

CA FINAL
FINANCIAL REPORTING
OLD COURSE

5 DAYS FACE TO FACE REVISION BATCH

BY

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DAY - 3

Topic: Consolidation, Associate, Joint Venture

CONSOLIDATION OF FINANCIAL STATEMENTS OF GROUP COMPANIES

AS 21, 23, 27

Consolidation means: Grouping of Financial Statements of group companies. Group companies means Holding co. (Parent Co.), Subsidiary Co., Associates and Joint Ventures.

Holding Company: Sec 2 (46) of Companies Act, 2013

'Holding Company in relation to one or more other companies, means a company of which such companies are subsidiary companies'.

In simple language, a company which enjoys 'CONTROL' over the other companies is Holding Company. Holding and Subsidiary companies are however separate entities but they work as a group. Therefore users of Holding company needs financial information of subsidiaries to understand the performance and financial position of the holding as well the group.

Subsidiary Company: Sec 2 (87) of Companies Act, 2013

Subsidiary Company means a company in which the holding company -

- (a) Controls the composition of the Board of Directors; or
- (b) Controls/Holds more the 50% of the total share capital either at its own or together with one or more of its subsidiary companies.

Notes:

- (1) Together with one or more of its subsidiary companies - it denotes 'Indirect control through the subsidiary companies'.
- (2) Control over composition of Board of Directors means holding company has Power to Appoint or Remove all or a majority of the Directors of the Subsidiary company.
- (3) **Total Share Capital means:** Sum of Paid up Equity Share Capital and Convertible Preference Share Capital.

(4) Subsidiary company can-not hold the shares in holding company (Sec 19 of CA, 2013) except in following circumstances:

- Subsidiary co. is a shareholder even before it became a subsidiary company of the holding company; or
- Subsidiary co. holds such shares as a trustee; or
- Subsidiary co. holds such shares as a legal representative of a deceased member of the holding co.

Components of Consolidated Financial Statements: As per AS 21 Consolidated FS includes

- Consolidated Balance Sheet
- Consolidated Statement of Profit and Loss
- Consolidated Cash Flow Statement
- Notes and statements and Explanatory schedules that forms part of FS

Holding Co. shall prepare Two sets of Balance Sheet:

1. BS under Separate Financial Statements : under which value of Investment in Subsidiary co. will be shown at cost as per AS 13
2. BS under Consolidated Financial Statements: under which value of Investment in Subsidiary co. shall be replaced by the Net Assets of subsidiary co.

Calculation of Cost of Control (Goodwill/Capital Reserve):

Book Value of Investment held at Balance Sheet Date	XXX
Less: Net Assets of Subsidiary co. Owned by Parent co. <u>on the date of investment</u> , still held by subsidiary (Share capital +/- Pre-Acquisition Share of P/L - Dividend Adjustment)	XXX
	Goodwill/(CR)

Net Assets = Share Capital + All Reserves and Surplus - Losses

- Goodwill denotes that parent co. has paid extra amount as compared to the value of net worth acquired. Such extra amount may be paid for any future advantage. Goodwill will not be written off unless question requires.

- Capital Reserve denotes that parent co. has paid lesser than the value of net assets acquired by it. Under Ind AS 103 (Business Combinations) it is called "Gain on Bargain Purchase".
- Pre-Acquisition profit means all the reserves and surplus of subsidiary till the date of acquisition i.e. it is capital profit which is not earned by parent but acquired by parent co.
- Post-Acquisition profit means the share in profit & reserves earned by subsidiary after the date of acquisition of shares by parent co.

Minority Interest (Non Controlling Interest):

1. That part of Net Assets of Subsidiary which is not owned by Parent Co. either directly or indirectly.
2. It represents the claim of outside shareholders of subsidiary.
3. Minority Interest should be presented in Consolidated Balance Sheet separately from liabilities and the equity of the parent's shareholders. It should be shown after 'Share Application Money' as separate head.

