A/c i.e. balance Credit Available for use in subsequent periods, will be shown on the Assets Side of the Balance Sheet under the head "Loans and Advances".
- Journal Entries for Sale, payment of balance Excise Duty are as in Point 2 above.

(v) CENVAT Credit where Capital Goods are acquired on Lease / Hire Purchase:

(a) Accounting in Lessor's Books: Lessor should account for the price of asset acquired from the Supplier, **net of excise duty only.** When the financing arrangement also covers ED portion, ED recoverable from the lessee should be debited to a separate a/c (and not included in Minimum Lease Payments) and recovered from the lessee. When the financing arrangement does not cover ED portion, the lessee would pay the ED directly to the Supplier and hence need not be recorded in the books of the Lessor.

(b) Accounting in Lessee's Books: CENVAT Credit Receivable on Capital Goods acquired on lease should be treated in the same manner as in the case of outright purchase of asset.

(vi) Review of balances in CENVAT Receivable Accounts:

(a) Write-off: Balances in CENVAT Credit Receivable Accounts (Inputs and Capital Goods), should be reviewed at the end of every year. If it is found that the balances of the CENVAT are not likely to be used in the normal course of business, then, notwithstanding the right to carry forward such amounts under Excise Rules, the **non-usable excess credit** should be adjusted in the accounts, as under -

CENVAT Credit relating to	Treatment
(i) Inputs	• Debit the specific Raw Material or Purchase A/c, so as to increase the cost of consumption, & valuation of closing stocks. • Apportion the excess credit pro-rata to all purchases/ components, if the specific Raw Material cannot be identified.
(ii) Capital Goods/FA purchased	• Debit the cost of Specific Fixed Asset. • Charge depreciation on the revised unamortized depreciable amount, over the balance useful life, prospectively. • If the specific Fixed Asset no longer exists, write off the excess unutilisable credit to P&L Account.
(iii) Capital Goods on Lease / HP	Write off on pro-rata basis to P&L A/c, along with Lease Rentals.

(b) Reconciliation: A reconciliation statement between the CENVAT Credit Receivable (Dr.) as per financial accounts and the credit available as per Excise Registers, should be prepared.

(c) Non compliance with conditions: Where conditions for availing credit have not been complied with, or are not being capable of compliance, e.g. where inputs are destroyed or fixed assets cannot be used for manufacture of the final products, the appropriate adjustments should be made as per point (a) above.

(vii) Payment of Duty Demands by set-off i.e. Debit to CENVAT Credit Receivable Account:

Situation	Treatment	RM Valuation
(a) Duty relating to Finished Goods	Excise Duty A/c Dr. To CENVAT Credit Rec'ble	No change
(b) Disallowance of CENVAT Credit on purchases during the period	Purchases / Raw Material A/c Dr. To CENVAT Credit Rec'ble	RM Inputs Cost to be increased to include ED
(c) Disallowance of CENVAT Credit on purchases of previous periods	If such inputs are consumed during the year: Same entry in (a) above. If such inputs are still in stock at the end of year: Same entry in (b) above.	**Not Applicable** RM Inputs Cost to be increased to include ED

(viii) Inventory Valuation Principles: The principles of inventory valuation are summarized below-

Item valued	Inventory Valuation Principle
Inputs where CENVAT Cr. Availed	Purchase Price net of Input Duty. (See Note below)
Inputs if CENVAT Cr. Not Availed	Total Purchase Price, including Input Duty. *e.g. purchases without requisite documents for availing CENVAT Credit; -purchases from Small Scale Supplier's who are Exempted from duty; purchases from dealers who are not eligible to issue CENVAT Invoice as per Excise Rules etc.*
Final Products	Value of Inputs should be net of duty on inputs i.e. Purchase Pricfc, net of Input Duty. However, provision should be made/ added for Excise Duty Liability on Final Products.
Capital Goods	Purchase Price net of Input Duty.

Note: If any input is used in the production of more than one final product, some of which are excisable while others are not excisable or charged to Nil rate of duty, the valuation of RM input will be as under -

- <u>If separate RM inventory records are not maintained:</u> All RM Inventory should be valued net of input duty.
- <u>If separate RM jfly/entorv records are maintained:</u> RM Inventory used for production pf excisable final products should be valued net of input duty; RM Inventory used for production of non-excisable goods or Nil duty goods, should be valued at actual cost, inclusive of input duty.

Inventory Valuation principles

Illustration 14.

A Factory started activities on 1st April. From the following data, obtain the Value of Closing Stock on 30th April.

- Raw Materials purchased during April = 80,000 kg at ₹12 (out of which Excise Duty = ₹2 per kg). Stock on hand as on 30th April = 5,000 kg.
- Production during April = 14,000 units (of which 10,000 unite were sold). In addition to the production, 1,000 units were lying as WIP on 30th April (100% complete as to Materials and 60% complete as to conversion).
- Wages and Production Overheads = ₹30 per completed unit.
- Selling Price = ₹110 per unit (of which Excise Duty is ₹10 per unit)

Solution:

Particulars	Computation	₹
1. Raw Material Valuation (net of Input Excise Duty)	5,000kg x ₹ l0 per kg	50,000
2. WIP Valuation (net of RM input duty)	(₹50 + 60% of ₹30) x 1,000 units	68,000
3. Finished Goods Valuation (including ED on SP)	(RM 50 + Lab & OH 30 + ED 10) = ₹90 x (14,000 units - 10,000 units)	3,60,000
Total		**4,78,000**

Computation of Cost per unit of production:

- Raw Materials: (80,000 - 5,000) = 75,000 kg for 15,000 units total = 5 kg x ₹ 10 (net of ED) = ₹50
- Wages and Production Overhead = ₹30 per completed unit (given)

CENVAT Credit Accounting

Illustration 15.

A Factory went into commercial production on 1st April, it uses two raw materials M and N, on which excise duty of ₹30 per Kg and ₹20 per Kg respectively is paid. On 31st March it had stock of 2,000 Kg of M and 1,500 Kg of N which it had purchased at an all inclusive price of ₹150 per Kg for M and ₹120 per Kg for N. The Suppliers of the materials are to receive payment on 15th May.

During the month of April, the Factory manufactured 4,000 units of the end product for which the consumption of Materials M and N were 6,000 Kg and 4,500 Kg respectively. The Excise Duty on the end product is ₹60 per unit. 30,000 units of the end product were despatched, 800 units were kept in bonded warehouse and balance 200 units were kept in finished goods godown.

During the month the Factory purchased 5,000 Kg of M at ₹145 per kg (inclusive of Excise Duty ₹30 per Kg) on credit of 60 days and 5,000 Kg of N at ₹110 per Kg (inclusive of Excise Duty ₹20 per Kg) on credit of 45 days.

The cost of "converting" the raw materials into finished product amounts to ₹150 per unit of end product of which ₹ 100 is "cash cost" paid immediately and ₹50 represents non-cash charge for depreciation. There is no Work In Process.

Sales are made at ₹750 per unit in respect of credit transactions and at ₹700 per unit in respect of cash transactions. 20% of despatches were in respect of cash transactions while the balance 80% were in respect of credit transactions (1 month credit).

(i) Calculate CENVAT Credit Available, CENVAT Credit Availed of and balance in CENVAT Credit as on 30th April.

(ii) Show the necessary ledger accounts in respect of CENVAT.

(iii) Value the inventory of - (a) Raw Material; (b) Finished Goods in Bonded Warehouse and (c) Finished Goods in Finished Goods Godown on "First In First Out" principle.

(iv) Show the Ledger Accounts of Customers, Suppliers and Bank, assuming that the necessary bank balance is available at the start of the month to meet "cash" expenses of that month.

(v) Calculate the profit earned for the month.

(vi) Calculate the Working Capital as on 30th April. State the impact of 'CENVAT' on Working Capital Requirement of the Factory as on 30th April.

Solution:

1. CENVAT Credit Available, Availed of and Balance Credit at the end of April

Material	M			N			Total Amount ₹
	Kgs.	ED Rate	Amount	Kgs.	ED Rate	Amount	
Opening Stock for April	2,000	30	60,000	1,500	20 20	30,000	90,000
Purchases during April	5,000	30	1,50,000	5,000		1,00,000	2,50,000
Total Credit Available			**2,10,000**			**1,30,000**	**3,40,000**
Less: CENVAT Credit availed on Production of 40,000 units at ₹60 p.u **(See Note)**							2,40,000
Balance in CENVAT Credit at the end of April							**1,00,000**

Note:

- Guidance Note on Accounting Treatment for Excise Duty, requires that a provision for liability in respect of unpaid excise duty should be made in the accounts in respect of stocks lying in the factory or bonded warehouse since the liability for excise duty arises when the manufacture of the goods is completed.

- CENVAT Rules permit storage of goods in bonded warehouses, without payment of duty. In the absence of information, Excise Duty has been considered on 800 units also which were kept in bonded warehouse.

2. CENVAT related Ledger Accounts

Dr. **(a) CENVAT Credit Receivable Account** Cr.

	Particulars		₹		Particulars	₹
Apr 1	To balance b/d	M = 60,000		Apr 30	By Excise Duty A/c	2,40,000
		N = 30,000	90,000	Apr 30	- Transfer	
Apr 30	To Suppliers A/c	M = 1,50,000			By balance c/d	1,00,000
		N= 1,00,000	2,50,000		(closing balance)	
	Total		**3,40,000**		**Total**	**3,40,000**

Dr. **(b) Purchases Account** Cr.

	Particulars	₹		Particulars	₹
April	To Suppliers A/c		Apr 30		
	M = 5,000 kg x (145-30)	5,75,000		By balance c/d	10,25,000
	N = 5,000 kg x (110-20)	4,50,000		(closing balance)	
	Total	**10,25,000**		**Total**	**10,25,000**

3. Valuation of Inventory

(a) Raw Material Valuation

Material	Opg Stock + Purchases - Consumption = Clg Stock	Rate per kg	Value of Stock
M	2,000 + 5,000 - 6,000 = 1,000 kgs	145-30 = ₹115	₹ 1,15,000
N	1,500 + 5,000 - 4,500 = 2,000 kgs	110-20 = ₹ 90	₹ 1,80,000
	Total		**₹ 2,95,000**

Note: Raw Materials should be valued at Cost, net of CENVAT Credit.

(b) Finished Goods Valuation (assuming FIFO based consumption of Raw Materials)

Particulars	₹
1. Computation of Cost of Production of 4,000 units	
(a) Raw Materials M: 6,000 kg at (145 - 30 = ₹ 115 per kg)	6,90,000
(b) Raw Materials N: 4,500 kg at (110 - 20 = ₹ 90 per kg)	4,05,000
(c) Conversion Costs at ₹150 per unit for 4,000 units	6,00,000
Total Cost of Production (net of Excise Duty on RM)	16,95,000
2. Cost per unit of Finished Product (net of Excise Duty on RM)	₹ 423.75
3. **Add:** Excise Duty Payable on Finished Product (ED payable on manufacture). Hence, provision is to be created for unpaid duty liability.	₹ 60.00
4. Average Valuation Rate per unit for Final Product	₹483.75
5. Valuation of Finished Goods:	
(a) Bonded Warehouse Stock: 800 units x ₹483.75	₹ 3,87,000
(b) Finished Goods Godown Stock: 200 units x ₹483.75	₹ 96,750
6. Total Value of Finished Goods	₹ 4,83,750

Note: Valuation of Finished Goods is based on FIFO principle. Hence, Closing Stock of Finished Goods would consist of goods produced by consuming materials out of current period purchase. Hence, entire raw materials consumption has been taken at current period net purchase price of ₹l 15 and ₹90 per kg respectively.

4. Customers, Suppliers and Bank Accounts

(a) Customers Account

Date	Particulars	₹	Date	Particulars	₹
April 1,	To Sales 3,000 x 80% x ₹750	18,00,000	April 30	By Balance c/d (closing balance)	**18,00,000**

(b) Suppliers Account

Date	Particulars	₹	Date	Particulars	₹
April 30	To Balance c/d (closing bal)	**17,55,000**	April 1	By Balance b/d (opening balance) M: 2,000 kg x ₹ 150 = 3,00,000 N: 1,500 kg * ₹120 = 1,80,000	4,80,000
			April	By Purchases A/c (value net of ED)	10,25,000
			April	By CENVAT Credit Receivable M: 5,000 kg x ₹30 = 1,50,000 N : 5,000 kg x ₹20 = 1,00,000	2,50,000
	Total	**17,55,000**		**Total**	**17,55,000**

(c) Bank Account

Date	Particulars	₹	Date	Particulars	₹
April 1	To balance b/d (See Note)	4,00,000	April	By Expenses A/c (4,000 x ₹ 100)	4,00,000
April	To Sales 3,000 x 20% x ₹700	4,20,000	Apr 30	By Balance c/d (closing balance)	4,20,000
	Total	**8,20,000**		**Total**	**8,20,000**

Note: It is assumed that the Factory has adequate cash balance equivalent to meet cash expenses for the month.

5. (a) Profit and Loss Account for the month of April

Particulars	₹	Particulars	₹
To Opening Stock of Materials:		By Sales: Cash: 3,000 * 20% x 700	4,20,000
M(150-30) x 2,000 kgs	2,40,000	Credit: 3,000 x 80% x 750	18,00,000
N(120-20) x 1,500 kgs	1,50,000	By Closing Stocks:	
To Purchases (as per Purch A/c above)	10,25,000	- Material M (as per valuation above)	1,15,000
To Excise Duty (CENVAT availed)	2,40,000	- Material N (as per valuation above)	1,80,000
To Conversion Costs (4,000 x 150)	6,00,000	- Finished Goods (as per vain above)	4,83,750
To Gross Profit c/d	**7,43,750**		
Total	**29,98,750**	**Total**	**29,98,750**

Note: It is assumed that Sale Prices of ₹700 and ₹750 are inclusive of the Duty of ₹60 per unit on FG.

5. (b) Reconciliation of Profits

Particulars	₹
Profits for Output Sold: Cash Sales: 3,000 x 20% * (700 - 483.75)	1,29,750
Credit Sales: 3,000 x 80% x (750-483.75)	6,39,000
Total Profit based on Quantity Sold	
Less: Excess Cost of Opening Stock of Materials not considered in FG Valuation:	7,68,750
M: 2,000 kgs x (₹120 - ₹l 15) (all prices net of ED)	10,000
N: 1,500 kgs x (₹ 100 - ₹ 90) (all prices net of ED)	15,000
Profit as per above P&L Account	**7,43,750**

6. Computation of Working Capital as on 30th April

Particulars				₹
A. Current Assets:	Raw Materials Stock	Material M	1,15,000	
		Material N	1,80,000	2,95,000
	Finished Goods Stock	Bonded Warehouse	3,87,000	
		Finished Goods Godown	96,750	4,83,750
	Debtors/Customers			18,00,000
	Bank Balance			4,20,000
	CENVAT Credit Receivable			1,00,000
	Total Current Assets			**30,98,750**
B. Current Liabilities: Suppliers/Sundry Creditors				17,55,000
C. Net Working Capital (A - B)				13,43,750

Impact of CENVAT on Working Capital Requirements:

- 3,000 units of Finished Goods have been despatched by way of sale without payment of a single rupee in cash. Cash outlay so saved at ₹60 perunit is ₹2,40,000. (i.e. to the extent of CENVAT Credit Availed).
- Creation of a Current Assess worth ₹ 1,00,000 in CENVAT Credit Receivable Account, reduces the pressure on Working Capital.

CENVAT on Capital Goods

Illustration 16.

A Company purchased a plant for ₹50 Lakhs during the financial year and installed it immediately. The price charged by the Vendor included Excise Duty (CENVAT Credit Available) of ₹5 Lakhs. During this year, the Company also produced excisable goods on which Excise Duty chargeable is ₹4.50 Lakhs. Show the Journal Entries describing CENVAT Credit treatment. At what amount should the Plant be capitalized?

Solution:

1. Journal Entries

S. No.	Transaction and Entry		Debit	Credit
1	Fixed Assets A/c	Dr.	45,00,000	
	CENVAT Credit Receivable (Capital Goods) A/c	Dr.	2,50,000	
	CENVAT Credit Deferred (Capital Goods) A/c	Dr.	2,50,000	
	To Asset Vendor / Bank A/c			50,00,000
	(Being Plant purchased recorded, including immediate CENVAT Credit available of 50%, balance 50% (assumed) credit available in subsequent year)			
2	Excise Duty A/c	Dr.	2,50,000	
	To CENVAT Credit Recble A/c (Capital Goods)			2,50,000
	(Being set off of CENVAT Credit during the year)			
3	Excise Duty A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being balance Excise Duty payable ₹4,50,000 ₹2,50,000 set-off, now settled)			
4	**Subsequent Financial Year**			
	CENVAT Credit Receivable (Capital Goods) A/c	Dr.	2,50,000	
	To CENVAT Credit Deferred (Capital Goods) A/c			2,50,000
	(Being transfer of balance CENVAT Credit available on Capital Goods)			

2. Balance Sheet (abstract)

Liabilities	₹	Assets	₹
		Fixed Assets: Plant at Cost	45,00,000
		Less: Depreciation	??
		Long-term Loans and Advances:	
		— Other loans & Advances	2,50,000

F. State Level Value Added Tax (VAT)

(i) Salient Features of VAT:

(a) VAT Credit: A registered dealer (trader/manufacturer) is entitled to an input tax credit (called as VAT Credit), in respect of taxes paid on purchases made during the period, where the purchases arise in the course of his activities as a dealer.

(b) Set Off Facility: VAT Credit is jillowed for purchase of inputs/supplies meant for sale, or for utilization in the process of production for such sale, irrespective of when these are utilized/ sold, and reduces the immediate tax liability of the dealer.

(c) Purchase within State: VAT Credit is available for all for purchase of inputs/supplies in a State, meant for sales within the State or sale in other States. Even for Stock Transfer/Consignment Sales of goods out of the State, input tax paid in excess of a certain percentage is eligible for VAT Credit. VAT Credit is not allowable for taxes paid on purchases from other States.

(d) Refund of Excess VAT Credit: Where VAT Credit exceeds the tax payable on sales in a month, the excess credit is carried over to the future month(s). Any excess unadjusted VAT Credit at the end of the specified period, is eligible for refund.

(e) **VAT Goods, Exempt and Zero Rate Goods:** VAT legislation of each State will specify the goods which are covered under VAT, and the relevant VAT rates. In case of "exempt" goods, the dealer is not eligible to claim VAT Credit for tax paid on the purchase of inputs. However, in case of "Zero Rate" Goods, the dealer is eligible to claim VAT Credit for tax paid on the purchase of inputs. Also, Goods not covered by VAT are taxed under the Sales Tax Act or other Act.

(f) **Export Sales:** Export Sales are "Zero Rate" Sales under VAT. Hence, VAT need not be charged and paid on Sales made. However, the Exporter is entitled to VAT Credit in respect of tax paid within a State on the purchase of inputs. This VAT Credit is not restricted only to those goods which are meant or used in the manufacture of exports. If in any tax period, the VAT Credit exceeds the output tax, and the dealer has declared international exports in the same tax period, he can claim refund of excess VAT credit. The units located in SEZ/EOU's are either exempted from payment of input tax, or eligible for refund of input tax paid, within a specified period.

(g) **Deferral Scheme:** In some State VAT laws, industrial units may be granted deferral facility for payment of tax, net of VAT Credit, i.e. output tax is collected from customers at the time of making sale; but the payment (after setting off VAT Credit on inputs) is deferred to a future point of time.

(h) **Capital Goods – 36 months spread over:** VAT Credit is also available on capital goods (except a few items included in the negative list of respective State laws). This may be adjusted over a maximum of 36 equal monthly instalments. However, some States may reduce the number of instalments or may grant full credit in the month of purchase of Capital Goods.

(i) **Small Dealers – Composition Scheme:** Small dealers with annual gross turnover not exceeding specified limits, who are otherwise liable to pay VAT, however, have the option to pay tax under the Composition Scheme. Such dealers may pay tax at a prescribed small percentage of the Gross Turnover, and are not entitled to any VAT Credit.

(j) **Works Contracts:** Dealers executing Works Contracts may have the following options - (a) pay tax on the value of goods at the time of incorporation of goods in the works executed, at the rates applicable to those goods; or (b) pay tax under composition scheme, at a prescribed rate on the total consideration received. In the second case, such dealers may not be entitled to any VAT Credit or may be eligible for partial VAT Credit.

(ii) VAT Credit in case of Inputs/Supplies: The Accounting treatment illustrated herebelow is required only where VAT Credit is available. Hence, it is not required in the situations given below —

(a) Dealers not registered under VAT;

(b) Dealers having turnover below the specified limits and opting for Composition Scheme;

(c) Dealers engaged in Works Contracts and opting for tax by way of composition; and

(d) Purchase of goods from Unregistered Dealers (not eligible for VAT Credit).

Suggested Accounting Treatment

S.No.	Transaction and Entry	Debit	Credit
1	Purchase of Inputs (with VAT thereon) Purchases A/c (different category items) Dr. VAT Credit Receivable (Inputs) A/c Dr. To Suppliers / Sundry Creditors / Bank A/c	Purc Price net of VAT VAT Paid on Purchases	Purc Price incl. VAT
2	Sale of goods Bank/Sundry Debtors A/c Dr. To Sales A/c (different category items) To VAT Payable A/c	Price incl. VAT on Sales	Price excl. VAT VAT Colin on Sales
3	Set-off of VAT Credit VAT Payable A/c Dr. To VAT Credit Receivable (Inputs) A/c	VAT Credit available or VAT payable, whichever is less	
4	**Payment of balance VAT (if credit recble is less)** VAT Payable A/c Dr. To Bank	To be passed at the time of payment To the extent of VAT actually paid in cash, i.e. when Credit Rec'ble < VAT Payable on Sales	

Note:

- **Disclosure in Balance Sheet:**

  (a) Debit balance in VAT Credit Receivable (Inputs), if any, will be shown on the Assets Side of the Balance Sheet under the head **"Loans and Advances".**

  (b) Alternatively, credit balance in VAT Payable A/c, if any, will be shown under **"Current Liabilities".** Where the dealer enjoys deferral benefits of VAT Payable, the credit balance will be shown as **Long Term Liability.**

- **Common Inputs:**

  (a) Where common inputs axe used for making taxable sales as well as exempt sales, the dealer should, on the date of purchase, estimate the inputs expected to be used for making the taxable sales and for making exempt sales,

  (b) VAT Credit should be recognized only in respect of inputs which are expected to be used in making taxable sales. No VAT Credit should be recognized on inputs which are expected to be used in making exempt sales,

  (c) Where the actual use is different from the estimated use, an adjustment entry should be passed.

- **Stock Transfer/Consignment Sale:** In case of Stock Transfer/Consignment Sale of goods outside the State where VAT Credit is available only to an extent of input tax paid, the dealer should estimate the expected Stock Transfers/Consignment Sales and account for accordingly.

(iii) VAT Credit in case of eligible Capital Goods:

S.No.	Transaction and Entry	Debit	Credit
1	**Purchase of Capital Goods (with VAT thereon)** Fixed Assets A/c Dr. VAT Credit Deferred (Capital Goods) A/c Dr. To Asset Vendor / Bank A/c	 Purchase Price net of VAT VAT paid on Purchases	 Purchase Price incl. VAT
2	**Transfer of VAT Credit Rec'ble during the year** VAT Credit Recble (Capital Goods) A/cDr. To VAT Credit Deferred (Capital Goods)	Credit available during the year as per the relevant State VAT Law	

Note:

- Debit balance in VAT Credit Receivable (Capital Goods) A/c (after utilization for set-off for payment during the period) and Debit balance in VAT Credit Deferred (Capital Goods) A/c i.e. balance Credit Available for use in subsequent periods, will be shown on the Assets Side of the Balance Sheet under the head **"Loans and Advances".**
- Depreciation on Machinery will be charged on the Purchase Price net of VAT.

(iv) Adjustment (i.e. Debit) to VAT Credit Receivable A/c-

Situation	Treatment	Other Points
(a) Set-off of VAT Payable on Sales	VAT Payable A/c Dr. To VAT Credit Receivable	No change in Input Stock Valuation.
(b) Disallowance of VAT Credit on purchases during the period	Purchases / Raw Material A/c Dr. To VAT Credit Receivable	RM Inputs Cost to be increased to include VAT
(c) Disallowance of VAT Credit on purchases of previous periods	<u>If such inputs are used/sold during the year:</u> (prior period item) Profit and Loss A/c Dr. To VAT Credit Receivable <u>If such inputs are still in stock at the end of year:</u> Same entry in (b) above.	RM Inputs Cost to be increased in include VAT
(d) Disallowance of VAT Credit on Capital Goods (See Note below)	<u>If asset is still in use:</u> Relevant Asset A/c Dr. To VAT Credit Receivable <u>If asset no longer exists:</u> Profit and Loss A/c Dr. To VAT Credit Receivable	Deprn to be charged on revised amt, incl. VAT Appropriate disclosure to be made in a/cs.

Note: In situation (d) above, where the VAT Credit disallowed on Capital Goods is VAT Credit Deferred (Capital Goods) Account and has not be transferred to VAT the former account shall be credited while passing the Journal Entries.

(v) **Inventory Valuation Principles:** The principles of inventory valuation are summarized below -

Item Valued	Inventory Valuation Principle
Inputs where VAT Credit Availed	Purchase Price net of Input VAT.
Inputs if VAT Credit Not Availed	Total Purchase Price, including Input VAT. *e.g. purchases without requisite documents for availing VAT credit, purchases from small dealers who are exempted from VAT; purchases from unregistered dealers who are not eligible to issue VAT Invoice etc.*
Final Products	Value of Inputs should be net of VAT on inputs i.e. Purchase Price, net of Input VAT.
Capital Goods, Components etc.	Purchase Price net of Input Duty

(vi) **Income Accounting:** Sales should be reported net of VAT. Hence, VAT Collection and VAT Payment should **not** be treated as Income and Expense respectively. VAT charged and collected by a dealer on Sales made by him should be credited separately to "VAT Payable Account". When a dealer has not charged VAT separately, but has made a composite charge, he should segregate the portion of Sale Price and VAT Collection at periodic intervals and credit the VAT Collection to "VAT Payable Account".

(vii) **VAT Refund Accounting:** Input tax which cannot be adjusted against VAT payable over the specified period of time and input tax paid on purchases made for exports, are eligible for refund. Refund of such VAT is recorded by the following entry –

Bank A/c	Dr.	Refund Amount received
To VAT Credit Receivable (Inputs/Capital Goods) A/c		

(viii) **VAT Credit on Inputs lying in Stock at the beginning of the Scheme:** VAT Credit is also available on tax-paid goods lying in stock at the inception of the VAT Scheme, if required documents are available with the dealer. The suggested accounting treatment is -

Transaction and Entry	Debit	Credit
VAT Credit available on Opening Stock		
VAT Credit Receivable (Inputs) A/c Dr.	If Credit is available immediately	Credit Available
VAT Credit Deferred (Opening Stock) A/c Dr.	If Credit is available in future	
To VAT Credit Available on Opening Stock		

Note:

- A Transfer Entry will be made from VAT Credit Deferred (Opening Stock) A/c to VAT Credit Receivable (Inputs) A/c, as and when VAT Credit on Opening Stock becomes available.
- VAT Credit Available on Opening Stock A/c (Credit Balance) will be shown as a deduction from "Opening Stock" in the Profit and Loss Account.

VAT Accounting – Inputs / Supplies – Basics

Illustration 17.

The details of purchases made by a Registered Dealer during March are –

Particulars	Total Purchase Value	Input Tax Paid	Net Balance Amount
4% VAT Goods	₹20,80,000	₹ 80,000	₹20,00,000
12.5% VAT Goods	₹ 18,00,000	₹2,00,000	₹ 16,00,000
VAT Exempt Goods	₹ 4,00,000	–	₹ 4,00,000
Total	**₹42,80,000**	**₹2,80,000**	**₹40,00,000**

The above input tax paid is fully eligible for VAT Credit. The details of Sales during this month are -

Particulars	Total Sale Value	Output Tax Collected	Net Sales Consideration
4% VAT Goods	₹22,88,000	₹ 88,000	₹22,00,000
12.5% VAT Goods	₹20,25,000	₹2,25,000	₹ 18,00,000
VAT Exempt Goods	₹ 5,00,000		₹ 5,00,000
Total	**₹48,13,000**	**₹3,13,000**	**₹45,00,000**

Suggest the accounting treatment for the above.

Solution:

S.No.	Particulars		Debit	Credit
1	4% VAT Goods Purchase A/c	Dr.	20,00,000	
	12.5% VAT Goods Purchase A/c	Dr.	16,00,000	
	VAT Exempt Goods Purchase A/c	Dr.	4,00,000	
	VAT Credit Receivable (Inputs) A/c	Dr.	2,80,000	
	To Bank/Suppliers/Sundry Creditors			42,80,000
	(Being purchases of various goods and input tax thereon paid)			
2	Bank/Customers/Sundry Debtors A/c	Dr.	48,13,000	
	To 4% VAT Goods Sales A/c			22,00,000
	To 12.5% VAT Goods Sales A/c			18,00,000
	To VAT Exempt Sales A/c			5,00,000
	To VAT Payable A/c			3,13,000
	(Being sale of various goods and VAT collection thereon)			
3	VAT Payable A/c	Dr.	2,80,000	
	To VAT Credit Receivable (Inputs) A/c			2,80,000
	(Being set-off of VAT Credit against liability for VAT payment)			
	• At the end of this month, the balance in VAT Payable A/c ₹ 33,000 will be displayed in the B/Sheet under the head **"Current Liabilities".** • The dealer may include the following disclosures in the Notes: (a) Cost of Inventories is net of VAT Credit; (b) Sales are exclusive of VAT.			

4	**For payment of VAT in the subsequent month** VAT Payable A/c Dr. To Bank A/c (Being liability for VAT of previous month, now settled)	33,000	 33,000

VAT Accounting – Capital Goods – Basics

Illustration 18.

On 1st June, a Registered Dealer purchased a Machinery for ₹93,60,000 which includes State VAT of ₹3,60,000. As per the State VAT Laws, the input VAT on Capital Goods is adjustable in 36 equal monthly instalments beginning from 1st July of the year. During the financial year, the dealer has set-off a sum of ₹25,000 from the VAT Credit Receivable on Capital Goods, against VAT payable on the sales made by him. The dealer charges 10% p.a. depreciation on Machinery. Suggest the accounting treatment for the above.

Solution:

S.No.	Particulars	Debit	Credit
1	Machinery A/c Dr. VAT Credit Deferred (Capital Goods) A/c Dr. To Bank/Asset Vendor (Being machinery purchased and input tax thereon paid)	90,00,000 3,60,000	 93,60,000
2	VAT Credit Receivable (Capital Goods) A/c Dr. To VAT Credit Defeired (Capital Goods) A/c (Being VAT Credit availaole on Capital Goods for the current period i.e. 1st July to 31st March = ₹3,60,000 x 9/36 = ₹90,000)	90,000	 90,000
3	VAT Payable A/c Dr. To VAT Credit Receivable (Capital Goods) A/c (Being set-off of VAT Credit against liability for VAT payment)	25,000	 25,000
4	Depreciation A/c Dr. To Machinery A/c (Being Depreciation on Machinery = ₹90,00,000 x 10% x 10/12)	7,50,000	 7,50,000

Balance Sheet as on 31st March end of financial year) (abstract)

Liabilities	₹	Assets		₹
		Fixed Assets:		
		Tangible – Machinery	90,00,000	
		Less: Depreciation	7,50,000	82,50,000
		Long-term Loans and Advances		
		– Other Loans & Advances		
		VAT Credit Deferred (Capital Goods)		2,70,000
		VAT Credit Receivable (Capital Goods)		65,000

7.7 FINANCIAL REPORTING BY MUTUAL FUNDS, MERCHANT BANKERS, NON BANKING FINANCE COMPANIES, STOCK AND COMMODITY MARKET INTERMEDIARIES

Non- Banking Financial Company (NBFC)

A. I. NBFC: A Non- Banking Financial company (NBFC) is a Company registered under the Companies Act, 2013 and is engaged in the business of –

- **(a)** Loans and advances,
- **(b)** Acquisition of shares / stock / bonds / debentures / securities issued by Government or local authority or other securities of like marketable nature,
- **(c)** Leasing,
- **(d)** Hire – purchase,
- **(e)** Insurance business,
- **(f)** Chit business

but does not include any institution whose principal business is that of agriculture activity, industrial activity, sale / purchase / construction of immovable property.

II. NBFCs Vs Banks: NBFCs function like that of Banks, however there are a few differences:

- **(a)** a NBFC cannot accept **demand deposits;**
- **(b)** it is not a part of the payment and settlement system and as such cannot issue cheques to its customers; &
- **(c)** deposit insurance and Credit Guarantee Corporation does not insure the NBFC deposits.

B. Classification of Non – Banking Financial Companies (NBFCs)

Classification of NBFC's based on Registration with RBI

NBFC's compulsorily to be registered with RBI

i. Venture capital fund / Merchant banking Companies / stock Broking Companies, registered with SEBI;

ii. Insurance companies registered with IRDA;

iii. Nidhi companies notified u/s 406 of the companies Act, 2013;

iv. Chit Companies as defined u/s 2(b) of Chit Funds Act, 1982;

v. Housing Finance Companies regulated by National Housing bank.

These companies are exempted from registration with RBI, to obviate dual regulation.

NBFC's not required to be registered with RBI

i. Equipment Leasing company – engaged in Equipment Leasing or financial such activity. ii. Hire purchase Finance company – engaged in HP Transaction or financial such transactions. iii. Loan Company – engaged in financing by making loans / advances or otherwise for any activity other than its own, but excludes EL / HP / Housing Finance companies (HFCs). iv. Investments Company – engaged in acquisition and trading in such securities to earn a profit. v. Residuary Non- Banking Company (RNBC). NBFC's in items (i) to (iv) above may be further classified into – (a) those accepting deposits and (b) those not accepting deposits.

C. Applicability of NBFC prudential Norms (Reserve Bank) Directions, 1998.

Applies to	Does not apply to
All NBFCs and RNBCs	1. Mutual Benefit Financial Companies and Mutual Benefit companies with Net owned Fund ₹ 25 Lakhs and above and accepting / holding public Deposit. 2. Investment Company with – (a) 90% of its Net Assets invested in securities of group Companies, Holding company or subsidiary companies; (b) Not trading in the securities so invested; and (c) not accepting / holding public deposits. 3. Government Company. [However para 13A applies to Government Company also].