SPECIAL ADJUSTEMENTNS:

<p>Balances of Reserves and Surplus Missing</p>	<p>For Balance of Profit & Loss A/c : Assume Zero Balance as on 1st Day of the year.</p> <p>For Balance of Other Reserves : Assume the Same amount as at the end of the year.</p>
<p>Treatment of Abnormal Items</p>	<p>While preparing AOP:</p> <ol style="list-style-type: none"> 1. Effect of Abnormal Items should be eliminated (Ab. Loss will be added and Ab. Profit will be deducted) - (Jaha se already adjust hua hai vahi se eliminate karenge) 2. Apply time adjustment (if required) 3. Re-instate the effect of Abnormal Items (Ab. Loss deducted and Ab. Profit added) - (Jis period me A.Item occur hua hai vahi pe adjust karenge) <p>Ab. Loss will be calculated net of claims</p>
<p>Treatment of Revaluation of Assets</p>	<ul style="list-style-type: none"> • Revaluation of Assets of Parent co. is not relevant. • Revaluation of Assets of Subsidiary co. is relevant to find out the fair value of Net Assets of Subsidiary co. for the calculation of Cost of Control. (Net assets ki real aukaat pata karne k liye market value of assets dekhenge, book value nai) • Revaluation of Assets will be checked on the acquisition date of investments.

	<ul style="list-style-type: none"> • Revaluation Profit or Loss is calculated as follows: Book Value of Assets on the date of Acquisition - XXX Less: Market Value of Assets on the date of Acquisitions - XXX • Revaluation Profit/Loss is treated as pre-acquisition profit/loss. (profit ko plus aur loss ko minus karenge) • Additional Depreciation will be calculated in case of Revaluation profit and adjusted in post acquisition profit. (minus karenge) • Saving in depreciation will be calculated in case of Revaluation loss and adjusted in post acquisition profit. (plus karenge) • Revaluation adjustment will be done after applying Time Adjustment.
<p>Treatment of Bonus issue of Shares by Subsidiary</p>	<p>Bonus issue of shares effects calculation of holding ratio. So we should be very careful while calculating holding ratio.</p> <p>We will always assume that bonus is distributed out of past profits/reserves (purane kamaye hue profits me se bonus issue hoga, na ki current year k profits me se)</p> <p>There can be either of the two possible cases:</p> <ol style="list-style-type: none"> 1. Bonus entry has been passed in books: Treat like Abnormal Loss/Dividend paid. 2. Bonus entry has not been passed yet: Pre-Acquisition Profits A/c Dr To Share Capital A/c <p>Bonus shares receive karne wala koi bhi entry nai karega, kyunki usko shares free me mile hai.</p>
<p>Dividend Paid by Subsidiary Co. (Same as Abnormal Items)</p>	<p>Two types of Dividends Final Dividend and Interim dividend</p> <p>We always assume that: Dividend paid is Final if question is silent Pre-acquisition dividend received by parent is wrongly credited to its P&L A/c Necessary appropriation for final dividend was not made by subsidiary in last year.</p> <p>Dividend is calculated on paid up share capital At the end of the year in case of Final Dividend On the date of Distribution for Interim Dividend</p> <p>Dividend Received by Parent can be: Pre-acquisition : to be adjusted in COC (i.e. deducted from</p>

	<p>investments) Post acquisition : to be transfer to Cons. P&L A/c of Holding</p> <p>(Agar pre acquisition dividend galti se p&l me daal diya parent ne to vaha se hatana padega to minus karenge and COC me dalna padega to vaha pe bhi minus karenge)</p> <p>Treatment of Dividend paid in AOP:</p> <ol style="list-style-type: none"> 1. Added back to the profits from where it has been appropriated. 2. Apply time adjustement 3. Reduce dividend from its actual source of profits <p>Final Dividend source is profit of last year and moving backwards Interim Dividend source is profit of current year upto the date of distribution.</p> <p>CDT will be appropriated just like dividend, but it will not be received or rectified by parent.</p>
Unrealised Profit/Loss on assets/stocks transferred within the group	<ol style="list-style-type: none"> 1. Calculate Book value of asset/stock transferred within the group (net of depreciation if any) 2. Calculate U.profit/loss on above book value. 3. If such transaction is upstream (i.e. sale by subtsy to parent) then eliminate profit/loss in AOP with similar effect in Asset/Stock value 4. If such transaction is downstream (i.e. sale by parent to subtsy) then eliminate profit/loss Cons. P&L with similar effect in Asset/Stock value) <p>If date of transaction is missing then assume such date to be the last date of period.</p>
Rectification of Errors	<p>If question specifies any error then such errors should be rectified <u>before time adjustment.</u></p>
Contra Items	<p>Whenever Payable and Receivable are within group (i.e. H and S), then such payable/receivable should be eliminated.</p> <p style="text-align: center;">Payable A/c Dr. To Receivable A/c</p> <p>Note:</p> <ol style="list-style-type: none"> 1. If payable is less than receivable then difference is called cheque in transit 2. If payable is more than some Error will be given in the question. Such error will be rectified and then contra adjustment will be made.
Contingent Liabilities	<p>The Portion which is discounted and shown as Contingent liability will not to be shown in Consolidated BS</p>