D. Various terms relevant to Non – Banking Financial Companies.

Term	Meaning
Break up value	$\frac{\text{(Equity Capital + Reserve) } \textbf{Less} \text{ (Intangible Assets + Revaluation Reserves)}}{\text{Number of shares of investee company}}$
Carrying cost	Book value of Assets including Interest accrued thereon and not received.
Current Investment	Readily realizable investments intended to be held for not more than one year from the date of investment.
Doubtful Asset	(a) Term Loan, or (b) Lease Assets, or (c) Hire purchase asset, or (d) any other assets, remaining substandard for a period exceeding 18 months.
Earnings Value	Capitalized value of an Equity share of a company based on average of the past three year's profit attributable to Equity shareholders i.e. PAT minus preference Dividend and adjustments for extra – ordinary and non- recurring items. Capitalisation Rate to be applied are as under – (a) Manufacturing company - 8% (b) Trading company - 10% (c) Other Company (incl. NBFC) - 12% **Note : If Investee Company is a loss making Company , earning value = Zero**

Fair Value	Average of Earning value and break up value per share.
Hybrid Debt	Capital Instrument having the characteristics of equity and debt.
Loss Asset	• Asset identified as Loss asset by – (a) NBFC; or (b) its internal / External Auditor; or (c) RBI (during NBFC's inspection), to the extent it is not written of by the NBFC. • Asset which is adversely affected by a potential threat of non- recoverability due to (a) erosion in the value of security; or (b) non- availability of security; or (c) any fraudulent act or omission on the part of the borrower.
Long term Investment	Investment other than a Current Investment.
Net Asset Value	Latest declared NAV by the concerned Mutual Fund, in respect of that particular scheme.
Net Book Value of Hire purchase Assets	Aggregate of Overdue and Future Instalments Receivable **Less**: Balance of Unmatured Finance Charges **Less:** Provisions for Non – performing Assets
Net Book Value of Leased Assets	Aggregate of Capital Portion of Overdue Lease Rentals Receivable **Add:** Depreciated Book Value of the Lease Asset **Add / Less:** Balance of Lease Adjustment Account.
Owned Fund	Paid up Equity share Capital **Add:** Preference Shares Capital compulsorily convertible into Equity **Add:** Free Reserves, Share Premium A/c, capital reserves (representing surplus arising out of sale of assets etc.) (Revaluation Reserves should be excluded). **Less:** Accumulated Losses, Intangible Assets, Deferred Revenue Expenditure.
Past Due	Income or interest remaining unpaid for a period of 30 days beyond the due date.
Standard Asset	Assets – • On which no default in repayment of principal or payment of interest is perceived; and • Which does not disclose any problems; and • Which does not carry more than normal risk attached to the business.
Sub – Standard Asset	• Asset classified as NPA for a period of up to 18 months; • Asset where the terms of the agreement regarding interest and / or principal have been renegotiated / rescheduled / restructured after commencement of operations. This will be classified as Sub – Standard until the expiry of 1 year of satisfactory performance under the renegotiated or rescheduled or restructured terms. **Note: The above does not apply to Infrastructure Loans, for which separate considerations apply.**

Subordinated Debt	Fully paid up Capital instruments which are – • Unsecured; • Subordinated to the claims of other creditors; • Free from Restrictive clauses; • Not redeemable at the instance of the holder or without the consent of the supervisory authority of the NBFC. The book value of such instrument should be discounted as under – **Remaining Maturity of the Instrument Rate of discount** Upto 1 year 100% More than 1 year but up to 2 years - 80% More than 2 year but up to 3 years - 60% More than 3 year but up to 4 years - 40% More than 4 year but up to 5 years - 20% **The Discounted Value should not exceed 50% of the Tier I Capital.**
Substantial Interest	Holding beneficial interest in excess of **10%** of the paid up capital of the company. Beneficial Interest may be held either singly or jointly i.e. in respect of an Individual, by him and his spouse/ minor child; for a partnership Firm by all the partners.

E. Meaning of Infrastructure Loan with reference to NBFCs.

I. Meaning: Infrastructure Loan is a Credit Facility extended to a borrower by way of –

(a) Term Loan;

(b) Project Loan subscription to Bonds / Debentures / Preference Shares/ Equity Shares in a project Company where the subscription amount is treated as in the "nature of advance" or any other Long Term Funded facility.

II. Eligible Borrowers: The Borrower Companies should be engaged in –

(a) Developing; or

(b) Operating and Maintaining; or

(c) Developing, Operating and Maintaining, any infrastructure facility.

III. Infrastructure Facility: Infrastructure Facility means project in any of the following sectors-

(a) **Roads and Highway projects** – Road, Toll Road, Bridge or Rail system, including other activities being an integral part of the Highway project;

(b) **Port** – Port, Airport, Inland Waterway or Inland Port;

(c) **Water Supply Projects,** Irrigation Project, Water Treatment System, Sanitation and Sewerage System or Solid Waste Management System;

(d) **Telecommunication Services** (basic or cellular) – Including Radio Paging, Domestic Satellite Service, network of Trunking, Broadband Network and Internet Services;

(e) **Industrial Parks** or Special Economic Zone;

(f) **Power Sector –** Generation or / and distribution of Power; Transmission or Distribution by laying Transmission or Distribution lines;

(g) **Construction Projects –**

- Relating to projects involving agro – processing and supply of inputs to agriculture;
- For preservation and storage of processed agro – products, perishable goods and includes quality testing facilities;
- Educational Institutions and Hospitals;

(h) **Residual Category** – i.e. any other infrastructure facility of a similar nature.

F. Tier – I capital and Tire – II capital.

Tier – I Capital	**Tier – II Capital**
Owned Fund **Less**: Investment in Shares of other NBFCs. **Less**: Investment in Shares / Debentures / Bonds / Outstanding Loans / Advances including HP and Lease Finance made to and Deposits with Subsidiaries and Group Companies, in excess of **10%** of owned Fund.	Aggregate of – A. Preference Shares (except those considered in Owned Funds i.e. not convertible into Equity); B. Revaluation Reserves discounted at 55%; C. General Provision & Loss Reserves to the extent these are not attributable to actual diminution or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of 1.25% of Risk Weighted Assets; D. Hybrid Instruments; and E. Subordinated Debt. **Tier II Capital should not exceed Tier – I Capital**

G. Requirements of NBFCs as to Capital Adequacy

I. Every NBFC shall, maintain a Minimum Capital Ratio consisting of Tier I and Tier II capital which shall not be less than 12% of its Aggregate Risk- Weighted Assets.

II. The total of Tier II Capital, at any point of time, shall not exceed 100% of Tier I Capital.

H. Non- performing assets in relation to an NBFC

Non- Performing Asset (NPA) means –

Nature of Asset / Advance	Situation when considered as NPA
An Asset (general)	• Interest **overdue** for 6 months or more.
Term Loans (inclusive of Unpaid Interest)	• Installment **overdue** for 6 months or more; or • Interest **overdue** for 6 months or more;

Demand / Call Loan	• **Overdue** for 6 months or more from the date of demand / call; **or** • Interest **overdue** for 6 months or more;
Bill	• **Overdue** for 6 months or more.
Debt and Other Short – Term Loans / Advances, classified under "Other Current Assets'	• Interest / Income thereon **overdue** for 6 months or more.
Dues on account of sale of asset / services rendered /reimbursement of expenses	• **Overdue** for 6 months or more.
Lease Rentals and Hire Purchase Installments	• **Overdue** for 12 months or more.

Note:

- **Borrower – wise Vs. Facility wise:** NPA should be determined borrower – wise and not facility wise. Even if any one of the Credit facilities granted to a borrower becomes non-performing, all the facilities granted to that borrower will be regarded as NPA irrespective of the performing status of other facilities.
- **Lease and HP Transactions:** For lease and Hire Purchase transactions, an NBFC may classify each such account on the basis of its record of recovery instead of classifying them borrower – wise.

I. Income recognition principles for a NBFC

I. **Basis of Recognition:** Income recognition should be based on recognised accounting principles.

II. **Income from NPAs:** Income including interest / discount or any other charges on NPA should be recognised only when it is **actually realized**. Any income recognised before the asset was classified NPA and remaining unrealized should be reversed.

III. **HP Assets:** If the installments are overdue for more than 12 months, income shall be recognised only when hire charges are **actually received**. Any income credited to P&L A/c before the HP Asset was classified as NPA, and remaining unrealized should be reversed.

IV. **Lease Rentals:** Where the lease rentals are overdue for more than 12 months, the income shall be recognised only on **actual realization** of the lease rentals. The Net lease rentals (i.e. Gross Lease rent adjusted by amount debited / credited Lease Adjustment Account **Less** depreciation) credited to P&L a/c before the asset became NPA and remaining unrealized should reversed.

V. **Income from Investments:** The following principles apply -

Investment Income	**Income Recognition Principle**
(a) Dividend on Shares of Companies and Units of Mutual Fund.	**Cash Basis**. Accrual basis may be followed when the dividend is declared at the company's AGM and NBFC's right to receive payment is established.
(b) Income from Bonds, debentures of Corporates and Government Securities / Bonds	**Accrual Basis** if interest rate is predetermined, interest is serviced regularly and interest is not in arrears.
(c) Income from Government Guaranteed Bonds and Securities of Corporate Bodies.	**Accrual Basis**.

J. Guidelines relating to Investments of a NBFC

I. Investment Policy: Board of Directors of the NBFC should frame and implement an Investment policy for the company containing the criteria for classifying investments into current and long term.

II. Classification: Each investment should be classified into either current Investment or Long Term Investment at the time of making investment. Inter- class transfer can be done only at the beginning of each half – year (either on 1st April or 1st October) **only** with the approval of the Board.

III. Accounting for Inter- Class Transfer:

(a) Investments should be transferred scrip- wise at lower of book value or market value from the long term to current or vice versa.

(b) Depreciation in each scrip should be **fully provided for** and appreciation should be **ignored**.

(c) Depreciation in one scrip should be set off against appreciation in another scrip at the time of such inter- class transfer even if they are in the same category.

IV. Grouping of Quoted Investments: Quoted Current Investments should be grouped as under for valuation purposes – (a) Equity Shares; (b) Preference Shares; (c) Debentures and Bonds; (d) Government Securities (including Treasury Bills); (e) Units of Mutual Fund; and (f) Others.

V. Valuation of Investments:

Investment	**Valuation**
(a) Long Term Investment	As per AS issued by ICAI
(b) Quoted Current Investments (for each category, to be considered scrip-wise)	Cost or Market value whichever is lower. **(See Note below)**
(c) Unquoted Equity Shares held as Current Investments	Cost or Break up Value, whichever is lower. • Fair Value may be substituted for Break-up Value, if considered necessary. • Where Investee Company's B/Sheet is not available for 2 years, value of shares = ₹ **1 only**.
(d) Unquoted Pref. Shares held as Current Investments	Cost or Face Value, whichever is lower.
(e) Unquoted Government Securities/ Government Guaranteed Bonds	Carrying Cost.
(f) Unquoted Current Investments in units of Mutual Fund	NAV declared by Mutual Fund for each scheme
(g) Commercial Papers	Carrying Cost

Note: For Quoted Current Investments –

- If the aggregate Market Value (i.e. total of all scrips in that category) for any category is less than the aggregate cost for that category, the net depreciation shall be provided for / charged to P & L A/c.
- 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.

Note: Unquoted Debentures shall be treated as Term Loans or other type of credit facilities (and not as investments) depending upon the tenure of such debentures for the purpose of income recognition and asset classification.

K. Principles relating to Asset Classification and Provisioning for NPA in NBFC's

I. Classification: Every NBFC shall, after taking into account the degree of well defined credit weaknesses and extent of dependence on collateral security for realization, classify its lease/ hire purchase assets, loans and advances and any other forms of credit into –

(a) Standard Assets;

(b) Sub – Standard Assets;

(c) Doubtful Assets; and

(d) Loss Assets.

Note: The above class of assets shall not be upgraded merely as a result of rescheduling, unless it satisfies the conditions required for the upgradation.

II. Provisioning requirements: Every NBFC shall, after taking into account the time lag between an account becoming non- performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against – (a) Sub-Standard Assets, (b) Doubtful Assets and (c) Loss Assets as under –

(a) **For Loans, Advances and other credit facilities including Bills Purchased and Discounted**

Type of Asset	Provisioning Norms
(1) Standard Assets	0.25%
(2) Sub-Standard Assets	10% of Total outstanding.
(3) Doubtful Assets	• 100% of the Unsecured portion i.e. extent to which the advance is not covered by the realizable value of the security; • Additional Provision as under – Period for which the Asset is doubtful Additional Provision Upto 1 year 20% of Secured portion. 1-3 years 30% of Secured portion More than 3 years 50% of Secured portion
(4) Loss Assets	The entire asset shall be written off. If the assets are permitted to remain in the books for any reason, 100% of the outstanding should be provided for.

(b) **Lease and HP Assets:**

- **Basic Provision**: In respect of HP assets, provision should be made for the total dues (overdue and future installments taken together) as reduced by – (a) Finance charges not credited to P & L Account and carried forward as unmatured finance charges; and (b) depreciated value of the underlying asset. For provisioning purpose, depreciated value of the asset shall be notionally computed as original / Actual cost Less depreciation at 20% p.a. on SLM basis.

- **Additional Provision:** For lease and HP Assets, additional provisioning will be as under –

Type of Asset	Period of overdue	Provisioning Norms
(1) Sub- Standard Assets	More than 12 months but up to 24 months	10% of Net Book Value.
(2) Doubtful Assets	More than 24 months but up to 36 months More than 36 months but up to 48 months	40% of Net Book Value. 70% of Net Book Value.
(3) Loss Assets	More than 48 months	100% of Net Book value.

Note: On expiry of a period of 12 months after the due date of the last installment of hire purchase / leased asset, the entire Net Book Value shall be fully provided for.

Additional Points:

- Caution Money / Margin Money or Security Deposits kept by the borrower with the NBFC in pursuance of the HP agreement may be deducted against the basic provision, if not already taken into account while arriving at the EMI's under the agreement. The value of any other security available in pursuance to the HP agreement may be deducted only against the additional provisions.
- Security Deposits kept by the borrower with the NBFC in pursuance to the lease agreement together with the value of any other security available in pursuance to the lease agreement may be deducted only against the additional provisions described above.
- Income Recognition on and provisioning against NPAs are two different aspects of prudential norms. The fact that income on an NPA has not been recognised cannot be taken as reason for not making provision.
- An asset which has been renegotiated or rescheduled shall be as sub- standard asset or continue to remain in the same category in which it was prior to its renegotiation or reschedulement as a doubtful asset or a loss asset as the case may be. Necessary provision is required to be made as applicable to such asset till it is upgraded.

III. Disclosure of Provisions in the Balance Sheet:

(a) Every NBFC shall separately disclose in its Balance Sheet the provisions made as above without netting them from the income or against the value of assets. The provisions shall be distinctly indicated under separate heads of accounts as – (i) provisions for bad and doubtful debts; and (ii) provisions for depreciation in investments.

(b) Such provisions shall not be appropriated from the General Provisions and Loss Reserves held, if any, by the NBFC.

(c) Such provisions for each year shall be debited to the P&L Account. The excess of provisions, if any, held under the heads "General Provisions and Loss Reserves" may be written back without making adjustment against them.

L. Explain the guidelines in relation to Infrastructure Loans.

These following are applicable to restructuring/ rescheduling/ renegotiation of the terms of agreement relating to infrastructure loans, which is fully or partly secured standard and Sub-Standard Asset and to the loan, which is subjected to restructuring / rescheduling / renegotiation of terms with effect from 2003 – 2004.

I. Time Point for Restructuring: Restructuring of principle and/ or of interest may take place, with or without sacrifice, as part of the package evolved. The NBFCs may, not more than once, restructure the terms of infrastructure loan agreement under the following stages –

(a) Before commencement of commercial production;

(b) After commencement of commercial production but before asset has been classified as Sub- standard;

(c) After commencement of commercial production and the asset has been classified as sub- standard:

II. **Additional Provision**: Where the asset is partly secured, a provision to the extent of shortfall in the security available, shall be made while restructuring / rescheduling/ renegotiation of the loans, apart from the provision required on Present Value basis and as per prudential norms.

III. **Restructured Standard Loan**:

(a) The rescheduling of the installments **of principal alone**, at the aforesaid first two stages shall not cause a standard asset to be re- classified in the sub- standard category, if the project is re- examined and found to be viable.

(b) Rescheduling of interest element at the first two stages shall not cause to be downgraded to sub- standard category subject to the condition that the amount of interest foregone, if any, on account of adjustment in the element of interest as specified later, is either written off or 100% provision is made there against.

IV. **Restructured sub- standard asset**: A Sub- Standard Asset shall continue to remain in the same category in case of restructuring of the installments of principal until the expiry of **one year** and the amount of interest foregone, if any, on account of adjustment, including adjustment by way of write off of the past interest dues, in the element of interest as specified later, shall be written off or 100% provision made thereagainst.

V. **Adjustment of Interest**: Where rescheduling involves a **reduction** in the rate of interest, the interest adjustment shall be computed by taking the difference between the rate of interest as currently applicable to infrastructure loan (as adjusted for the risk rating applicable to the Borrower) and the reduced rate and aggregating the present Value (discounted at the rate current applicable to infrastructure loan, adjusted for risk enhancement) of the future interest payable so stipulated in the restructuring proposal.

VI. **Funded Interest**: In the case of funding of interest in respect of NPAs, where the interest funded is recognized as **income**, the interest funded shall be fully provided for.

VII. **Income recognition norms**: The Income Recognition in respect of Infrastructure Loan shall be governed by the general income recognition principles.

VIII. **Treatment of Provision held**: Provisions held by the NBFCs against non- performing infrastructure loan, which may be classified as 'Standard after the coming into effect of these norms, shall **continue to be held** and **shall not be reversed** until full recovery of the loan is made.

IX. **Upgradation**: The restructured asset shall not be upgraded to standard category until expiry of **one year** of satisfactory performance under the restructuring terms.

X. **Conversion of Debt into Equity**:

(a) Where the amount due as interest is converted into equity or any other instrument, and income is recognized in consequence, full provision shall be made for the amount of income so recognized to offset the effect of such income recognition.

(b) No provision is required to be made, if the conversion of interest is into equity which is quoted. In such cases, interest income may be recognized at market value of equity, as on the date of conversion, not exceeding the amount of interest converted to equity.

XI. **Conversion of Debt into Debentures**: Where principle and / or interest amount in respect of NPAs is converted into debentures, such debentures shall be treated as NPA, **ab initio**, in the same asset classification as was applicable to the loan just before conversion and provision shall be made as per norms.

M. **Discuss the provisions relating to acceptance of Public Deposits by NBFCs**.

I. **Prohibition**: Mutual Benefit Finance Company cannot accept or renew any public Deposit except from its Shareholders. Such Deposits should not be in the nature of Current Account.

II. **Condition for Acceptance of Public Deposits**:

(a) **Minimum Net Owned Funds**: The NBFCs accepting public Deposits have minimum stipulated net owned fund and comply with the Directions issued by the Reserve Bank.

(b) **Registration Certificate**: All NBFCs are not entitled to accept Public deposits. Only those NBFCs holding a valid certificate of Registration with authorization to accept public Deposits can accept or hold public Deposits.

III. **Credit Rating:**

(a) The ability of NBFC to raise public deposits is based on its credit rating, Capital to Risk Asset Ratio. A NBFC with credit rating of investment grade and above, can accept public Deposits subject to specified maximum ceiling.

(b) **Norms for Public deposits (Illustrative List):**

Type of NBFC	Public deposit Amount
Equipment Leasing and Hire purchase companies maintaining Capital to Risk Asset Ratio (CRAR) of -	
• 15% without credit rating	1.5 times of net owned funds or ₹10 Crores, whichever is less.
• 12% with minimum investment grade credit rating	Upto 4 times of Net Owned Funds
Loan Companies and investment companies maintaining capital to Risk Asset ratio of 15% with minimum investment grade credit rating	1.5 times of Net Owned Funds.
Residuary NBFC (RNBC)	Unlimited, provided Amounts Deposited and Investments made by such companies are not less than the aggregate amount of liabilities to the depositors.

Other points:

- **Nature of Investments for RNBC:** RNBCs are required to invest in a portfolio comprising of highly liquid and secured instrument viz. Central or State Government securities, fixed deposit or certificate of deposits of scheduled commercial Banks or units of mutual funds etc.
- **Downgrading Investment Rating:** If the rating of a NBFC is downgraded to below minimum investment grade rating, it must stop accepting further public deposit and report the within 15 Working days to the RBI. The amount of public deposit already accepted must also be reduced within 3 years from the date of such downgrading of credit rating, nil or to the permissible level.
- **Maximum interest on Deposits:** The maximum interest that a NBFC can pay its deposits is restricted to 14% per annum. The maximum frequency of compounding is months.
- **Brokerage for Collecting Deposits:** The rate of brokerage that a NBFC can pay for collecting deposits is 2%. The maximum reimbursement of actual expenses allowed is 0.5% of deposits collected.

- **Period of deposits:** The NBFCs are allowed to accept to renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.
- **No Additional Benefits:** NBFCs cannot offer gifts or incentives or any other additional benefit to the depositors.
- **Nature of Public Deposits:** Public deposits are **unsecured**. The deposits with NBFCs are neither insured nor RBI Guarantees their repayments. The NBFCs accepting deposits are required to file annual returns and financial statements with RBI.

N. Write notes on Liquid Asset Requirements of NBFCs.

I. Minimum Liquid Assets: NBFCs accepting public deposits should maintain Liquid Assets the minimum level of 15% of public deposits outstanding as on the last working day of the second preceding quarter. [Section 45 – IB of RBI Act]

II. Break Up for Minimum Level:

(a) Government Securities / Guaranteed Bonds: Of this minimum level, not less than 10% must be invested in approved securities i.e. in Government Securities or Government Guaranteed Bonds. The liquid assets in form of investments in approved Securities must be maintained in dematerialized form only.

(b) Term Deposits: The remaining 5% of Minimum Liquid Assets can be invested in unencumbered Term Deposits with any Scheduled commercial Bank.

III. Utilisation: The Liquid Assets maintained as above are utilized for payment of claims of depositors. However, the Deposits being unsecured, the depositors do not have any direct claim on Liquid Assets.

O. Write notes on Asset Liability Management

I. Definition: Asset Liability Management (ALM) is a **Risk Management Tool** that helps a bank or NBFC **to manage its liquidity risk and interest rate risk**. This helps Banks or NBFCs plan Long Term Financial, Funding and Capital Strategy using present value Analysis.

II. Application / Uses of ALM:

(a) With ALM, a bank or NBFC can model interest income and expenses for analysis and re-price Assets and Liabilities.

(b) Based on ALM position, Banks or NBFCs can also model effects of Competitive pricing to create innovative and imaginative Banking products.

(c) ALM also helps regulatory compliance for Banks or NBFCs by through appropriate investment or Disinvestment Decisions to maintain the required Statutory Liquidity ratio (SLR), credit reserve Ratio (CRR) and other ratios specified by RBI Guidelines.

III. Components of ALM: ALM involves Structural Liquidity Gap Analysis, Interest rate gap analysis Duration Gap analysis, Trend Analyses, comparative analysis, Present Value Analysis, Forward analysis and Scenario Analysis.

Valuation of Investments by NBFC

Illustration 19.

Ma Lakshmi Finance Ltd., is a non- banking finance company. It makes available to you the costs and market price of various investments held by it.(Fifures in ₹ lakhs) as on 31.03.2015

Scrips	Cost	Mkt. Price	Scrips	Cost	Mkt. price
Equity Shares					
A	60.00	61.20	Mutual Funds MF 1	39.00	24.00
B	31.50	24.00	MF 2	30.00	21.00
C	60.00	36.00	MF3	6.00	9.00
D	60.00	120.00			
E	90.00	105.00			
F	75.00	90.00	**Govt. Securities GV1**	60.00	66.00
G	30.00	6.00	**GV2**	75.00	72.00

i. Can the company adjust depreciation of a particular item of investment within a category?

ii. What should be the value of investments as on 31.03.2015?

iii. Is it possible to off- set depreciation in investment in mutual funds against appreciation of the value investment in Equity Shares and Government Securities?

Solution:

1. Quoted Current Investments are to be valued at cost of Market Value, whichever is lower. Such amount can be aggregated for all scrips in that category and the net depreciation should be computed. Hence, depreciation of a particular items **can be adjusted** within the same category of investments.

2. Value of Investments will be as under –

Type of Investment	**Valuation Principle**	**Value of Investments**
Equity Shares (aggregate)	Lower of Cost or Market Value	₹406.50 Lakhs
Mutual Funds	NAV (Market Value assumed)	₹54.00 Lakhs
Government Securities	Cost	₹135.00 Lakhs
Total		₹595.50 Lakhs

3. Inter – Category Adjustments of appreciation and depreciation in values of investments cannot be done. Hence, it is **not possible** to offset depreciation in investment in Mutual Funds against appreciation of value of investments in Equity Shares and Government Securities.

Provisioning by NBFC

Illustration 20.

While closing its books of account on 31st March, a NBFC has its advances classified as follows –

Particulars	₹ Lakhs	Particulars	₹ Lakhs
Standard Assets	8,400	Unsecured Portion of Doubtful Debts	87
Sub-Standard Assets	910	Loss Assets	24
Secured Portions of Doubtful Debts:			
- Up to one year	160		
- One year to three years	70		
- more than three years	20		

Calculate the amount of provision which must be made against the advances.

Solution:

Particulars	Loan ₹ Lakhs	Provision %	Provision ₹ Lakhs
Standard Assets	8,400	Nil	Nil
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			265

Illustration 21.

While closing its books of account on 31st March, 2015 a Non- banking Finance company has its advances classified as follows -

Particulars	₹ in Lakhs
Standard Assets	16,800
Sub- Standard Assets	1,340
Secured Positions of Doubtful Debts:	
- Up to one year	320
- one year to three years	90
- more than three years	30
Unsecured Portions of Doubtful debts	97
Loss Assets	48

Calculate the amount of provision which must be made against the advances

Solution:

Particulars	Loan ₹ Lakhs	Provision %	Provision ₹ Lakhs
Standard Assets	16,800	Nil	Nil
Sub- Standard Assets	1,340	10%	134
Secured Portion of Doubtful Debts:			
- Up to one year	320	20%	64
- 1 year to 2 years	90	30%	27
- more than 3 years	30	50%	15
Unsecured Portion of Doubtful debts	97	100%	97
Loss Assets	48	100%	48
Total			385

MERCHANT BANKERS

A. Merchant Banker:

Merchant Banker means an entity registered under SEBI (Merchant Banks) Regulations, 1999. Merchant Banker is a person engaged in the business of –

i. **Issue Management** either by making arrangements regarding selling, buying or subscribing to securities as manager, consultant, adviser or

ii. Rendering **Corporate Advisory Services** in relation to Issue Management.

B. Requirements to be fulfilled by a Merchant Banker for registration with SEBI:

The applicant should comply with the following requirements for applying certificate of Registration for to act as a Merchant Banker –

i. **Body Corporate**: The applicant should be a Body corporate other than a NBFC under the RBI Act, 1934.

ii. **Infrastructure**: Applicant should have necessary infrastructure like adequate office Space, Equipments, and Manpower to effectively discharge its activities.

iii. **Expertise**: Atleast 2 persons who have experience in to conduct the business of Merchant banker should be in employment with the Merchant banker.

iv. **Bar on Registration**: Person directly or indirectly connected with the applicant should not have been granted registration by SEBI. Such person include Associate, subsidiary, Group Company of the Applicant Body Corporate.

v. **Capital Adequacy requirements**: Applicant should fulfill the Capital adequacy requirements.

vi. **Litigations**: Applicant, its partner, Director or principal officer should not be involved in any litigation connected with the securities market which has an adverse effect on the applicant’s business;

vii. **Economic offence**: Applicant, its Director, partner or principal officer should not have been convicted for any offence involving moral turpitude or found guilty of any economic offence;

viii. **Professional Qualification**: Applicant should have a professional qualification from an Institution recognised by the Government in Finance, Law or Business Management;

ix. **Fit and Proper**: The Applicant should be a fit and proper person.

x. **Investor’s interest**: Grant of Certificate to the applicant is in the best interest of the investors.

C. Conditions for grant/renewal of Certificate of Registration:

No person can act as Merchant Banker without holding a Certificate of Registration from SEBI. SEBI may grant or renew a certificate to a Merchant Banker (valid for 3 year period) under the following conditions –

i. **Change in Status**: Merchant Banker should obtain the prior permission from SEBI to carry on its Merchant Banking Activities if there is any change in its status or constitution.

ii. **Payment of Fees:** The Merchant Banker should he shall pay the amount of fees for registration or renewal (as applicable), in the manner required by SEBI.

iii. **Investor's Grievance Redressal**: The Merchant Banker should take adequate steps to redress the Investor's Grievances within one month from the date of receipt of the complaint. It should also keep the Board informed about the number, nature and other particulars of the complaints received;

iv. **Adherence to Regulations**: Merchant Banks should he strictly abide by and adhere to the rules and regulations made under the SEBI Act, in respect of the activities carried on by it.

D. Guidelines in respect of regulation/registration of Merchant Bankers:

i. **Renewal Application:** Application for renewal of Certificate of Registration shall be made by the Merchant Bankers as per Regulation 9 of SEBI (Merchant Bakers) Rules and Regulations, 1992. The application should be in Form A of these Regulations and also contain additional information as contained in Schedule XXVI.

ii. **Change in Information, if any:** While filing the renewal application for the Certificate of Registration as Merchant Banker, it shall provide a statement highlighting the changes that have taken place in the information that was submitted to SEBI for earlier registration and a declaration stating that no other changes other than as mentioned in the above statement has taken place.

iii. **Half Yearly Reports:** Under Regulation 28 of SEBI (Merchant Bankers') Regulations 1992, the Merchant Bakers shall send half – yearly report in Schedule XXVII format relating to their merchant banking activities. This report shall be submitted twice a year, as on 31st March and 30th September and should reach SEBI within 3 months from the close of the period to which it relates.

iv. **Registration with Association of Merchant Bankers of India (AMBI):** Registered Merchant Bankers shall inform the Board of their having become a member of AMBI with relevant details.

v. **Issue of Penalty Points:** Penalty points may be imposed on the Merchant Banker for violation of any of the provisions of operational guidelines under these Chapters. The Merchant Banker, on whom penalty point of 4 or more has been imposed may be restrained from filing any offer document or associating or managing any issues for a particular period. SEBI may initiate other action under the Regulations, irrespective of whether a penalty point is imposed of not. Imposition of penalty point is not a condition precedent for initiation of proceeding against the Merchant Banker under the SEBI (Merchant Bankers) Regulations.

E. Capital Adequacy Requirements applicable to Merchant Bankers:

The Capital Adequacy Requirement should not be less than the Net Worth of the person making application for grant of Registration. The Net Worth Required by Merchant Bakers is based on the nature of activity undertaken by them as detailed below –

Activity	Minimum Net Wroth
1. Issue Management consisting of – Preparation of Prospectus and other information relating to issue; Determining Financial Structure; Tie up of Financiers; and Final Allotment and Refund of Subscriptions; and Act as Advisor, Consultant, Manager, Underwriter, Portfolio Manager	₹5 Crores
2. Role as Advisor, Consultant, Co-Manager, Underwriter, Portfolio Manager.	₹50 Lakhs
3. Role as an Underwriter, Advisor or consultant to an issue.	₹20 Lakhs
4. Advisory or Consultancy to an issue	NIL

F. Books and records to be maintained by Merchant Bankers

i. Records to be maintained: Merchant Bankers are required to maintain the following books of account and records and documents –

(a) Copy of Balance Sheet as at end of each accounting period;

(b) Copy of Profit and Loss Account for the period noted above;

(c) Copy of Auditor's Report on the Accounts for that period;

(d) Statement of Financial Position;

ii. Period of Maintenance: Merchant Bankers are required to preserve the books of account and other records and documents maintained for a minimum period of five years.

iii. Intimation of SEBI: Merchant Bankers are required to intimate to the Board, the place of maintenance of books of accounts, records and documents.

iv. Furnishing of Accounts to SEBI: After each accounting year, Merchant Bankers are required to furnish copies of the Balance Sheet, Profit and Loss Account and other documents to SEBI. The documents and financial statements may relate to any of the five preceding financial years.

G. List of various information to be furnished by Merchant Bankers to SEBI:

A Merchant Banker should disclose the following information to SEBI, when required by it –

i. Responsibilities of the Merchant Banker with regard to management of an issue;

ii. Change in the information or particulars previously furnished which affect the Certificate granted to it;

iii. Details of Company whose issue the Merchant Banker has managed or has been associated with;

iv. Details relating to the breach of the Capital Adequacy requirements as specified in the Regulations;

v. Details relating to activities as Manager, Underwriter; Consultant or Advisor to an issue;

H. Inspection of books of Merchant Bankers by SEBI / Authorised Person.

i. Purpose : SEBI may appoint one or more persons as inspecting authority to inspect the books of account, and other records and documents of the Merchant Banker for –

(a) Ensuring that books of accounts and other books are being maintained in the manner required;

(b) To confirm compliance with the statutory requirements under Act, Rules and Regulations;

(c) Investigating into the complaints received from investors, other Merchant Bankers, or any other person on any matter affecting the Merchant Banker's activities.

(d) Investigating in the interest of Securities Business or Investor's interest into the affairs of Merchant Banker.

ii. Duty of Merchant Banker:

(a) **Access to Premises:** Merchant Bankers should allow the Inspecting Authority to have reasonable access to the premises occupied by the Merchant Banker and by any person on its behalf.

(b) **Facility to examine books:** It should extent reasonable facility for examining any books, records, documents and computerized data in its possession or in possession of such other person.

(c) **Copies of Documents:** It should provide copies of documents or other materials to the Inspecting Authority which in their opinion is relevant for the purposes of inspection.

Stock and Commodity Market Intermediaries

A. **Books of accounts/documents required to be maintained by the Member of a Stock Exchange:**

I. Required by Statute: A Member is required to maintain the following books as per Rule 15 of Securities Contracts (Regulation) Rules, 1957 and Rule 17 of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992 –

(a) Transactions Register (Sauda Book) / Daily Transaction List.

(b) Clients Ledger.

(c) General Ledger.

(d) Journals.

(e) Cash Book.

(f) Bank Pass Book.

(g) Securities Inward – Outward Register for particulars of shares / securities received and delivered.

(h) Members' Contract Book for all contracts entered into him with other Members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other Members.

(i) Counterfoils / Duplicates of contracts notes issued to clients.

(j) Written consent of clients in respect of contracts entered into as principals

(k) Margin Deposit Book.

(l) Register of Accounts of Sub-brokers.

(m) Agreement with a sub-broker giving the scope of authority and responsibilities of the stock-broker and such sub-brokers.

II. Required by the Exchange: The following additional books / documents / registers may be required under the rules / regulations / bye-laws of the concerned Stock Exchange –

(a) Copies of all Margin Statements downloaded from the Exchange.

(b) Copies of Spot Delivery Transactions entered into (including securities delivered and payments made to Members).

(c) Client Database and Broker Client Agreement.

(d) Copy of Registration Certificate of each Sub-broker issued by SEBI.

(e) Copy of approval for each Remisier given by the Exchange.

(f) Copy of the Power of Attorney / Board Resolution authorizing Directors / Employees to sign the Contract Notes.

(g) Copies of Pool Account Statements.

III. Other conditions:

(a) A Member should maintain separate sets of books of accounts / documents / records under the following circumstances –

- Where he holds membership of any other recognized Stock Exchange;
- Where he holds membership in a different segment of the same Stock Exchange;

(b) A Member should intimate to SEBI the place where the books of accounts, records and documents are maintained.

(c) The books of accounts and other records maintained under regulation 17 should be preserved for a minimum period of five years.

IV. Penal Consequences: A Stock Broker who fails to comply with the regulations or laws relating to Securities Contract or contravenes any of them, shall be liable to – (a) Suspension of Registration; or (b) Cancellation of Registration.

B. **Briefly discuss inspection of Stock Broker's books by SEBI.**

SEBI may appoint one or more persons as inspecting authority to inspect the books of account, and other records and documents of the Stock Brokers for –

(a) Ensuring that books of accounts and other books are being maintained in the manner required;

(b) To confirm compliance with the statutory requirements under Act, Rules and Regulations;

(c) Investigating into the complaints received from investors, other stock brokers, sub-brokers or any other person on any matter affecting the stock-broker's activities.

(d) Investigating in the interest of Securities Business or Investor's interest into the affairs of Stock Brokers.

C. **Write short notes on maintenance of Books of Account by Stock Brokers.**

I. **Required by Statute:** A Members is required to maintain the following books as per Rule 15 of Securities Contracts (Regulation) Rules, 1957, and Rule 17 of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992 –

(a) Transactions Register (Sauda Book) / Daily Transaction List.

(b) Clients Ledger and General Ledger.

(c) Journals and Cash Book.

(d) Bank Pass Book.

(e) Securities Inward – Outward Register for particulars of Shares / Securities received and delivered.

(f) Members' Contract Book for all contracts entered into by him with other Members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other Member.

(g) Counterfoils/Duplicates of Contract Notes issued to Clients.

(h) Written Consent of Clients in respect of contracts entered into as principles.

(i) Margin Deposit Book.

(j) Register of Accounts of Sub-Brokers.

(k) Agreement with a Sub-Broker giving the scope of authority and responsibilities of the Stock-Broker & such Sub-Brokers.

II. **Required by the Exchange:** The following additional books / documents / registers may be required under the Rules /Regulations / Bye-Laws of the concerned Stock Exchange –

(a) Copies of all Margin Statements downloaded from the Exchange.

(b) Copies of Spot Delivery Transactions entered into (including securities delivered and payments made to Members).

(c) Client Database and Broker Client Agreement.

(d) Copy of Registration Certificate of each sub-Broker issued by SEBI.

(e) Copy of approval for each Remisier given by the Exchange.

(f) Copy of Power of Attorney / Board Resolution authorizing Directors / Employees to sign Contract Notes.

(g) Copies of Pool Account Statements.

III. **Other Conditions:**

(a) A Member should maintain separate sets of books of accounts / documents / records, if he holds membership – (i) of any other recognized Stock Exchange, or (ii) in a different segment of the same Stock Exchange.

(b) A member should intimate of SEBI, the place where the books of accounts, records and documents are maintained.

The books of accounts and other records maintained under Regulation 17 should be preserved for a minimum period of 5 years.

7.8 GUIDANCE NOTES ON DERIVATIVES

ACCOUNTING FOR EQUITY INDEX AND EQUITY STOCK OPTIONS

1. Financial Instrument

(i) **Meaning:** Financial Instrument is a contract giving rise to a Financial Asset to an enterprise and Financial Liability to another. They include -

(a) Primary Instruments i.e. Equity Shares, Preference Shares; Debentures etc. and

(b) Derivative Instruments Options, Futures, Forwards, Swaps etc. However Commodity Derivatives are not Financial Instrument.

(ii) **Financial Asset:** It includes (a) Cash; (b) Contractual Right to receive cash or other financial asset from another enterprise; (c) Contractual Right to exchange financial instruments with another enterprise which is potentially favourable; and (d) Equity Instruments of another enterprise.

(iii) **Financial Liability:** It is a contractual obligation to - (a) deliver cash or other financial asset to another enterprise, or (b) to exchange a financial instrument with another enterprise that is potentially unfavourable.

2. Interest Rate Swap.

(i) **Nature:** Interest Rate Swap is a financial contract between two parties to exchange a set of payments to minimize the interest cost to either of them.

(ii) **Exchange of Payment Obligation:** It involves exchange of one interest rate payment with other interest rate payment where the principal (an agreed amount called notional principal) is denominated in the same currency and is of the same value for an agreed period of time.

(iii) **Interest on Obligations:** One of the payment obligations exchanged will be entail a Floating Rate of Interest and the other will entail a Fixed Rate of Interest Payment.

(iii) **Swap Bank:** The parties to the Contract upon entering into the Contract, transact the payment obligations through the Swap Bank an intermediary to effect the Interest Rate Swap.

3. Currency Options relating to Foreign Exchange.

(i) **Meaning:** Currency options give the client the right, but not the obligation, (a) to buy – in case of a put option; (b) sell - in case of a call option, a specific amount of currency at a specific price on a specific date.

(ii) **Risk Hedging Tool:** They act as a useful tool to hedge foreign exchange risk arising out of the Firm's operations. They help remove the downside risk without limiting the upride potential.

4. Derivatives: Meaning of Characteristics.

(i) **Meaning:**

(a) Derivative is a product whose value is derived from the value of one or more basic variables called bases i.e. value of an underlying asset.

(b) Derivative is a forward, future, option or any other hybrid contract of pre-determined fixed duration, linked for the purpose of contract fulfillment to the value of a specified real or financial asset or to an index of securities.

(ii) **Bases/Underlying Asset:** The underlying asset can be Securities, Commodities, Bullion, Currency, Livestock (Index) or anything else.

(iii) **SCRA Definition:** As per Securities Contracts (Regulation) Act, derivative includes -

(a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security; or

(b) a contract which derives its value from the prices, or index of prices, of underlying securities.

(iv) **Features:**

(a) It has one or more underlying asset and one or more notional amounts or payments provisions or both. These terms determine the amount of settlement(s) and in some cases, whether or not settlement is required.

(b) It requires no initial net investment or an initial net investment that is smaller than what is required for similar responses to change in market factors.

(c) Its terms require or permit net settlement; it can be readily settled net by means outside the contract or it provides for delivery of an asset that puts the recipient in a position not substantially different from net settlement.

5. Futures Contract.

(a) Futures Contract means a legally binding agreement to buy or sell the underlying security on a future date.

(b) Futures Contracts are the organized/standardized contracts in terms of quantity, quality (in case of commodities), delivery time and place for settlement on any date in future.

(c) The contract expires on a pre-specified date which is called the expiry date of the contract. On expiry, futures can be settled by delivery of the underlying asset or cash. Cash settlement enables the settlement of obligations arising out of the future/option contract in cash.

6. (i) 'Option' and 'Option Premium'? (ii) "Buyer or Holder" "Seller or Writer" of an Option? (iii) How Option Contract operates.

(a) **Meaning:** Option is a type of derivative instrument whereby a person gets the right to buy or sell at an agreed amount an underlying asset on or before the specified future date.

(b) **Buyer/Holder:** The person who gets such right is called 'Buyer' or 'Holder'.

(c) **Seller/Writer:** The person against whom the buyer/holder can exercise his right is called 'Seller' or 'Writer'.

(d) **Obligation to Buy/Sell:**

- The Buyer/Holder of the Option **has the right but not the obligation to buy or sell.**
- The seller/writer of an option **has no right** but **has an obligation** to sell/buy the underlying asset as and when the buyer/holder exercises his right.

(e) **Option Premium:** Option Premium is the price paid by the buyer/holder to the seller writer of an option for acquiring the right of option.

(f) **Tenor of Options Contract:** Every option contract is for a specific period of time. On the expiry of the specified period, the contract also expires. The period of time is specified in the contract itself.

(g) **Strike Price/Exercise Price:** The price at which the buyer/holder has the right to buy or sell and the seller/writer has an obligation to sell or buy is known as the Strike/Exercise price.

(h) **Minimum/Maximum Gain or Loss:** The extent of loss/gain to parties to the Contract is as under –

Party	Buyer	Seller
Loss	Amount of loss is restricted to the premium paid to the Seller of the Option.	Unlimited Loss
Gain	Unlimited Gain	Maximum Gain is limited to the option premium charged by him from the buyer.

(i) **Assets traded under Options Contract:** There can be options on commodities, currencies, securities, stock index, individual stock, **etc.**

(j) **Futures vs. Options:** In a Futures Contract, both the parties are under obligation to complete the contract on the expiry date. Under Options Contract, the Buyer/Holder has a right, but no obligation to exercise the option, whereas the Seller/Writer has an obligation but no right to complete the contract.

7. Classification of an Options Contract.

Classification of Options Contract

- **Based on time of exercising right**
  - **American Style**
    Buyer / Holder can exercise his right **at any time before the contract** expires or on expiry date
  - **European Style**
    Buyer / Holder can exercise his right **only on the expiry**
- **Based on the nature of right**
  - **Call Option**
    Buyer / Holder gets the right to **purchase** the underlying asset. **date.**
  - **Put Option**
    Buyer / Holder gets the right to **sell** the underlying asset.

8. Rights and obligations of the parties involved in an Options Contract.

Option Type	Buyer / Holder	Seller / Writer
Call	• He has a right but not an obligation to buy the underlying asset. • Person buying a call option is considered to have made a 'long call'	• Obligation but no right to sell the underlying asset. • Person selling a call option is considered to have made a 'short call'.
Put	• Right but not an obligation to sell the underlying asset. • Person buying a put option is considered to have made a 'long put'.	• Obligation but no right to buy the underlying asset. • Person selling a put option is considered to have made a 'short put'.

9. Difference between Equity Index Options and Equity Stock Options.

Particulars	Equity Index Options	Equity Stock Options
Meaning	Derivative instruments whereby a person gets the right to buy/sell an agreed amount of equity index on the specified future date.	Derivative instruments whereby a person gets the right to buy/sell an agreed amount of equity stock on or before the specified future date.
Underlying Asset	Equity Index itself.	Equity Shares of a Company.

Particulars	Equity Index Options	Equity Stock Options
Time of Settlement	European Style, i.e., Buyer/Holder can exercise his option **only on the day on which the option expires.**	American Style, i.e., the Buyer/Holder can exercise his option at any time before the expiry date or on the date of expiry itself.
Mode of Settlement	Since delivery cannot be made, the difference between the strike/ exercise price and the value of the index on the maturity date, is paid or received in cash.	Settlement either through delivery of shares or by payment of the difference between strike/exercise price and the value of the share in cash

10. The concept of 'at the money', 'in the money' and 'out of the money'.

Concept	Call Option	Put Option
At the Money	CMV = Exercise Price of the Option.	CMV = Exercise Price of the Option.
In the Money	CMV > Exercise Price of the Option.	CMV < Exercise Price of the Option.
Out of Money	CMV < Exercise Price of the Option.	CMV > Exercise Price of the Option.

CMV = Current Market Value

11. Key terms in connection with Options Contracts.

Term	Definition
Clearing Corpn. / House	Clearing Corporation/ House approved by SEBI for clearing and settlement of trades on the Derivatives Exchange/ Segment.
Clearing Member	Member of the Clearing Corporation and includes all categories of Clearing Members as may be admitted as such by Clearing Corporation to the Derivatives Segment.
Client	Person, on whose instructions and, on whose account, the Trading Member enters into any contract for the purchase/sale of any contract or does any act in relation thereto.
Contract Month	Month in which the Expiry Date falls.
Derivatives Exchange	Exchange approved by SEBI as a Derivative Exchange.
Derivatives Segment	Segment of an existing Exchange approved by SEBI as Derivatives Segment.
Derivatives	Derivatives includes – (a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security; (b) a contract which derives its value from the prices, or index of prices, of underlying securities.
Exercise Date	Exercise Date is the date on which the buying/selling right in the option is actually exercised by the buyer/holder.
Exercise of an option	Exercise of an option means **enforcing the right** by the buyer/holder under the options contract of buying or selling the underlying asset at the Strike Price.
Expiry Date	Expiry Date is the **last date** on or up to which the option can be exercised.

Final Settlement Price	Final Settlement Price is the closing price of the Equity Index/Stock Option Contract on the last trading day of the contract or such other price as may be specified by the Clearing Corporation/House, from time to time.
Open Options	Total number of Equity Stock/Index Options which have not yet been offset and closed by an Opposite Equity Stock/Index Options nor fulfilled either by delivery of cash or by actual delivery of equity stock.
Trading Member	Member of the Derivatives Exchange/Segment and registered with SEBI.

12. Membership categories in the derivatives market.

The various types of membership in the derivatives market are as follows -

(i) **Trading Member (TM) –** Member of the Derivatives Exchange and can trade on his own behalf and on behalf of his clients.

(ii) **Clearing Member (CM) –** Members permitted to settle their own trades as well as the trades of the other non-clearing members known as Trading Members who have agreed to settle the trades through them.

(iii) **Self-clearing Member (SCM) –** Clearing Members who can clear and settle their own trades only.

13. Trading mechanism in Equity Index Options and Equity Stock Options.

(i) **Trading:** In India, trading in Options is done in a separate segment of existing Stock Exchanges known as 'Derivatives Segment'. A Client can trade in Options only through a Trading Member of the Exchange. A Clearing Member can also act as Trading Member.

(ii) **Guarantee:** The Clearing Corporation/House of the Exchange may act as legal counter-party to all deals or may provide an unconditional guarantee for all the deals in Options on the Exchange. So, both the parties (buyer & seller) in an Options Contract would be assured that the obligations of the other party would be met, either by the other party or by the Clearing House by virtue of its guarantee.

(iv) **Time Period:** Each Exchange introducing trading in Options specifies the period for which such a contract can be entered into.

Example: "Near Three Months" Contract means that, in January, one would be able to enter into contracts for January, February and March.

(v) **Expiry Day:** The contracts will expire on a specified date of every month and the new contracts will be introduced on the next trading day. Example: In National Stock Exchange, the last Thursday of the Contract Month is the expiry date for contract.

(v) **Multiplier:** Each exchange permitting trading in Equity Index Options and Equity Stock Options would provide the contract specifications. Such specifications would include size of a market lot for each individual stock.

14. Margin Requirements in respect of Option Contracts.

(i) **Margins:** To minimise the risk of failure of parties to a contract in fulfilling their respective obligations under the contract, the Clearing Corporation prescribes margin requirements, including initial margin on Open Interests, and collects them from its Clearing/Trading Members. Clearing/Trading Members would collect margins from their respective clients.

(ii) **Mode of Payment:** Margins can be paid in any of the following forms - (a) Cash; (b) Provided by way of a Bank Guarantee; (c) Deposit Receipts; (d) Securities; or (e) such other prescribed mode.

(iii) **Members' Obligation:** The margins paid would be subject to such terms and conditions as the Clearing Corporation may specify from time to time. There is a continuing obligation on the members to maintain margins at the levels during the contract period. The levels are specified by the Clearing Corporation from time to time.

(iv) **Time of Payment:** Margins are required to be paid at the inception of the option contract (initial margin) as well as on daily basis (daily margin).

(v) **Liability to Pay:** It is the Option Seller/Writer who is required to meet the margin requirements as he carries the obligation to perform the contract. The Option Buyer/Holder is not required to meet any margin requirements of the Clearing Corporation, as he possesses a right but no obligation to exercise call or put.

(vi) **Release of Margin:** If any margin charged by the Clearing Corporation is released, the Clearing Member will credit the account of the respective client.

15. Standard Portfolio Analysis of Risk (SPAN): How to compute-Margin Requirements?

(i) **Software:** Standard Portfolio Analysis of Risk (SPAN) is a software used to calculate the margin requirements.

(ii) **Process:** SPAN calculates risk arrays for all products specified and gives the output in the form of a risk parameters file.

(iii) **Distribution:** The risk parameters file from SPAN is distributed to all the participants of Derivatives Segment.

(iv) **Calculation of Margin Requirement** Members, firms, customers, etc., use the data from SPAN risk file, together with their position data, to calculate SPAN margin requirements on their respective positions.

(v) **Risk Scenarios:** SPAN calculates margin by determining the worst possible loss using 16 risk scenarios.

16. Premium.

(i) **Meaning:** Option Premium is the price paid by the buyer / holder to the seller writer of an option for acquiring the right of option.

(ii) **Separate Bank Account:** When a person buys or sells options, the premium amount will be debited or credited to the separate bank account of the Clearing Member with the Clearing Corporation.

(iii) **Day of Credit/Debit:** The day on which the premium is normally debited or credited varies from Stock Exchange to Stock Exchange. Example: At the BSE and the NSE, this premium is normally debited or credited on the next trading day (T + 1 Basis).

17. "Squaring off of the position"?

(i) **Meaning:** "Squaring Off of the position" refers to the process of entering a reverse contract, after entering into an option contract, in the same series with the same strike price

(ii) **Gain / Loss:** The gain or loss of the client will be the difference between the Option Premium Received and Paid after reducing / adding the brokerage charged by the Clearing Member.

(iii) **Objective:** It is a tool to mitigate the loss to the difference in the premium amounts by squaring off the position before the Expiry Date.

(iv) **Example:** A buyer/holder having bought S&P CNX NIFTY **call option** of January 2005 series with strike price of ₹ 1,120 can square off his position by **selling/writing** S&P CNX NIFTY call option of January 2005 series with ₹1,120 as strike price.

18. How the option will be exercised on expiry of Call option/ Put Option?

(i) **Call Option:** On the expiry of a call option, if the market price of the underlying asset is lower than the strike price, the call would expire unexercised.

(ii) **Put Option:** If on the expiry of a put option, the market price of the underlying asset is higher than the strike price, the put option would expire unexercised.

(iii) **Notice:** When an option Buyer/Holder decides to exercise his option, he gives the exercise notice through the Trading Network during the time specified by the Clearing Corporation.

(iv) **Assigning Notice:** The Clearing Corporation assigns the exercise notice to the option Seller/ Writer through the trading member.

(v) **Deemed to be Exercised:** Generally, options which are favourable to the Buyer/Holder on Expiry Date are deemed to be exercised and no special notice is required to be sent by the Buyer/Holder.

(vi) **Letting go a favourable option:** The Buyer/Holder can let a favourable option expire unexercised upon intimation to the Stock Exchange.

19. The Accounting treatment for payment of margin on Equity Index/Stock Options.

(i) **Accounting Entry:** The following Journal Entry should be passed in the books of the Seller/Writer:

	Transaction	Accounting Entry
(a)	**Payment** of Margin	Equity Index Option/Stock Option Margin A/c Dr. To Bank Account
(b)	**Receipt** of Margin	Bank Account Dr. To Equity Index Option/Stock Option Margin A/c
(c)	**Lumpsum Deposit** of Margin Money (instead of paying/receiving on a daily basis)	Deposit for Margin A/c Dr. To Bank Account
(d)	**Payment** of Margin **adjusted** against Deposit	Equity Index Option/Stock Option Margin A/c Dr. To Deposit for Margin A/c
(e)	**Receipt** of Margin **adjusted** against Deposit	Deposit for Margin A/c Dr. To Equity Index Option/Stock Option Margin A/c

(ii) **Disclosure in the Balance Sheet:**

(a) **Equity Index/Stock Option Margin Account:** In the Balance Sheet, the balance in Equity Index/ Stock Option Margin Account should be shown separately under "Current Assets".

(b) **Deposit for Margin Account:** At the year-end, any balance in the "Deposit for Margin Account" should be shown as a deposit under the head "Current Assets".

20. Entries for payment/receipt of Equity Index or Equity Stock Option Premium.

(i) **Liability to Pay Premium:** The Buyer/Holder of the option is required to pay the premium.

(ii) **Accounting Treatment:** The accounting treatment in the books of the Buyer and Seller are as under –

Party	Buyer / Holder	Seller / Writer
Journal Entry for Premium	Equity Index/Stock Option Premium A/c Dr. To Bank A/c	Bank Account Dr. To Equity Index/Stock Option Premium A/c
Provision for Loss at year-end	**Amount of Provision =** Premium Paid Less Premium prevailing on the B/S date.	**Amount of Provision =** Premium prevailing on B/S date **Less** Premium received.
Journal Entry for Provision	Profit and Loss A/c Dr. To Provn for Loss on EIO/ESO A/c	Profit and Loss A/c Dr. To Provn for Loss on EIO/ESO A/c
Disclosure of unexpired options (Open Contracts)	**Assets Side: <u>Current Assets:</u>** Balance in "EIO/ESO Premium A/c" **Less:** Provn for Loss on EIO/ESO A/c	**Liabilities Side: <u>Current Liabilities</u>** Balance in "EIO/ESO Premium A/c" **Plus:** Provision for Loss on EIO/ESO

(iii) **Multiple Options:** In case of multiple options, entries recommended above at the inception of the contract may be made in one "Equity Index/Stock Options Premium Account" in respect of options of all scrips. The amount of provision required in respect of each scrip or index should be aggregated and a composite "Provision for Loss on Equity Index/Stock Options Account" should be created by debiting the P&L A/c.

(iv) **Adjustment of Opening Balance:** Opening balances, if any, in the "Provision for Loss on Equity Index/Stock Options Account" should be adjusted against the current year provision.

Illustration 22.

Arunavo furnishes the following information about all options at the Balance Sheet Date. Determine the amount of provision to be made in his books of account.

Securities	L	K	J
<u>Details of Options Bought</u>			
Premium Paid	20,000	10,000	10,000
Premium prevailing on Balance Sheet date	30,000	5,000	8,000
<u>Details of Options Sold:</u>			
Premium Received	10,000	30,000	10,000
Premium prevailing on Balance Sheet date	25,000	20,000	15,000

Solution:

Determination of Provision Required in the Books of Ajay (₹)

Particulars	L	K	J
For Options Bought:			
Premium Paid on all Open Options Bought	20,000	10,000	10,000
Less: Total premium prevailing on Balance Sheet Date	(30,000)	(5,000)	(8,000)
Total (A)	**(10,000)**	**5,000**	**2,000**
For Options Sold:			
Total premium prevailing on the Balance Sheet Date	25,000	20,000	15,000
Less: Total premium received on all Open Options sold	10,000	30,000	10,000
Total (B)	**15,000**	**(10,000)**	**5,000**
Provision required = A + B	**5,000**	**NIL (Note)**	**7,000**
Aggregate Provision to be made (₹5,000 + ₹7,000)		**12,000**	

Note:

1. **Multiple Option:** At the year-end, a **Stockwise provision** should be made **considering all open options** of any strike price and any expiry date under that stock/index taken together.
2. **Stock Q:** The aggregate amount for Stock Q constitutes an unrealized gain and therefore no provision should be made under consideration of prudence.

21. Accounting entries to be passed when the Multiple Open Options are settled.

Party	Buyer / Holder	Seller / Writer
Effect of Settlement	Buyer exercises his option only if it is favourable. Hence, the settlement results only in **profit.** Consequently, the difference amount is **received** by the Buyer.	Buyer exercises his option only if it is favourable to him. Hence, the settlement results only in a loss to the Seller. So, the difference amount is paid by the Seller.
Recognition of Premium	Profit and Loss A/c Dr. To Equity Index/Stock Option Premium A/c	Equity Index/Stock Option Premium A/c Dr. To Profit and Loss A/c
Settlement of Difference	Bank A/c Dr. To Gain on EIO/ESO A/c	Loss on EIO/ESO A/c Dr. To Bank
Margin released by Clg Corpn	*Buyer would not have paid any margin to Clearing Corporation. Hence no entry.*	Bank A/c Dr. To EIO/ESO Margin A/c

Note:

- **Squaring off of Transactions:** For calculating Profit or Loss in case of outstanding multiple options of the same scrip/index with the same **Strike Price** and the **same Expiry Date**, Weighted Average Method should be followed on squaring off of transactions.
- **Exercise of Options before Expiry Date:** For determining the Profit or Loss in case of outstanding multiple Equity Stock Options of the same **scrip, strike price** and **expiry date,** Weighted Average Method should be followed, if such options are exercised before the expiry date.

22. In respect of Equity Stock Options, what is the accounting treatment for options which are settled by actual delivery?

If the option is exercised, shares will be **transferred in consideration for cash at the strike price.** Theaccounting treatment in this case will be as under –

Party	Buyer / Holder	Seller / Writer
Call Option	Equity Shares of... Ltd A/c Dr. To Bank A/c (Being **receipt** of Equity Shares and **payment** of amounts due to Seller)	Bank A/c Dr. To Equity Shares of Ltd A/c (Being **delivery** of Equity Shares and receipt of amount due from the Buyer)
Put Option	Bank A/c Dr. To Equity Shares of Ltd A/c (Being **delivery** of Equity Shares and **receipt** of amount due from the Seller)	Equity Shares of... Ltd A/c Dr. To Bank A/c (Being **receipt** of Equity Shares and **payment** of amounts due to Buyer)

Note: Apart from the above, entries for transfer of balance in Option Premium Account to the Profit and Loss Account, Receipt of Margin etc. should also be passed.

23. Disclosure requirements applicable to Equity Index and Equity Stock Options.

(i) **Accounting Policies and Method:**

(a) Accounting Policies and the methods adopted for Equity Index Options and Equity Stock Options.

(b) Criteria for recognition and the basis of measurement applied for Equity Index Options and Equity Stock Options.

(ii) **Margin Money Paid by Bank Guarantee/Lodging of Securities:** The following should be disclosed in respect all outstanding contracts at the year end:

(a) Amount of Bank Guarantee.

(b) Book Value and Market Value of Securities Lodged.

(iii) **Details of Outstanding Option Contracts:**

(a) Name of the Equity Option Index

(b) Total Premium carried forward as at the year end after adjustment of Provision for Losses.

Settlement of Call Option

Illustration 23.

Mr. Investor buys a stock option of Z Ltd. in July 2011 with a Strike Price on 30th July, 2015 ₹250 to be expired on 30th August, 2015. The premium is ₹20 per unit and the market lot is 100. The margin to be paid is ₹120 per unit. Show the accounting treatment in the books of Buyer when:

(a) the option is settled by delivery of the asset, and

(b) the option is settled in cash and the Index price is ₹260 per unit.

Solution:

Journal Entries in the Books of Investor/Buyer

1. When the option is settled by delivery of the asset

S. No.	Particulars	Debit ₹	Credit ₹
1 30.7.15	Equity Stock Option Premium (Z Ltd.) A/c Dr. To Bank Account (Being Premium Paid on Stock Option of Z Ltd. purchased at ₹20 per unit for 100 units constituting one lot)	2,000	 2,000
2 30.8.15	Equity Shares of Z Ltd. A/c Dr. To Bank A/c (Being Call Option exercised and the shares acquired)	25,000	 25,000
3 30.8.15	Profit & Loss A/c Dr. To Equity Stock Option Premium A/c (Being Premium on option written off on exercise of option)	2,000	 2,000

Note: No entries have passed in respect of Margin Payments. This is because, the buyer of the option contract is not required to pay any margins.

2. When the option is settled in cash and the Index Price is ₹ 260 per unit

S.No.	Particulars	Debit ₹	Credit ₹
1 30.7.15	Equity Stock Option Premium (Z Ltd.) A/c Dr. To Bank Account (Being Premium Paid on Stock Option of Z Ltd. purchased at ₹20 per unit for 100 units constituting one lot)	2,000	 2,000
2 30.8.15	Bank A/c Dr. To Profit & Loss A/c (Being the profit on exercise of option received. Profit = Market Lot of 100 x (Index Price of ₹260 Less Strike Price of ₹250)	1,000	 1,000
3 30.8.15	Profit & Loss A/c Dr. To Equity Stock Option Premium (Being Premium on option written off on exercise of option)	2,000	 2,000

Open Contracts - Disclosure in Balance Sheet

Illustration 24.

Devdas buys the following Equity Index Option and the seller/writer of this Option is Nitin.

Date of Purchase	28.03.2015
Type of Options	S&P CNX NIFTY - Call
Expiry date	31.05.2015
Premium per unit (₹)	15
Contract Multiplier (No. of units)	2,000
Margin per unit (₹)	150
Strike price (₹)	880

Margin calculated by SPAN is as follows:

On 29.03.2015 is ₹3,50,000; On 30.03.2015 is ₹2,50,000; On 31.03.2015 is ₹2,70,000;

On 31.3.2015, the prevailing Premium Rate for the above option is ₹12.50 Per Unit.

Give the accounting treatment in the books of both the parties. Also, show the B/Sheet (as at 31.3.2015) extract containing the appropriate disclosure of balance in Margin A/c.

Solution:

1. Books of Devdas (Buyer / Holder)

(a) Journal Entries

S.No.	Particulars	Debit ₹	Credit ₹
1 28.3.15	Equity Stock Option Premium A/c Dr. To Bank Account (Being Premium Paid on Stock Option purchased at ₹15 per unit for 2,000 units constituting one lot)	30,000	 30,000
2 31.3.15	Profit and Loss A/c Dr. To Provision for Loss on Equity Stock Option A/c [Being amount provided for loss on Equity Stock Option A/c to the extent of ₹2.50 per unit (Premium Paid ₹15.00 Less Premium Prevailing ₹ 12.50) for 2,000 Units]	5,000	 5,000

Note: No entries have passed in respect of Margin Payments. This is because the buyer of the option contract is not required to pay any margins.

(b) Extract of Balance Sheet of Puru as at 31st March, 2015

Liabilities	₹	Assets	₹	₹
		Current Assets, Loans and Advances		
		(A) Current Assets	30,000	
		Equity Index Option Premium		
		Less: Provision for Loss	(5,000)	25,000

2. Books of Nitin (Seller / Writer)

(a) Journal Entries

S.No.	Particulars	Debit ₹	Credit ₹
1	Bank A/c Dr.	30,000	
28.3.15	To Equity Stock Option Premium A/c		30,000
	(Being premium received on Stock Option sold at ₹15 per unit for 2,000 units constituting one lot)		
2	Equity Index Option Margin A/c Dr.	3,00,000	
28.3.15	To Bank A/c		3,00,000
	(Being Initial margin paid on option contract at ₹150 per unit for 2,000 units)		
3	Equity Index Option Margin A/c Dr.	50,000	
29.3.15	To Bank A/c		50,000
	(Being further margin collected by the Stock Exchange as per SPAN i.e. ₹3,50,000 - ₹3,00,000)		
4	Bank A/c Dr.	1,00,000	
30.3.15	To Equity Index Option Margin A/c		1,00,000
	(Being refund of extra margin received from the Stock Exchange as per SPAN i.e. ₹2,50,000 - ₹3,50,000)		
5	Equity Index Option Margin A/c Dr.	20,000	
31.3.15	To Bank A/c		20,000
	(Being further margin collected by the Stock Exchange as per SPAN i.e. ₹2,70,000 - ₹2,50,000)		

(b) Extract of Balance Sheet of Krish as at 31st March, 2015

Liabilities	₹	Assets	₹
Current Liabilities and Provisions:	30,000	**Current Assets, Loans and Advances**	2,70,000
Equity Stock Option Premium A/c		(A) Current Assets	
		Equity Index Option Margin	

Options Trading

Illustration 25.

On the basis of the following information related to trading in Options, you are required to pass relevant Journal Entries (at the time of inception and at the time of final settlement) in the books of Aman (Buyer) and Suman (Seller). Assume that the price on expiry is ₹950 and both Aman and Suman follow the calendar year as an accounting year.

Date of Purchase	Option Type	Expiry Date	Premium per unit	Contract Lot	Multiplier
29.03.2015	Equity Index, Call	31.05.2015	₹10	2000 units	₹850 p.u

Solution:

1. In the books of Aman (Buyer)

S. No.	Particulars		Debit ₹	Credit ₹
29.03.15	Equity Index Option Premium A/c	Dr.	20,000	
	To Bank A/c			20,000
	(Being premium paid on Equity Stock Options)			
31.05.15	Profit and Loss A/c	Dr.	20,000	
	To Equity Index Stock Option A/c			20,000
	(Being premium on option written off on expiry)			
31.05.15	Bank A/c	Dr.	2,00,000	
	To Profit and Loss A/c			2,00,000
	(Being profit on exercise of option received = 2,000 units * (₹950 - ₹850)) (Exercise Price - Spot Price)			

2. In the books of Suman (Seller)

S. No.	Particulars		Debit ₹	Credit ₹
29.03.15	Bank A/c	Dr.	20,000	
	To Equity Index Option Premium A/c			20,000
	(Being premium on Option collected)			
31.05.15	Profit and Loss A/c	Dr.	2,00,000	
	To Bank A/c			2,00,000
	(Being loss on Option paid)			
31.05.15	Equity Index Option Premium A/c	Dr.	20,000	
	To Profit and Loss A/c			20,000
	(Being premium on option recognized as income)			

24. Accounting for Equity Index Futures

(i) Equity Index Futures (EIF).

(a) **Derivatives** are a kind of financial instruments whose values change in response to the change in specified variable e.g. interest rates, security prices, commodity prices, index of prices or rates, or similar variables.

(b) Equity Index Futures are a type of financial instruments/**derivatives**, which are bought or sold with specific motives like speculation, hedging and arbitrage.

(c) EIF Contract represents a Futures Contract, where the underlying asset is **an Equity Index Future**, e.g. S&P CNX NIFTY Index, BSE 30 SENSEX etc.

(d) Trading in the index reflects the views of the parties to the contract about the movement in the index. For example, if two persons enter into an EIF contract of one month's maturity at a price of ₹ 1,000 per unit, it means that the Buyer expects that the price of equity index at the time of maturity of the contract would be higher than ₹ 1,000 while the Seller expects it to be less than ₹ 1,000.