	Contra Adjustment will be made only for that portion which is not yet discounted and shown under Bills receivable and Bills payable
Proposed Dividend (Equity)	<p>If dividend is proposed after the date of Balance Sheet then According to Schedule III of Companies Act, 2013, then it is not required to recognize as a liability, it will be shown as Contingent Liability. (Matlab ye ki jis saal me dividend propose/declare kiya hai ussi saal me record karo)</p> <p>Therefore, we will ignore the treatment of proposed dividend in the Consolidated FS</p> <p>However if Proposed dividend is declared before or up to balance sheet date then it is to be provided for in the Balance sheet of the year it belongs. Treatment will be:</p> <ol style="list-style-type: none"> 1. Add back in AOP, if entry is already passed (ignore if entry not passed) 2. Deduct from Minority Interest and show MI's share of PD as Short Term Provisions
Proposed Dividend (Pref Share)	<ol style="list-style-type: none"> 1. Add back in AOP, if entry is already passed (ignore if entry not passed) 2. Apply Time Adjustment 3. Deduct in AOP from Pre and/or Post according to the date of Investment. 4. If this dividend is receivable by Parent then share of parent will be transfer to COC (Pre) or CPL (Post) 5. MI's Share in dividend will be shown as Short Term Provisions separately.
<p>Para 26 of AS 21: Losses applicable to Minority in Consolidated Financial Statements may exceed the Minority Interest in the equity/net worth of the subsidiary. The excess, and any further losses applicable to minority are adjusted against majority interest except to the extent the minority has binding obligation to, and is able to make good the losses. If subsidiary subsequently reports profits, then all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.</p> <p>Q1: A Ltd. acquired 70% equity shares of B Ltd. on 01.04.2008 at cost of Rs. 10,00,000 when B Ltd. had an equity share capital of Rs. 10,00,000 and reserves and surplus of Rs. 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of Rs. 2,50,000, Rs. 4,00,000, Rs. 5,00,000 and Rs. 1,20,000 respectively. Thereafter in 2012-13, B Ltd. experienced turnaround and registered an annual profit of Rs. 50,000. In the next two</p>	

years i.e. 2013-14 and 2014-15, B Ltd. recorded annual profits of Rs. 1,00,000 and Rs. 1,50,000 respectively. Show the Minority Interests and Cost of Control at the end of each year for the purpose of Consolidation. (RTP - May 2015)
 (Answer: COC - 2,44,000 and MI - 3,24,000; 2,49,000, 1,29,000; Nil; Nil, Nil, Nil, 33,000)

Multiple Acquisitions (Further Acquisition of Subsidiary's Shares)

Following points should be kept in mind while solving the question:

1. For each Acquisition, AOP should be prepared separately.
2. Minority Interest is to be calculated at Balance Sheet date based on final holding by parent. Minority Interest will be calculated as usual.
3. Share of Profit belonging to MI can be computed in **any AOP**.
4. Dividend paid after the acquisition of shares on 1st time but before the acquisition of shares on 2nd time may be Post acquisition dividend for 1st AOP and Pre -Acquisition Dividend for 2nd AOP.