25. Forward Contract and Futures Contract.

Point	Forward Contract	Futures Contract
Meaning	Agreement between two parties to buy or sell an asset at a certain time in future for an agreed price (called Delivery Price).	Agreement between two parties to buy or sell an underlying asset (generally Equity Index) at a certain time in future for an agreed price.
Trading Place	There is no specific place for trading. It can be traded like any other commodity.	Normally traded on an Exchange.
Settlement	At maturity, the contract is settled by delivery of the asset by the seller to the buyer in return for payment of the Delivery Price.	EIF contract is settled by payment of difference between the price per unit as agreed in the contract and the value of the index on the maturity date. There is **no "delivery"** as such.
Exchange Regulations	Stock Exchange may not prescribe detailed regulations/features for Forward Contracts.	Stock Exchange may prescribe certain standardized features for a Futures Contract, including guarantee mechanism in order to minimize the risk of default by parties.

Key terms used in relation to EIF Contracts.

Term	Definition
Clearing Corporation/House	Clearing Corporation/House approved by SEBI for clearing and settlement of trades on the Derivatives Exchange/Segment.
Clearing Member	Member of the Clearing Corporation and includes all categories of Clearing Members as may be admitted as such by the Clearing Corporation to the Derivatives Segment.
Client	Person, on whose instructions and, on whose account, the Trading Member enters into any contract for the purchase or sale of any contract or does any act in relation thereto.
Contract Month	Month in which the Exchange/Clearing Corporation Rules require a contract to be **finally settled.**
Daily Settlement Price	Closing Price of the EIF Contract **for the day** or such other price as may be decided by the Clearing House from time to time.
Derivative Exchange/Segment	Exchange/Segment approved by SEBI as a Derivative Exchange / Segment.
Final Settlement Price	**Closing Price** of the EIF Contract **on the last trading day** of the contract or such other price as may be specified by the Clearing Corporation, from time to time.
Long Position (in a EIF Contract)	**Outstanding Purchase Obligations** in respect of the EIF contract at any point of time.

Open Interest	It refers to the total number of EIF Contracts that have - 1. Not yet been offset and closed by an opposite EIF Contract; or 2. Not yet been fulfilled by delivery of cash.
Settlement Date	Date on which the **outstanding obligations** in an EIF contract are **required to be settled** as provided in the byelaws of the Derivatives Exchange / Segment.
Short Position (in a EIF Contract)	**Outstanding Sale Obligations** in respect of an EIF Contract at any point of time.
Trading Member	Member of the Derivatives Exchange/Segment and registered with SEBI.

26. Trading Mechanism in Equity Index Futures.

(i) **Trading:** In India, trading in EIF is done in a separate segment of existing Stock Exchanges known as 'Derivatives Segment'. A Client can trade in EIF only through a Trading Member of the Exchange. A Clearing Member can also act as Trading Member.

(ii) **Guarantee:** The Clearing Corporation/House of the Exchange may act as legal counter-party to all deals or may provide an unconditional guarantee for all the deals in EIF on the Exchange. So, both the parties (buyer & seller) in an EIF contract would be assured that the obligations of the other party would be met, either by the other party or by the Clearing House by virtue of its guarantee.

(iii) **Time Period:** Each Exchange introducing EIF trading specifies the period for which such a contract can be entered into. Example: "Near Three Months" Contract means that, in January, one would be able to enter into contracts for January, February and March.

(iv) **Expiry Day:** The contracts will expire on a specified date of every month and the new contracts will be introduced on the next trading day.

Example: In National Stock Exchange, the last Thursday of the Contract Month is the expiry date for contract.

(v) **Multiplier:** Each Exchange permitting EIF trading would provide the contract specifications, e.g. National Stock Exchange permits a contract multiplier of 200 for the S&P CNX NIFTY Futures Contracts.

27. Margin Requirements in Equity Index Futures.

(i) **Margins:** To minimise the risk of failure of parties to a contract in fulfilling their respective obligations under the contract, the Clearing Corporation prescribes margin requirements, including initial margin on Open Interests, and collects them from its Clearing/Trading Members. Clearing/Trading Members would collect margins from their respective clients.

(ii) **Mode of Payment:** Margins can be paid in any of the following forms - (a) Cash; (b) Provided by way of a Bank Guarantee; (c) Deposit Receipts; (d) Securities; or (e) such other prescribed mode.

(iii) **Members' Obligation:** The margins paid would be subject to such terms and conditions as the Clearing Corporation may specify from time to time. There is a continuing obligation on the members to maintain margins at the levels during the contract period. The levels are specified by the Clearing Corporation from time to time.

28. Daily Settlement Price and Daily Settlement Mechanism.

(i) **Meaning:** Daily Settlement Price is the **Closing Price** of the EIF Contract **for the day** or such other price as may be decided by the Clearing House from time to time.

(ii) **Settlement Price:** All outstanding contracts (both Long and Short) of a Clearing Member in an EIF Contract would be deemed to have been settled at the Daily Settlement Price.

(iii) **Settlement of Dues:**

(a) **Amount of Settlement:** The Trading Member would be liable to pay to/entitled to collect from, the Clearing House the difference between the -

- Purchase/Sale Price of the contract and the Daily Settlement Price of that day; or
- Previous Day's Settlement price and Trading Day's Settlement Price.

(b) **Payment Mode:** The daily settlement obligation would be paid only in Cash.

(c) **Long or Short:** After settlement with the Clearing House, the Member would be deemed to be long or short, as the case may be, in contracts at the Daily Settlement Price.

Example: A Member buys one unit of an Equity Index Future of April Series (one-month) on 29th March for ₹ 1,420. The daily differences will be settled between the Member and the Clearing House as under-

Closing Price of Date	Assumed Price of EIF	Effect (called as Mark-to-Market Margin)
29th March	₹ 1,400	Dealer should pay ₹20 to the Clearing House.
30th March	₹ 1,435	Dealer should receive ₹35 from the Clearing House.
31th March	₹ 1,430	Dealer should pay ₹5 to the Clearing House.

The differences would be debited/credited to the separate Bank Account maintained by the Clearing Member with the Clearing Corporation. The Clearing Member would in turn, debit/credit the Bank Account of the Trading Member, who in turn would debit/credit the Bank Account of the Client.

Clearing Corporation ⟶ Clearing Member ⟶ Trading Member ⟶ Client

(iv) **Reverse Contracts:** At any time during the currency of the contract, either party to an EIF can square up its future obligations under the contract, by entering into a reverse contract, e.g. a buyer of 300 units of EIF under (say) August series can enter into a contract for sale of 300 units of EIF of the same series. On entering into reverse contracts, the loss/gain of purchase and sales contracts, offset each other automatically.

(v) **Non-Payment of Dues by Clients:** In case of non-payment of daily settlement dues by clients, before the next trading day, the Clearing Member would be at liberty to close out the transactions by selling or buying the index futures contracts, as the case may be. Loss incurred in this regard would be borne by Client and met out of the margin moneys given by the Client, while gains if any, would accrue to the Client.

29. Accounting treatment at the inception of EIF Contract in the books of the Client.

(i) **Accounting Entries:** No entry is made for recording the contract of Purchase/Sale of EIF, at its inception, except for payment of Margin Moneys. The following entry should be passed for payment of - (a) Initial Margin determined by the Clearing Corporation House for entering into EIF Contracts; and (b) Additional Margins paid, if any.

Initial Margin - Equity Index Futures A/c	Dr.	XXX	
To Bank Account			XXX

Note: No entry is passed when the amount due under the margin is furnished in the form of a Bank Guarantee or when it is furnished by lodging Securities.

(ii) **Disclosure Requirements:**

(a) Initial Margin/Additional Margin: The balance in the "Initial Margin - EIF A/c" should be shown separately under **"Current Assets"** in the Balance Sheet.

(b) Amount paid in excess of Initial/Additional Margin: Where any amount has been paid in excess of the initial/additional margin, the excess should be disclosed separately as a **"Deposit"** under the head **"Current Assets".**

(c) Bank Guarantee/Lodging of Securities: Where the Client provides bank guarantees or lodges securities with the member, a disclosure should be made in the "Notes" to the Financial Statements of the Client.

30. Accounting treatment in case of payment/receipt of Mark-to-Market Margin at the time of daily settlement.

(i) **Objective:** Mark-to-Market Margin is collected to cover the notional loss, which a member or his client would incur if the net cumulative outstanding transactions in all securities are closed out at the Closing Price of the relevant trading date, which is different from the Transaction Price.

(ii) **Computation of Margin Amount:**

(a) **For Buy Position:** (Actual Trade Price Less Closing Price) x Cumulative Buy Position.

(b) **For Sell Position:** (Closing Price Less Actual Trade Price) x Cumulative Sell Position.

(iii) **Accounting Entries:**

	Transaction	Accounting Entry	
(a)	**Payments made** on account of Daily Settlement by the Client	Mark-to-Market Margin - EIF A/c To Bank Account	Dr.
(b)	**Payments received** on account of Daily Settlement by the Client	Bank Account To Mark-to-Market Margin - EIF	Dr.
(c)	**Depositing a lumpsum amount** with the Broker/Trading Member for Mark-to-Market Margin Money	Deposit for Mark-to-Market Margin - EIF A/c To Bank Account	Dr.
(d)	**Transfer** from Deposit A/c to Margin A/c for **payment of Margins**	Mark-to-Market Margin - EIF A/c To Deposit for Mark-to-Market Margin - EIF A/c	Dr.
(e)	**Transfer** from Deposit A/c to Margin A/c **for receipt of Margins**	Deposit for Mark-to-Market Margin - EIF A/c To Mark-to-Market Margin - EIF A/c	Dr.

(iv) **Disclosure:** At the year-end, balance in the "Deposit for Mark-to-Market Margin Account" should be shown as a "Deposit" under "Current Assets" in the Balance Sheet.

31. Open Interests accounted for as on the Balance Sheet date Accounting treatment for balances in "Mark-to-Market - EIF A/c".

Mark-to-Market Margin - EIF A/c	Debit balance	Credit balance
1. Meaning of Dr. / Cr. Balance	**Net Amount paid** on the basis of movement in the prices of index futures till the B/Sheet date.	**Net Amount received** on the basis of movement in prices of index futures till the B/Sheet date.

2. Accounting Treatment	**Provision** should be created by debiting the P&L A/c, for anticipated loss equivalent to the net payment made to the Broker.	Net amount received being anticipated profit should be **ignored.**
3. Disclosure in Balance Sheet	Disclosed as **"Current Assets,** Loans and Advances'' **Less** Provision thereon.	Disclosed as Current Liability under **"Current Liabilities and Provisions''.**

32. Accounting treatment at the time of final settlement or at the time of squaring-up of the contract.

(i) **Profit or Loss:** Profit/Loss on Final Settlement is determined at the expiry of a series of EIF Contracts as -**Profit/(Loss)** = Final Settlement Price **Less** Contract Prices of all the contracts in the series.

(ii) **Weighted Average:** If more than one contract in respect of the relevant series of EIF Contract is outstanding at the time of the squaring up of the contract, the contract price of the contract so squared-up, should be determined using Weighted Average Method for calculating Profit / Loss on squaring-up.

(iii) **Accounting Entries:**

	Transaction	**Accounting Entry**	
(a)	**Recognizing Profit** on Final Settlement in the P&L Account	Mark-to-Market Margin - EIF A/c To P&L A/c (Profit on Final Settlement A/c)	Dr.
(b)	**Recognizing Loss** on final settlement in the Profit and Loss Account **(provision for loss not created)**	P & L A/c (Loss on Final Settlement A/c) To Mark-to-Market Margin - EIF A/c	Dr.
(c)	**Recognizing Loss** on final settlement in the Profit and Loss Account **(provision for loss created)**	Provision for Loss on Final Settlement (upto avlble amt) P & L A/c (Loss on Final Settlement A/c) (bal. figure) To Mark-to—Market Margin - EIF A/c	Dr. Dr.
(d)	**Release of Initial Margin** paid on Equity Index Futures Account on Final Settlement, **if received**	Bank A/c To Initial Margin - Equity Index Futures A/c	Dr.
(e)	**Release of Initial Margin** paid on EIF Account on Final Settlement, **if adjusted through Deposit Account**	Deposit for Mark-to-Market Margin - EIF A/c To Initial Margin - Equity Index Futures A/c	Dr.

33. Accounting Treatment in case Client defaults in making payment in respect of Daily Settlement

When a Client defaults in making payment in respect of a Daily Settlement, the contract is closed out. The accounting entries are given below –

	Transaction	**Accounting Entry**	
(a)	Adjustment of amount not paid, against the initial margin	Mark-to-Market Margin - Equity Index Futures A/c To Initial Margin - Equity Index Futures A/c	Dr.
(b)	**Release of initial margin** in excess of amount adjusted against Mark-to-Market Margin not paid, if received	Bank Account To Initial Margin - Equity Index Futures A/c	Dr.

(c)	**Release of initial margin** in excess of amount adjusted against Mark-to-Market Margin not paid, **if adjusted through Deposit Account**	Deposit for Mark-to-Market Margin - EIF A/c Dr. To Initial Margin - Equity Index Futures A/c

Note:

- **Excess Liability:** Where the amount to be paid on daily settlement exceeds the initial margin, the excess is a liability and is shown under "Current Liabilities and Provisions", if it continues to exist on the B/Sheet date.
- **Profit/Loss on Contract:** The Profit/Loss on the contract so closed out should be calculated and recognised in the Profit and Loss Account in the same manner as in the case of squaring up of a contract.

34. Disclosure requirements for Equity Index Future Contracts.

(i) **Margin Money Paid by Bank Guarantee/Lodging of Securities:** The following should be disclosed in respect all outstanding contracts at the year end –

(a) Amount of Bank Guarantee.

(b) Book Value and Market Value of Securities Lodged.

(ii) **Details of Contracts:**

(a) Total number of contracts entered during the year.

(b) Gross number of units of Equity Index Futures bought in respect of each series.

(c) Gross number of units of Equity Index Futures Sold in respect of each series.

(iii) **Details of Outstanding Contracts:**

(a) Number of Equity Index Futures contracts not settled (Open Interests).

(b) Number of units of Equity Index Futures pertaining to outstanding contracts.

(c) Daily Settlement Price as at the Balance Sheet date separately for Long and Short Positions, in respect of each series of Equity Index Futures.

Arpita furnishes the following details about purchase of Equity Index Futures (EIF)

Illustration 26.

Date of Purchase	Name of Future	Expiry Date/ Series	Contract Price per unit (₹)	Contract Multiplier (No. of Units)
28.3.2015	ABC	May 2015	1,420	200
29.3.2015	CKD	June 2015	4,280	50
29.3.2015	ABC	May 2015	1,416	200

Daily Settlement Prices of the above units of Equity Index Futures were as follows:

Date	ABC May Series	CKD May Series
28.3.2015	1410	-
29.3.2015	1428	4300
30.3.2015	1435	4270
31.3.2015	1407	4290
01.4.2015	1415	4250
02.4.2015	1430	-
03.4.2015	1442	-

The contracts were settled as under:

(a) CKD June Series were settled on 1.4.2015.

(b) A contract of 200 units of ABC May Series were settled on 2.4.2015.

(c) The other contract of ABC May Series was settled on 3.4.2015.

Arpita had to pay a Initial Margin of ₹5,000 by Cash on the inception of contract for ABC May 2015 Series Equity Index Futures.

Required:

1. Journal Entries in the books of Arpita.
2. Mark-to-Margin Account.
3. Balance Sheet extract showing treatment of Mark-to-Margin Account.

Solution:

1. Computation of Mark-to-Market Margin Money Receivable/Payable on Daily Settlement

Date	ABC May Series (₹)		CKD June Series (₹)		Net Amount (₹)	
	Receive	Pay	Receive	Pay	Receive	Pay
28.03.2015	-	2,000	—	—	—	2,000
29.03.2015	6,000	—	1,000	—	7,000	—
30.03.2015	2,800	—	—	1,500	1,300	—
31.03.2015	—	11,200	1,000	—	—	10,200
01.04.2015	3,200	—	—	2,000	1,200	—
02.04.2015	6,000	—	—	—	6,000	—
03.04.2015	2,400	—	—	—	2,400	—

Date	Units	DSP	Contract Price/ Previous DSP	Receive/ (Pay)	Units	DSP	Contract Price/Previous DSP	Receive/ (Pay)
1	2	3	4	5 = (3 - 4) x 2	6	7	8	9 = (7 - 8) x 6
28.03.2015	200	1,410	1,420	(2,000)	—	—	—	—
29.03.2015	200 200	1,428 1,428	1,410 1,416	-3,600- 2,400 = **6,000**	50	4,300	4,280	**1,000**
30.03.2015	400	1,435	1,428	**2,800**	50	4,270	4,300	**(1,500)**
31.03.2015	400	1.407	1,435	**(11,200)**	50	4,290	4,270	**1,000**
01.04.2015	400	1,415	1,407	**3,200**	50	4,250	4,290	**(2,000)**
02.04.2015	400	1,430	1,415	**6,000**	—	—	—	-
03.04.2015	200	1,442	1,430	**2,400**	—	—	—	—

2. Mark-to-Market Margin - EIF A/c

Date	Particulars	₹	Date	Particulars	₹
28.3.2015	To Bank	2,000	29.3.2015	By Bank	7,000
31.3.2015	To Bank	10,200	30.3.2015	By Bank	1,300
			31.3.2015	By Balance c/d	3,900
	Total	**12,200**		**Total**	**12,200**
1.4.2015	To balance b/d	3,900	1.4.2015	By Bank A/c	1,200
2.4.2015	To Profit & Loss A/c	2,400	1.4.2015	By Provn. for Loss - EIF A/c	1,500
3.4.2015	To Profit & Loss A/c	4,800	2.4.2015	By Bank A/c	6,000
			3.4.2015	By Bank A/c	2,400
	Total	**11,100**		**Total**	**11,100**

3. Accounting Entries in the Books of Shiva: (financial year ended 31.3.2015)

Date	Particulars		Debit ₹	Credit ₹
28.3.2015	Initial Margin - Equity Index Futures A/c	Dr.	5,000	
	To Cash Account			5,000
	(Being initial margin money paid in cash)			
28.3.2015	Mark-to-Market Margin - EIF A/c	Dr.	2,000	
	To Bank A/c			2,000
	(Being Net Margin Money paid for the day)			
29.3.2015	Bank A/c	Dr.	7,000	
	To Market-to-Margin - EIF A/c			7,000
	(Being Net Margin Money received for the day)			
30.3.2015	Bank A/c	Dr.	1,300	
	To Market-to-Market Margin - EIF A/c			1,300
	(Being Net Margin Money received for the day)			
31.3.2015	Market-to-Market Margin - EIF A/c	Dr.	10,200	
	To Bank A/c			10,200
	(Being Net Margin Money paid for the day)			
31.3.2015	Profit & Loss A/c	Dr.	3,900	
	To Provision for Loss on EIF A/c			3,900
	(Being Provision created for amount equal to debit balance in Mark-to-Margin for anticipated loss)			

4. Balance Sheet of Mr. Shiva as at 31.3.2015 (Extract)

Liabilities	₹	Assets	₹	₹
		Current Assets, Loans and Advances		
		(A) Current Assets		
		(B) Loans and Advances		
		Initial Margin - EIF A/c		5,000
		Mark-to-Margin - EIF A/c	3,900	
		Less: Provision for Loss - EIF A/c	(3,900)	NIL

5. Notes to the Financial Statements as at 31.3.2015

(a) The following Equity Index Futures contracts have Open Interests as on the Balance Sheet date:

Name of Future	ABC	CKD
Series of Future	May 2015	June 2015
Nature of Position (Long/Short)	Long	Long
Number of Contracts	2	1
Number of Units involved	400	50
Daily Settlement Price as on Balance Sheet date (₹)	1407	4290

(b) Initial margin on Equity Index Futures Contracts has been paid in cash only.

(c) No Equity Index Futures Contract has been settled during the year.

6. Accounting Entries in the books of Arpita: (financial year ended 31.3.2015)

Date	Particulars		Debit ₹	Credit ₹
1.4.2015	Bank A/c	Dr.	1,200	
	To Mark-to Market Margin - EIF A/c			1,200
	(Being Net Margin Money received for the day)			
1.4.2015	Provision for Loss - EIF A/c	Dr.	1,500	
	To Market-to-Margin - EIF A/c			1,500
	(Being loss on settlement of PQR June 2015 Series)			
2.4.2015	Bank A/c	Dr.	6,000	
	To Market-to-Market Margin - EIF A/c			6,000
	(Being Net Margin Money received for the day)			
2.4.2015	Market-to-Market Margin - EIF A/c	Dr.	2,400	
	To Profit & Loss A/c			2,400
	(Being profit on settlement of ABC May 2015 Series - Lot 1)			
3.4.2015	Bank A/c	Dr.	2,400	
	To Market-to-Market Margin - EIF A/c			2,400
	(Being Net Margin Money received for the day)			
3.4.2015	Market-to-Market Margin - EIF A/c	Dr.	4,800	
	To Profit & Loss A/c			4,800
	(Being profit on settlement of ABC May 2015 Series - Lot 2)			
3.4.2015	Bank A/c	Dr.	5,000	
	To Initial Margin - EIF A/c			5,000
	(Being receipt of Initial Margin)			

7. Computation of Profit / Loss arising on settlement or squaring up of the contract

Name of the EFI	CKD	ABC (Lot 1)	ABC (Lot 2)
Series	June 2015	May 2015	May 2015
Date of Settlement	1.4.2015	2.4.2015	3.4.2015
Contract Price Per Unit	₹4,280	₹1,418 (See Note)	₹1,418 (See Note)
Settlement Price per unit (in ₹)	₹4,250	₹ 1,430	₹ 1,442
Profit/(Loss) per unit	(₹30)	₹12	₹24
Number of units	50	200	200
Total Profit/(Loss)	(₹ 1,500)	₹2,400	₹4,800

Note: For ABC EIF, weighted average price should be considered for Contract Price Per Unit. Weighted Average Price = [(₹ 1,420 x 200 Units of Lot 1) + (₹ 1,416 x 200 Units of Lot 2)] ÷ [Lot 1 200 + Lot 2 200] = ₹1,418.

Miscellaneous Problems

Illustration 27.

1. PQ Ltd. needs $ 3,00,000 on May 1, 2015 for repayment of loan installment and interest. AS on December 1, 2014, it appears to the company that the dollar may be dearer as compared to the exchange rate prevailing on that date, $ 1 = ₹ 43.50. Accordingly, PQ Ltd. enter into a forward contract with a banker for $ 3,00,00. Assume forward rate as on December 1, 2014 is $ 1 = ₹ 44.80.

Journalise in the books of PQ Ltd.

Solution:

Journal entries in the books of PQ Ltd.

Date	Particulars		Debit ₹	Credit ₹
1.12.2014	Premium on Forward Exchange Contract A/c To, SWAP Bank A/c (Being premium recognised) [3,00,000 (44-43.50)]	Dr.	1,50,000	 1,50,000
	Profit & Loss A/c To, Premium on Forward Exchange Contract A/c (Being premium written off)[1,50,000 122/153]	Dr.	1,19,608	 1,19,608
1.05.2015	Loan A/c Exchange Difference A/c To, Bank A/c (Being liability settled)	Dr. Dr.	1,30,50,000 3,90,000	 1,34,40,000
1.05.2015	SWAP Bank A/c To, Exchange A/c (Being amount of exchange difference transferred)	Dr.	3,90,000	 3,90,000
1.05.2015	Bank A/c To, SWAP Bank A/c (Being SWAP settled)	Dr.	2,40,000	 2,40,000
1.05.2015	Profit & Loss A/c To, Premium on Forward Exchange Contract A/c (Being premium written off)	Dr.	30,392	 30,392

Illustration 28.

Mr. Roy buys the following Equity Stock Options and the seller/writer of the options is Mr. Bose.

Date of purchase	Type of option	Expiry date	Market lot	Premium per unit ₹	Strike price ₹
29 June, 2014	AB Co. Ltd.	30 Aug., 2014	100	30	460
30 June, 2014	XY Co. Ltd.	30 Aug., 2014	200	40	550

Journalise assuming price of AB Co. Ltd. and XY Co. Ltd. on 30th August, 2014 is ₹470 and 500 respectively.

Solution:

Journal (Books of Roy)

Date	Particulars	Debit ₹	Credit ₹
29.6.2014	Option Premium A/c Dr. To, Bank A/c (Being option premium paid)	3,000	 3,000
30.06.2014	Option Premium A/c Dr. To, Bank A/c (Being option premium paid)	8,000	 8,000
30.08.2014	Bank A/c Dr. To, Profit on option (Being profit recognised) (470-460)100 = 1,000 (550-500)200 =10,000 11,000	11,000	 11,000
	Profit & Loss A/c Dr. To, Option premium A/c (Being premium written off)	11,000	 (3,000+8,000) =11,000

Journal (Books of Bose)

Date	Particulars	Debit ₹	Credit ₹
29.6.2014	Bank A/c Dr. To, Option premium A/c (Being option premium received)	11,000	 11,000
30.08.2014	Loss on Derivatives A/c Dr. To, Bank A/c (Being loss recognised)	11,000	 11,000
30.08.2014	Option premium A/c Dr. To, Profit & Loss A/c (Being Premium transferred to income)	11,000	 11,000

Accounting for Equity Index Options

Illustration 29.

Mr. X buys the following equity Stock options and seller/writer of the options is Mr. Y.

Date of purchase	Type of option	Expiry date	Market Lot	Premium per unit	Strike Price ₹
29th June, 2015	NFF Co. Ltd. call	Aug 30, 2015	100	15	230
29th March, 2015	Infosys Ltd. Put	Aug 30, 2015	200	20	275

Prepare Journal Entries. Assume price of NFF Co. Ltd. on 30th August is ₹240 and Infosys Ltd. is ₹290.

Solution:

In the books at the buyer/holder i.e., Mr. X

Date	Particulars	Debit ₹	Credit ₹
29.03.2015	Option Premium A/c Dr. To, Bank A/c (Being option premium paid)	7,000	7,000
31.03.2015	**Calculation of loss on contract**	**Call**	**Put**
	Option Premium Paid	200×15=3,000	200×20=4,000
	(-) Option premium receivable based on Contract Price	200×6=1,200	200×28=5,600
		1,800	**1,600**
		Loss	**Gain**
	Particulars	**Debit ₹**	**Credit ₹**
	Profit & Loss A/c Dr. To, Prov. For amortization of option premium (Being amount for option premium raised)	1,800	1,800
	Gain of ₹1,600 will not be recognized since, not yet certain (AS-1)		
May 2015	Bank A/c Dr. To, Profit on options (Being option settled)	1,000	1,000
	P/L A/c Dr. To, Option Premium A/c (Being option premium written off)	7,000	7,000
	Prov. For amount of option premium Dr. To, P/L A/c (Being prov. cancelled)	1,800	1,800

Books of Y

Date	Particulars	Debit ₹	Credit ₹
29.3.2015	Bank A/c Dr. To, Option premium A/c (Being option premium received)	7,000	7,000
31.03.2015	**Calculation of loss on contract**	**Call**	**Put**
	Option premium received	3,000	4,000
	(-) Option premium payable	200×6=1,200	200×28=5,600
		1,800	**1,600**
		Gain	**Loss**
Date	**Particulars**	**Debit ₹**	**Credit ₹**
	Profit & Loss A/c Dr. To, Prov. For loss on option (Being prov. Paid)	1,600	1,600
	Loss on option Dr. To, Bank A/c (Being loss recognized)	1,600	1,600
	Option Premium A/c Dr. To, Bank A/c (Being not transferred to P/L A/c)	7,000	7,000
	Provision for loss A/c Dr. To, P/L A/c (Being provisioned cancelled)	1,600	1,600

Illustration 30.

Manish Investment Ltd. deals in equity derivatives. Their current portfolio comprises of the following instruments:

ITech ₹ 5,600 Call Expiry June 2015 2,000 unit bought at ₹197 each (cost)

ITech ₹5,700 Call Expiry June 2015 3,600 unit bought at ₹131 each (cost)

ITech ₹5,400 Put Epiry June 2015 4,000 unit bought at ₹81 each (cost)

What will the profit or loss to Manish Investments Ltd. in the following situations?

(i) ITech closes on the expiry day at ₹6,041

(ii) ITech closes on the expiry day at ₹5,812

(iii) ITech closes on the expiry day at ₹5,085

Solution:

Payoff/unit at Itech Closing price

Instrument	ITech Units	Closing Cost	Price Strike	ITech (i) At ₹ 6,041	Closing (ii) At ₹ 5,812	Price (iii) At ₹ 5,085
5,600 Call	2,000	197	5,600	441	212	NIL
5,700 Call	3,600	131	5,700	341	112	NIL
5,400 Put	4,000	81	5,400	NIL	NIL	315

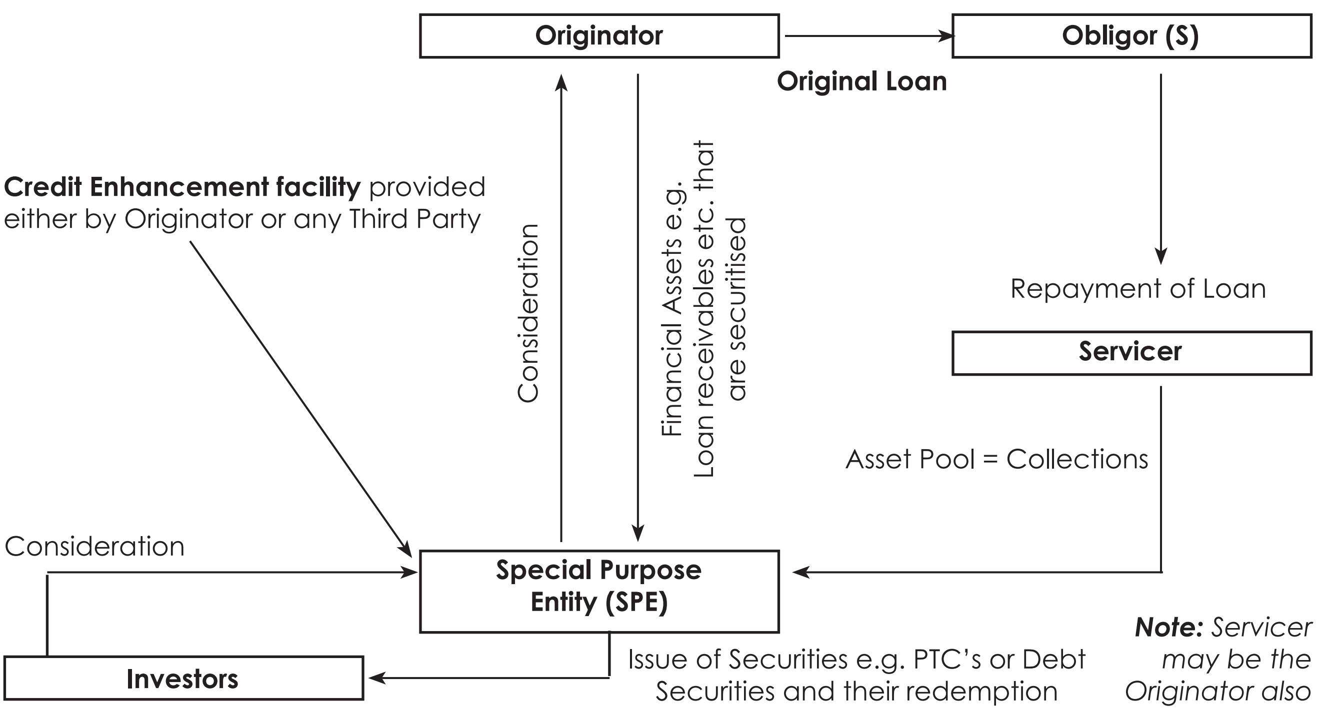
	Profit per unit			Profit Amount		
	ITech	Closing	Price	ITech	Closing	Price
Instrument	6,041	5,812	5,085	6,041	5,812	5,085
5,600 Call	244	15	-197	4,88,000	30,000	-3,94,000
5,700 Call	210	-19	-131	7,56,000	-68,400	-4,71,600
5,400 Put	-81	-81	234	-3,24,000	-3,24,000	9,36,000
				9,20,000	-3,24,000	70,400

7.9 GUIDANCE NOTES FOR SPECIAL BUSINESS/REPORTS

1. ACCOUNTING FOR SECURITISATION

(a) **Securitisation:** Securitisation is the process by which financial assets (e.g. Loan Receivables, Mortgage backed receivables, Credit Card balances, Hire Purchase Debtors, Trade Debtors etc.) are transformed into securities. Securitisation is different from Factoring since the latter involves transfer of debts without transformation thereof into securities.

(b) **Securitisation Flow:** The parties involved and the Securitisation Process is described as under -



2. Securitisation Process:

(a) Initial Lending Function: Originator gives various Loans to different Borrowers (Obligors). Borrowers have to repay the loans in EMI's (Interest + Principal). These EMI's constitute financial assets/receivables for the Originator.

(b) Securitisation Function: Financial Assets/Receivables or defined rights therein, are transferred, fully or partly, by the Originator to a SPE. SPE pays the Originator immediately in cash or in any other consideration for taking over the financial assets. The assets transferred are termed **'Securitised Assets'** and the assets or rights retained by the Originator are called **'Retained Assets'**.

(c) Financing Function: SPE finances the assets transferred to it by issue of securities such as Pass Through Certificates (PTCs) and/or debt securities to Investors.

3. Features of Securitisation.

(a) **Servicing:** The Originator may continue to service the securitised assets i.e. collect amounts due from borrowers, etc.), with or without servicing fee for the same. Sometimes, the Servicer may be an entity other than the Originator.

(b) **Future Receivables:** The Originator may securitise or agree to securitise future receivables, i.e., receivables that are not existing at the time of agreement but which would be arising in future. In case of such, securitisation, the future receivables are estimated at the time of entering into the transaction and the purchase consideration for the same is received by the Originator in advance.

(c) **Revolving Period Securitisation:** Future Receivables can be transferred as and when they arise, or at specified intervals, the transfers being on pre-arranged terms.

(d) **Credit Enhancement:** It is an arrangement designed to protect the Investors (i.e. holders of the securities issued by an SPE) from losses and/or cash flow mismatches arising from shortfall or delays in collections from the securitised assets. The arrangement often involves one or more of the following –

(i) **Cash Collateral:** Deposit of cash which can be used by the SPE, in specified circumstances, for discharging its financial obligation on its securities held by the investors.

(ii) **Over Collaterisation:** Assets in excess of the securitised assets are made available to the SPE, so that their realisation can be used to fund the shortfalls and/or mismatches in fulfilment of SPE's financial obligations.