Q2. On 1st January 1987, A Ltd. acquired 8,000 shares of Rs.10 each of B Ltd. at Rs. 90,000. The respective Balance Sheets as on 31st December, 1989 are given below:

Equity & Liabilities	A Ltd.	B Ltd.
<i>Shareholder Funds:</i>		
Share Capital (Rs.10)	1,00,000	1,00,000
Reserve	40,000	26,000
P & L A/c	36,000	35,000
<i>Current Liabilities:</i>		
Creditors	71,000	48,000
	2,47,000	2,09,000
Assets		
	A Ltd.	B Ltd.
Fixed Assets	60,000	1,10,000
Investments	1,00,000	15,000

Current Assets:

Debtors	25,000	20,000
Stock	30,000	40,000
Bank	32,000	24,000
	2,47,000	2,09,000

Additional Information:

1. At the time of acquiring shares, B Ltd. had Rs. 24,000 in reserves and Rs. 15,000 in Profit and Loss account.
2. B Ltd. paid 10% dividend in 1987, 12% in 1988, 15% in 1989 for 1986, 1987 and 1988 respectively. All dividends received have been credited to the Profit and Loss account.
3. Proposed Dividends of the both the companies for 1989 are 10% on paid up share capital excluding bonus.
4. One bonus share per 5 fully paid shares held has been declared by B Ltd. out of pre-acquisition reserve on 31st December, 1989. No effect has been given to that in the above accounts.
5. On 1st January, 1987, Building of B Ltd. which stood in the books at Rs. 1,50,000 was revalued at Rs. 1,60,000 but no adjustment has been made in the books. Depreciation has been charged @ 10% p.a. on reducing balance method.
6. In 1989 A Ltd. Purchased from B Ltd. goods for Rs. 10,000 on which B Ltd. made a profit of 20% on sales, 25% of such goods are lying unsold on 31st December, 1989.

Prepare the consolidated Balance Sheet as at 31st December, 1989.

(Ans.: Capital Reserve Rs. 29,200, BS - Rs. 3,72,790, M/I - 33,558 as per Companies Act, 2013)

Solution:

Q3. H Ltd. acquired shares of S Ltd. as follows:

Date	No. of shares	%	Amount
1/1/2000	8000	40%	120,000
1/4/2001	3000	15%	40,000
1/4/2002	3000	15%	42,000

Every year on 31st May, Subsidiary Co. pays dividend of 10% for previous year. Shares of S Ltd. are of Rs.10/- each. Profit & loss of subsidiary is as follows:

Balance on 1/1/2000	100,000
Add profit for year 2000	<u>60,000</u>
	1,60,000
Less dividend paid in year 2000	<u>20,000</u>
Balance as on 1/1/01	140,000
Add Profit for the year 2001	90,000
Less: Dividend paid in year 2001	<u>20,000</u>
	2,10,000
Add profit for the year 2002	1,20,000
Less Dividend paid in year 2002	<u>20,000</u>
Balance on 31/12/2002	3,10,000

(Ans: Cost of Control Rs. 38,375; M/1 Rs 1,53,000 and Cons. P&L - 1,16,625)

Consolidation of Two or More Subsidiary

1. Start with AOP of smallest subsidiary co.
2. Distribute the Profits of Smallest subsidiary co. among parent co. and other subsidiary co. having investments in smallest co.
3. Now, prepare the AOP of next big subsidiary co. and add the share of profit received from smallest subsidiary co.
4. Only the Post acquisition profits shall be transferred from AOP of smallest subsidiary to AOP of next big subsidiary.
5. Pre acquisition profits shall be directly transferred to the calculated of COC.

Q4.

The balance sheet of three companies Anand Ltd., Bajaj Ltd. and Charan Ltd. as on 31st December 2001 are given below:

Equity & Liabilities	Aanad Ltd.	Bajaj Ltd.	Charan Ltd.
Shareholder Funds:			

Share Capital (Share of 100 each)	1,50,000	1,00,000	60,000
Reserves	20,000	10,000	7,500
Profit & Loss A/c	50,000	30,000	25,000
<i>Current Liabilities:</i>			
Sundry Creditors	20,000	25,000	15,000
Anand Ltd.	-	10,000	8,000
Total	2,40,000	1,75,000	1,15,500
<i>Non Current Assets:</i>			
Goodwill	20,000	15,000	10,000
Fixed Assets	70,000	50,000	60,000
Shares in Bajaj Ltd. (750 shares)	90,000	-	-
in Charan Ltd (100 shares)	15,000	-	-
in Charan Ltd (350 shares)		52,000	
<i>Current Assets:</i>			
Due from Bajaj Ltd.	12,000	-	-
Charan Ltd.	8,000	-	-
Current Assets	25,000	58,000	45,500
	2,40,000	1,75,000	1,15,500

All shares were acquired on 1st July, 2001. On 1st January, 2001, the balance were:

	Anand Ltd.	Bajaj Ltd.	Charan Ltd.
Reserves	10,000	10,000	5,000
Profit & Loss Account	5,000	(Dr.) 5,000	3,000

Profits during 2001 were earned evenly over the year

In August 2001 each company declared and paid an interim dividend of 10% p.a. for six months. Anand Ltd. and Bajaj Ltd. have credited their Profit & Loss Account with the dividends received. During 2001, Charan Ltd. fabricated a machine costing Rs.10,000 which is sold to Bajaj Ltd. for Rs. 12,000. Bajaj Ltd then sold the machine to Anand Ltd., for Rs. 13,000, the transactions being completed on 31 st December 2001.

Prepare the consolidated Balance Sheet of the Group as on 31st December, 2001

(Ans.: Goodwill 47,593; Min. Intt. 58,650; Con P&L 65,688, BS 3,55,093)

Solution:

Disposal of Shares:

Without Loss of Control

1. Whenever the shares are partially sold by parent **without loss of control** then there will be no additional treatment except percentage of holding will be changed.
2. Sometimes the wrong entry may be passed by parent as under:

Bank A/c Dr.
To Investment A/c

Then rectification entry is required by reversing the investment to recognize Profit or Loss

3. To Calculate the correct profit or loss on sale, First of all we shall calculate the correct value of Investments as under: **Original Cost - Pre acquisition Dividend received if any**

Full/Partial Disposal of Share (with loss of control)

In case parent sells entire investments with loss of control or sells majority of investment and retain such portion which does not result in Significant Influence then consider following journal entry:

Bank A/c	Dr.		(Sale Proceeds)
Investments A/c	Dr.		(Value of retained investments if any at Fair Value)
Minority Interest	Dr.		(Proportionate share in NA)
Capital Reserve	Dr.		(Previously recognised if any on COC)
		To Net Assets A/c	(Value on the date of sale)
		To Goodwill A/c	(Previously recognised if any on COC)

(any difference in above entry will be transfer to Profit and Loss A/c of Holding co.)

Partial Disposal of Share (with loss of control but retaining significant influence)

In this situation, subsidiary co. will become Associate entity of Investor and the accounting will be made as per AS 23. It will be discussed in the next unit.

Q5.

A Ltd. had acquired 80% shares in the B Ltd. for Rs 15 lakhs. The net assets of B Ltd. on that day are Rs 22 lakhs. During the year, A Ltd. sold the investment for Rs 30 lakhs and net assets of B Ltd. on the date of disposal was Rs 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

Answer:

A Ltd. had acquired 80% shares in the B Ltd. for Rs 15 lakhs. The net assets of B Ltd. on that day are Rs 22 lakhs. During the year, A Ltd. sold the investment for Rs 30 lakhs and

net assets of B Ltd. on the date of disposal was Rs 35 lakhs. Calculate the profit or loss on disposal of this investment to be recognized in the Financial Statements of A Ltd.

Calculation of Profit/Loss on disposal of investment in subsidiary

Particulars	Rs
Proceeds from the sale of Investment	30,00,000
Less: A Ltd.'s share in net assets of B Ltd. (W.N.1)	(28,00,000)
	2,00,000
Add: Capital Reserve at the time of acquisition of shares in B Ltd. (W.N.2)	2,60,000
Profit on sale of investment	4,60,000

Working Notes:

1. A Ltd.'s share in net assets of B Ltd.

	Rs
Net Assets of B Ltd. on the date of disposal	35,00,000
Less: Minority Interest (20% of ` 35 lakhs)	(7,00,000)
A Ltd.'s share in the net assets of B Ltd.	28,00,000

2. Capital Reserve at time of acquisition of shares in B Ltd.

	Rs
A Ltd.'s share in the net assets of B Ltd. on the date of acquisition (80% of Rs 22 lakhs)	17,60,000
Less: Cost of investment	(15,00,000)
Capital Reserve at time of acquisition of shares in B Ltd.	2,60,000

UNIT - 2

AS 23 - INVESTMENTS IN ASSOCIATES

&

AS 27 - INTEREST IN JOINT VENTURES

JOINT VENTURES - AS 27

1. A Joint venture is defined as a **Contractual Arrangement** whereby two or more parties undertake an economic activity, which is **subject to Joint Control**.