(iii) **Recourse Obligation:** Obligation accepted by the Originator of the Securitisation Process.

(iv) **Third Party Guarantee:** Guarantee given by any Third Party, to meet any shortfall on the part of the SPE in meeting its financial obligations in respect of the securitisation transaction.

(v) **Structuring of instruments:** Instruments issued by an SPE are structured into Senior Securities (issued to Investors) and Subordinate Securities (issued to Originators). Payments on subordinated securities are due only after the amounts due on the senior securities are discharged.

Note: *Credit Enhancement facility can be provided either by the Originator himself or by any Third Party.*

4. Terms used in relation to Securitisation Process.

Call Option	An option that entitles the Originator to repurchase the Financial Assets transferred under a securitisation transaction from the SPE. The Option may be at a predetermined price or at a value to be determined, for example, fair value on the date of exercise of Call Option.
Clean-up Call Option	• An option which entitles the Servicer (who may be the Originator) to purchase the remaining transferred securitised assets or beneficial interests in the SPE. • The Servicer may use this option if the cost of servicing those assets or beneficial interests exceeds the benefits of servicing them.
Interest Strip	A contractual arrangement to **separate** the right to all or part of the **interest due** on a Debenture, Bond, Mortgage Loan or other interest bearing financial asset from the financial asset itself.
Investor	Persons who finance the acquisition of the securitised assets/beneficial interest therein by subscribing to PTCs/debt securities issued by an SPE.
Originator	Entity that owns the financial assets proposed to be securitized, and initiates the process of securitisation in respect of such assets.
Pass Through Certificates	Instruments acknowledging a beneficial interest in the securitised assets. Payment of interest on such instruments and the repayment of the principal are directly or indirectly linked to realisations from the underlying securitised assets. **(PTCs)**
Principal Strip	Right to the remainder of the financial asset, net of all rights that have been stripped therefrom by one or more contractual arrangements like the Interest Strip.
Recourse Obligation	It is an obligation of the Originator to - (a) Reimburse or compensate, fully or partly, the shortfall to the Investors; or (b) bear the risk of shortfalls, such as those arising from - • Failure of debtors to pay or to pay when due; • Pre-payments; or • Other defects in secuntised financial assets.
Servicing Asset	• A contract to service financial assets under which the estimated future revenues from servicing fees, late charges and other related revenues are expected to more than adequately compensate the Servicer (who may be the Originator) for performing the services. • A Servicing Contract can be either - (a) undertaken together with selling/securitising the financial assets being serviced; or (b) purchased or assumed separately.
Special Purpose Entity (SPE)	An independent entity, which acquires the financial asset under securitisation and holds them till maturity. SPE is generally constituted as a Trust. It may also be constituted in other forms like a Limited Company formed with a small capital, for the specific purpose of funding the transaction by issue of PTC's or Debt Securities.

5. Principles of derecognition of Securitised Asset in the books of Originator.

(a) **Derecognition Criterion:** Securitised Assets should be **derecognized** in the Originator's Books, if and only if the Originator loses control of the contractual rights that comprise the securitised asset, either by a single transaction or by a series of transactions taken as a whole. The Originator loses such control if it surrenders the rights to benefits specified in the contract.

(b) **Analysis of Conditions:** Whether or not the Originator has lost control over the securitised asset should be determined on the basis of the facts and circumstances of the case by considering all the evidence available. If the position of either the Originator or SPE indicates that the Originator has retained control, the Originator **should not remove** the securitised asset from its balance sheet.

(c) **No Loss of Control:** The Originator will not be deemed to have lost control over the securitized asset, in each of the following cases – *(Hence, derecognition may not be permissible in the following cases)*

(i) **Creditors' Rights:** Creditors of the Originator are entitled to attach or otherwise deal with the securitised assets;

(ii) **No Rights to SPE:** SPE does not have the right (to the extent it was available to the Originator) to pledge, sell, transfer or exchange for its own benefit the securitised asset;

(iii) **Resumption of Control:** Originator has the right to reassume control of the securitised asset except –

- Where it is entitled to do so by a Call Option, where such Call Option can be justified on its own commercial terms as a separate transaction between the SPE and the Originator, e.g. Where the Call Option is exercisable at fair value of the asset on the date of exercise of the Option; or
- Where it is entitled to do so by a Clean-up Call Option.

(d) **Originator's Obligation of Repurchase:**

(i) **Obligation Only:** Sometimes the securitised asset may be beyond the control of the Originator, but the Originator may be under an obligation (not an entitlement) to repurchase the Securitised Asset at a later date, at a specified price. Such obligation accepted by the Originator should be accounted for as per AS - 4 and a provision should be created for the contingent loss arising from the obligation.

(ii) **Obligation-cum-Entitlement:** Where the Originator is both entitled and obligated to repurchase the securitised asset at a pre-determined price, the Originator has not lost control over the securitised asset. So, it **should not be removed (i.e. should not be derecognized)** from the Originator's Balance Sheet.

6. Accounting treatment for Securitised Asset in the books of an Originator

Particulars	Derecognition Criterion met	Derecognition Criterion not met
Treatment of Consideration	Difference between Book Value of Securitised Asset and consideration received should be disclosed separately as Gain/Loss arising arising on securitization, in the **P&L** Account.	Asset should continue to be recognised in the books of Originator. Consideration received for the transferred assets, should be accounted as a Borrowing secured against the Securitised Assets.
Expenses on Transactions e.g. Legal Fee	Should be **expensed** at the time of the transaction and should not be deferred.	Should be either amortised over the term of the Secured Borrowing or recognized immediately in the P & L Account.
Disclosure in P&L Account	• Gain (Cr.) [or] Loss (Dr.) on Securitisation; • Expenses on Transaction **(fully)** (Dr.)	Expenses on Transaction (Dr.) - • either **fully** w/off in year of transaction; • or amortization share for the year.
Disclosure in Balance Sheet	Securitised Assets will not be shown in the Originator's Balance Sheet.	• **Assets Side:** Securitised Assets. • **Liabilities Side:** Secured Loans from SPE (Secured against Securitised Assets)
Recourse Obligation	Contingent Loss arising therefrom should be recognized by creating a provision as per AS-4.	

7. Accounting for Future Receivables /Revolving Securitisation.

Particulars	Future Receivables	Revolving Securitisation
Consideration from SPE	Receivables that are not existing at the time of agreement but which would be arising in future are securitized. Consideration therefor is received by the Originator **in advance.**	Financial Assets are transferred as and when they come into existence or at specified intervals. Consideration is paid to the Originator **at the time of such transfer.**
Accounting Treatment	• Consideration received by Originator should be accounted for as an **Advance.** • Derecognition principles will be applicable as and when the relevant assets come into existence.	All accounting requirements applicable for regular Securitisation (like derecognition, expenses on transaction etc.) except those applicable to Future Receivables, apply to Revolving Securitisation also.

8. Measurement & Recording the consideration received by the Originator

(a) **Consideration:** Consideration given by SPE to the Originator may consist of- (a) Cash or (b) Non-Cash items (e.g. Securities issued by SPE).

(b) **Measurement of Consideration:** While Cash Consideration is directly determinable, the Non-Cash component of the consideration should be measured at the lowest of–

(i) Fair Value of the non-cash component;

(ii) Net Book Value of the securitised assets as reduced by the cash received; and

(iii) Net Realisable Value of the securitised assets as reduced by the cash received.

(c) **Fair Value:** Fair Value is the price agreed upon between knowledgeable, willing parties in an Arm's Length Transaction. Fair Value is determined based on the following principles –

Situation	Fair Value =
Where Quoted Market Price in an active, liquid and freely accessible market is **available**	Quoted Market Price
Where Quoted Market Price is not available	• Value based on the market prices of assets similar to those received as consideration, if available, **[or]** • Value based on generally accepted valuation techniques e.g. Present Value of Estimated Future Cash Flows.

9. Partial Derecognition: The accounting requirements

(a) **Partial Securitisation:** The Originator may sometimes transfer only a part of the financial asset in a securitisation transaction instead of transferring the complete asset. This may be done either by - (a) Transfer of Proportionate Share in the asset; (b) Transfer of one or more benefit streams in the asset.

(b) **Accounting Treatment:** The accounting treatment for part transfer is described as under –

Particulars	Transfer of Proportionate Share in the asset	Transfer of one or more of benefit streams (Interest Strip, Principal Strip, etc.) in the asset:
Explanation	Transfer of proportionate share of loan (including right to receive both interest and principal), in such a way that all future cash flows, profit/loss arising on loan will be **shared** by Originator and SPE in **fixed proportions.**	Originator may securitise the Principal Strip of the loan while retaining the Interest Strip and Servicing Asset.
Accounting	• Part of the original asset which meets the derecognition criteria set out above should be derecognized. • The remaining part (not transferred) should continue to be recognized in the books. • If any new interest has been created as a result of the securitization transaction (e.g. Call Option), such new interest should also be recognized as per accounting principles.	
Carrying Amount	Previous Carrying Amount of the asset is apportioned among the part transferred and the part retained in the **agreed ratio** e.g. 60% for Originator and 40% for SPE. 60% will be derecognized while 40% of the previous carrying amount will be retained in B/Sheet.	Carrying Amount of the financial asset should be apportioned between the part(s) transferred and the part(s) retained on the basis of their **relative fair values** as on the date of transfer.

Note: If Fair Value of the part of the asset that is retained cannot be measured reliably, that part should be valued at a nominal value of Re.l.

10. Priyanka Ltd. holds ₹10,000 of loans yielding 18% interest p.a. for their estimated lives of 9 years The Fair Value of these loans, after considering the interest yield is estimated at ₹11,000.

The Company securitises the principal component of the loan plus the right to receive interest at l4% to Gunjan Corporation, a Special Purpose Entity, for ₹10,000.

Out of the balance interest of 4%, it is stipulated that half of such balance interest, namely 2%, will be due to Priyanka as fees for continuing to service the loans. The Fair Value of the servicing asset so created is estimated at ₹350. The remaining half of the interest is due to Arul as an interest strip receivable, the Fair Value of which is estimated at ₹650.

Give the accounting treatment for the above.

1. Fair Value of securitised component of Loan

Particulars	₹	₹
Fair Value of Loan		11,000
Less: Fair Value of Servicing Asset	350	1,000
Fair Value of Interest Strip	650	
Fair Value of securitised component of Loan		**10,000**

2. Apportionment of Carrying Amount based on Relative Fair Values

Particulars	Fair Values ₹	% to Total Fair Value	Proportionate Carrying Amount ₹
(1)	(2)	(3)	(4) = ₹ 10,000 x (3)
Fair Value of Securitised Component of the Loan	10,000	90.91%	9,091
Fair Value of Servicing Asset	350	3.18%	318
Fair Value of Interest Strip	650	5.91%	591
Total Fair Value	**11,000**	**100.00%**	**10,000**

3. Profit on Securitisation = Net Proceeds from Securitisation **Less** Apportioned Carrying Amount
= ₹ 10,000 Less ₹9,091 = ₹**909**

4. Journal Entries in the books of Originator

S.No.	Particulars		Debit ₹	Credit ₹
1	Bank A/c	Dr.	10,000	
	To Loans (Cost of Securitised Component)			9,091
	To Profit on Securitisation			909
	(Being Securitisation of Principal and right to 14% interest)			
2	Servicing Asset A/c	Dr.	318	
	Interest Strip A/c	Dr.	591	909
	To Loans			
	(Being creation of Servicing Asset and Interest Strip Receivable)			

11. Accounting treatment of Securitisation Transactions in the books of SPE.

(a) **Asset Recognition:** The SPE should recognise the asset received under a securitisation transaction, if the Originator loses control over the securitised asset, as per the conditions described earlier.

(b) **Consideration:** The asset so received should be recognised at the **amount of consideration**, if paid in cash. In case of **non-cash consideration,** the asset should be recorded either at its intrinsic value or at the fair value of the consideration, whichever is more clearly evident. If both the values are equally evident the asset should be valued at the **lower** of the two values.

(c) **No Control Rights to SPE:** The SPE **should not recognise** the asset received if– (a) beneficial ownership in the securitised asset has not been transferred to the SPE; or (b) the Originator has not lost control over the asset. In such case, the consideration paid to the Originator should be recorded as a lending secured against the financial asset received under securitisation transaction.

(d) **Amounts received under PTC:** Amount received by the SPE (from Investors) on issue of PTCs or other Debt Securities should be shown on the **Liability Side** of the Balance Sheet, properly describing its stature.

12. Accounting treatment for Securitisation in the books of the investor.

(a) **AS - 13:** The Investor should account for the PTCs and/or debt securities acquired by it as an investment as per AS - 13, 'Accounting for Investments'.

(b) **Other Accounting Principles:** Where AS - 13 is not applicable because the Investor is specifically exempted from the application of AS - 13, the investments in PTCs and/or other securities should be valued and accounted for as per the relevant accounting principles applicable to the Investor.

13. **Disclosure requirements in the Financial Statements of various parties.**

Originator	Special Purpose Entity	Investor
• Nature and extent of securitisation transaction(s), including the financial assets that have been derecognised. • Nature and amounts of the new interests created, if any. • Basis of determination of fair values, wherever applicable.	• Nature of the securitisation transaction(s) including, in particular, a description of the rights of the SPE vis-a-vis the Originator whether arising from the securitisation transaction or a transaction associated therewith. • Basis of determination of fair values, wherever applicable.	• Disclosure of investments in PTCs and/or debt securities as per AS - 13. • Where Investor is specifically exempted from the application of AS - 13, the Investor should make suitable disclosures as per the relevant requirements.

Note: In the Financial Statements of the Originator, Contingent Loss arising from Recourse Obigation should be recognized by creating a provision therefor as per AS - 4.

2. ACCOUNTING FOR OIL & GAS PRODUCING ACTIVITIES

Introduction.

(a) **Applicability:** This Guidance Note applies to costs incurred on acquisition of mineral interests in properties, exploration, development and production of oil and gas activities, i.e., upstream operations of E & P Industry. The Guidance Note deals with accounting aspects of such costs, but does not apply to –

(i) Accounting and reporting issues relating to the transporting, refining and marketing of oil and gas;

(ii) Activities relating to the production of natural resources other than oil and gas; and

(iii) Production of geothermal steam or the extraction of hydrocarbons as a by-product of the production of geothermal steam or associated geothermal resources.

(b) **Terms and Definitions:**

Term	Definition
Cost Centre	Unit identified to capture costs based on suitable criteria such as geographical or geological factors, e.g. a field or a country.
Field	Area consisting of a reservoirs) related to individual geological structural feature and/or stratigraphic condition.
Reservoir	Porous and permeable underground formation containing a natural accumulation of producible oil or gas that is confined by resistant rock or water barriers and is individual and separate from other reservoirs.
Unit of Production (UOP) method	Method where is calculated on the basis of the number of production or similar units expected to be obtained from the asset by the enterprise.
Abandon	To discontinue attempts to produce oil and gas from a mining lease area or a well and to plug the reservoir as per regulatory requirements and salvage all recoverable equipments.
Block	A defined area for purposes of licensing or leasing to an enterprise or enterprises for exploration, development and production rights.

Bottom-Hole Contributions	• Money or property paid to an operator for use in drilling a well on property in which the payer has no property interest. The payer may receive proprietary information on the well's potential productivity. • Such contributions are payable when the well reaches a pre-determined depth, regardless of whether the well is productive or non-productive.
Condensate	Low vapour pressure hydrocarbons obtained from Natural Gas through condensation or extraction and refer solely to those hydrocarbons that are liquid at normal surface temperature and pressure conditions.
Dry Hole Contribution	Contribution made by one enterprise to costs incurred by another enterprise that is drilling a nearby well to obtain information from the enterprise drilling the well. It is generally made when the well is complete and is found to be unsuccessful.
Geological and Geophysical Studies	Processes which seek surface or subterranean indications of earth structure or formation where experience has shown the possibility of existence of mineral deposits.
Geological Survey	Exploratory programme directed to examination of rock and sediments obtained by boring or drilling, or by inspection of surface outcroppings.
Geophysical Survey	Study of the configuration of the earth's crust in a given area, as determined by the use of seismic, gravity, magnetic and geo-chemical procedures.
Mining Lease	License issued for offshore and onshore properties for conducting development and production activity.
Natural Gas Liquids (NGL)	Hydrocarbons (primarily ethane, propane, butane and natural gasoline) which can be extracted from wet natural gas and become liquid under various combinations of increasing pressure and lower temperature.
Petroleum Exploration License (PEL)	License issued for offshore and onshore properties for conducting exploration activity; issued by Central Government for off-shore properties and respective State Government for on-shore properties.
Support Equipment and Facilities	Equipment and facilities of the nature of service units, camp facilities, godowns (for stores and spares), workshops (for equipment repairs), transport services (trucks and helicopters), catering facilities and drilling and seismic equipment.
Work-Over	Remedial work to the equipment within a well, the well pipework or relating to attempts to increase the rate of flow.

(c) **Oil and Gas Reserves: Classification.**

(i) **Meaning:** Oil and Gas Reserves are those quantities of mineral oil, natural oil and natural gas liquids, which are anticipated to be **commercially recoverable** from known accumulations from a given date onward. Estimation of all oil and gas reserve involves some degree of uncertainty, depending upon availability of reliable geological and engineering data at the time of the estimate and interpretation of data.

(ii) **Classification:** Based on relative degree of uncertainty, Oil and Gas Reserves can be classified as –

Oil and Gas Reserves

Proved Oil and Gas Reserves — Those which are **reasonably certain** to be commercially recoverable in future from known oil and gas reservoirs.

further classified into

- **Proved Developed Oil and Gas Reserves** — Reserves that can be expected to be recovered from - through **existing wells** with **existing equipment** and operating methods.
- **Proved Undeveloped Oil and Gas Reserves** — Reserves that are expected to be recovered
  - **new wells on un-drilled acreage**, or
  - existing well for which a relatively major expenditure is required for recompletion

Unproved Oil and Gas Reserves — Those the recoverability of which has **not been proved with reasonable certainty.**

Note:

- Additional Oil and Gas expected to be obtained should be included as "Proved Developed Reserves" only– (i) after testing by a pilot project; or (ii) after the operation of an installed programme has confirmed though production response that increased recovery will be achieved.
- lReserves on un-drilled acreage should be limited to those drilling units offsetting productive units that are reasonably certain of production when drilled. Other reserves can be claimed only if it can be demonstrated with certainty that there is continuity of production from existing productive formation.
- Estimates for Proved Undeveloped Reserves should not include any acreage for which an application of advanced recovery technique is contemplated unless such techniques have been proved effective by actual tests in the area and in the same reservoir.

(d) **Different types of "Wells" in the context of exploration activities.**

Well Type	Description
Development Well	It is a well which is drilled, deepened, completed or recompleted within a **proved area** of an oil or gas reservoir, to the depth of a stratigraphic horizon known to be **productive.**
Service Well	It is a well drilled or completed for the purpose of **supporting production** in an existing field e.g. wells for purposes like gas injection (natural gas, propane, butane or flare gas), water injection, steam injection, air injection, polymer injection, salt-water disposal, water supply for injection, observation or injection for combustion.

Stratigraphic Test Well or Expendable Well	• It is a drilling effort, geologically directed, to obtain information pertaining to a specific geologic condition. • They are drilled **without the intention of being completed** for hydrocarbon production. They include wells identified as core tests and all types of expendable holes related to hydrocarbon exploration. • These Wells are classified as - (a) Development-Type Stratigraphic Test Well (**drilled** in a proved area) and (b) Exploratory-type Stratigraphic Test Well (**not drilled** in a proved area).
Exploratory Well	• It is drilled for the purpose of **searching** undiscovered oil and gas accumulations on any geological prospect. An exploratory well is a well that which is not a Development Well or Service Well or Stratigraphic Test Well.
Appraisal Well	It is a a well drilled as part of an **appraisal drilling programme** to determine the physical extent of oil and gas reserves and likely production rate of a field.
Dry Hole	A well which has proved to be non-productive.

(e) **Petroleum Industry (E&P Industry): Cost Classification.**

The costs of E&P Industry are classified based on the nature of activities as under –

Activities	Brief description of Activity	Treatment
1. Acquisition Activities	Towards **acquisition right(s)** to explore, develop and produce oil and gas.	**Capitalised initially;** Depreciation (Depletion) charged to cost of oil and gas produced based on Units **of Production** Method.
2. Exploration Activities	Towards **prospecting activities** conducted in the search for oil and gas.	
3. Development Activities	**Development** activities for extraction of oil & gas.	
4. Production Activities	**Operation and Maintenance** an enterprise's wells and related equipment and facilities, including depreciation and operating costs.	Added to the cost of oil and gas produced, as on **Operating Revenue Cost.**

(i) **Acquisition Activities:**

Description of Activity	Costs incurred
• Identification of areas of oil and gas finds. • Approaching the owner who owns the rights for the exploration, development and production of the under ground minerals in the respect of the property or area. • Obtaining a License (PEL) from State/Central Government for surveys and exploration. • Obtaining a Mining Lease (ML) for engaging, in development and production activities.	• All costs incurred to purchase, lease etc. to **acquire a property** or mineral right; • Costs incurred in **acquiring the right** to explore, drill and produce oil and gas; • Initial Costs (and **not** Annual License Fees) incurred for obtaining the PEL / LOA and ML. • Lease Bonus, Brokers' Fees, Legal Costs, Cost of temporary occupation of land, Crop Compensation paid to farmers etc.

(ii) **Exploration Activities:**

Description of Activity	Costs incurred
• Aerial, Geological, Geophysical, Geochemical, Palaeontological, Palynological, Topographical and Seismic surveys, analysis, studies and their interpretation; • Investigations relating to the subsurface geology including structural test drilling; • Exploratory type stratigraphic test drilling; • Drilling of exploration and appraisal wells and other activities such as surveying; • Drill site preparation and all work necessarily connected therewith for the purpose of oil and gas exploration.	All direct and allocated indirect expenditure of exploration activities including– • Costs of surveys and studies, rights of access to properties to conduct those studies and salaries and other expenses of geologists, geophysical crews and other personnel conducting those studies; (G & G Costs) • Costs of carrying and retaining undeveloped properties, such as delay rental, *ad valorem* taxes on properties, legal costs for title defence, maintenance of land and lease records and annual licence fees in respect of PEL; • Dry Hole and Bottom Hole Contributions; • Costs of drilling and equipping exploratory and appraisal wells; and • Costs of drilling exploratory-type stratigraphic test wells.

(iii) **Development Activities:**

Description of Activity	Costs incurred
• Purchase, shipment or storage of equipment and materials used in developing oil and gas accumulations; • Completion of successful exploration wells; • Drilling, completion, re-completion and testing of development wells; • Drilling, completion, and re-completion of service wells; • Caying of gathering lines; • Construction of offshore platforms and installations, installations of separators, tankages, pumps, artificial lift; • Other producing and injection facilities required to produce, process and transport oil or gas into main oil storage or gas processing facilities, either onshore or offshore; and • Laying of infield pipelines, the installation of the storage or gas processing facilities.	• Costs incurred to gain access to and prepare well locations for drilling; • Costs of surveying well locations for the purpose of determining specific development drilling sites, clearing ground, draining, road building and relocating public roads, gas lines and power lines necessary to develop proved oil and gas reserves; • Drill and equip development wells, development-type stratigraphic test wells and service wells, cost of platforms and of well equipment e.g. casing, tubing, pumping equipment and the wellhead assembly; • Costs incurred to acquire, construct and install production facilities like lease flow lines, separators, treaters, heaters, manifolds, measuring devices and production storage tanks, natural gas cycling and processing plants and utility and waste disposal systems; • Costs of providing advanced recovery system. • Depreciation Cost and Operating Cost of support equipment and facilities in connection with development activities, and annual license fees for Mining Lease.

(iv) **Production Activities:**

Description of Activity	Costs incurred
• **Pre-Wellhead Activity:** Lifting the oil and gas to the surface, operation and mainenance of wells, extraction rights, etc; • **Post-Wellhead Activity:** Gathering, treating, field transportation, field processing, etc. upto the outlet valve on the lease or field production storage tank, etc.	• **Pre-Wellhead costs:** Labour, R & M, materials, supplies, fuel and power, property taxes, insurance, severance taxes, royalty, etc., in respect of lifting the oil and gas to the surface, operation and maintenance including servicing and work-over of wells. • **Post-Wellhead costs:** Labour, R&M, materials, supplies, fuel and power, property taxes, insurance, etc., in respect of gathering, treating, field transportation, field processing, including cess upto the outlet valve on the lease or field production storage tank, etc.

(v) **Methods of capitalisation of Acquisition, Exploration and Development Costs**

Acquisition, Exploration & Development Costs can be capitalized using - (1) Successful Efforts Method **(SEM)** and (2) Full Cost Method **(FCM)**. The accounting treatment under these methods are compared below –

Capital WIP: The following costs should be treated as **"Capital WIP"** of a Cost Centre **when incurred -**

Successful Efforts Method (SEM)	Full Cost Method (FCM)
(a) **All** Acquisition Costs; (b) Exploration Costs **for -** (i) drilling and equipping exploratory and appraisal wells; & (ii) drilling exploratory-type stratigraphic test wells; (c) **All** Development Costs.	(a) **All** Acquisition Costs; (b) **All** Exploration Costs; (c) **All** Development Costs.

Charging off as Expense:

Successful Efforts Method (SEM)	Full Cost Method (FCM)
• **General:** Costs incurred for purposes other than acquisition, exploration & development should be charged as expense when incurred. • **No Proved Reserves:** If the cost of drilling exploratory well relates to a well that is **determined to have no proved reserves,** then such costs net of any salvage value should be transferred from Capital Work in Progress and charged as **expense.**	Costs incurred for purposes other than acquisition, exploration and development should be charged as expense when incurred.

Capitalisation / Transfer:

Successful Efforts Method (SEM)	Full Cost Method (FCM)
• **Acquisition Costs: Entire Cost** should be capitalised from Capital WIP to the "Gross Block of Assets". • **Exploration & Development Costs:** Costs relating to **"Proved Developed Oil and Gas Reserves"** should be capitalised as **'Completed Wells'** from Capital WIP, when a well is ready to commence commercial production or within 2 yrs from date of completion of drilling, whichever is earlier. **Note:** Costs can be carried over for more than 2 years only if - (a) presence of proved reserves can be **reasonably demonstrated;** and (b) development of the field in which the well is located has been **planned** with required capital investment.	• **Commercial Production:** When any well in a cost centre is ready to commence commercial production, the costs corresponding to all the proved oil and gas reserves in that cost centre should be capitalised from Capital WIP. • **Reserves proved subsequently:** If oil and gas reserves are proved subsequently, Capital WIP relating to such reserves should be capitalised at the time when the said reserves are proved. • **Unsuccessful Efforts:** Expenditure which does not result in discovery of proved oil and gas reserves should be transferred from Capital WIP to the "Gross Block of Assets" as and when **so determined.**

Depreciation under Units of Production Method: Under SEM, Depreciation is calculated separately for – (a) Acquisition Costs and (b) Other Costs. *See separate question below*

Suggested Method: The Guidance Note recommends the use of **SEM as the preferred method,** though the use of FCM is also permitted. Change from FCM to SEM can be made, and with **retrospective effect only**. The change will be treated as a change in accounting policy and AS - 5 and the resulting deficiency/surplus should be charged/credited to the P & L A/c in the year of such change.

(vi) **Depreciation charged under SEM and FCM**

Depreciation under SEM: The Depreciation Charge within a cost Centre is determined as under–

Item	For Acquisition Costs	For Other Costs
Depreciation Rate (UOP Rate)	$\frac{\text{Acquisition Cost of the Cost Centre}}{\text{Proved Oil and Gas Reserves}}$	$\frac{\text{Depreciation Base of the Cost Centre}}{\text{Proved Developed Oil and Gas Reserve}}$
Depreciation (UOP) Charge for the period	UOP Rate x Production for the period	UOP Rate x Production for the period .

Notes:

(a) Depreciation Base for the Cost Centre is calculated as under

	Gross Block of the cost centre **(excluding Acquisition Costs)**	xxxx
Add:	Estimated Dismantlement and Abandonment costs (Net of estimated salvage values) pertaining to Proved Developed Oil and Gas Reserves	xxxx
Less:	Accumulated Depreciation	(xxxx)
Less:	Accumulated Impairment Charge ofthe Cost Centre	(xxxx)
	Depreciation Base for the Cost Centre	xxxx

(b) Proved Oil and Gas Reserves = Proved Oil and Gas Reserves estimated at the end of the period + Production during the period.

(c) Proved Developed Oil and Gas Reserves is calculated as under-

	Proved Developed Oil and Gas Reserves estimated at the end ofthe period	xxxx
Add:	Production during the period	xxxx
Add:	Additional reserves from advanced recovery techniques (only if the required investments have been capitalized)	xxxx
	Proved Developed Oil and Gas Reserves	xxxx

Depreciation under FCM: Depreciation Charge for all costs within a cost centre is determined as under –

Depreciation (UOP) Rate = Depreciation base ofthe Cost Centre # Proved Oil and Gas Reserves.

Depreciation (UOP) charge for the period = UOP Rate x Production for the Period.

Notes:

(a) Depreciation Base of the Cost Centre is calculated as under –

	Gross Block ofthe Cost Centre	xxxx
Add:	Estimated Dismantlement and Abandonment Costs (Net of estimated salvage values) for facilities set up for developing Proved Oil and Gas Reserves	xxxx
Add:	Estimated Future Expenditure (based on Current Costs) to be incurred in developing the Proved Oil and Gas Reserves	xxxx
Less:	Accumulated Depreciation	(xxxx)
Less:	Accumulated Impairment Charge ofthe Cost Centre.	(xxxx)
	Depreciation Base for the Cost Centre	**xxxx**

(b) Proved Oil and Gas Reserves is calculated as under–

	Developed and Undeveloped Oil and Gas Reserves estimated at the end of the period	xxxx
Add:	Production during the period	xxxx
	Proved Oil and Gas Reserves	**xxxx**

Other Points relating to Depreciation:

(a) If the Oil Reserves and Gas Reserves are contained, **a common unit of measure** is used to determine depreciation. Conversion Factor used is 1000 Cubic Meters of Gas = 1 Metric Tonne of Oil.

(b) Rates of depletion should be reviewed for revision once in every year. These revisions are accounted for **prospectively** as Changes in Accounting Estimates.

(c) **AS - 28** (Impairment of Assets) provisions should be applied at the end of every year. Each Cost Centre should be treated as a Cash Generating Unit.

(vii) **Arguments for and against Successful Efforts Method (SEM).**

Arguments in favour of SEM	Arguments against SEM
1. An asset is an economic resource expected to provide future benefits. SEM reflects this **normal concept of asset.**	1. Under SEM, the P&L Statement can give a **false impression of performance** in terms of success in finding new oil and gas reserves.
2. Costs of unsuccessful efforts are charged to expense as they occur. This **prevents** the capitalisation of unsuccessful exploratory efforts & consequent **distortion of financial statements.**	2. Charge-off of unsuccessful pre-production costs under SEM results in an understatement of assets and net income of a growing enterprise that has a successful and increasing exploration programme.
3. SEM recognizes the **matching concept** thereby recognizing only those expenses in the P & L Statement that bear a direct association to the earning of specific items of income.	3. Success of projects usually cannot be measured till completion of exploration activities, taking many years. SEM leads to **pre-mature** assessment of success/failure.
4. Income smoothing is greatly reduced. So, SEM realistically **reflects the management's successes or failures** in its efforts to find new oil and gas reserves.	4. All pre-production costs are incurred to find and develop whatever reserves result from pre-production activities, on an enterprise-wide basis SEM does not recognize this aspect and has a project-wise micro-view (than macro-view).

(viii) **Arguments for and against Full Cost Method (FCM).**

Arguments in favour of FCM	Arguments against FCM
1. All exploration projects will not result directly in addition of reserves. FCM **recognizes uncertainty** and reflects the way in which enterprises search for, acquire, and develop mineral resources.	1. Many Costs that fail to meet the general definition of 'asset' are **wrongly capitalized.**
2. Total Costs are depreciated on a pro-rata basis in relation to the total reserves in a large cost centre, rather than independently to reserves in many small cost centres. So, there is a **better matching** of income and expenses.	2. Costs that do not result directly in future benefits should be immediately charged to revenue. FCM capitalizes these costs, thus deferring the effects of expenses. Thus, **recognition of loss is delayed.**
3. Costs of unsuccessful efforts are akin to normal recurring spoilage occurring in manufacturing operations and should be absorbed by good units manufactured. So, FCM operates like **absorption costing** for long-term inventories.	3. Costs of unsuccessful activities are treated in the same way as successful activities and are matched against future revenues from all of the enterprise's successful exploration and development activities. This **hampers the measurement** of the **efficiency and effectiveness** of the enterprise's exploration and development activities.
4. FCM **avoids annual 'distortions'** of income resulting from expensing the charges for unsuccessful pre-production activities are eliminated substantially, as compared to SEM.	

(ix) **Accounting treatment of Abandonment Costs.**

Meaning: Abandonment Costs are the costs incurred on discontinuation of all operations and surrendering the property back to the owner, e.g. plugging and abandoning of wells, dismantling of wellheads, production and transport facilities and to restoration of producing areas as per license/legal requirements.

Accounting Treatment:

(a) The enterprise should capitalise the amount of provision required to be created for subsequent abandonment, at the beginning itself.

(b) Provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, etc. Abandonment Costs should not be discounted to their present value.

Recognition of Gain/Loss:

(a) Gain or Loss **should not be recognised** if only an individual well or individual item of equipment is abandoned as long as the remainder of the wells in the cost centre continue to produce oil or gas. Instead, the asset being abandoned be deemed to be fully depreciated.

(b) Gain or loss **should be recognised** when the last well on the cost centre ceases to produce and the entire cost centre is abandoned.

(x) **Accounting treatment of – (1) Support Facility Costs and (2) Borrowing Costs.**

Type of Cost	Accounting Treatment
Cost of acquiring or constructing support equipment and facilities used in E & P Activities	• Entire Cost should be capitalized as per AS - 10. • Depreciation/depletion should be calculated as per AS - 6 and accounted for as Exploration Cost, Development Cost or Production Cost, as appropriate.
Borrowing Costs	Should be **capitalized** as per AS - 16. For this purpose, all the costs that are classified under Capital WIP are considered as "Qualifying Asset".

(xi) **Disclosure requirements in the Financial Statements of E & P enterprise.**

An E & P enterprise should disclose the following in its financial statements -

1. Method of accounting followed i.e. whether Full Cost Method of Successful Efforts Method.
2. Net Quantities of an enterprise's interests in proved reserves and proved developed reserves of- (a) Oil (including condensate and natural gas liquids); and (b) Gas.

Note:

- Quantitative data should be given as at the beginning and additions, deductions, production and closing balance for the year, on Geographical Basis.
- Quantities should be stated in Metric Tonnes for Oil Reserves and Cubic Meters for Gas Reserves.

7.10 MANAGEMENT DISCUSSION AND ANALYSIS

Illustrative: Management Discussion and Analysis

Company Name: LXY Ltd.

Global Economic Scenario:

Past two years were the most volatile years for the world economy since great depression of 1929. Though the domestic economies of India and China were relatively less impacted, their exports substantially declined as a result of global recession. However, with the sign of revival in the global economy specially the US economy from the third quarter of the year (Fourth quarter GDP growth of 5.6%), the growth has started showing signs of pick up. Although the outlook for the current and the coming quarters may be marginally better than that of the previous year, the recent turbulence due to poor fiscal discipline of some of the European countries has unsettled the Euro and drawn attention to the divergence in growth potential and fiscal health of various countries in Europe and as a result, the confidence is impacted.

Indian Economic Scenario: Resilience of the Indian Economy

India faced the financial crisis better than the West. Various measures like soft interest rates and reduced excise and service taxes were brought in as a part of the stimulus package. These have helped the economy to post more than 7% growth in 2009-10. The stimulus has helped exports and manufacturing to grow after months of decline. The Index of Industrial Production (IIP) rose by 16.7% in January and 15.10% in February 2010. In 2010-11 economic growth is projected at 8%+. The sales of the Corporate India grew by 13.4% in December 2009 and 4.7% for the year. Sectors like automobiles, auto ancillaries, tyre and textiles have benefitted from the pickup in the demand. The resilient economy could absorb the impact of the weakest monsoon since 1972.

However, the stimulus packages while sustaining growth have triggered the inflationary pressures and the inflation is now a matter of concern. Oil prices have started increasing and crossed the USD90 per barrel and are a major cause of concern. WPI rose by 9.9% in March 2010. To tame the inflation, RBI has initiated measures in its annual policy and announced hike in CRR and also raised the key rates.

Interest Rate Scenario:

Interest rates remained stable during the year due to the stimulus package and easy liquidity. The rates are likely to harden as the RBI takes measures to suck a part of the liquidity out of the system and pick up in the credit expected in the second quarter. The Company is engaged in financing of short term receivables and is subject to Rate Risk due to volatility in rates in the short term. To mitigate this risk the Company matches the maturity profile of its assets with short term funding options.

Merger of LX Ltd. with Y Ltd:

The process of merger of LX Ltd., with the Company initiated last year has been completed successfully during the year under the order of the Hon'ble Bombay High Court with effect from 11th February 2010. The merged company has been named as LXY Ltd. with effect from 23rd March 2010. The new entity commands 85% market share. The LXY Ltd. has now 17 branches in strategic locations in India. The combined entity enjoys highest ratings of A1+ & LAAA (Stable) from ICRA and CARE respectively for its short and long terms borrowings. The new Company has adopted a new logo. The new logo while preserving the brand recall of both the Companies symbolizes the synergy between the two Companies and the lineage of the merged entity.

The Company has appointed leading consultant Ernst & Young to prepare a new HR policy. Both the merged Companies operated on different software platforms developed by different vendors. For the merged entity, a new software has been commissioned and developed, which has since been successfully implemented in the Company.

Outlook for the Factoring Services:

The factoring services were launched in India in 1991 by L Ltd. by promoting X Ltd. In the last 19 years many Factoring companies entered the market and also shut their shops. However, the contribution of factoring products in meeting the total working capital requirement of the companies in India is less than 0.50%. As per the reports of Factors Chain International, an umbrella organization of factoring companies world-wide, in last 8 years the factoring turnover in China grew from 2,640 Mi EUR to 67,300 Mi EUR. In comparison, the turnover in India increased from 1615 Mi EUR to 2650 Mi EUR. Despite the growth in Indian Factoring in last five years at more than 60% compared to the worldwide growth of 50% in the same period, the share of Indian Factoring is less than 1% of the total volumes generated in the world. The reasons for the slow growth are several like inadequacies in the legal framework and ad valorem stamp duty on the assignment of debts. A comprehensive legislation to address the legal hurdles affecting the growth of the factoring industry is under consideration of Government of India. In spite of these impediments factoring products have gained popularity with the SMEs more particularly auto ancillary industry, component manufacturers for engineering companies etc. A number of such units are dealing satisfactorily with us and with revival of economy and auto industries in particular, the factoring can record a good growth in near future.

Performance of the Company:

Due to economic downturn the accounts of a number of clients of the Company have become nonperforming. In some client accounts, irregularities such as fake invoices and under valuation of securities were also noticed. The Company has classified these accounts as frauds and reported these for criminal investigation. The Company has adequately provided for these NPAs in its books out of current year's profits, which has affected its profits for the year. The Company has put a focus on the recovery of the NPA. The efforts have already started yielding dividend.

Study Note - 8

REPORTING THROUGH XBRL (EXTENDED BUSINESS REPORTING LANGUAGE)

This Study Note includes

8.1 Introdcution
8.2 Evolution of XBRL
8.3 XBRLS (XBRL Simple Application Profile)
8.4 What XBRL Not?
8.5 Users of XBRL
8.6 Advantages of Using XBRL
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8.10 An Introduction to XML
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8.12 Working Principle of XBRL
8.13 Main Features of XBRL
8.14 Taxonomies

8.1 INTRODUCTION

XBRL stands for e**X**tensible **B**usiness **R**eporting **L**anguage. It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet. XBRL provides major benefits in the preparation, analysis and communication of business information and is fast becoming an accepted reporting language globally. It offers major benefits to all those who have to create, transmit, use or analyse such information.

Let us take a closer look at the meaning of the term:

(a) **Extensible**: means the user can extend the application of a particular business data beyond its original intended purpose and the major advantage is that the extended use can bedetermined 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.

The property of extensibility is very handy in situations when list of items reported for various elements of the financial statements are not the same across firms, industries, and countries. For example, many of item constituting non-current assets in Oil and Gas Industry (items like rigs, exploratory oil and gas wells) may not be applicable to companies in general. In a situation of this kind, XBRL may prepare a taxonomy called a 'Global Common Document' (GCD) for items common to all the firms, industries, and countries, and, any country specific, industry specific and firm-specific variations (extensions / limitations) can, then, be written as independent taxonomies that can be imported and incorporated with the GCD.

(b) **Business:** means relevant to the type of business transaction. XBRL focus is on describing the financial statements for both public and private companies.

(c) **Reporting**: the intention behind promoting 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 XML, which 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.

Potential XBRL applications:

(a) XBRL for Financial Statements - financial statements of all sorts used to exchange financial information

(b) XBRL for Taxes -specification for tax returns which are filed and information exchanged for items which end up on tax returns

(c) XBRL for Regulatory Filings – specifications for the large number of filings required by government and regulatory bodies

(d) XBRL for Accounting and Business Reports - management and accounting reporting such as all the reports that are created by your accounting system rendered in XML to make re-using them possible

(e) XBRL for Authoritative Literature - a standard way for describing accounting related authoritative literature published by the AICPA, FASB, ASB, and others to make using these resources easier, "drill downs" into literature from financials possible

There is a dramatic improvement in processing of Financial Statements as XBRL documents can be prepared efficiently, extracted reliably, published more easily, analyzed quickly, retrieved by investors simply, and enables smarter investments.

XBRL solves two significant issues. The first issue is that preparing a financial statement for printing, for a Web site, and for filing today means that a company could typically enter information three times. With XBRL, information will be entered once and the same information will be "rendered" as a printed financial statement, an HTML document for a Web site, an EDGAR (Electronic Data Gathering, Analysis, Retrieval) filing file, a raw XML file, or a specialized reporting format such as periodic banking and other regulatory reports.

The second issue is that earlier, extracting specified detailed information from a financial statement, even an electronic financial statement like a regulatory filing, was a manual process. For example, a company cannot tell a computer program to "Get the prepaid expenses for 2008" from an electronic financial statement. If a financial statement is prepared using XBRL, computer programs can easily extract every piece of information in that statement.

8.2 EVOLUTION OF XBRL

Brief History

The inception of XBRL can be traced back to **April 1998**, when **Charles Hoffman**, a CPA with Knight Vale and Gregory, a Washington based firm, investigated how XML could be used for electronic reporting of financial information. Charles Hoffman along with the High Task Force of the AICPA began developing prototypes of financial statements and audit schedules using XML.

In **January 1999**, the completed prototype (ultimately named XBRL) was handed over to the AICPA, which agreed that XBRL was important to the Accounting profession. Later in **June 1999**, Charles Hoffman along with his associates created a business plan for XML-based financial statements, originally code named **XFRML** (later changed to XBRL).

In **August 1999** an **XBRL Steering Committee** was formed comprising twelve companies along with the AICPA as its members. These twelve companies were Arthur Andersen LLP, Deloitte & Touche LLP, e-content company, Ernst & Young LLP, FreeEDGAR.com, Inc. (now Edgar Online, Inc.), FRx Software Corporation, Great Plains, KPMG LLP, Cohen Computer Consulting, Microsoft Corporation, PricewaterhouseCoopers LLP, and The Woodburn Group.

In **October 1999**, the XBRL Steering Committee's first meeting took place in New York, where the development began on the **first taxonomy** namely - **XBRL for Financial Statements for the Commercial and Industrial Sector**, which represented about 80% of all publicly-traded U.S. companies.

In **April 2000**, the **new brand** for the technology namely **"XBRL"** was unveiled for the first time in a press conference held in New York.

In **July 2000**, the Steering Committee released **Specification 1.0**, the first XBRL Specification for Financial Statements for Commercial and Industrial Companies in the United States.

Around the same time, the Committee also announced the formation of a non-profit international organization namely **XBRL International**, for rapid global expansion and adoption of XBRL. Membership in the XBRL Steering Committee grew to more than 50 entities, including several international professional organizations.

In **August 2000**, **Bill Gates** declared XML to be the next revolution on the Internet and announced the net strategy, which included XML tools in upcoming Microsoft products.

In **June 2001**, XBRL International announced development efforts to create **XBRL for General Ledger** to allow tagged data to be moved into and out of the general ledger. This would serve as a bridge between business reporting and transaction reporting.

In **October 2001**, XBRL Australia, XBRL Canada, XBRL Germany, XBRL IASB, XBRL Japan, XBRL-Netherlands, and XBRL-UK formed the **first jurisdictions under XBRL International** to support the development of XBRL.

In **December 2001**, XBRL International finalised **XBRL 2.0**, the Enhanced XML Schema-Based Specification for Global Business Reporting. This release implemented the new World Wide Web Consortium (W3C) XML Schema Recommendation and utilised other new technologies such as XML Linking.

In **December 2003**, XBRL International issued a **Public Working Draft** of the **XBRL 2.1 Conformance suite**, which provided more than 200 tests to verify that applications processed XBRL 2.1 documents correctly. The **Financial Reporting Taxonomies Architecture (FRTA) 1.0,** which was also released at the same time, provided guidelines for the effective creation and use of taxonomies.

In **January 2004**, **TSX Group Inc. (TSX Group)** became the **first Canadian public company**, as well as the **first publicly-listed stock exchange globally**, to publish its annual financial results in XBRL.

In **March 2004**, the **total jurisdictions** under XBRL International **increased to 9** with Ireland and Spain too joining in. Subsequently, over the **years 2004-05**, the Steering Committee released **new taxonomies for GL as well as for US GAAP and UK GAAP.**

8.3 XBRLS (XBRL Simple Application Profile)

In 2008 Charlie Hoffman and Rene van Egmond proposed a simplified, more user-friendly XBRL application profile of XBRL that makes using XBRL easier for most business users, improves the potential for interoperability, and improves the potential for comparability needed by most business users, business communities, regulators and independent software vendors.

The stated goals of XBRLS are "to maximize XBRL's benefits, reduce costs of implementation, and maximize the functionality and effectiveness of XBRL. XBRL is a general purpose specification, based on the idea that no one is likely to use 100% of the components of XBRL in building any one solution. XBRLS specifies a subset of XBRL that is designed to meet the needs of most business users in most situations, and offers it as a starting point for others. This approach creates an application profile of XBRL (equivalent to a database view but concerned with metadata i.e. text, voice, or image that describes what the audience wants or needs to see or experience).

XBRLS is intended to enable the non-XBRL expert to create both XBRL metadata and XBRL reports in a simple and convenient manner. At the same time, it seeks to improve the usability of XBRL, the interoperability among XBRL-based solutions, the effectiveness of XBRL extensions and to reduce software development costs.

The profile was created by Rene van Egmond and Charlie Hoffman, who was the initial creator of XBRL. It borrows heavily from the US GAAP Taxonomy Architecture.

8.4 What XBRL Not?

(a) 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 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 it ability to transport data between disparate software applications that might be used within an organizations operational structures.

(c) XBRL is not a GAAP translator. It does not provide a mechanism for facilitating a drilldown of existing GAAP information into lower levels of information that would be necessary for translating financial statements from one GAAP to another. The business-reporting document contains the same GAAP information, be it in an XBRL format or an MS word or PDF format.

(d) XBRL is not a proprietary technology. XBRL is freely licensed and available to the public. XBRL is XML-based and therefore is expected to be widely available in software applications.

(e) XBRL is not a Transaction Protocol. XBRL is designated to address issues related to generation and usage of information contained within business reports and begin at the accounting classification level. XBRL is about business reporting information, not about data capture at the transaction level.

8.5 USERS OF XBRL

(A) Corporations:

Since XBRL was designed to handle corporate financial information, it logically follows that corporations would be one of the primary users. These days most major corporations provide some sort of company financial information via the Internet. Both the corporations providing this information and the investors who are receiving it need an easy way to do so. XBRL provides a method via which financial information can be delivered to end users quickly and easily.

The main benefit to the corporation is that the information can be entered once and maintained in a standard format. Required forms and documents can then be automatically generated from the XBRL formatted document. This prevents the duplication of financial data and thereby helps prevent errors and inconsistencies.

(B) Investors, Accountants and other users of Corporate Financial Data:

Having a standardized and machine-readable format is invaluable to consumers of corporate financial information. XBRL provides just such a format. Without it, consumers of the data would be stuck trying to negotiate a format for a data feed with each corporation they wished to receive data from or would be forced to manually enter data obtained from a non-machine-readable source. In addition to the lessening the time and expense involved with either of the alternatives, XBRL also helps prevent the errors they can cause. By having a standardized format, developers can share code designed to read XBRL or purchase tools with XBRL support built in. On top of preventing errors, being able to use previously tested XBRL tools also increases productivity and brings the data to those who might otherwise not have the time, money, know-how to retrieve it on their own.

8.6 ADVANTAGES OF USING XBRL

(A) Overall Advantages

XBRL offers major benefits at all stages of business reporting and analysis. The benefits are mainly by way of automation, cost saving, faster, more reliable and more accurate handling of data, improved analysis and better quality of information and decision-making. These overall advantages of XBRL have been briefly discussed below:

(i) Automated Data Processing: XBRL enables automation of financial data thus making it computer readable. This eliminates the laborious manual process of data collation, re-entry, comparison as well as the inaccuracies that go with it.

XBRL allows very efficient handling of business data by computer software and supports all the standard tasks involved in compiling, storing and using business data. XBRL software also facilitates automatic checking of information and thus makes the entire process of data collection and analysis more reliable and accurate.

For example, data from different company divisions with different accounting systems can be assembled quickly, cheaply and efficiently if the sources of information have been upgraded to using XBRL.

(ii) Cost Saving: A lot of effort would be expended if all the tasks ranging from data collection to analysis and reporting were to be done manually. This entire process would prove to be very expensive and tedious. However adoption of XBRL for data processing will reduce the manpower involved and result in considerable amount of cost saving.

(iii) Time Saving: Use of manual workforce for gathering and collating financial information will be a time consuming affair and will delay the process of analysis and meaningful reporting of data. However the powerful XBRL software increases the speed of handling the data and completes all aspects of data processing in quick time. This time reduction will allow users to increase their focus on analysis and help in prompt decision making.

For example, searches for particular information which might normally take hours can be completed with XBRL in a fraction of a second.

(iv) Better Financial Reporting: XBRL also facilitates preparation of quality and timely reports to suit different needs. Once data is gathered in XBRL, different types of reports using varying subsets of the data can be produced with minimum effort.

A company finance division, for example, could quickly and reliably generate internal management reports, financial statements for publication, tax and other regulatory filings, as well as credit reports for lenders.

XBRL also does not enforce any standardisation in financial reporting. Its language is flexible and supports all current aspects of reporting in different countries and industries. It can also be adjusted to meet particular business requirements of individual organizations. Taxonomy extensions also permit diverse companies to include additional concepts in their business reports besides meeting the accounting regulations of their respective countries.

(v) Multi Language Capability: XBRL can read and understand data in different languages and accounting standards and can be flexibly adapted to meet different needs of various users. The taxonomies and tags associated with the system allow for speedier multi-language data reads and also enhance transmission of data across the globe. Software and mapping tools allow businesses to transfer existing information into XBRL quickly and efficiently.

(vi) Improved Data Analysis: The XBRL software helps to automatically validate and manipulate data received electronically. XBRL facilitates a deeper and accurate analysis of the automated data to meet the requirements of all types of end users. This thorough analysis will equip business leaders with greater confidence to make financial decisions that impact their companies, For example, banks and other financial institutions can analyse loan applications as well as a borrower's financial records more quickly and more accurately which may increase the approval of good loans and significantly lower the acceptance of loans to high risk borrowers.

(B) Advantages to Individual Stakeholders

All types of organisations can use XBRL to save costs and improve efficiency in handling business and financial information. Due to its flexible nature, XBRL can be adapted to suit a wide variety of requirements of preparers as well as users of financial data.

The prominent entities that can benefit from use of XBRL are government regulators, stock exchanges, investment analysts, banks, financial companies, accountants, auditors, accountancy software vendors, and information technology companies.

The ways in which some of these main organisations benefit by use of XBRL are given below:

Regulators and Government Bodies: By introducing XBRL for reporting, regulators and other government authorities can:

- Obtain data which can be entered automatically into systems without reformatting or other "translation" effort.
- Dramatically reduce costs by automating routine tasks.
- Quickly and automatically identify problems with filings.
- Analyse and compare data much more quickly, efficiently and reliably. Benefit from the use of software in validation and analysis.
- Monitor data and activities and reach judgments with far greater speed and confidence.
- Focus effort on analysis, decision-making and dealing with counterparties rather than on data manipulation.
- Provide a much faster and focused response to counterparties.
- Promote efficiencies and cost savings throughout the regulatory filing process.

(i) Stock Exchanges: Stock Exchanges can use XBRL to

- Make their process of company data collection more efficient, comprehensive, and reliable.
- Increase the value and competitiveness of the data products which they offer to institutions and private investors.
- Strengthen the transparency and robustness of information on their markets.

Depending on the circumstances, Exchanges may be able to encourage or mandate the filing of information by companies in XBRL or convert company data into XBRL. They can then offer data in XBRL form, benefitting all consumers of investment information. The result is a set of more competitive and valuable exchange data products as well as improved exposure for the Exchange.

(ii) Investment Analysts: By using XBRL, investment analysts and advisers can benefit from:

- Much greater transparency, clarity and consistency in company financial data.
- The ability to handle and compare a broader range of companies and deeper set of information.
- More powerful software tools for analysis, comparison and benchmarking.
- Far more efficient means of finding specific company data.
- The ability to select data from a variety of companies within seconds for comparison and analysis.

In short, XBRL can help the analyst community provide quicker and better quality investment advice and decisions.

(iii) Financial Companies: Through the adoption of XBRL, companies in the financial information industry will be able to:

- Obtain company financial data in a standardised and predictable form.
- Significantly reduce costs by automating many aspects of the gathering and storage of financial data.
- Switch efforts from routine data gathering to analysis.
- Provide a faster, clearer, deeper and more accurate view of company financial performance.
- Produce richer and more usable products containing XBRL data.

(iv) Banks: Through XBRL, loan and credit management departments of banks can:

- Obtain data quickly and reliably via automated reporting.
- Reduce costs in processing data.
- Compare and analyse financial information much more reliably, fully and effectively using automated processes.
- Track financial performance more quickly and efficiently.
- Reach decisions more confidently and provide a quicker response to clients.

In particular, Credit Risk Assessment companies are already working within XBRL International on the introduction of XBRL in this area. XBRL also facilitates Credit Insurance Underwriting decisions through a high-quality assessment of the concerned data.

(v) Accountants: The development of XBRL software and its implementation all over the world has helped the community of accountants and auditors immensely. Through the use of XBRL in companies, accountants will be able to:

- Obtain more rapid and reliable data on company financial performance.
- Greatly reduce effort and costs in gathering and analysing data.
- Simplify and automate tasks.
- Focus effort on analysis and value-added work.
- Make better use of software to improve efficiency and speed.
- Facilitate paperless financial reporting.

As XBRL software allows for automated machine-to-machine communication, accountants, data entry clerks, and auditors can receive and begin to review and study blocks of data at significantly reduced speeds. Auditors around the world can also devote more of their time to reviewing data received from another country rather than focusing on validating the accuracy of the information. In short, XBRL can speed up, reduce effort and increase reliability in accounting and auditing tasks.

The accounting community can play an important role in explaining and encouraging the adoption of XBRL. Major accounting companies are important members of the XBRL Consortium.

(vi) Software, Systems and IT Companies: XBRL offers software, systems and IT companies a range of opportunities to enhance existing products, develop new ones and expand their business. It enables these companies to:

- Adopt a data standard for transferring business and financial information, avoiding the commercial conflicts and client aggravation caused by competing proprietary standards.
- Create software to support the preparation, publication and collection of data in XBRL.
- Create software to select, compare and analyse financial data in XBRL.

Software, systems and IT companies are among key members of the XBRL consortium. Their areas of activity range though general software and data handling, accounting, data analysis and validation, business systems, data publishing, to specialist XBRL and XML products.

8.7 XBRL INTERNATIONAL

XBRL International is a not-for-profit consortium of approximately 550 companies and agencies worldwide working together to build the XBRL language and promote and support its adoption. It is comprised of jurisdictions which represent countries, regions or international bodies and which focus on the progress of XBRL in their area. The number of established jurisdictions has grown from 7 to 22 over the years. Around 5 jurisdictions, including India are presently in the provisional stage.

It operates mainly through the XBRL Steering Committee and has over the years produced a variety of specifications and taxonomies for digitizing financial information in accordance with the accounting rules and other regulations prevailing in different countries. The consortium members meet periodically in international conferences and conduct committee work regularly throughout the week.

This collaborative effort began in 1998 and has produced a variety of specifications and taxonomies to support the goal of providing a standard, XML-based language for digitizing business reports in accordance with the rules of accounting in each country or with other reporting regimes such as banking regulation or performance benchmarking

8.8 INTERNATIONAL SCENARIO

Development of XBRL is taking place all over the world with increasing participation from individual countries and international organisations. Today, around 15-18 countries have already established jurisdictions for promotion of XBRL and a few more are in the process of doing so.

- United States has been the pioneer in the development of XBRL. So far in the US, XBRL has been used mainly in the capital markets. To expand the use of XBRL in the country, the SEC has framed rules in January 2009 making it compulsory for all companies to file returns in the XBRL format in a phased manner over a three year period 2009-2011. These rules will apply to domestic and foreign companies using U.S. GAAP and to foreign private issuers using IFRS.
- In Europe, XBRL development started with government wide and cross-border applications with public and private sector working together for this purpose. Tax regulators drove development in Ireland, Municipalities in Germany, the Banking Sector in Spain, the Water Board in the Netherlands, and the Companies House in Denmark. In 2004 the Committee of European Bank Supervisors started using XBRL for Basel II reporting across all 27 member states, while the European Commission too formally urged its member states to register their taxonomies with XBRL International.
- The Bank of Spain has developed an XBRL-based financial information exchange system to support XBRL-based reporting of the public financial statements by credit institutions to the Bank of Spain.
- The Dutch Taxonomy project team issued the first version of the taxonomy that will be used to contribute to the effort to reduce administration burden. Dutch municipalities are filing quarterly reports in XBRL.
- U.K. Inland Revenue is using XBRL in electronic filing based on XBRL-UK GAAP Taxonomy
- Australian lending information being collected from all Australian banks in XBRL
- Sumitomo Mitsui Bank of Japan integrated XBRL as interchange format for letters of credit for international trade as part of complex supply chain application
- The Tokyo Stock Exchange has been accepting corporate financial information in XBRL format since early 2003.
- In the Netherlands, all government agencies, from the justice department to bank regulators to tax collectors are working together on a national taxonomy of business reporting items.
- The Toronto stock Exchange publishes its financial statement in XBRL since 2003.
- The Australian Prudential regulation Authority has been collecting regulatory data in XBRL since 2005.

8.9 XBRL INDIA

The development of XBRL technology in India started mainly around the period 2005-07. India is probably the first among developing countries to introduce XBRL standard in its reporting system.

XBRL India is the provisional jurisdiction of XBRL International and is facilitated by the Institute of Chartered Accountants of India (ICAI). XBRL India is governed by a Steering Committee which is headed by the President, ICAI.

Its objectives are:

- To promote and encourage the adoption of XBRL in India as the standard for electronic business reporting in India
- To facilitate education and marketing of XBRL
- To develop and manage XBRL taxonomies
- To keep the developed XBRL taxonomies updated with regard to international developments
- To represent Indian interests within XBRL International
- To contribute to the international development of XBRL

XBRL India has developed Draft General Purpose Financial Reporting XBRL taxonomy for Commercial and Industrial Companies. This taxonomy covers the financial statements like Balance Sheet, Statement of Profit and Loss, and Cash Flow Statement and related non-financial information. The draft taxonomy has been developed conforming to Indian Accounting Standards and Company Law. XBRL India is currently developing XBRL Taxonomy for the Banking Sector.

Other Organisations in India using XBRL

Members of XBRL India among others include regulators such as Reserve Bank of India (RBI), Insurance Regulatory and Development Authority (IRDA), Securities and Exchange Board of India (SEBI), Ministry of Corporate Affairs (MCA), stock exchanges like Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE), and some private sector companies.

Both leading stock exchanges of India, BSE and NSE have migrated to XBRL from the paper based model and offer a unified electronic platform, popularly known as 'CorpFiling' system, which enables the companies listed in either or both of the exchanges to electronically file their disclosures. Approximately 100 top companies of India are using CorpFiling XBRL platform for filing mandatory information. BSE has played an important role in the initiation of XBRL reporting platform in India and was the first one to formally adopt XBRL in the country.

To attune to the new XBRL based reporting standards, legal and regulatory changes are required. SEBI has thus issued a mandate for select companies to submit their Financial Statements through the Corporate Filing and Dissemination System (CFDS) starting in the first phase in 2008.

Recently, RBI has also moved to XBRL based electronic filing system for the Basel II Reporting by Banks, wherein banks are required to submit their returns for capital adequacy returns data through the existing Online Return Filing System (ORFS). Banks are now upgrading to Core

Banking Solution (CBS) and also sprucing up their internal Management Information Systems (MIS), which will create a platform for the implementation of XBRL solutions.

Ministry of Corporate Affairs [MCA] is planning to use extensible business reporting language (XBRL) in an effort to work closely with SEBI and RBI, which are also migrating to XBRL. While MCA maintains a database of all registered companies, SEBI deals with listed firms and RBI with banks and non-banking finance companies. "Through e-filing, MCA has obtained a mass database which is available in public domain. So far its use is restricted to getting information on companies. But this data can be productively used for examining and analysing the direction in which companies are moving. XBRL, combined with a sophisticated technology, will further support these objectives

8.10 AN INTRODUCTION TO XML

Meaning of XML

XML stands for eXtensible Markup Language and is a markup language for documents containing structured information. Structured information contains both content and some indication of what role that content plays. Almost all documents have some structure. A markup language is a mechanism to identify structures in a document. The XML specification defines a standard way to add markup to documents.

A number of applications currently being developed that are based on, or make use of, XML documents include vector graphics, e-commerce transactions, mathematical equations, object meta-data, server APIs, and a thousand other kinds of structured information.

There are hundreds and thousands of computers programming language and one among them is XML. Also XML markup language has types of programming language. There are 187 types of XML markup language and amongst them one of them is XBRL.

Evolution of XML

Limitations of HTML gave birth to XML. The Limitations were as follows:

- Limited number of Tags
- Browsers are forgiving.
- Browser developers may be tempted to add new tags that only work with their product.
- Cannot customize layout from client side
- Product comparison.

The above limitations gave birth to XML. It was the World Wide Web Consortium (W3C) where XML group (originally known as the SGML Editorial Review Board) worked and invented XML. The work was started in 1996. On 10th February, 1998 XML version 1.0 recommendation was released. The Second Edition of XML was then released on 6th October, 2000.

The XML Working Group consists of about 14 companies and organizations with a strong interest in either providing or utilizing XML tools. This group includes Adobe, ArborText, DataChannel, Fuji Xerox, Hewlett-Packard, Inso, Isogen, Microsoft, Netscape, SoftQuad, Sun Microsystems, and the University of Chicago, along with W3C representatives and independent experts. The working group was chaired by John Bosak, Chief computer Engineer of Sun Microsystems.

Advantages of XML over HTML:

- HTML tells how the data should look whereas XML tells what it means.
- XML applies context to the data and separates data content from data presentation.
- XML provides a hierarchical structure. However XML is not designed to replace HTML.

XML Family of Languages

XML has been developed as an activity of the World Wide Web Consortium (W3C). Within W3C, a number of other XML-related language development activities have been going on, where the intent is to specify syntactic and semantic rules either for some specific kind of XML data or for data to be used together with XML data for a specific purpose. Therefore a group of languages evolved which together with XML, is called the XML family of languages.

Considering the purpose of the XML-related languages developed at W3C, four main categories can be identified. The first category consists of the different versions of XML itself. XML is intended for representing information as structured documents on the Web and for defining special languages for special purposes. The other three categories are called in this classification XML Accessories, XML Transducers, and XML Applications:

XML Accessories are languages which are intended for wide use to extend the capabilities specified in XML. Examples of XML accessories are the XML Schema language extending the definition capability of XML DTDs and the XML Names extending the naming mechanism to allow in a single XML document element and attribute names that are defined for and used by multiple software modules.

XML Transduces are languages which are intended for transducing some input XML data into some output form. Examples of XML transducers are the style sheet languages CSS and XSL intended to produce an external presentation from some XML data and XSLT intended for transforming XML documents into other XML documents. A transducer language is associated with some kind of processing model which defines the way output is derived from input.

XML Applications are languages which define constraints for a class of XML data for some special application area, often by means of a DTD. Examples of XML applications are MathML defined for mathematical data or XML-Signature intended for digital signatures. XML accessories and XML transducers are often XML-based languages and thus also XML applications. In this report a language is however classified as an XML application only if it has not been included in the accessories or transducers.

The languages in the XML applications category can be further divided into four subcategories according to the applicatio

- Non-textual forms of data like mathematical data or voice.
- Web publishing, to replace HTML by XML-based representation format.
- Semantic web.
- Web communication and services.

8.11 DIFFERENCES BETWEEN XML AND XBRL

While it is true that XBRL is built on XML, and that all XBRL documents must also be XML valid, there are major differences between the two. The most important conceptual distinction is that XBRL provides a way to express and validate semantics. For example, *Assets = Equity + Liabilities* can be expressed using XBRL but not using native XML.

XBRL accommodates change better than XML. For example, XBRL separates the schema from the data. XBRL instance (data) documents are simple, containing normalized data immune to their sequence, and without hierarchy. Users can make changes to the XBRL taxonomy, such as changing parent-child relationships or adding new children, without having to reformat instance documents. Similarly, data in the instance document may be reordered without having an impact on the taxonomy. Normalized data also simplifies database storage.

Another unique feature of XBRL is its native support of multidimensional modeling, which is very similar to Microsoft Excel pivot tables. Consider the situation where you want a metadata model to support segmentation of product sales by country and also by product line. Assuming a simple example of product sales by three countries (US Canada, and India) and two product lines (software and hardware), a pure element-based approach would result in 12 elements:

- sales_US_software
- sales_US_hardware
- sales_US_allProducts
- sales_Canada_software
- sales_Canada_hardware

- sales_Canada_allProducts
- sales_India software
- sales_India_hardware
- sales_India_allProducts
- sales_allCountries_software
- sales_allCountries_hardware
- sales_allCountries_allProducts

Adding another product to the product line adds another four elements. Add another line item, such as cost of goods sold, and that one additional line item would result in another twelve elements. Such an approach quickly gets out of control, and is extremely frustrating to model and manage.

Using XBRL dimensions, there would be the single element of sales, along with the two dimensions of country and product line.

8.12 WORKING PRINCIPLE OF XBRL

XBRL is a member of the family of languages based on **XML, or Extensible Markup Language**, which is a standard for the electronic exchange of data between businesses and on the internet. Under XML, **identifying tags** are applied to items of data so that they can be processed efficiently by computer software.

XBRL, a more powerful and flexible version of XML, has been defined specifically to meet the requirements of business and financial information. It enables **unique identifying tags** to be applied to items of financial data, such as say 'net profit' or say "Asset". For example let us take the item "Asset". It is defined in XBRL as follows:

<Asset>1000</Asset>

The word Asset together with brackets "<" and ">" is called a tag. Opening tags are denoted by <…> while closing tags are denoted by </…>.

However besides the numerical value of the asset, the computer needs to be told about accounting perspective of the term "Asset", its normal balance nature of "Debit" as well its relationship with other financial terms like Equity or Liabilities etc.

This is done by the powerful XBRL tags. Besides being identifiers, these tags provide a range of information about the item, such as whether it is a monetary item, percentage or fraction. XBRL allows labels in any language to be applied to items, as well as accounting references or other subsidiary information.

XBRL can show how items are related to one another and can thus represent how they are calculated. It can also identify whether they fall into particular groupings for organisation or presentation purposes. Most importantly, XBRL is easily extensible, so companies and other organisations can adapt it to meet a variety of special requirements.

The rich and powerful structure of XBRL allows very efficient handling of business data by computer software. It supports all the standard tasks involved in compiling, storing and using business data. Such information can be converted into XBRL by suitable mapping processes or generated in XBRL by software. It can then be searched, selected, exchanged or analysed by computer, or published for ordinary viewing.