Example:

IDBI gave loan to the joint venture entity of L&T and Tania Construction, they signed an agreement according to which IDBI will be informed for all important decisions of the joint venture entity. This agreement is to protect the right of the IDBI, hence just signing the contractual agreement will not make investor a venturer.

Similarly, just because contractual agreement has assigned the role of a manager to any of the venturer will not disqualify him as venturer.

2. Joint Ventures can be of Three Types -

- (a) Joint Control Operation - (JCO)
- (b) Joint Control Assets - (JCA)
- (c) Joint Control Entity - (JCE)

3. In case of JCO and JCA separate entity is not formed. In these cases Assets and Liabilities, Incomes and Expenses are shown in the financial statements of Ventures as "Share in JV"

If any Investor in the JV has any transaction of Sale and Purchase with his JV then profit/loss on sale transaction **should be ignored to the extent of own share**.

However loss can be recognized to the extent of own share **if the loss is due to decline in market price**.

4. **JCE** - A new entity is formed by Investors of JV. Such new entity is jointly

controlled by investors through "Contractual Arrangement"

Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

JCE shall be consolidated with the parent **only to the extent of own share**. It is called "*Proportioned Consolidation*" and hence **Minority Interest is not calculated**.

Contra and Unrealised profit adjustments are for Pro-rata part only.

(Note - if the share in JV is more than 50% then it will be treated as subsidiary for solving the question)

According to the Companies Act, 2013 and IND AS 111 (Joint Arrangement), JVs are to be Consolidated irrespective of any Subsidiary with parent.

A venturer should **discontinue the use of the proportionate consolidation method** from the date that:

- a. It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.
- b. The use of the proportionate consolidation method is no longer appropriate because the **joint venture operates under severe long-term restrictions** that significantly impair its ability to transfer funds to the venturers.

From the date of discontinuing the use of the proportionate consolidation method,

- a. If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.
- b. If interest is 20% or more but upto 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statement.
- c. For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

For this purpose, the carrying amount of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost thereafter.

ASSOCIATE - AS 23

1. Associate means an entity which is under the significant influence of another entity.
2. Significant influence means "Power to Participate in Financial and/or Operating decisions" of the company.
3. Associate can be formed due to any of the following ways:
 - (a) **Through Voting Power** - If the entity acquires 20% or more voting power but upto 50% then the investor (acquirer) entity will have significant influence unless other proved. (In some situations a voting power of less than 20% can also be considered as significant influence if it is proved)
 - (b) **Through application of Law** - If any law gives power to participate in the decision making of any entity then there will be significant influence even without acquiring voting power.(SBI and SBI associate banks, LIC and LIC housing finance)
 - (c) **Through Agreement with Shareholders** - If the Shareholders holding 20% or more voting rights enter into any agreement that gives power to participate then also there will be significant influence.

Treatment of Associates:-

1. If there is no Subsidiary then no consolidation, therefore there is no AS 23.
2. If there is Control over one company and significant influence over other company then in Consolidation Financial Statements, Investment in Associates shall be revalued according to **EQUITY METHOD**.
3. Equity Method - Investment will be revalued in CFS as under

Investment Cost	XXX
(+/-) Share in Post Acquisition Profits of Associates	XXX
(-) Distribution received from Associates (if any)	XXX
(+/-) Contra Adjustment and Unrealised Gains/losses adjustment to the extent of Investor's share	XXX

Q6. (ICAI)

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for Rs 10 lacs. On that date B Ltd. had 1,00,000 equity shares of Rs 10 each fully paid and accumulated profits of Rs 2,00,000.

During the year 20X1-20X2, B Ltd. suffered a loss of Rs 10,00,000.

During 20X2-20X3 loss of Rs 12,50,000 and during 20X3-20X4 again a loss of Rs 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Solution

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	Rs
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% of Net Asset	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1

Assets	Rs	Rs
Investment in B Ltd.	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment in the year ended on 20X1-20X2

Particulars	Rs
Investment in B Ltd.	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 × 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2

Assets	Rs	Rs
Investment in B Ltd.	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment in the year ended on 20X2-20X3.