Working of XBRL is governed **mainly by two main features namely Specifications and Taxonomies.**

8.13 MAIN FEATURES OF XBRL

(i) **Specifications: Specifications** provide the **fundamental technical definition** of how XBRL works. The main, current specification for XBRL is **version 2.1**.

New specifications are developed from requirements statements. They are initially discussed as Internal Working Drafts within the consortium and then released as **Public Working Drafts**. After a careful process of review, they are then finally released as **official XBRL Recommendations**. A Recommendation represents consensus within the XBRL International community as well as a stamp of approval for its widespread deployment.

(ii) **Taxonomies**:

The word 'taxonomy', is derived from Greek verb tassein which means to classify and noun nomos that could be translated into English as law or science. Combined and interpreted word for word it would mean classification of some kind of knowledge. Initially, it referred to the science of classifying living things, but later it received wider meaning and is currently applied to either classification of things in general or rules governing this classification.

Frequently, taxonomies are given hierarchical structures or are built in the form of networks so, as well as the elements, they also represent relationships.

Virtually everything could be a subject of classification under some taxonomy. The most common example of taxonomy is classification of living creatures. The root element (the most general one) is Organism since all living things are of this group. Its first child is Domain which in turn is a parent of Kingdom whose subgroup is Division that is divided into Classes and so on.

One important characteristic of taxonomies is that children (lower level elements) may have many parents (upper level elements). In some classifications, spiders could be categorised as insects, in others as eight-legged creatures and in another as non-flying organisms.

Now, how does this term apply to XBRL?

Taxonomies are the dictionaries used by XBRL. They define the specific tags for individual items of data (such as "Asset"). Different taxonomies will be required for different financial reporting purposes. National jurisdictions may need their own financial reporting taxonomies to reflect their local accounting regulations. Many different organisations, including regulators, specific industries or even companies, may require taxonomies to cover their own business reporting needs. Taxonomy has got the following components:

(a) **Schema:** This is the core part of the taxonomy and stores information about taxonomy elements i.e. their names, ids and other characteristics. It can be regarded as a container where an unstructured list of elements and references to linkbase files are described. The main purpose of XBRL schemas is to provide the computer with information on how it should represent and process accounting terms.

(b) **Element:** An element (which is a part of the Schema) is a business concept (such as Assets, Liabilities, Income…) presented to a computer in a way that it could learn its main characteristics. Definitions of elements that appear in schemas are constructed according to a specific set of rules.

For example say in the case of "Asset"

<element name="Assets" id="Assets" periodType="instant"

balance="debit" abstract="false" substitutionGroup="item"

type="monetaryItemType"/>

The characteristics of "Asset" like its name, type, balance and period type are described from a business perspective by the element to the computer.

(c) **Linkbases:** are a collection of Links, which themselves are a collection of locators, arcs, and potentially resources. Locators are elements that essentially reference a concept and provide an arbitrary label for it. In turn, arcs are elements indicating that a concept links to another concept by referencing the labels defined by the locators. Some arcs link concepts to other concepts. Other arcs link concepts to resources, the most common of which are human-readable labels for the concepts. The XBRL 2.1 specification defines five different kinds of linkbases.

- ❖ Label Linkbase - This linkbase provides human readable strings for concepts. Using the label linkbase, multiple languages can be supported, as well as multiple strings within each language.
- ❖ Reference Linkbase - This linkbase associates concepts with citations of some body of authoritative literature.
- ❖ Calculation Linkbase - This linkbase associates concepts with other concepts so that values appearing in an instance document may be checked for consistency.
- ❖ Definition Linkbase - This linkbase associates concepts with other concepts using a variety of arc roles to express relations such as is-a, whole-part, etc.
- ❖ Presentation Linkbase - This linkbase associates concepts with other concepts so that the resulting relations can guide the creation of a user interface, rendering, or visualisation.

Besides these, other features which also form a part of XBRL working are:

(iii) **Instance Document:** An XBRL instance document is a business report in an electronic format created according to the rules of XBRL. It contains facts that are defined by the elements in the taxonomy it refers to, together with their values and an explanation of the context in which they are placed. The instance document assigns a value to an element and provides additional information about the currency in which it is disclosed and defines a period and the entity that it refers to.

The instance document begins with the <xbrl> root element. There may be more than one XBRL instance embedded in a larger XML document. The XBRL instance document itself holds the following information:

■ *Business Facts* - facts can be divided into two categories

- *Items* are facts holding a single value. They are represented by a single XML element with the value as its content.
- *Tuples* are facts holding multiple values. They are represented by a single XML element containing nested Items or Tuples.

In the design of XBRL, all Item facts must be assigned a context.

■ *Contexts* define the entity (e.g. company or individual) to which the fact applies, the period of time the fact is relevant, and an optional scenario. Date and time information appearing in the period element must conform to ISO 8601. [an international standard covering the exchange of date and time-related data] Scenarios provide further contextual information about the facts, such as whether the business values reported are actual, projected, or budgeted.

■ *Units* define the units used by numeric or fractional facts within the document, such as USD, shares. XBRL allows more complex units to be defined if necessary. Facts of a monetary nature must use a unit from the ISO 4217 [international standard describing three-letter codes (also known as the **currency code**) to define the names of currencies established by the International Organization for Standardization (ISO) namespace.

(iv) **Footnote**: Footnotes appear on instance documents and provide additional information for some of the elements.

(v) **Taxonomy Extension:** Public taxonomies, such as IFRS, define elements and relationships between them according to particular legislation or standards and allow companies to create financial statements that are valid and compliant with their requirements.

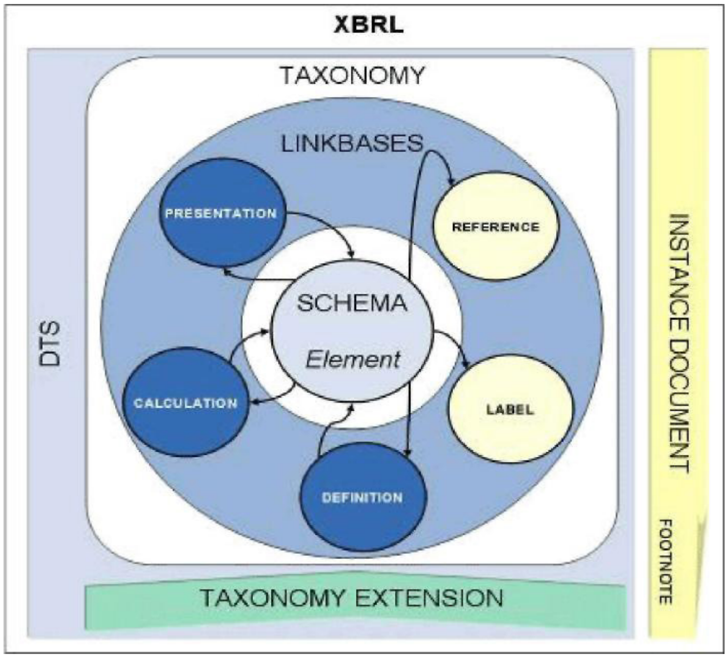
But in the diverse world of finance, companies are required to include in their business reports additional concepts (usually related to the area of their activity or the reporting purpose). XBRL allows for such extensions of taxonomy without loss of comparability and integrity of data.

(vi) **DTS (Discoverable Taxonomy Set):** It contains one or more taxonomies i.e. a number of schemas together with linkbases related to them. This term was developed as taxonomies became more complicated and more closely related to each other.

After describing the above features of XBRL, one can now mention with reference to the earlier example of **<Asset>iooo</Asset>** that

- values between tags (<Asset>1000</Asset>) will be found in instance documents;
- information on what an Asset is and how a computer should treat it will be provided in schema files;
- Relationships will be described in linkbases.

Thus the above features of XBRL can be best illustrated by the following diagram:



8.14 TAXONOMIES

Types of Taxonomies

Types of taxonomies officially recognised by XBRL International are given below.

i. **Financial Reporting Taxonomies**: These have been officially recognised by XBRL

International and have two levels of recognition. **Approved Taxonomies** have to comply with the official XBRL guidelines for that type of taxonomy, as well as with the XBRL Specification. **Acknowledged Taxonomies** just have to comply with the XBRL Specification.

a) **Approved Taxonomies** must

1. Comply with the FRTA document.
2. Have been used to create a number of instance documents which confirm it adequately covers the data it purports to represent.
3. Have been through a period of open review following initial Acknowledgement.

b) **Acknowledged Taxonomies** are recognised by XBRL International as being in compliance with the XBRL Specification. They are acknowledged against a specific version of the Specification. Compliance is confirmed by testing taxonomy in a defined range of XBRL applications which may be upgraded and changed from time to time.

ii. **GL Taxonomy:** This is a special taxonomy designed to support collation of data and internal reporting within organisations. It is intended to enable the efficient handling of financial and business information contained within an organisation. Often this is scattered across disparate accounting systems. XBRL allows it to be brought together, analysed and used in a highly cost-effective way, overcoming the inefficiencies of different accounting systems or approaches.

The XBRL Global Ledger taxonomy **allows the representation** of anything that is found in a **chart of accounts, journal entries or historical transactions**, financial and non-financial. It does not require a standardised chart of accounts to gather information, but it can be used to tie legacy charts of accounts and accounting detail to a standardised chart of accounts to improve communications within a business.

XBRL Global Ledger is **reporting independent**. It collects general ledger and after-the-fact receivables, payables, inventory and other non-financial facts, and then permits the representation of that information using traditional summaries and through flexible links to XBRL for reporting.

XBRL Global Ledger is **system independent**. Any developer can create import and export routines to convert information to XBRL GL format. This means that accounting software developers need only consider one design for their XML import/export file formats. Application service providers can offer to supply XBRL import and output so end-users can more easily use their own data. Companies developing operational products, such as point of sale systems or job costing, or reporting tools can link with many accounting products without needing specialised links to each one.

XBRL Global Ledger permits **consolidation**. Popular low-end products and mid-market solutions are not designed to facilitate consolidating data from multiple organisations. XBRL GL can help transfer the general ledger from one system to another, be used to combine the operations of multiple organisations, or bring data into tools that will do the consolidation.

XBRL Global Ledger provides **flexibility**, overcoming the limitations of other approaches such as Electronic Data Interchange (EDI). It offers an **extensible, flexible, multinational solution** that can exchange the data required by internal finance, accountants, and creditors.

It complements **XBRL for financial reporting**, linking financial reports to the detail behind them, providing all the specific information required for audit work papers, budget planning, and detailed reporting.

Extensibility

Besides the creation of additional modules, XBRL International supports several methods for continuing expansion of shared XBRL functionality.

- Link Role Registry - This registry, hosted at xbrl.org, collects link roles and arc roles to promote reuse across taxonomies.
- Functions Registry - This registry collects XPath functions for reuse in formula linkbases.
- Format Registry - This registry collects common numeric formats for reuse in Inline XBRL applications.
- Best Practice RFCs - These documents will share common practices among community members to improve interoperability of design.

Study Note - 9

GOVERNMENT ACCOUNTING IN INDIA

This Study Note includes

9.1 Government Accounting in India
9.2 General Principles of Government Accounting
9.3 Methods of Government Accounting
9.4 Comparison with commercial accounting
9.5 Comptroller and Auditor General of India
9.6 Audit of Government Companies (Commercial Audit)
9.7 Audit Board Setup in Commercial Audit
9.8 Public Accounts Committee
9.9 Role of Public Accounts Committee
9.10 Committee on Public Undertakings
9.11 Specimen Report
9.12 Government Accounting Standards Issued by Government Accounting Standards Advisory Baord (GASAB)
9.13 Government Accounting & Reporting

9.1 Government Accounting in India

The accounting of Government activities is specialised in nature. Government of India means the Central (union) government or state government or union territory government or all the three as the context may imply. The immediate objective of Government accounting is not to ascertain the gain or loss on the transactions of the Government as a whole in carrying out its activities. The activities of the Government are determined by the needs of the country. The main branches of its activities being known, it is a matter for decision what expenditure will be necessary during any year in carrying out these activities. After a decision has been reached on this point, it becomes necessary to determine how to raise sufficient money to meet that expenditure.

9.2 General Principles of Government Accounting

The general principles of Government Accounting are as follows:

1. The Government Expenditure are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of account, the accounting is more elaborate that that followed in commercial accounts. The method of budgeting and accounting under the service heads is not designed to bring out the relation in which Government stands to its material assets in use, or its liabilities due to be discharged at more or less distant dates.

2. In its Budget for a year, Government is interested to forecast with the greatest possible accuracy what is expected to be received or paid during the year, and whether the former together with the balance of the past year is sufficient to cover the later. Similarly, in the compiled accounts for that year, it is concerned to see to what extent the forecast has been justified by the facts, and whether it has a surplus or deficit balance as a result of the year's transactions. On the basis of the budget and the accounts, Government determines (a) whether it will be justified in curtailing or expanding its activities (b) whether it can and should increase or decrease taxation accordingly.

3. 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.

Basic Structure of the form of the accounts:

(1) 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.

(2) Cash basis Accounts: With the exception of such book adjustments as may be authorized by these rules on the advice of the Comptroller and Auditor General of India (CAG). The transaction in government accounts shall represents the actual cash receipt and disbursement during a financial year.

Form of Accounts: There are mainly three parts i.e. consolidated fund, contingency fund and public account.

In consolidated fund there are two divisions i.e. revenue consisting of section for receipts heads and expenditure heads [Revenue Accounts] capital, public debts, loan consisting of section of receipts heads [capital accounts] where as contingency fund accounts shall be recorded to the transactions connected with the government set up under article 267 of the constitution and Public account transactions relating to the debt deposit, advances, remittances and suspense shall be recorded.

9.3 Methods of Government Accounting

The mass of the Government accounts being on cash basis is kept on Single Entry. There is, however, a portion of the accounts which is kept on the Double Entry System, the main purpose of which is to bring out by a more scientific method the balance of accounts in regard to which Government acts as banker or remitter, or borrower or lender. Such balances are, of course, worked out in the subsidiary accounts of single entry compilations as well but their accuracy can be guaranteed only by a periodical verification with the balance brought out in the double entry accounts.

Business and merchant accounting methods are different than government accounting system because government accounting system is ruling over the nation and keeps various departments i.e. production, service utility or entertainment industry etc. The operations of department of government some times include under talking of a commercial or quasi-commercial character and industrial factory or a store. It is still necessary that the financial results of the undertaking should be expressed in the normal commercial form so that the cost of the services or undertaking may be accurately known. In the government account there are few problems affected adversely. In the case of central and state government transaction communication procedure, bank accounts and uniformity are improper. In the paper it suggested Central and state government should adopt it fully computerized accounting system in routine procedure of all transactions and adopted accounting system should be familiar with global accounting standards. Improvement programs i.e. symposium, seminar is helpful for sustaining the accounting system. Graduate level accounting syllabus should be modified as per government accounting procedure and methods.

Business and merchant accounting methods are different than government accounting system because government accounting system is ruling over the nation and keeps various departments i.e. production, service utility or entertainment industry etc. government accounting system is wider than the any specific company accounts.

9.4 Comparison with commercial accounting

The principles of Commercial and Government Accounting differ in certain essential points. The difference is due to the fact that, while the main function of a commercial concern is to take part in the production, manufacture or inter-change of gods or commodities between different groups or individuals and thereby to make profit, Government is to govern a country and, in connection therewith, to administer the several departments of its activities in the best way possible.

Government Accounts are designed to enable Government to determine how little money it need take out of the pockets of the tax-payers in order to maintain its necessary activities at the proper standard of efficiency. Non-Government Commercial accounts, on the other hand, are meant to show how much money the concern can put into the pockets of the proprietors consistently with the maintenance of a profit-earning standard in the concern.

9.5 Comptroller and Auditor General of India

The organisations subject to the audit of the Comptroller and Auditor General of India are:

- All the Union and State Government departments and offices including the Indian Railways and Posts and Telecommunications.
- About 1200 public commercial enterprises controlled by the Union and State governments, i.e. government companies and corporations.
- Around 400 non-commercial autonomous bodies and authorities owned or controlled by the Union or the States.

Over 4400 authorities and bodies substantially financed from Union or State revenues

9.6 Audit of Government Companies (Commercial Audit)

There is a special arrangement for the audit of companies where the equity participation by Government is 51 percent or more. The primary auditors of these companies are Chartered Accountants, appointed by the Union Government on the advice of the Comptroller and Auditor General, who gives the auditors directions on the manner in which the audit should be conducted by them. He is also empowered to comment upon the audit reports of the primary auditors. In addition, he conducts a supplementary audit of such companies and reports the results of his audit to Parliament and State Legislatures.

9.7 Audit Board Setup in Commercial Audit

A unique feature of the audit conducted by the Indian Audit and Accounts Department is the constitution of Audit Boards for conducting comprehensive audit appraisals of the working of Public Sector Enterprises engaged in diverse sectors of the economy.

These Audit Boards associate with them experts in disciplines relevant to the appraisals. They discuss their findings and conclusions with the managements of the enterprises and their controlling ministries and departments of government to ascertain their view points before finalisation.

The results of such comprehensive appraisals are incorporated by the Comptroller and Auditor General in his reports

Nature of Audit

While fulfilling his Constitutional obligations, the Comptroller and Auditor General examines various aspects of Government expenditure. The audit done by CAG is broadly classified into Regularity Audit and Performance Audit.

Performance Audit

Performance audit to see that Government programmes have achieved the desired objectives at lowest cost and given the intended benefits.

Regularity Audit (Financial)

In regularity (financial) audit and in other types of audit when applicable, auditors should analyse the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied with. Analysis of financial statements should be performed to such a degree that a rational basis is obtained to express an opinion on financial statements.

Action on Audit Reports

The scrutiny of the Annual Accounts and the Audit Reports thereon by the Parliament as a whole would be an arduous task, considering their diverse and specialised nature, besides imposing excessive demands on the limited time available to the Parliament for discussion of issues of national importance. Therefore the Parliament and the State Legislatures have, for this purpose, constituted specialized Committees like the Public Accounts Committee (PAC) and the Committee on Public Undertakings (COPU), to which these audit Reports and Annual Accounts automatically stand referred.

CAG's Role

Under section 10 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 (56 of 1971), the Comptroller and Auditor General shall be responsible-

(a) for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such accounts; and

(b) for keeping such accounts in relation to any of the matters specified in clause (a) as may be necessary;

Provided that the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for compiling-

(i) the said accounts of the Union (either at once or gradually by the issue of several orders); or

(ii) the accounts of any particular services or departments of the Union;

Provided further that the Governor of a State with the previous approval of the President and after consultation with Comptroller and Auditor General, by order, relieve him from the responsibility for compiling-

(i) the said accounts of the State (either at once or gradually by the issue of several orders); or

(ii) the accounts of any particular services or departments of the State;

Provided also that the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for keeping the accounts of any particular class or character.

(2) Where, under any arrangement, a person other than the Comptroller and Auditor General has, before the commencement of this Act, been responsible-

(i) for compiling the accounts of any particular service or department of the Union or of a State, or

(ii) for keeping the accounts of any particular class or character, such arrangement shall, notwithstanding anything contained in subsection (1), continue to be in force unless, after consultation with the Comptroller and Auditor General, it is revoked in the case referred to in clause (i), by an order of the President or the Governor of the State, as the case may be, and in the case referred to in clause (ii) by an order of the President.

Section 11—Comptroller and Auditor General to prepare and submit accounts to the President, Governors of State and Administrators of Union Territories having Legislative Assemblies

The Comptroller and Auditor General shall, from the accounts compiled by him or by the Government or any other person responsible in that behalf prepare in each year accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrators of the Union Territory having a Legislative Assembly, as the case may be, on or before such dates, as he may, with the concurrence of the Government concerned, determine:

Provided that the President may, after consultation with the Comptroller and Auditor General, by order, relieve him from the responsibility for the preparation and submission of the accounts relating to annual receipts and disbursements for the purpose of the Union or of a Union Territory having a Legislative Assembly:

Provided further that the Governor of a State may, with the previous approval of the President and after consultation with the Comptroller and Auditor General, by order relieve him from the responsibility for the preparation and submission of the accounts relating to annual receipts and disbursements for the purpose of the State.

The Comptroller and Auditor General of India play a key role in the functioning of the financial committees of Parliament and the State Legislatures. His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports. He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness submit to the Committees and helps the Committees to check the correctness of facts and figures in their draft reports.

The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations. The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature.

In respect of those cases in Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature. This ensures that the audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

9.8 Public Accounts Committee

Composition

The Committee on Public Accounts is constituted by Parliament each year for examination of accounts showing the appropriation of sums granted by Parliament for expenditure of Government of India, the annual Finance Accounts of Government of India, and such other Accounts laid before Parliament as the Committee may deem fit such as accounts of autonomous and semi-autonomous bodies (except those of Public Undertakings and Government Companies which come under the purview of the Committee on Public Undertakings).

The constitution and working of the Public Accounts Committee is governed by Rules 253 to 286 and 308 to 309 of the Rules of Procedure and Conduct of Business in Lok Sabha and Directions 48 to 73, 96A, 97, 97A, 99 and 100 of the Directions by the Speaker, Lok Sabha.

Constitution of the Committee

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. The Chairman is appointed by the Speaker from amongst its members of Lok Sabha. The Speaker, for the first time, appointed a member of the Opposition as the Chairman of the Committee for 1967-68. This practice has been continued since then. A Minister is not eligible to be elected as a member of the Committee. If a member after his election to the Committee is appointed a Minister, he ceases to be a member of the Committee from the date of such appointment. The Public Accounts Committee consists of fifteen Members elected by Lok Sabha every year from amongst its members according to the principle of proportional representation by means of single transferable vote. Seven members of Rajya Sabha elected by that House in like manner are associated with the Committee. This system of election ensures that each Party/Group is represented on the Committee in proportion to its respective strength in the two Houses.

Change in set-up

From its inception in the year 1921 till early 1950, the Finance-member was appointed as the Chairman of the Committee and its Secretarial functions were looked after by the Finance Department (later Ministry of Finance). With the coming into force of the Constitution of India on 26th January, 1950, the Committee became a Parliamentary

Committee under the control of Speaker. Its Secretarial functions were transferred to the Parliament Secretariat (now Lok Sabha Secretariat).

Functions of the Committee

The Examination of the Appropriation Accounts relating to the Railways, Defence Services, P&T Department and other Civil Ministries of the Government of India and Reports of the Comptroller and Auditor-General of India thereon as also the Reports of the Comptroller and Auditor-General on Revenue Receipts mainly form the basis of the deliberation of the Committee.

One of the duties of the Committee is to ascertain that money granted by Parliament has been spent by Government within the scope of the demand. It considers the justification for spending more or less than the amount originally sanctioned. If any money has been spent on a service in excess of the amount granted by the House for the purpose, the Committee examines with reference to the facts of each case, the circumstances leading to such an excess and makes such recommendations as it may deem fit.

The functions of the Committee extend however, "beyond, the formality of expenditure to its wisdom, faithfulness and economy". The Committee thus examines cases involving losses, nugatory expenditure and financial irregularities.

While scrutinising the Reports of the Comptroller and Auditor-General on Revenue Receipts, the Committee examines various aspects of Government's tax administration. The Committee, thus examines cases involving under-assessments, tax-evasion, non-levy of duties, misclassifications etc., identifies the loopholes in the taxation laws and procedures and makes recommendations in order to check leakage of revenue.

Working of the Committee

The representatives of the Ministries appear before the Committee when examining the Accounts and Audit Reports relating to their Ministries. The Committee proceeds by way of interrogation of witnesses. The Comptroller and Auditor General is the "friend, philosopher and guide" of the Committee. He attends the sittings of the Committee and assists it in its deliberations.

The Committee may appoint one or more Sub-Committees/ Sub Groups to examine any particular matter. At the beginning of its term, the Committee appoints a few Working Groups/Sub Committees to facilitate the examination of the various Accounts and Audit Reports and Sub-Committee to consider the action taken by the Government on the recommendations made by the Committee in its earlier Reports. If it appears to the Committee that it is necessary for the purpose of its examination that an on the- spot study should be made, the Committee may, either in its entirety or by dividing itself into Study Groups decide to undertake tours to make an on-the-spot study of any project or establishment. All discussions held during tour by the Committee/Study Groups, with the representatives of the establishment, Ministries/Departments, non-official organisations, Labour Unions etc. are treated as confidential and no one having access to the discussion, directly or indirectly is to communicate to the Press or any unauthorized person, any information about matters taken up during the discussions.

Report and Minutes

The conclusions of the Committee on a subject are contained in its Report, which, after its adoption by the Committee, is presented by the Chairman to the Lok Sabha. Minutes of the sittings of the Committee form Part II of the Report. A copy of the Report is also laid on the Table of Rajya Sabha. Generally, the Reports of the Committee are adopted by consensus among members. Accordingly, there is no system of appending minute of dissent to the Report.

Action Taken on Reports

After presentation to the Lok Sabha, the Report is forwarded to the Ministry or Department concerned which is required to take action on the recommendations and conclusions contained in the Report and furnish action taken replies thereon within six months.

Action taken notes received from the Ministries/ Departments are examined by the Action Taken Sub-Committee and Action Taken Reports of the Committee are presented to the House. A copy of the Report is also laid on the Table of Rajya Sabha.

Statements of action taken on Action Taken Reports

Replies received from Government in respect of recommendations contained in the Action Taken Reports are also laid on the Table of Lok Sabha/Rajya Sabha in the form of Statements. Government take action on the recommendations of the Committee and submit action taken notes to the Committee.

The Committee then present an Action Taken Report after considering the views of the Government. The Government further submit an "Action Taken Statement" on the action taken by the Government on the "Action Taken Report" of the Committee. The Action Taken Statement is generally laid before the House without any further examination by the Committee. Normally, almost all the recommendations of the Committee are implemented by the Government.

Process of Election

In April each year a motion is moved in Lok Sabha by the Minister of Parliamentary Affairs or Chairman of the Committee, if in office, calling upon members of the House to elect from amongst themselves 15 members to the Public Accounts Committee. After the motion is adopted, a programme, fixing the dates for filing the nominations/withdrawal of candidatures and the election, if necessary, is notified in Lok Sabha Bulletin Part-II. On receipt of nominations, a list of persons who have filed nomination papers is put up on the Notice Boards. In case the number of members nominated is equal to the number of members to be elected, then, after expiry of time for withdrawal of candidatures, the members nominated are declared elected and the result published in Bulletin Part-II. If the number of members nominated after withdrawals is more than number of members to be elected, election is held on the stipulated date and result of election published in Bulletin Part-II.

Association of Members of Rajya Sabha

Another motion is moved in Lok Sabha recommending to Rajya Sabha to nominate seven members of that House for being associated with the Committee. After adoption, the motion is transmitted to Rajya Sabha through a Message. Rajya Sabha holds election of members to the Committee and the names of members elected are communicated to Lok Sabha.

Appointment of Chairman

The Chairman of the Committee is appointed by the Speaker from amongst the members of Lok Sabha elected to the Committee.

As a convention, starting from the Public Accounts Committee of 1967-68, a member of the Committee belonging to the main opposition party/group in the House is appointed as the Chairman of the Committee.

Minister not to be Member of Committee

A Minister is not eligible to be elected as a member of the Committee and if a member, after his election to the Committee, is appointed as a Minister, he ceases to be a member of the Committee from the date of such appointment.

Term of Office

The term of office of the members of the Committee is one year.

Association of Members with Government Committees

A member, on his election to the Committee, has to communicate to the office of the Committee, the particulars regarding the various Committees appointed by Government with which he is associated, for being placed before the Speaker. Where the Speaker considers it inappropriate that a member should continue to serve on the Government Committee, the member is required to resign membership of the Committee constituted by Government. Where the Speaker permits a member to continue to hold membership of Government Committee, he may require that the report of the Government Committee shall be placed before the Committee on Public Accounts for such comments as the latter Committee may deem fit to make, before it is presented to Government. Whenever the Chairman or any member of the Committee on Public Accounts is invited to accept membership of any Committee constituted by Government, the matter is likewise to be placed before the Speaker before the appointment is accepted.

Functions of the Committee

The Public Accounts Committee examines the accounts showing the appropriation of the sums granted by Parliament to meet the expenditure of the Government of India, the Annual Finance Accounts of the Government of India and such other accounts laid before the House as the Committee may think fit. Apart from the Reports of the Comptroller and Auditor General of India on Appropriation Accounts of the Union Government, the Committee also examines the various Audit Reports of the Comptroller and Auditor General on revenue receipts, expenditure by various Ministries/ Departments of Government and accounts of autonomous bodies. The Committee, however, does not examine the accounts relating to such public undertakings as are allotted to the Committee on Public Undertakings.

While scrutinising the Reports of Comptroller and Auditor General on Revenue Receipts, the Committee examines various aspects of Government's tax administration. The Committee, thus, examines cases involving under-assessments, tax-evasion, non-levy of duties, mis-classifications etc., identifies loopholes in the taxation laws and procedures and make recommendations in order to check leakage of revenue.

Regularisation of Excess Expenditure

If any money has been spent on a service in excess of the amount granted by the House for the purpose, the Committee examines the same with reference to the facts of each case, the circumstances leading to such an excess and make such recommendations as it may deem fit. Such excesses are thereafter required to be brought up before the House by Government for regularisation in the manner envisaged in article 115 of the Constitution. In order to facilitate speedy regularisation of such expenditure by Parliament, the Committee presents a consolidated report relating to all Ministries/ Departments expeditiously in advance of other reports.

Selection of Subject for Examination

As the work of the Committee is normally confined to the various matters referred to in the Audit Reports, and Appropriation Accounts, its work normally starts after the Reports of the Comptroller and Auditor General on the accounts of the Government are laid on the Table of the House. As soon as the Committee for a year is constituted, it selects paragraphs from those reports of the Comptroller and Auditor General were presented by for examination during its term of office.

Assistance by Comptroller and Auditor General

The Committee is assisted by the Comptroller and Auditor General in the examination of Accounts and Audit Reports.

Constitution of Working Groups/Sub-Committees

A number of Working Groups/Sub-Committees are constituted by the Chairman from amongst the members of the Committee for detailed examination of the subjects selected by the Committee and for considering procedural matters. A Sub-Committee is also constituted for scrutiny of action taken by Government on the recommendations contained in the previous reports of the Committee.

Calling for Information from Government

The Committee calls for, in the first instance, advance information from the Ministries/Departments in regard to subjects selected by it for examination.

Study Tours

The Committee undertakes on the spot study tours/visits of various Departments/Establishments connected with the subjects taken up for examination.

For the purpose, members of the Committee are divided into study groups. Each study tour is undertaken with the specific approval of the Speaker.

Evidence of Officials

The Committee later takes oral evidence of the representatives of the Ministries/Departments concerned with the subjects under examination.

Ministers not called before Committee

A Minister is not called before the Committee either to give evidence or for consultation in connection with the examination of Accounts by the Committee. The Chairman of the Committee may, however, when considered necessary but after its deliberations are concluded, have an informal talk with the Minister concerned to apprise him of (a) any matters of policy laid down by the Ministry with which the Committee does not fully agree; and (b) any matters of secret and confidential nature which the Committee would not like to bring on record in its report.

9.9 Role of Public Accounts Committee

The role of the Public Accounts Committee is to assess the integrity, economy, efficiency and effectiveness of government financial management. It achieves this by:

- examining Government financial documents; and
- considering the reports of the Auditor - General.

A significant amount of the committee's work involves following up matters raised in the reports to Parliament by the Auditor - General. This ensures that public sector financial issues are scrutinised for the benefit of the Parliament and the public.

While scrutinising the Appropriation Accounts of the Government of India and the Reports of the Comptroller and Auditor General thereon, it is the duty of the Committee to satisfy itself—

– that the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged;

– that the expenditure conforms to the authority which governs it; and

– that every re-appropriation has been made in accordance with the provisions made in this behalf under rules framed by competent authority.

An important function of the Committee is to ascertain that money granted by Parliament has been spent by Government "within the scope of the demand". The functions of the Committee extend "beyond the formality of expenditure to its wisdom, faithfulness and economy". The Committee thus examines cases involving losses, nugatory expenditure and financial irregularities.

It is also the duty of the PAC to examine the statement of accounts of autonomous and semi-autonomous bodies, the audit of which is conducted by the Comptroller & Auditor General either under the directions of the President or by a Statute of Parliament.

9.10 Committee on Public Undertakings

The Committee on Public Undertakings exercises the same financial control on the public sector undertakings as the Public Accounts Committee exercises over the functioning of the Government Departments. The functions of the Committee are:-

a. to examine the reports and accounts of public undertakings.

b. to examine the reports of the Comptroller & Auditor General on public undertakings.

c. to examine the efficiency of public undertakings and to see whether they are being managed in accordance with sound business principles and prudent commercial practices.

The examination of public enterprises by the Committee takes the form of comprehensive appraisal or evaluation of performance of the undertaking. It involves a thorough examination,including evaluation of the policies, programmes and financial working of the undertaking.

The objective of the Financial Committees, in doing so, is not to focus only on the individual irregularity, but on the defects in the system which led to such irregularity, and the need for correction of such systems and procedures.

Review of accounts

The accounts of Government Companies set up under the provisions of the Companies Act (including Government Insurance Companies and deemed Government Companies) are audited by the Comptroller and Auditor General of India (CAG) under the provisions of Section 143 of the Companies Act. Under these provisions, the CAG (i) shall appoint statutory auditor of a Government company,

(ii) may conduct supplementary or test audit of accounts of a Government Company, and (iii) may comment upon the report of the statutory auditor. In addition he issues directions to the statutory auditors regarding the manner in which the accounts of a Government Company are to be audited.

The accounts certified by the Statutory Auditors (Chartered Accountants) appointed by the Central Government on the advice of the CAG under the Companies Act, 2013 are subjected to supplementary or test audit by officers of the CAG and CAG gives his comments or supplements the report of the Statutory Auditors. The Companies Act, 2013 empowers the CAG to issue directions to the Statutory Auditors on the manner in which the Company's accounts shall be audited.

Audit Reports

Reports in relation to the accounts of a Government Company or Corporation are submitted to the Government by the CAG under the provisions of Section 19-A of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 as amended in 1984. Every year, the CAG present Audit Reports to the Parliament containing his observations on the accounts and transactions of Government companies and corporations as detailed below:

Report No.1 (Commercial) - Review of Accounts and financial results gives an overall appreciation of the performance of the Companies and Corporations as revealed by their accounts and information obtained in audit. This report has been prepared without taking into account the comments under Section 143 of the Companies Act, 2013 and the qualifications contained in the Statutory Auditors' Report.

Report No. 2 (Commercial) - Comments on Accounts' gives a resume of the important comments of the CAG on the accounts of the Companies and Corporations and the reports submitted by the Statutory Auditors (Chartered Accountants) on the audit of the Companies in pursuance of the directions issued by the CAG.

'Report No. 3 (Commercial) - Audit Observations' contains the results of supplementary audit and observations on individual topics of interest noticed in the course of audit of the Companies and Corporations and short reviews on aspects of their working.

The statutes governing some corporations and authorities require their accounts to be audited by the CAG and reports given by him. In respect of Airports Authority of India, National Highways Authority of India, Inland Waterways Authority of India and Damodar Valley Corporation, the CAG is the sole auditor under the relevant statutes. In respect of Central Warehousing Corporation and Food Corporation of India, the CAG has the right to conduct audit independently of the audit conducted by the Chartered Accountants appointed under the statutes governing the two Corporations.

Audit Boards are set up under the supervision and control of the CAG to undertake comprehensive appraisals of the performance of the Companies and Corporations subject to audit by CAG. Each Audit Board consists of the Chairman (Deputy Comptroller and Auditor General), two or three whole-time members of the rank of Principal Directors of Audit under CAG and two technical or other experts in the area of performance of the Company or Corporation, who are part-time members. The part-time members are appointed by the Government of India (in the respective Ministry or Department controlling the Company or Corporation) with the concurrence of the CAG. The reports of the CAG based on such performance appraisals by the Audit Board and other reviews are issued to the Government as separate reports in addition to the annual reports.

Provision exists in the Acts governing Reserve Bank of India, Export-Import Bank of India, Industrial Reconstruction Bank of India, National Bank for Agricultural and Rural Development and National Housing Bank for the Central Government to appoint CAG, at any time, to examine and report upon their accounts.

9.11 Specimen Report

REVIEW OF ACCOUNTS OF – FOR THE YEAR ENDED 31ST MARCH 2015 BY THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

Note : This Review of Accounts has been prepared without taking into account the comments under Section 143 of the Companies Act, 2013 and qualifications contained in the Statutory Auditors' Report.

1. FINANCIAL POSITION

The table below summarises the financial position of the Company under broad heading for the last three years

(₹ in lakh)

	2012-13	2013-14	2014-15
Liabilities			
(a) Paid-up capital			
(i) Government			
(ii) Deposits awaiting allotment of shares			
(b) Reserves and surplus			
(i) Free reserves and surplus			
(ii) Share premium account			
(iii) Capital reserves			
(c) Borrowings			
(i) From Government of India			
	2012-13	**2013-14**	**2014-15**
(ii) From Financial institutions			
(iii) Foreign currency loans			
(iv) Cash credit			
(v) Others			
(vi) Interest accrued and due			
(d) (i) Current liabilities and provisions			
(ii) Provision for gratuity			
Total			
Assets			
(e) Gross block			
(f) Less : Depreciation			
(g) Net block			
(h) Capital work-in progress			
(i) Investments			
(j) Current assets, loans and advances			

(k) Miscellaneous expenditure not written off			
Total			
(l) Working capital (j-d(i)-c(vi))			
(m) Capital employed (g+m)			
(n) Net worth (a+b(i)+b(ii)-k)			
(o) Net worth per Rupee of Paid-up capital (in ₹)			

2. SOURCES AND UTILISATION OF FUNDS

Funds amounting to ₹ – lakh from internal and external sources were realised and utilised during the year as follows :-

		(₹ in lakh)
Sources of funds		
(a)	Depreciation	
(b)	Increase in borrowed funds	
(c)	Decrease in working capital	
Utilisation of funds		
(a)	Loss for the year	
(b)	Increase in Fixed assets	
(c)	Increase in Misc. Exp. not written of	
(d)	Increase in capital work in progress	

3. WORKING RESULTS

The working results of the Company for the last three years ending 31st March 2015 are given below:
(₹ in lakh)

Particulars	**2012-13**	**2013-14**	**2014-15**
(i) Sales			
(ii) Less : Excise duty			
(iii) Net Sales			
(iv) Other or Misc. Income			
(v) Profit/Loss before tax and prior period adjustments			
(vi) Prior period adjustments			
(vii) Profit/Loss before tax			
(viii) Tax Provisions			
(ix) Profit after Tax			
(x) Proposed Dividend			

4. RATIO ANALYSIS

Some important ratios on the financial health and working of the Company at the end of last three years ending 31st March 2015 are as follows.

	2012-13	**2013-14**	**2014-15**
A. Liquidity Ratio			
Current ratio			
Current assets, loans and advances to Current liabilities and provision and interest accrued and due)			
B. Debit-Equity Ratio			
Long term debt to Net worth C(i)+C(v)/O			

C.	Profitability Ratios			
	(a) Profit before tax to	(In percentage)		
	(i) Capital employed			
	(ii) Net worth			
	(iii) Sales			
	(b) Profit after tax to Equity			
	(c) Earning per share (in ₹)			

5. INVENTORY LEVELS

The inventory levels at the close of the last three years ending 31st March, 2015 are as under :

(₹ in lakh)

Particulars		2012-13	2013-14	2014-15
(a)	Raw materials			
(b)	Stores and spares			
(c)	Finished goods			
(d)	Others			
	Total			

The stock of finished goods represented -- days' sales each in and and 2 days sales in

6. SUNDRY DEBTORS

The following table indicates the volume of Sundry Debtors and sales for the last three years :

(₹ in lakh)

As on 31st March	Sundry debtors			Sales (including Excise Duty) during the year	% age of Sundry Debtors to Sales
	Considered good	Considered doubtful	Total		
2006					
2007					
2008					

The Sundry Debtors as on 31st March, 2015 were outstanding for the period indicated below :-

(₹ in lakh)

Debt Outstanding	Govt. Department	Private Parties	Total
(i) Upto one year			
(ii) More than one year but less than 2 year			
(iii) 2 years or more but less then 3 years			
(iv) 3 years or more			
Total			

Principal Director of Commercial Audit & Ex-officio Member, Audit Board

9.12 Government Accounting Standards Issued by Government Accounting Standards Advisory Baord (GASAB)

Background

Government Accounting Standards Advisory Board (GASAB) has been constituted by Comptroller and Auditor General of India (CAG), with the support of Government of India through a notification dated 12th August, 2002.

The decision to set-up GASAB has been taken in the backdrop of the new priorities emerging in the Public Finance Management and to keep pace with the International trends.

The new priorities focus on good governance, fiscal prudence, efficiency & transparency in public spending instead of just identifying resources for public scheme funding.

The accounting systems, the world over, are being revisited with an emphasis on transition from rule to principle based standards and migration from cash to accrual based system of accounting.

GASAB, as a nodal advisory body in India, is taking similar action to establish and improve standards of government accounting and financial reporting and enhance accountability mechanisms.

Constitution of Government Accounting Standards Advisory Board (GASAB)

Government of India have supported the proposal for establishment of a Government Accounting Standards Advisory Board for the Union and the States by the Comptroller and Auditor General of India in order to establish and improve standards of governmental accounting and financial reporting and enhance accountability mechanisms.

Accordingly, the Comptroller and Auditor General of India has constituted a Government Accounting Standards Advisory Board (GASAB) consisting of the following officers:

1. Deputy Comptroller and Auditor General (Accounts) as Chairperson
2. Controller General of Accounts
3. Financial Commissioner, Railways
4. Controller General of Defence Accounts
5. Additional Secretary (Budget), Ministry of Finance, Government of India
6. Deputy Governor, Reserve Bank of India or his nominee
7. Director General, National Council of Applied Economic Research (NCAER), New Delhi
8. President, Institute of Chartered Accountants of India (ICAI), or his Nominee

9-12 Principal Secretary (Finance) of four States by annual rotation

13. Principal Director (Accounts)

The Comptroller and Auditor General of India as Member Secretary GASAB will, inter alia, have the following responsibilities:

(i) To formulate and propose standards that improve the usefulness of financial reports based on the needs of the financial report users.

(ii) To keep standards current and reflect changes in the governmental environment.

(iii) To provide guidance on implementation of standards.

(iv) To consider significant areas of accounting and financial reporting that can be improved through the standard setting process.

(v) To improve the common understanding of the nature and purpose of information contained in financial reports.

Responsibilities of the Board

1. To establish and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms.
2. To formulate and propose standards that improve the usefulness of financial reports based on the needs of the users.
3. To keep the standards current and reflect change in the Governmental environment;
4. To provide guidance on implementation of standards.
5. To consider significant areas of accounting and financial reporting that can be improved through the standard setting process.
6. To improve the common understanding of the common understanding of the nature and purpose of information contained in the financial reports.

Board Secretariat

The Secretariat of GASAB is constituted by officers of various Accounts and Finance streams belonging to Civil Services. They are listed below:

1. Indian Audit and Accounts Service (IA&AS)
2. Indian Civil Accounts Service (ICAS)
3. Indian Defence Accounts Service (IDAS)
4. Indian Post and Telecom Accounts Service (IP&TAFS)
5. Indian Railway Accounts Service (IRAS)

Indian Government Accounting Standards

GASAB is developing two types of Accounting Standards for the Government to address the issues related with the existing cash system of accounting and its migration to the accrual system of accounting in future. The standards being developed to make existing cash system of accounting more transparent are called Indian Government Accounting Standards (IGAS). The standards being developed for accrual system of accounting in the Government are called Indian Government Financial Reporting Standards (IGFRS).

Preface to Indian Government Accounting Standards (IGASs) and Indian Government Financial Reporting Standards (IGFRSs)

This Preface sets out the objectives and standard-setting procedure of the Government Accounting Standards Advisory Board (GASAB) and explains the scope and authority of the Indian Government Accounting Standards (IGASs) for cash system of accounting and Indian Government Financial Reporting Standards (IGFRSs) for accrual system of accounting. The Exposure Drafts issued by GASAB and the IGASs and IGFRSs formulated by GASAB and notified by the President of India in accordance with the provisions of Constitution of India should be read in the context of this Preface.

GASAB

Standard-setting Procedure for Accounting Standards

1. The following procedures are adopted by the GASAB for formulating Standards:

   1.1 The GASAB Secretariat identifies areas for Standard formulation and places them before the GASAB for selection and approval. While doing so, the Secretariat places before the GASAB all important suggestions, references, proposals received from various sections of the Union and State Governments, members of GASAB, members of Civil Society, Professional Bodies and other stakeholders. The priorities, as approved by the GASAB, guide further functioning of the GASAB Secretariat.

1.2 The GASAB Secretariat thereafter prepares the discussion paper on the selected issues for consideration of the GASAB.

1.3 While doing so, the Secretariat studies the existing rules, codes and principles as internal sources, and documents/pronouncements/Standards issued by other national and international Standard setting and regulatory bodies. The Secretariat may also hold consultation with such other persons as are considered necessary for this purpose.

1.4 On consideration of the Discussion paper and the comments received thereon, the GASAB finalizes the Exposure Draft.

1.5 The GASAB may constitute Standing Committee and/or Task based Groups from amongst the Members or their representatives to consider specific areas before finalization.

1.6 The Exposure Draft, as approved for issue by the GASAB, are widely circulated in the public domain and forwarded to all stakeholders. The Exposure Draft is required to be hosted at the website of GASAB.

1.7 Based on the comments received on the Exposure Draft, the Standards are finalized by the GASAB. The Standards, as finalized, are forwarded to the Government for notification in accordance with the provisions of the Constitution of India.

2. The meetings are normally chaired by the Chairperson. In unforeseen circumstances when Chairperson is unable to attend, the senior-most member from the Central Government will chair the meeting. The Comptroller & Auditor General of India will be kept informed of the important developments in the meetings of GASAB.

3. The GASAB may meet as often as is deemed necessary but generally not less than four times in a financial year. The decisions of the GASAB may preferably be by general consensus. In case differences persist, the decision shall be on the basis of voting favoring the recommendation. The dissenting views should also be forwarded to the Government along with the recommendations.

4. GASAB allows an exposure period of 90 days for inviting comments on Exposure Draft.

GASAB

5. The format of the IGASs and IGFRSs ordinarily includes the following:

   (i) Introduction

   (ii) Objective

   (iii) Scope

   (iv) Definition of the terms used in the Standard

   (v) Accounting and Presentation requirements

   (vi) Disclosure requirements for complying with the Standard, including format of disclosure, etc., if necessary

   (vii) Explanatory paragraphs

   (viii) Transitional Provisions, if any

   (ix) Effective Date.

Compliance with IGASs and IGFRSs

1. All the Standards are mandatory from the effective date(s) mentioned therein after notification of the Standards by Government. Financial Statements cannot be described as complying with IGASs and IGFRSs unless they comply with all the requirements of each applicable IGAS and IGFRS.

2. Where the accounting authorities of the Union and State Governments have deviated from the applicable notified Standards, a disclosure shall be made with reasons for such deviations as well as the effect of the deviations on the Financial Statements.

IGAS Notified by Government of India:

IGAS 1	Guarantees given by Governments: Disclosure Requirements
IGAS 2	Accounting and Classification of Grants-in-aid
IGAS 3	Loans and Advances Made by Governments

IGAS - 1

Guarantees given by Governments: Disclosure Requirements

Introduction

1. The Union Government and the State Governments give Guarantees for repayment of borrowings within such limits, if any, as may be fixed upon the security of the Consolidated Fund of India or of the State, as the case may be, in terms of Articles 292 and 293 of the Constitution of India. Guarantees are also given by the Union Government for payment of interest on borrowings, repayment of share capital and payment of minimum annual dividend, payment against agreements for supplies of materials and equipments on credit basis on behalf of State Governments, Union Territories, local bodies, railways, government companies/ corporations, joint stock companies, financial institutions, port trusts, electricity boards and co-operative institutions. Guarantees are also given by the Union Government to the Reserve Bank of India, other banks and financial institutions for repayment of principal and payment of interest, cash credit facility, financing seasonal agricultural operations and for providing working capital in respect of companies, corporations, co-operative societies and co-operative banks. Further, Guarantees are also given in pursuance of agreements entered into by the Union Government with international financial institutions, foreign lending agencies, foreign governments, contractors and consultants towards repayment of principal, payment of interest and payment of commitment charges on loans. The Union Government also gives performance guarantees for fulfilment of contracts/projects awarded to Indian companies in foreign countries as well as foreign companies in foreign countries besides counter-guarantees to banks in consideration of the banks having issued letters of credit to foreign suppliers for supplies/ services made/ rendered by them on credit basis in favour of companies/ corporations. Furthermore, Guarantees are given by the Union Government to railways, and electricity boards for due and punctual payment of dues and freight charges by the companies and corporations. Similarly, Guarantees are also given by the State Governments.

2. As the statutory corporations, government companies, co-operative institutions, financial institutions, autonomous bodies and authorities are distinct legal entities, they are responsible for their debts. Their financial obligations may be guaranteed by a Government and thus the Government has a commitment to see that these are fulfilled. When these entities borrow directly from the market, it reduces a Government's budgetary support to them and the magnitude of a Government's borrowings. However, it adds to the level of Guarantees given by the Governments. In consideration of the Guarantees given by the Governments, the beneficiary entities are required to pay guarantee commission or fee to the Governments. The Guarantees have an important economic influence and result in transactions or other economic flows when the relevant

Event or conditions actually occur. Thus guarantees normally constitute contingent liabilities of the Government.

Objective

3. The objective of this Standard is to set out disclosure norms in respect of Guarantees given by the Union and the State Governments in their respective Financial Statements to ensure uniform and complete disclosure of such Guarantees.

Scope

4. This Standard applies to preparation of the Statement of Guarantees for inclusion and presentation in the Financial Statements of the Governments. Financial Statements should not be described as complying with this Standard unless these comply with all its requirements.

5. The Authority in the Government which prepares the Statement of Guarantees for inclusion and presentation in the Financial Statements shall apply this Standard. The Accounting Authority is responsible for inclusion and presentation of the Statement of Guarantees in the Financial Statements as provided by the Authority in the Government.

IGAS 2

Accounting and Classification of Grants-in-aid

Introduction

1. Grants-in-aid are payments in the nature of assistance, donations or contributions made by one government to another government, body, institution or individual. Grants-in-aid are given for specified purpose of supporting an institution including construction of assets. The general principle of grants-in-aid is that it can be given to a person or a public body or an institution having a legal status of its own. Such grants-in-aid could be given in cash or in kind used by the recipient agencies towards meeting their operating as well as capital expenditure requirement.

2. Grants-in-aid are given by the Union Government to State Governments and by the State Governments to the Local Bodies discharging functions of local government under the Constitution. This is based on the system of governance in India, which follows three-tier pattern with the Union Government at the apex, the States in the middle and the Local Bodies (LBs) consisting of the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) at the grass root level. Accounts of these three levels of Government are separate and consequently the assets and liabilities of each level of government are recorded separately. Grants-in-aid released by the Union Government to the State Governments are paid out of the Consolidated Fund of India as per Articles 275 and 282 of the Constitution. The Union Government releases grants-in-aid to the State/ Union Territory Government under Central Plan Schemes and Centrally Sponsored Schemes. Sometimes, the Union Government disburses funds to the State Governments in the nature of Pass-through Grants that are to be passed on to the Local Bodies. Funds are also released directly by the Union Government to District Rural Development Agencies (DRDAs) and other specialized agencies including Special Purpose Vehicles (SPVs) for carrying out rural development, rural employment, rural housing, other welfare schemes and other capital works schemes like construction of roads, etc.

3. The 73rd and 74th Constitutional Amendment Acts envisage a key role for the Panchayati Raj Institutions (PRIs) and the Urban Local Bodies (ULBs) in respect of various functions such as education, health, rural housing, drinking water, etc. The State Governments are required to devolve funds, functions and functionaries upon them for discharging these functions. The extent of devolution of financial resources to these bodies is to be determined by the State Finance Commissions. Such funds received by the Local Bodies from the State Governments as grants-in-aid are used for meeting their operating as well as capital expenditure requirements. The ownership of capital assets created by Local Bodies out of grants-in-aid received from the States Government lies with the Local Bodies themselves.

4. Apart from Grants-in-aid given to the State Governments, the Union Government gives substantial funds as Grants-in-aid to other agencies, bodies and institutions. Similarly, the State Governments also disburse Grants-in-aid to agencies, bodies and institutions such as universities, hospitals, cooperative institutions and others. The grants so released are utilized by these agencies, bodies and institutions for creation of capital assets as well as for meeting day-to-day operating expenses.

Objective

5. The objective 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. The Standard also aims to prescribe practical solutions to remove any difficulties experienced in adherence to the appropriate principles of accounting and classification of Grants-in-aid by way of appropriate disclosures in the Financial Statements of Government.

Scope

6. This Standard applies to the Union Government and the State Governments in accounting and classification of Grants-in-aid received or given by them. The Financial Statements should not be described as complying with this Standard unless they comply with all the requirements contained therein. This Standard encompasses cases of Pass-Through Grants mentioned in paragraph 2 above.

IGAS 3

Loans and Advances made by Governments

Introduction

1. The Government of India has been empowered under proviso (2) of Article 293 of the Constitution of India to make loans to the States, subject to such conditions as may be laid down by or under any law made by Parliament, any sums required for the purpose of making such loans being chargeable to the Consolidated Fund of India.

2. 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.

3. 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.

Objectives

4. The objective of the Standard is to lay down the norms for Recognition, Measurement, Valuation and Reporting in respect of Loans and Advances made by the Union and the State Governments in their respective Financial Statements to ensure complete, accurate, realistic and uniform accounting practices, and to ensure adequate disclosure on Loans and Advances made by the Governments consistent with best international practices.

Scope

5. This Standard applies to Loans and Advances given by the Government for incorporation and presentation in the Financial Statements of the Government. Financial Statements shall not be described as complying with this Standard unless they comply with all the requirements contained therein. This standard shall apply only to government accounts being maintained on a cash basis.

9.13 Government Accounting & Reporting

Budgetary Process and Accounting in Government of India

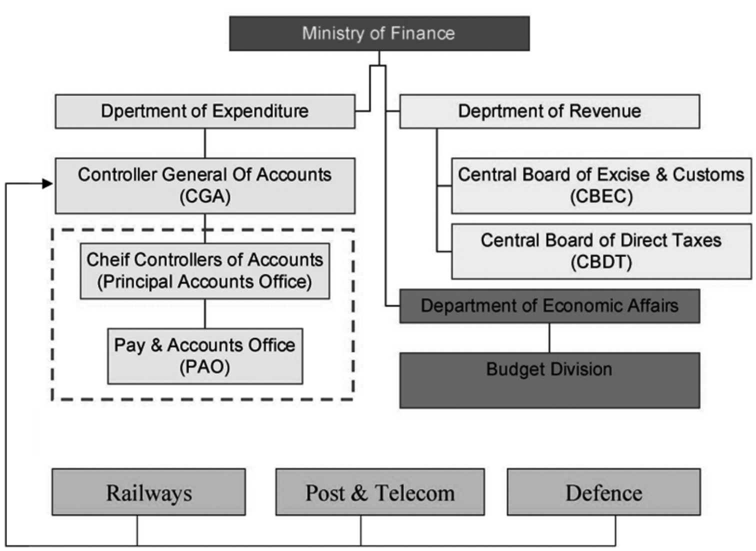
Overview

- Main Features
- Constitutional Provisions
- Classification
- Organizational Structure
- Information Flow
- Banking Arrangement & Reconciliation
- Financial Reporting

GOI Accounts - Main Features

- Annual Cycle - April to March
- Single Currency
- Double Entry System
- Cash Basis
    - Additional Disclosures:
        - Liabilities
        - Contingent Liabilities
        - Financial Assets
- Proforma Accounts
- Functional cum Programme Classification
- Decentralized Payment & Accounting system
- Single Cash Balance
- Elaborate Banking Arrangement

Organizational Structure



Civil Accounts Organization

- Controls Payment & Accounting setup in 42 Civil Ministries/Departments
- Controls and account for 78% of the payments from the CFI and almost the entire revenue collections
- 338 Pay & Accounts Offices located at 74 Locations through out the Country dealing with 5825 DDOs
- 9003 Employees (including 208 Gr "A" Officers)

Allocation of Business Rules, 1961

- Prescribe general principles of Government Accounting relating to Union and State Governments and Form of Accounts and to frame or revise rules and manuals relating thereto.
- Oversee maintenance of adequate standards of accounting by the Central Civil Accounts Offices.
- Consolidation of monthly accounts, preparation of annual accounts (including summary of Civil Appropriation Accounts) and compilation of Union Government Finance Accounts.
- Reconciliation of cash balances of the Union Government with the Reserve Bank of India.
- Administration of Central Government (Receipt & Payment) Rules.
- Coordination and assistance in the introduction of Management accounting system in the ministries.
- Cadre management of Indian Civil Accounts service and its Group B cadre.

Form of Accounts

- The accounts of the Union and of the States shall be kept in such form as the President may on the advice of the Comptroller & Auditor General, prescribe.

Principles and Form of Accounts

- Government Accounting Rules,
- Central Government Accounts (Receipt & Payment) Rules,
- Central Treasury Rules,
- Accounting Rules for Treasuries,
- Account Code for State Accountant Generals,
- Account Code - Vol III,
- List of Major & Minor Heads of Account,
- Civil Accounts Manual,
- Suspense Manual,
- Drawing & Disbursing Officers Manual, and
- Inspection Code.

Consolidated Fund of India

Subject to assignment of certain taxes to the States,

- all revenues received by the Government of India,
- all loans raised by the Government and
- all moneys received by that Government in repayment of loans

Shall form one consolidated fund to be called "the Consolidated Fund of India"

- No moneys shall be appropriated out of the Consolidated Fund of India except in accordance with law.
- No money can be issued out of Consolidated Fund of India unless the expenditure is authorised by an Appropriation Act.

Contingency Fund (Article 267) and Contingency Fund of India Act, 1950

- Parliament may by law establish a Contingency Fund in the nature of an imprest to be called "the Contingency Fund of India.
- Fund shall be placed at the disposal of the President to enable advances to be made for meeting unforeseen expenditure, pending authorization by Parliament

Public Account of India Article 266(2)

<u>All other public moneys</u> received by or on behalf of the Government of India shall be credited to the Public Account of India

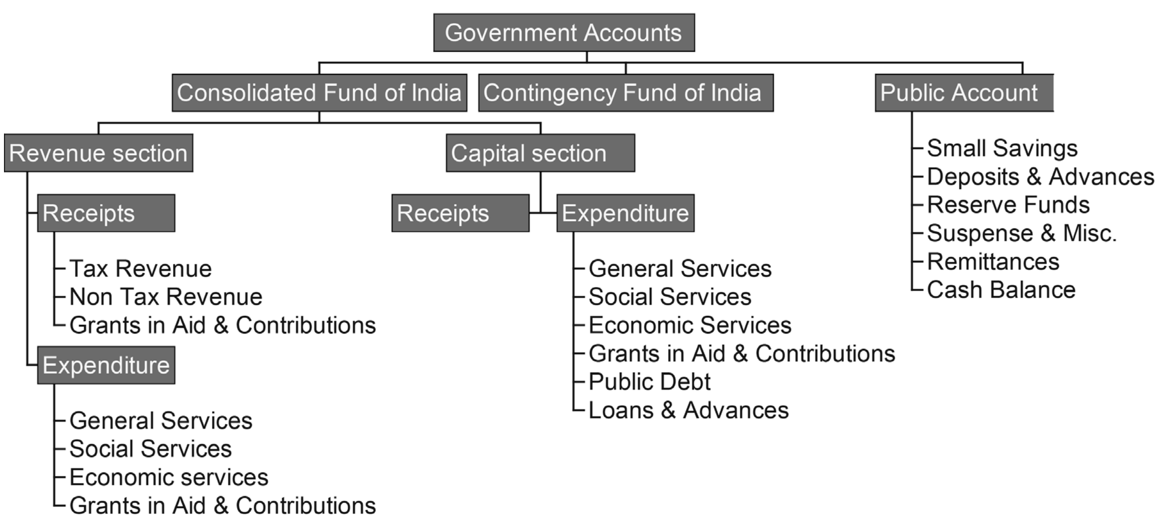
Revenue Account (Article 112)

- The estimates of expenditure embodied in the annual financial statement shall show separately ………………………………………………… …………and shall <u>distinguish expenditure on revenue account from other expenditure.</u>
- Proceeds of taxation and other receipts classed as revenue and Expenditure met there from

Capital Heads

- <u>Expenditure</u> met usually from borrowed funds with the object of increasing concrete assets of a material and permanent character. Includes receipts of capital nature intended to be applied as a set off to capital expenditure.
- <u>Receipts</u> of capital nature which cannot be applied as a set off to capital expenditure.

Classification



Major Head	Function	4
Sub-Major Head	Sub-Function	2
Minor Head	Programme	3
Subordinate Head	Schemes	2
Detailed Head	Sub-Schemes	2
Object Head	Object of expenditure	2

Voted & Charged Expenditure

- The estimates of expenditure embodied in the annual financial statement shall show separately
  - the sums required to meet expenditure described by this constitution as expenditure charged upon the Consolidated Fund of India and
  - the sums required to meet other expenditure proposed to be made from the Consolidated Fund of India

  Estimates relating to charged expenditure not to be submitted to the vote of Parliament.
- Each house competent to discuss such estimates.
- Estimates relating to other expenditure to be submitted in the form of demands for grants to the house of the People
- House of People shall have power to
  - assent
  - refuse to assent to any demand
  - assent to any demand subject to reduction.

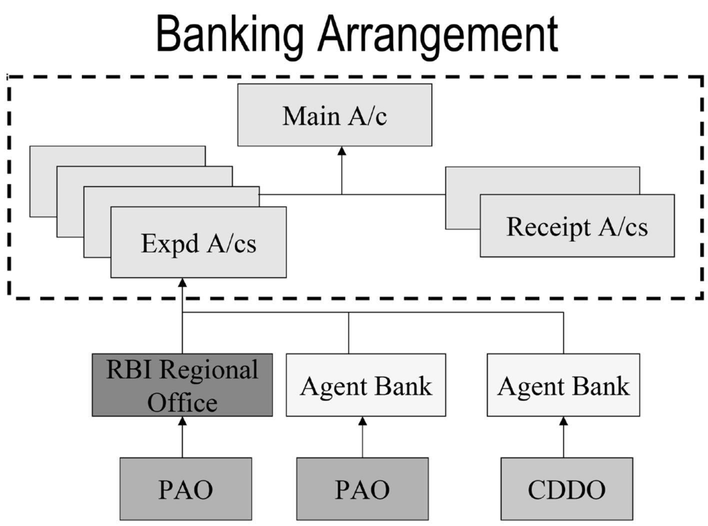
- Expenditure on and related to
  - The President & his office
  - Chairman, Deputy Chairman of the Council of States
  - Speaker, Deputy Speaker of House of People
  - Judges of Supreme Court & High Court
  - Comptroller & Auditor General of India
- Debt liability of GOI and related charges
- Sums required to satisfy a Judgment, decree, award
- Any other expenditure declared by Parliament

Sources of Revenue

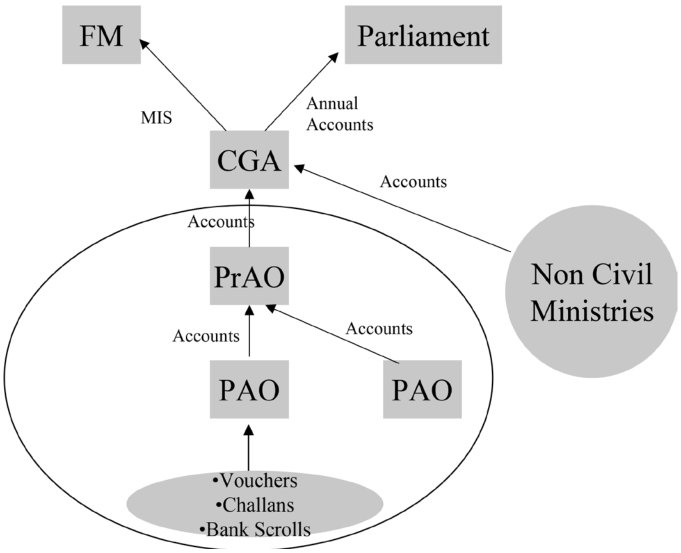
- Revenue Receipts
- Tax Revenue
    - Sharable with the States
    - Non sharable
- Non-Tax Revenue
    - Interest
    - Dividends
    - Receipts of Commercial Departments
- External Grants
- Capital Receipts
- Miscellaneous Capital Receipts
    - Disposal of Capital Assets
    - Divestment of SOE Shares
- Repayment of Loans

Banking Arrangements

- CGA in consultation with RBI prescribes the banking arrangements for government transactions. The banking network is spread all over the country involving around 32000 branches of 28 Public Sector and 4 Private Sector Banks.
    - This network handles around ₹ 800,000 crores (US$ 178 Billion) every year.
    - The Apex and Standing Committees, chaired by CGA, provide forum for the Government, RBI and Banks to discuss refinements to the system and other areas of common interest.
- ♦ CGA continuously monitors performance of agency banks to ensure timely remittances into Government account.



Financial Reporting



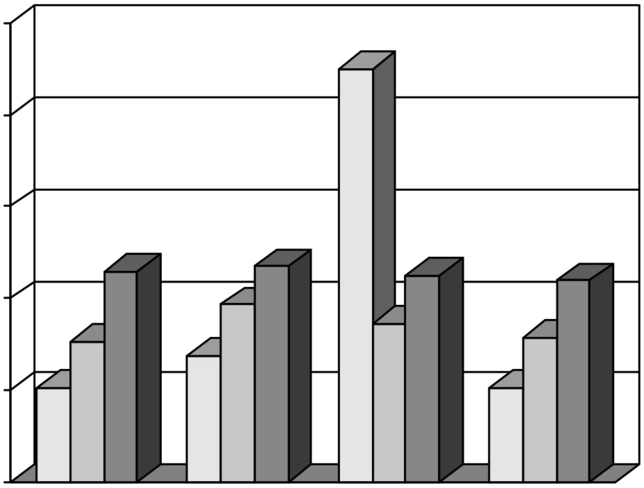
Monthly

- Flash Expenditure & Receipt Figures with the first week of the following Month
- Monthly Analytical reviews of Union Government Accounts by last day of the following month

Annual

- Unaudited Annual Accounts within two months of year end
- Finance Accounts
- Appropriation Accounts (Civil)
- Accounts at a Glance

Monthly Reporting



- Components
  - Revenue
  - Expenditure
  - Deficit &
  - Sources of financing the Deficit
- Features
  - Comparison with Previous year
  - Compliance with Budget

Statement of Accounts

- Receipts, Expenditure & Financing
- Detailed Statements
  - Receipts

- Tax Revenue
- Non Tax Revenue
- Capital Receipts
- Commercial Receipts
- Expenditure
- Plan Expenditure
- Non Plan Expenditure
- Expenditure incurred as per Object wise classification

TIMELY DELIVERY OF ACCOUNTING INFORMATION

- Analytical review of Union Government Accounts are available with the FM on the last day of the following month.
- Unaudited annual accounts, with over 98% accuracy, are available within two months of the end of the financial year.
- Greater transparency and higher user confidence through data dissemination in public domain

Financial Reporting

A slice of this data is also released on the Internet on CGA's website www.cgaindia.org.

Annual Accounts

- Annual Audited Accounts
  - Appropriation Accounts Finance Accounts
- Presented to the Legislature
  - Budgetary compliance Operating Performance Financial Position

APPROPRIATION ACCOUNTS

Reporting to Parliament every year, the Actual Expenditure with reference to the Budget approved by it and the variations between the two together with the reasons for the variations.

APPROPRIATION ACCOUNTS

	Final Grant	Actual Expenditure	EXCESS/SAVINGS
item 1			
original			
supplementary			
re-appropriation			
item 2			
original			
supplementary			
re-appropriation			

Finance Accounts

- Presents an account of receipts & disbursements
- together with
  - financial results disclosed by the revenue and capital accounts
  - accounts of public debt
  - liabilities & assets as worked out from the balances recorded in the accounts

CAG's Certificate

…. are correct statements of the receipts and disbursements for the purpose of the Union for the year…. subject to my observations in my Report on the accounts of the Union for the year…"

- Main Statements
  - Receipts & Payment Account
  - Statement showing Surplus/Deficit for the year
  - Summary of Balances
- Supporting Statements
  - Loans & Advances extended by the Union Government
  - Statement on Investments
  - Statement on Capital Expenditure
  - Statement of Public Debt
  - Statement on Guarantees