Particulars	Rs
Carrying Amount of Investment	6,00,000
Less: Loss for the year (12,50,000 × 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3

Assets	Rs	Rs
Investment in B Ltd.	-	-
Add: Goodwill	1,00,000	1,00,000

Calculation of Carrying Amount of Investment in the year ended on 20X3-20X4

Particulars	Rs
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40%)	(2,00,000)
Carrying Amount of Investment	(1,00,000)

Consolidated Balance Sheet (Extract) as on March 31, 20X4

Assets	Rs	Rs
Investment in B Ltd.		-

Q7. Eagle Ltd. had acquired 51% in Sparrow Ltd. for Rs. 75.80 lakhs on 1st April, 2010. On the date of the acquisition Sparrow's Assets stood at Rs. 196 lakhs and liabilities at Rs. 16 lakhs. The net asset position of Sparrow Ltd. as on 31st March, 2011 and 30th Sep 2011 were Rs. 280 lakhs and Rs. 395 lakhs respectively, the increase resulting from profits during the period.

On 1st October, 2011 25.5% holdings were sold for Rs. 125 lakhs. You are required explain the nature of the relationship between the two companies on the relevant dates and the accounting adjustments that are necessary as a result of any change in the relationship. The profit arising on part sale of investment, carrying value of the portion unsold and goodwill/capital reserve that arises on change in nature of the investment may also be worked out by you.

(November 2011, 8 marks)

Solution:

Sparrow Ltd. became a subsidiary of Eagle Ltd. on 1st April 20X0 when 51% thereof was acquired. The holding-subsidiary relationship continued till 30th September 20X1 and from 1st October, 20X1 the relationship between the two companies will change to Associate. As per para 24 of AS 21, "Consolidated Financial Statements", **the carrying value of the investment at the date it ceases to be subsidiary is regarded as cost thereafter.** Accordingly, if the nature of the investee changes to that of an associate, the carrying

amount of the investment in Consolidated Financial Statements of the investor, as on date it ceases to be a subsidiary, would be considered as cost of investment in the associate.

Goodwill or capital reserve arising on account of the change in the nature of the investment will be computed as on the date of such change. Accordingly, when a part of the investment takes the form of an investment in an associate, the results of operations of the subsidiary will be included in the consolidated statement of Profit and Loss for the period from the beginning of the period until it ceased to be a subsidiary.

**Ascertainment of Gain or Loss
on the Disposal of the Part of the Investment in Sparrow Ltd.**

		Rs
Proceeds received on sale of 25.5% holdings in Sparrow Ltd.		1,25,00,000
Net Assets of sparrow Ltd. on the date of disposal	3,95,00,000	
Less: Minority's interest in Sparrow Ltd. on the date of disposal	(1,93,55,000)	
Share of Eagle Ltd. in Net Assets	2,01,45,000	
Less: Capital reserve on acquisition (Refer W.N.)	(16,00,000)	
Total value of investment in consolidated financial statements of Eagle Ltd.	1,85,45,000	
Less: Carrying Value of investment disposed off		92,72,500
Profit on sale of 25.5% of investment		32,27,500

Carrying Value of the Investment retained in the Consolidated Financial Statements

		Rs
Total value of investment in consolidated financial statements of Eagle Ltd.	1,85,45,000	
Less: Carrying value of investment disposed off	(92,72,500)	
Carrying Value of the investment retained in consolidated financial statements including capital reserve		92,72,500
This amount of Rs 92,72,500 would be used to apply the equity method of accounting as specified in AS 23		

**Goodwill / Capital Reserve arising on the Carrying Value of Unsold Portion of the
Investment**

Rs

Carrying value of 25.5% holdings in Sparrow Ltd. as on 1 st October, 20X1	92,72,500
Less: Share in value of equity of Sparrow Ltd., as at date of investment when subsidiary relationship is transformed to an associate (3,95,00,000 x 25.5%)	(1,00,72,500)
Capital reserve arising on such investment under Equity method as per AS 23	(8,00,000)

Working Note:

Calculation of Goodwill/Capital Reserve on the Date of Acquisition of Shares in Sparrow Ltd.

	Rs
Net Assets on Acquisition date (Rs 1,96,00,000 - Rs 16,00,000)	1,80,00,000
51% thereof	91,80,000
Less: Cost of investment	(75,80,000)
Capital reserve on acquisition	16,00,000

Important Notes: