CHIRANJEEV JAIN
CLASSES

FOR CA - FINAL COURSE

QUESTION BANK

FOR

FINANCIAL REPORTING

As per the latest syllabus of Final issued by
Board of Studies of ICAI

"IT'S TIME TO BE BUSY BECAUSE TODAY WILL BE YESTERDAY VERY SOON"

PAPER: 1

FINANCIAL REPORTING

QUESTION BANK
VOLUME – III

COMPILED BY

CA. CHIRANJEEV JAIN

[B.COM (H); FCA; DISA; MBA(F)]

**WITHOUT PASSION, YOU DON'T HAVE ENERGY.
WITHOUT ENERGY, YOU HAVE NOTHING.**

EVERYTHING IS EITHER AN OPPORTUNITY TO GROW OR AN OBSTACLE TO KEEP YOU FROM GROWING. YOU GET TO CHOOSE.

Dedicated to
My Father Sri Mool Chand Jain
and
My Mother Smt. Sarala Devi Jain

IT'S NOT ABOUT PERFECT. IT'S ABOUT EFFORT. AND WHEN YOU BRING THAT EFFORT EVERY SINGLE DAY, THAT'S WHERE TRANSFORMATION HAPPENS. THAT'S HOW CHANGE OCCURS.

Dear student,

A person who never made a mistake never tried anything new. – Albert Einstein

Winner is a dreamer who never gives up.– Nelson Mandela

I can't change the direction of the wind, but I can adjust my sails to always reach my destination.– Jimmy Dean

No one can make you feel inferior without your consent.– Eleanor Roosevelt

Whether you think you can or you think you can't, you're right. – Henry Ford

The most common way people give up their power is by thinking they don't have any. – Alice Walker

Be thankful *for what you have; you'll end up having more. If you concentrate on what you don't have, you will never, ever have enough.– Oprah Winfrey*

Believe in yourself! Have faith in your abilities! Without a humble but reasonable confidence *in your own powers you cannot be successful or happy.– Norman Vincent Peale*

Winners from all walks of life have their own strategies and plans but they all have one thing in common – they TRY. Keep trying.

The most difficult thing is the decision to act, the rest is merely tenacity.– Amelia Earhart

Press forward. Do not stop, do not linger in your journey, but strive for the mark set before you. – George Whitefield

There will be obstacles. There will be doubters. There will be mistakes. But with hard work, there are no limits.– Michael Phelps

You just can't beat the person who never gives up. – Babe Ruth

Many of life's failures are people who did not realize how close they were to success when they gave up. – Thomas A. Edison

It is during our darkest moments that we must focus to see the light. – Aristotle Onassis

Failure will never overtake me if my determination to succeed is strong enough. – Og Mandino

It's not whether you get knocked down, it's whether you get up.– Vince Lombardi

The pessimist sees difficulty in every opportunity. The optimist sees opportunity in every difficulty. – Winston Churchill

PREFACE

Financial Reporting is Paper 1 in Chartered Accountancy – Final Course. It is rightly so because Accounting is the language of business and without understanding accounting terminology, it is not possible to understand business and commerce. It is, therefore, essential for all CA students to possess knowledge of Financial Reporting concepts and practices.

The approach of the book is examination-oriented problems from ICAI Study Resource and solutions have also been included in all chapters as per ICAI Suggested solution. Examples and Illustration (mostly selected from ICAI Study Modules) have been included in the book to understands the IND AS concepts.

Recent question from ICAI RTP, MTP and Exam papers with answers have been included to help the students.

Practical Question from Other Sources are also included in some of the chapters for better understanding of the concepts. Solutions for some of these questions may not be provided for which students may refer our class notes.

Considering the importance of the question bank and its practical implications, care has been taken to solve almost all the problems for the benefit of the students.

We are sure the book will prove extremely useful to CA Final students.

We are Thankful to all my students to have faith on me.

Suggestions from all readers would be highly appreciated and acknowledged.

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Chapter 27	*Related Party Disclosures (IND AS 24)*	***27.1***
Chapter 28	*The Effects of Changes in Foreign Exchange Rates (Ind AS 21)*	***28.1***
Chapter 29	*Business Combination (IND AS 103)*	***29.1***
Chapter 30	*Earnings Per Share (IND AS 33)*	***30.1***
Chapter 31	*FIRST-TIME ADOPTION OF IND AS (Ind AS 101)*	***31.1***
Chapter 32	*FAIR VALUE MEASUREMENT (IND AS 113)*	***32.1***
Chapter 33	*CORPORATE SOCIAL RESPONSIBILITY*	***33.1***
Chapter 34	*ANALYSIS OF FINANCIAL STATEMENTS*	***34.1***
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HARD TIMES DON’T CREATE HEROES. IT IS DURING THE HARD TIMES WHEN THE ‘HERO’ WITHIN US IS REVEALED.

NUMBER OF EXAMPLES & QUESTIONS COVERED

No	Chapter Name	Examples/ Illustrations	Questions
1	Framework for Preparation and Presentation of Financial Statement	16	8
2	IND AS – Introduction	-	-
3	Presentation of Financial Statements (IND AS 1)	-	29
4	Schedule III of Companies Act	-	4
5	Statement of Cash Flows (IND AS 7)	-	25
6	Accounting Policies, Changes in Accounting Estimates and Errors (Ind AS 8)	-	25
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10	Valuation of Inventories (IND AS 2)	-	35
11	Property, Plant and Equipment (IND AS 16)	11	40
12	Intangible Assets (IND AS 38)	18	37
13	Investment Property (IND AS 40)	5	17
14	Borrowing Costs (IND AS 23)	-	21
15	Government Grant (IND AS 20)	4	22
16	Agriculture (IND AS 41)	-	11
17	Impairment of Assets	-	44
18	Non-current Assets Held for Sale and Discontinued Operations	21	11
19	Operating Segments (IND AS 108)	-	19
20	Shares based Payment (IND AS 102)	22	37
21	Employee Benefits (IND AS 19)	8	34
22	Financial instruments (IND AS 32, 107 & 109)	71	70
23	Revenue from Contact with Customers (IND AS 115)	-	95
24	Leases (IND AS 116)	-	62
25	Accounting for Income Tax (IND AS 12)	-	43
26	Consolidated Financial Statement as per IND AS	70	86
27	Related Party Disclosures (IND AS 24)	26	15
28	The Effects of Changes in Foreign Exchange Rates	-	19
29	Business Combination (IND AS 103)	69	31
30	Earnings Per Share (IND AS 33)	-	22
31	FIRST-TIME ADOPTION OF IND AS (Ind AS 101)	-	28
32	FAIR VALUE MEASUREMENT (IND AS 113)	16	8
33	CORPORATE SOCIAL RESPONSIBILITY	-	14
34	ANALYSIS OF FINANCIAL STATEMENTS	-	15
35	INTEGRATED REPORTING	-	4
	Total	370	1024

CA Final - Paper 1 Financial Reporting

ABC & TREND ANALYSIS

Category	Chapter	May-18	Nov-18	May-19	Nov-19	Nov-20	Jan-21	Jul-21	Total
A	*Consolidated Financial Statement*	25	16	27		10	20	16	114
A	*Financial instruments*	16	20	12	14	6	19	19	106
A	*Revenue from Contact with Customers*	4	10	5	12	18	12	12	73
A	*ANALYSIS OF FINANCIAL STATEMENTS*	10	8	16	12	12		8	66
A	*Business Combination (IND AS 103)*	10	4	8	28	8		5	63
A	*Shares based Payment (IND AS 102)*	10	8	5	8	5	12	5	53
	Total (A)	**75**	**66**	**73**	**74**	**59**	**63**	**65**	**475**
B	*Impairment of Assets*		15	4		8		6	33
B	*Leases (IND AS 116)*	12				8	6	4	30
B	*Property, Plant and Equipment*		8		8		5		21
B	*Agriculture (IND AS 41)*				4		4	9	17
B	*Earnings Per Share (IND AS 33)*					8		8	16
B	*Employee Benefits (IND AS 19)*			8		6			14
B	*The Effects of Changes in Foreign Exchange Rates (Ind AS 21)*			5	4			5	14
B	*Non-current Assets Held for Sale and Discontinued Operations*				10				10
B	*Accounting for Income Tax*					6	4		10
B	*FIRST-TIME ADOPTION OF IND AS*							6	6
	Total (B)	**12**	**23**	**17**	**26**	**36**	**19**	**38**	**171**
C	*CORPORATE SOCIAL RESPONSIBILITY*	8	4			5	6	6	29
C	*Operating Segments (IND AS 108)*	10				6	4	8	28
C	*Interim Financial Reporting (IND AS 34)*		5	4		6		5	20
C	*Events occurring after the Balance Sheet Date*				8		8		16
C	*Intangible Assets (IND AS 38)*			5			10		15
C	*Presentation of Financial Statements*			4			5	4	13
C	*Statement of Cash Flows (IND AS 7)*					8	5		13
C	*FAIR VALUE MEASUREMENT*		5		8				13
C	*Government Grant (IND AS 20)*		5	4					9
C	*Valuation of Inventories (IND AS 2)*	4				4			8
C	*Borrowing Costs (IND AS 23)*				8				8
C	*INTEGRATED REPORTING*						6		6
C	*Framework for Preparation and Presentation of Financial Statement*			5					5
C	*Provisions, Contingent Liabilities and Contingent Assets (IND AS 37)*		4						4
C	*IND AS – Introduction*								0
C	*Schedule III of Companies Act*								0
C	*Accounting Policies, Changes in Accounting Estimates and Errors*								0
C	*Investment Property (IND AS 40)*								0
C	*Related Party Disclosures*								0
	Total (C)	**22**	**23**	**22**	**24**	**29**	**44**	**23**	**187**
	Portions Deleted	15	12	12					
	Total (A+ B+C)	**124**	**124**	**124**	**124**	**124**	**126**	**126**	

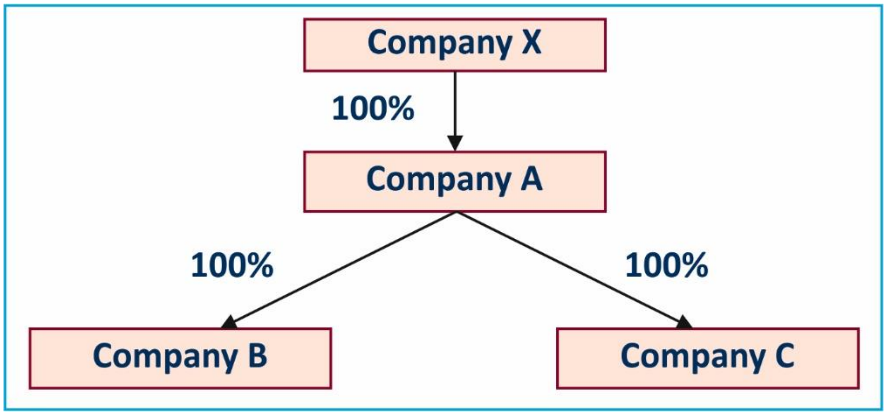
CHAPTER 26

CONSOLIDATED FINANCIAL STATEMENTS (AS PER IND AS)

ILLUSTRATIONS BASED QUESTIONS FROM ICAI SM

EXEMPTION FROM CONSOLIDATION

Illustration 1: Exception to prepare consolidated financial statements



Scenario A: Following is the structure of a group headed by Company X:

Company X is a listed entity in India and prepares consolidated financial statements as per the requirements of Ind AS. Company A is an unlisted entity and it is not in the process of listing any of its instruments in public market. Company X does not object to Company A not preparing consolidated financial statements. Whether Company A is required to prepare consolidated financial statements as per the requirements of Ind AS 110?

Scenario B: Assume the same facts as per Scenario A except, Company X is a foreign entity and is listed in stock exchange of a foreign country and it prepares its financial statements as per the generally accepted accounting principles (GAAP) applicable to that country. Will your answer be different in this case?

Scenario C: Assume the same facts as per Scenario A except, 100% of the investment in Company A is held by Mr. X (an individual) instead of Company X. Will your answer be different in this case?

Solution:

Scenario A: In this case, Company A satisfies all the conditions for not preparing consolidated financial statements i.e. it is not a listed entity nor it is in the process of listing, the parent of Company A prepares consolidated financial statements as per Ind AS which is available for public use and parent of Company A does not object Company A not preparing consolidated financial statements.

Hence, Company A is not required to prepare consolidated financial statements.

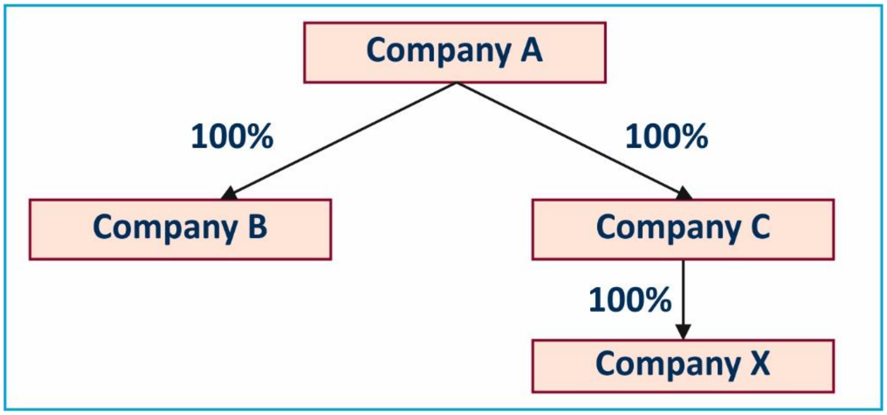
Scenario B: In this case, the consolidated financial statements of parent of Company A are not prepared under Ind AS. Hence Company A cannot avail the exemption from preparation of consolidated financial statements.

Scenario C: In this case, Mr. X (an individual) would not be preparing its financial statements as per the requirements of Ind AS which is available for public use.

Hence Company A cannot avail the exemption from preparation of consolidated financial statements.

Illustration 2: Exception to prepare consolidated financial statements

Scenario A: Following is the structure of a group headed by Company A.



Company A is a listed entity in India and prepares consolidated financial statements as per the requirements of Ind AS. Company C is an unlisted entity and it is not in the process of listing any of its instruments in public market. 60% of the equity share capital of Company C is held by Company A and balance 40% equity share capital is held by other outside investors. Company A does not object to Company C not preparing consolidated financial statements. Whether Company C is required to prepare consolidated financial statements as per the requirements of Ind AS 110?

Scenario B: Assume the same facts as per Scenario A except, the balance 40% of the equity share capital of Company C is held by Company B.

State whether C Limited is required to inform its other owner B Limited (owning 40%) of its intention to not prepare consolidated financial statements as mentioned in paragraph 4(a)(i)?

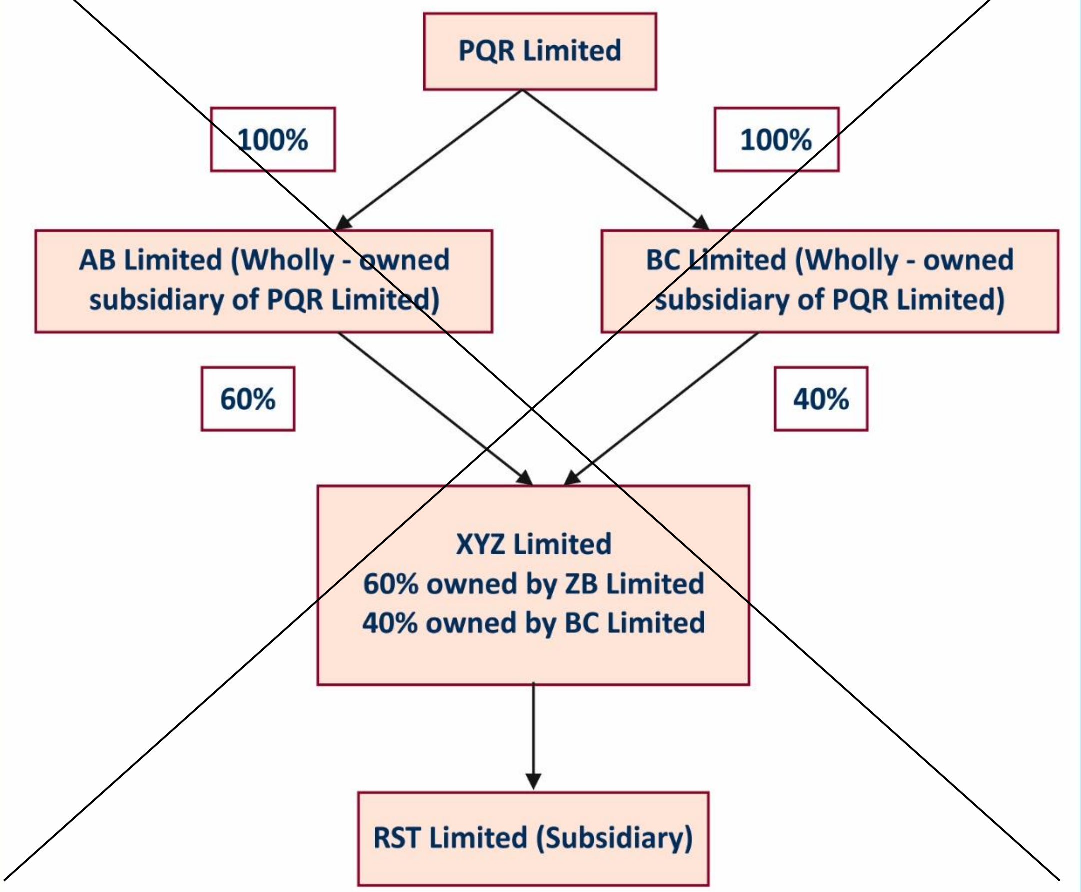
Solution:

Scenario A: Company C is a partly owned subsidiary of Company A. In such case, Company C should inform the other 40% equity shareholders about Company C not preparing consolidated financial statements and if they do not object then only Company C can avail the exemption from preparing consolidated financial statements.

Scenario B: In this scenario, Company C is 100% held by Company A (60% direct investment and 40% investment through Company B). Hence, Company C is not required to inform to Company B of not preparing consolidated financial statements and can avail the exemption from preparing the consolidated financial statements.

~~Illustration 3~~

~~Following is the structure of a group headed by PQR Limited~~


~~PQR Limited~~
~~100%~~
~~100%~~
~~AB Limited (Wholly - owned subsidiary of PQR Limited)~~
~~BC Limited (Wholly - owned subsidiary of PQR Limited)~~
~~60%~~
~~40%~~
~~XYZ Limited~~
~~60% owned by ZB Limited~~
~~40% owned by BC Limited~~
~~RST Limited (Subsidiary)~~

~~Under both the scenarios, XYZ Limited wishes to avail the exemption provided in Ind AS 110 from the presentation of consolidated financial statements. Assuming other conditions for such exemption are fulfilled, whether XYZ Limited is required to inform its other owner BC Limited (owning 40%) of its intention to not prepare consolidated financial statements?~~

~~Solution:~~

~~As per paragraph 4(a)(i) of Ind AS 110, a parent need not present consolidated financial statements if it is a:~~

- ~~wholly-owned subsidiary; or~~
- ~~is a partially-owned subsidiary of another entity~~
- ~~and all its other owners, including those not otherwise entitled to vote, have been informed about,~~
- ~~and do not object to, the parent not presenting consolidated financial statements.~~

~~In Scenario I, although XYZ Limited is a partly-owned subsidiary of AB Limited, it is the wholly- owned subsidiary of PQR Limited and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. AB Limited and BC Limited. Thus, XYZ Limited being the~~

~~wholly owned subsidiary is not required to inform its other owner BC Limited of its intention not to prepare the consolidated financial statements.~~

~~Therefore, XYZ Limited may take the exemption given under Ind AS 110 from presentation of consolidated financial statements.~~

~~In Scenario II, XYZ Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.~~

~~This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, XYZ Limited cannot be considered as wholly owned subsidiary of an entity.~~

~~Therefore, in the given case, XYZ Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption, its other owner, BC Limited should be informed about and do not object to XYZ Limited not presenting consolidated financial statements.~~

~~Further, for the purpose of consolidation of AB Limited and BC Limited, XYZ Limited will be required to provide relevant financial information as per Ind AS.~~

Illustration 4:

Gamma Limited, a parent company, is engaged in manufacturing and retail activities. The group holds investments in different entities as follows:

- Gamma Limited holds 100% Investment in G Limited and D Limited;
- G Limited and D Limited hold 60% and 40% in GD Limited respectively;
- Delta Limited is a 100% subsidiary of GD Limited

Firstly, Gamma Limited wants you to suggest whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements as per applicable Ind AS?

Secondly, if all other facts remain the same as above except that G Limited and D Limited are both owned by an Individual (say, Mr. X) instead of Gamma Limited, then explain whether GD Limited can avail the exemption from the preparation and presentation of consolidated financial statements.

[RTP May 2020]

Answer: As per paragraph 4(a) of Ind AS 110, an entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

A parent need not present consolidated financial statements if it meets all the following conditions:

a. it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

b. its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

c. it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

d. its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS.

In accordance with the above, it may be noted that as per paragraph 4(a)(i) above, a parent need not present consolidated financial statements if it is a:

- wholly-owned subsidiary; or
- is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

Although GD Limited is a partly-owned subsidiary of G Limited, it is the wholly-owned subsidiary of Gamma Limited (and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. G Limited and D Limited). Thus, GD Limited being the wholly owned subsidiary fulfils the conditions as mentioned under paragraph 4(a)(i) and is not required to inform its other owner D Limited of its intention not to prepare the consolidated financial statements.

Thus, in accordance with the above, GD Limited may take the exemption given under paragraph 4(a) of Ind AS 110 from presentation of consolidated financial statements.

In Alternative Scenario, where both G Limited and D Limited are owned by an individual Mr. X, then GD Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.

This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, GD Limited cannot be considered as wholly owned subsidiary of an entity.

Therefore, in the given case, GD Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption under paragraph 4(a), its other owner, D Limited should be informed about and do not object to GD Limited not presenting consolidated financial statements. Further, for the purpose of consolidation of G Limited and D Limited, GD Limited will be required to provide relevant financial information as per Ind AS.

ASSESSMENT OF CONTROL

Illustration 5: Different investors have ability to direct different relevant activities

A Ltd. and B Ltd. have formed a new entity AB Ltd. for constructing and selling a scheme of residential units consisting of 100 units. Construction of the residential units will be done by A Ltd. and it will take all the necessary decision related to the construction activity. B Ltd. will do the marketing and selling related activities for the units and it will take all the necessary decisions related to marketing and selling. Based on above, who has the power over AB Ltd.?

Solution: In this case, both the investors A Ltd. and B Ltd. have the rights to unilaterally direct different relevant activities of AB Ltd. Here, investors shall determine which activities can most significantly affect the returns of the investee and the investor having the ability to direct those activities would be considered to have power over the investee. Hence, if the investors conclude that the construction related activities would most significantly affect the returns of AB Ltd. then A Ltd. would be said to have power over AB Ltd. On the other hand, if it is concluded that marketing and selling related activities would most significantly affect the returns of AB Ltd. then B Ltd. would be said to have power over AB Ltd.

Illustration 6: Determining the relevant activities

A Ltd. is an asset manager of a venture capital fund i.e. Fund X. Out of the total outstanding units of the fund, 10% units are held by A Ltd. and balance 90% units are held by other investors. Majority of the unitholders of the fund have right to appoint a committee which will manage the day to day administrative activities of the fund. However, the decisions related to the investments / divestments to be done by Fund X is taken by asset manager i.e. A Ltd. Based on above, who has power over Fund X?

Solution: In this case, A Ltd. is able to direct the activities that can most significantly affect the returns of Fund X. Hence A Ltd. has power over the investee. However, this does not mean that A Ltd. has control over the fund and consideration will have to be given to other elements of control evaluation as well i.e. exposure to variable returns and link between power and exposure to variable returns.

Illustration 7

An investor holds a majority of the voting rights in the investee. Does the investor have current ability to direct the relevant activities given the fact that it takes 30 days to hold shareholder's meeting to take decisions regarding relevant activities?

Solution: The investor's voting rights are substantive because the investor is able to make decisions about the direction of the relevant activities when they need to be made. The fact that it takes 30 days before the investor can exercise its voting rights does not stop the investor from having the current ability to direct the relevant activities from the moment the investor acquires the shareholding.

Illustration 8

An investor is party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is in 25 days. Is the investor's forward contract a substantive right even before settlement of contract?

Solution: The investor becomes majority shareholder in the investee after the settlement of forward contract in 25 days. As per the facts given in the 'Facts' above, the existing shareholders are unable to change the existing policies over the relevant activities because a special meeting cannot be held for at least 30 days, at which point the forward contract would have been settled. Thus, the investor has rights that are essentially equivalent to the majority shareholder in Illustration 4 above (i.e. the investor holding the forward contract can make decisions about the direction of the relevant activities when they need to be made). Therefore, the investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled.

Illustration 9

If in the illustration given above, the investor's forward contract shall be settled in 6 months instead of 25 days, would existing shareholders have the current ability to direct the relevant activities?

Solution: Since the date of settlement of forward contact is in 6 months, the existing shareholders can hold a meeting within 30 days and direct relevant activities at which point the forward contract would not be settled. Therefore, the existing shareholders have substantive rights currently.

Illustration 10: Current ability to direct the relevant activities

An investment vehicle (the investee) is created and financed with a debt instrument held by an investor (the debt investor) and equity instruments held by a number of other investors. The equity tranche is designed to absorb the first losses and to receive any residual return from the investee. One of the equity investors who holds 30 per cent of the equity is also the asset manager.

The investee uses its proceeds to purchase a portfolio of financial assets, exposing the investee to the credit risk associated with the possible default of principal and interest payments of the assets. The transaction is marketed to the debt investor as an investment with minimal exposure to the credit risk associated with the possible default of the assets in the portfolio because of the nature of these assets and because the equity tranche is designed to absorb the first losses of the investee.

The returns of the investee are significantly affected by the management of the investee's asset portfolio, which includes decisions about the selection, acquisition and disposal of the assets within portfolio guidelines and the management upon default of any portfolio assets. All those activities are managed by the asset manager until defaults reach a specified proportion of the portfolio value (ie when the value of the portfolio is such that the equity tranche of the investee has been consumed). From that time, a third-party trustee manages the assets according to the instructions of the debt investor.

Based on the above, who has power over the investment vehicle?

Solution: Managing the investee's asset portfolio is the relevant activity of the investee.

The asset manager has the ability to direct the relevant activities until defaulted assets reach the specified proportion of the portfolio value; the debt investor has the ability to direct the relevant activities when the value of defaulted assets surpasses that specified proportion of the portfolio value.

The asset manager and the debt investor each need to determine whether they are able to direct the activities that most significantly affect the investee's returns, including considering the purpose and design of the investee as well as each party's exposure to variability of returns.

Illustration 11: Voting rights are substantive or not

Scenario A: Following is the voting power holding pattern of B Ltd.

- 10% voting power held by A Ltd.
- 90% voting power held by 9 other investor each holding 10%

All the investors have entered into a management agreement whereby they have granted the decision-making powers related to the relevant activities of B Ltd. to A Ltd. for a period of 5 years.

After 2 years of the agreement, the investors holding 90% of the voting powers have some disputes with A Ltd. and they want to take back the decision-making rights from A Ltd. This can be done by passing a resolution with majority of the investors voting in favour of the removal of rights from A Ltd.

However, as per the termination clause of the management agreement, B Ltd. will have to pay a huge penalty to A Ltd. for terminating the agreement before its stated term.

Whether the rights held by investors holding 90% voting power are substantive?

Scenario B: Assume the same facts as per Scenario A except, there is no penalty required to be paid by B Ltd. for termination of agreement before its stated term. However, instead of all other investors, there are only 4 investors holding total 40% voting power that have disputes with A Ltd. and want to take back decision-making rights from A Ltd.

Whether the rights held by investors holding 40% voting power are substantive?

Solution:

Scenario A: If the investors holding 90% of the voting power exercise their right to terminate the management agreement, then it will result in B Ltd. having to pay huge penalty which will affect the returns of B Ltd. This is a barrier that prevents such investors from exercising their rights and hence such rights are not substantive.

Scenario B: To take back the decision-making rights from A Ltd., investors holding majority of the voting power need to vote in favour of removal of rights from A Ltd. However, the investors having disputes with A Ltd. do not have majority voting power and hence the rights held by them are not substantive.

Illustration 13: Potential voting rights are substantive or not

Scenario A: An investor is holding 30% of the voting power in ABC Ltd. The investor has been granted an option to purchase 30% more voting power from other investors. However, the exercise price of the option is too high compared to the current market price of ABC Ltd. because ABC Ltd. is incurring losses since last 2 years and it is expected to continue to incur losses in future period as well. Whether the right held by the investor to exercise purchase option is substantive?

Scenario B: Assume the same facts as per Scenario A except, the option price is in line with the current market price of ABC Ltd. and ABC Ltd. is making profits. However, the option can be

exercised in next 1 month only and the investor is not in a position to arrange for the require amount in 1 month's time to exercise the option. Whether the right held by the investor to exercise purchase option is substantive?

Scenario C: Assume the same facts as per Scenario A except, ABC Ltd. is making profits. However, the current market price of ABC Ltd. is not known since the ABC Ltd. is a relatively new company, business of the company is unique and there are no other companies in the market doing similar business. Hence the investor is not sure whether to exercise the purchase option. Whether the right held by the investor to exercise purchase option is substantive?

Solution:

Scenario A: The right to exercise purchase option is not substantive since the option exercise price is too high as compared to current market price of ABC Ltd.

Scenario B: The right to exercise purchase option is not substantive since the time period for the investor to arrange for the requisite amount for exercising the option is too narrow.

Scenario C: The right to exercise purchase option is not substantive. This is because the investor is not able to obtain information about the market value of ABC Ltd. which is necessary in order to compare the option exercise price with market price so that it can decide whether the exercise of purchase option would be beneficial or not.

Illustration 14: Removal rights are substantive or not

A venture capital fund is managed by an asset manager who has right to take the investment and divestments decisions related to the fund corpus. The asset manager is also holding some stake in the fund. The other investors of the fund have right to remove the asset manager.

However, in the present scenario, there is absence of other managers who are willing or able to provide specialised services that the current asset manager is providing and purchase the stake that the current asset manager is holding in the fund. Whether the removal rights available with other investors are substantive?

Solution: If the other investors exercise their removal rights, then it will impact the operations of the fund and ultimately the returns of the fund since there is no substitute of the current asset manager available who can manage the corpus of the fund. Hence the removal rights held by other investors are not substantive.

Illustration 15: Protective rights of a franchisor

ABC Ltd. is a manufacturer of branded garments and is the owner of Brand X. PQR Ltd. has entered into a franchise agreement with ABC Ltd. to allow PQR Ltd. to set up a retail outlet to sell the products of Brand X.

As per the agreement, PQR Ltd. will set up the retail outlet from its own funds, decide the capital structure of the entity, hire employees and their remuneration, select vendors for acquiring capital items, etc. However, ABC Ltd. will give certain operating guidelines like the interior of the retail outlet, uniform of the employees and other such guidelines to protect the brand name of ABC Ltd.

Whether the rights held by ABC Ltd. protective or substantive?

Solution: The activities that most significantly affect the returns of PQR Ltd. are the funding and capital structure of PQR Ltd., hiring of employees and their remuneration, vendors for capital items, etc. which are exercisable by PQR Ltd. Further, the retails outlet is being set up by PQR Ltd. without any financial support from ABC Ltd. The rights available with ABC Ltd. are to protect the brand name of ABC Ltd. and such rights do not affect the ability of PQR Ltd. to take decisions about relevant activities. Hence, the rights held by ABC Ltd. are protective rights.

Illustration 16: Voting rights of investor are sufficient to give it power

An investor holds 45% of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1% of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Whether the investor holding 45% voting right have power over the investee?

Solution: On the basis of the absolute size of its holding by the investor and the relative size of the voting rights held by other shareholders, it is more likely that the investor would have power over the investee.

Illustration 17: Voting rights of investor are sufficient to give it power

ABC Ltd. holds 40% of the voting rights of XYZ Ltd. The remaining voting rights are held by 6 other shareholders, each individually holding 10% each. Whether the investor holding 40% voting right have power over the investee?

Solution: In this case, it is less likely that ABC Ltd. will have power over XYZ Ltd. since the size of the number of shareholders required to outvote ABC Ltd. is not so high. Additional facts and circumstances should also be considered to determine whether ABC Ltd. has power or not.

Illustration 18

A Limited holds 48% of the voting rights of B Limited. X Limited and Y Limited each hold 26% of the voting rights of B Limited. There are no other arrangements that affect decision-making. Who has power to take decisions in the present case?

Solution: In this case, the size of A Limited, voting interest and its size relative to the shareholdings of X Limited and Y Limited are sufficient to conclude that A Limited does not have power.

Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

Illustration 19: Voting patterns at previous shareholders' meetings

An investor holds 35% of the voting rights of an investee. Three other shareholders each hold 5% of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1% of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings—75% of the voting rights of the investee have been cast at recent relevant shareholders' meetings.

Whether the investor's voting rights are sufficient to give it power to direct the relevant activities of the investee?

Solution: In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

Illustration 20: Potential voting rights

Investor A and two other investors each hold a third of the voting rights of an investee. The investee's business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price. The conversion rights are substantive. If the debt were converted, investor A would hold 60% of the voting rights of the investee. Investor A would benefit from realising synergies if the debt instruments were converted into ordinary shares. Whether investor A has power over the investee?

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

Illustration 21

Entity P Ltd. develops pharmaceutical products. It has acquired 47% of entity S Ltd with an option to purchase remaining 53%. Entity S is a specialist entity that develops latest technology and does research in pharmaceuticals. Entity P has acquired stake in S Ltd. to complement its own technological research. The remaining 53% is held by key management of P Ltd. who are key to running a major project that will market a medicine with features completely new to the industry. However, if P Ltd. exercises the option the management personnel are likely to leave. They have unique technological knowledge in relation to the specific medicine. Option strike price is 5 times the value of entity's share price. Is the option substantive?

Solution: The option may not be substantive if entity P would derive no economic benefit from exercising it. High strike price and likely loss of key management indicate that the option may not be substantive.

Illustration 22

AB Ltd holds 40% in BC Ltd. CD Ltd holds 60% in BC Ltd. BC Ltd. is controlled through voting rights. AB Ltd. has call option exercisable in next 3 years for further 40% of investee. The option is deeply out of money and is expected to be the same over the life of the option. Further, investor would not gain any non-financial benefits from the exercise of option. Investor CD has been exercising its votes and is actively directing the relevant activities of the investee. Is right of AB Ltd substantive?

Solution: The option of AB Ltd. is not substantive. This is because although AB Ltd. has current ability to exercise his right to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee) but option is deeply out of money and is likely to remain so during option period and there are no other benefits gained from the exercise.

Illustration 23: Purpose and design of the investee

PQR Ltd. has entered into a contract with a state government to construct a power plant and distribute the electricity generated from the plant to the households of the state. For this, PQR Ltd. has set up a new entity XYZ Ltd. PQR Ltd. was involved in the design of XYZ Ltd. The decisions related to the relevant activities of XYZ Ltd. i.e. how much electricity to generate or the price at which units of electricity to be sold to customers, etc. are not determined by the voting rights. Whether PQR Ltd. has power over XYZ Ltd.?

Solution: PQR Ltd. was involved in the design of XYZ Ltd. Accordingly, its involvement in the design may indicate that the investor had the opportunity to obtain rights that are sufficient to give it power over the investee. However, being involved in the design of XYZ Ltd. alone is not sufficient to give PQR Ltd. control over XYZ Ltd. and hence other facts and circumstances, such as other contractual arrangements, should also be considered.

Illustration 24: Rights contingent upon future events

An investee's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. Following is the relevant fact pattern:

- The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due.

- Upon default of a receivable the investee automatically puts the receivable to an investor as agreed separately in an agreement between the investee and the investor.
- The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns.
- Managing the receivables before default is not a relevant activity because the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors.

Whether the investor has power over the investee?

Solution: In this question, the design of the investee ensures that the investor has decision-making power only in case of default of a receivable. The terms of the agreement between investee and investor are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of the investee.

Illustration 25: Commitment to ensure that an investee operates as designed

A Ltd. is a manufacturer of pharmaceutical products. A Ltd. has invested in share capital of B Ltd. which is a manufacturer of packing material for pharmaceutical products. A Ltd.'s requirements of packing materials for its products are entirely supplied by B Ltd. A Ltd. is not purchasing the packing materials from any other vendors because the materials supplied by other vendors are of inferior quality. Whether A Ltd. has power over B Ltd.?

Solution: A Ltd. would be the most affected by the operations of B Ltd. since it is dependent on B Ltd. for the supply of packing materials. Therefore A Ltd. would be committed to ensure that B Ltd. operates as designed. This can be an indicator of A Ltd. having power over B Ltd. But it has to consider other facts and circumstances as well to conclude whether it control B Ltd. or not.

Illustration 26: Link between power and returns

A decision maker (fund manager) establishes, markets and manages a publicly traded, regulated fund according to narrowly defined parameters set out in the investment mandate as required by its local laws and regulations. The fund was marketed to investors as an investment in a diversified portfolio of equity securities of publicly traded entities. Following is the relevant fact pattern related to fund manager:

- Within the defined parameters, the fund manager has discretion about the assets in which to invest.
- The fund manager has made a 10% pro rata investment in the fund and receives a market-based fee for its services equal to 1% of the net asset value of the fund.
- The fees are commensurate with the services provided.
- The fund manager does not have any obligation to fund losses beyond its 10% investment.

- The fund is not required to establish, and has not established, an independent board of directors. The investors do not hold any substantive rights that would affect the decision-making authority of the fund manager but can redeem their interests within particular limits set by the fund.

Whether the fund manager controls the fund?

Solution: Although operating within the parameters set out in the investment mandate and in accordance with the regulatory requirements, the fund manager has decision-making rights that give it the current ability to direct the relevant activities of the fund—the investors do not hold substantive rights that could affect the fund manager's decision-making authority. The fund manager receives a market-based fee for its services that is commensurate with the services provided and has also made a pro rata investment in the fund. The remuneration and its investment expose the fund manager to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal.

In this case, consideration of the fund manager's exposure to variability of returns from the fund together with its decision-making authority within restricted parameters indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Illustration 27: Link between power and returns

A decision maker establishes, markets and manages a fund that provides investment opportunities to a number of investors. The decision maker (fund manager) must make decisions in the best interests of all investors and in accordance with the fund's governing agreements. Nonetheless, the fund manager has wide decision-making discretion. The fund manager receives a market- based fee for its services equal to 1% of assets under management and 20% of all the fund's profits if a specified profit level is achieved. The fees are commensurate with the services provided.

Although it must make decisions in the best interests of all investors, the fund manager has extensive decision-making authority to direct the relevant activities of the fund. The fund manager is paid fixed and performance-related fees that are commensurate with the services provided. In addition, the remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund, without creating exposure to variability of returns from the activities of the fund that is of such significance that the remuneration, when considered in isolation, indicates that the fund manager is a principal.

The above fact pattern and analysis applies to various scenarios described below. Each scenario is considered in isolation. Determine whether the fund manager control the fund?

Scenario A The fund manager also has a 2% investment in the fund that aligns its interests with those of the other investors. The fund manager does not have any obligation to fund losses beyond its 2% investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

Scenario B The fund manager has a more substantial pro rata investment in the fund but does not have any obligation to fund losses beyond that investment. The investors can remove the fund manager by a simple majority vote, but only for breach of contract.

Scenario C The fund manager has a 20% pro rata investment in the fund but does not have any obligation to fund losses beyond its 20% investment. The fund has a board of directors, all of whose members are independent of the fund manager and are appointed by the other investors. The board appoints the fund manager annually. If the board decided not to renew the fund manager's contract, the services performed by the fund manager could be performed by other managers in the industry.

Solution:

Scenario A The fund manager's 2% investment increases its exposure to variability of returns from the activities of the fund without creating exposure that is of such significance that it indicates that the fund manager is a principal. The other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. In this example, although the fund manager has extensive decision-making authority and is exposed to variability of returns from its interest and remuneration, the fund manager's exposure indicates that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Scenario B In this scenario, the other investors' rights to remove the fund manager are considered to be protective rights because they are exercisable only for breach of contract. Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's investment together with its remuneration could create exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. The greater the magnitude of, and variability associated with, the fund manager's economic interests (considering its remuneration and other interests in aggregate), the more emphasis the fund manager would place on those economic interests in the analysis, and the more likely the fund manager is a principal.

For example, having considered its remuneration and the other factors, the fund manager might consider a 20% investment to be sufficient to conclude that it controls the fund. However, in different circumstances (i.e. if the remuneration or other factors are different), control may arise when the level of investment is different.

Scenario C Although the fund manager is paid fixed and performance-related fees that are commensurate with the services provided, the combination of the fund manager's 20% investment together with its remuneration creates exposure to variability of returns from the activities of the fund that is of such significance that it indicates that the fund manager is a principal. However, the investors have substantive rights to remove the fund manager—the board of directors provides a mechanism to ensure that the investors can remove the fund manager if they decide to do so.

In this scenario, the fund manager places greater emphasis on the substantive removal rights in the analysis. Thus, although the fund manager has extensive decision-making authority and is exposed to variability of returns of the fund from its remuneration and investment, the substantive

rights held by the other investors indicate that the fund manager is an agent. Thus, the fund manager concludes that it does not control the fund.

Illustration 28: Link between power and returns

An investee is created to purchase a portfolio of fixed rate asset-backed securities, funded by fixed rate debt instruments and equity instruments. The equity instruments are designed to provide first loss protection to the debt investors and receive any residual returns of the investee.

The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio.

On formation, the equity instruments represent 10% of the value of the assets purchased. A decision maker (the asset manager) manages the active asset portfolio by making investment decisions within the parameters set out in the investee's prospectus. For those services, the asset manager receives a market-based fixed fee (i.e. 1% of assets under management) and performance-related fees (i.e. 10% of profits) if the investee's profits exceed a specified level. The fees are commensurate with the services provided. The asset manager holds 35% of the equity in the investee. The remaining 65% of the equity, and all the debt instruments, are held by a large number of widely dispersed unrelated third-party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

Does the asset manager control the investee?

Solution: The asset manager is paid fixed and performance-related fees that are commensurate with the services provided. The remuneration aligns the interests of the fund manager with those of the other investors to increase the value of the fund. The asset manager has exposure to variability of returns from the activities of the fund because it holds 35% of the equity and from its remuneration.

Although operating within the parameters set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns - the removal rights held by the other investors receive little weighting in the analysis because those rights are held by a large number of widely dispersed investors. In this example, the asset manager places greater emphasis on its exposure to variability of returns of the fund from its equity interest, which is subordinate to the debt instruments. Holding 35% of the equity creates subordinated exposure to losses and rights to returns of the investee, which are of such significance that it indicates that the asset manager is a principal. Thus, the asset manager concludes that it controls the investee.

Following table summarises the above illustrations on link between power and returns by highlighting each of the factors for evaluating link between power and returns:

Illustration	Scope of the decision-making authority	Removal rights held by others	Remuneration from the investee	Variable returns from other interests	Conclusion
26	Narrowly defined	No such rights	1% of the net asset value of the fund	10% investment in the fund	Agent
27 (A)	Extensive decision-making authority	Removal for cause by simple majority	1% of assets under management and 20% of all the fund's profits if a specified profit	2% investment in the fund	Agent
27 (B)				20% investment in the fund	Principal
27 (C)		Removal without		20% investment in	Agent

		cause by board	level is achieved	the fund	
28	Decisions within the parameters set out in the investee's prospectus	Removal without cause by simple majority of widely dispersed investors	1% of assets under management and 10% of profits if the profits exceed a specified level	35% of equity in the investee	Principal

Illustration 29: Link between power and returns

A decision maker (the sponsor) sponsors a fund, which issues short-term debt instruments to unrelated third-party investors. The transaction was marketed to potential investors as an investment in a portfolio of highly rated medium-term assets with minimal exposure to the credit risk associated with the possible default by the issuers of the assets in the portfolio. Various transferors sell high quality medium-term asset portfolios to the fund. Each transferor services the portfolio of assets that it sells to the fund and manages receivables on default for a market-based servicing fee. Each transferor also provides first loss protection against credit losses from its asset portfolio through over-collateralisation of the assets transferred to the fund. The sponsor establishes the terms of the fund and manages the operations of the fund for a market-based fee. The fee is commensurate with the services provided. The sponsor approves the sellers permitted to sell to the fund, approves the assets to be purchased by the fund and makes decisions about the funding of the fund. The sponsor must act in the best interests of all investors.

The sponsor is entitled to any residual return of the fund and also provides credit enhancement and liquidity facilities to the fund. The credit enhancement provided by the sponsor absorbs losses of up to 5% of all of the fund's assets, after losses are absorbed by the transferors. The liquidity facilities are not advanced against defaulted assets. The investors do not hold substantive rights that could affect the decision-making authority of the sponsor. Whether the sponsor has control over the fund?

Solution: Even though the sponsor is paid a market-based fee for its services that is commensurate with the services provided, the sponsor has exposure to variability of returns from the activities of the fund because of its rights to any residual returns of the fund and the provision of credit enhancement and liquidity facilities (i.e. the fund is exposed to liquidity risk by using short-term debt instruments to fund medium-term assets). Even though each of the transferors has decision-making rights that affect the value of the assets of the fund, the sponsor has extensive decision-making authority that gives it the current ability to direct the activities that most significantly affect the fund's returns (i.e. the sponsor established the terms of the fund, has the right to make decisions about the assets (approving the assets purchased and the transferors of those assets) and the funding of the fund (for which new investment must be found on a regular basis)). The right to residual returns of the fund and the provision of credit enhancement and liquidity facilities expose the sponsor to variability of returns from the activities of the fund that is different from that of the other investors. Accordingly, that exposure indicates that the sponsor is a principal and thus the sponsor concludes that it controls the fund. The sponsor's obligation to act in the best interest of all investors does not prevent the sponsor from being a principal.

Illustration 30

An investee Noor Ltd. is floated to invest in a portfolio of equity oriented mutual funds, funded by fixed rate debentures and equity instruments. The equity instruments will receive any residual returns of the investee. The transaction was marketed to potential debt investors as an investment in a portfolio of asset-backed securities with exposure to the credit risk associated with the possible default of the issuers of the asset-backed securities in the portfolio and to the interest rate risk associated with the management of the portfolio. On formation, the equity instruments represent 15% of the value of the assets purchased by Noor Ltd. A decision maker (the asset manager) of Noor Ltd. manages the portfolio by making investment decisions strictly as per investee's prospectus. For services rendered by manager, receives a fixed fee (i.e. 0.5 percent of assets under management) and performance-related fee (i.e. 2 percent of profits) if profits exceed 10% over & above of previous financial year. The asset manager holds 40per cent of the equity in the investee. The remaining 60 per cent of the equity, and all the debentures are held by a large number of widely dispersed unrelated third party investors. The asset manager can be removed, without cause, by a simple majority decision of the other investors.

Solution: The asset manager is paid fixed and performance-related fees that depends on variability of portfolio performance backed by equity oriented mutual funds i.e the remuneration and interest of other investors aligns to increase the value of the fund. The asset manager has exposure to variability of returns from the relevant activities of the fund because it holds 40 per cent of the equity and from its remuneration.

Although operating within the guidelines set out in the investee's prospectus, the asset manager has the current ability to make investment decisions that significantly affect the investee's returns—the removal rights held by widely unrelated dispersed investors receive little weighting because those rights are held by a large number of widely unrelated dispersed investors.

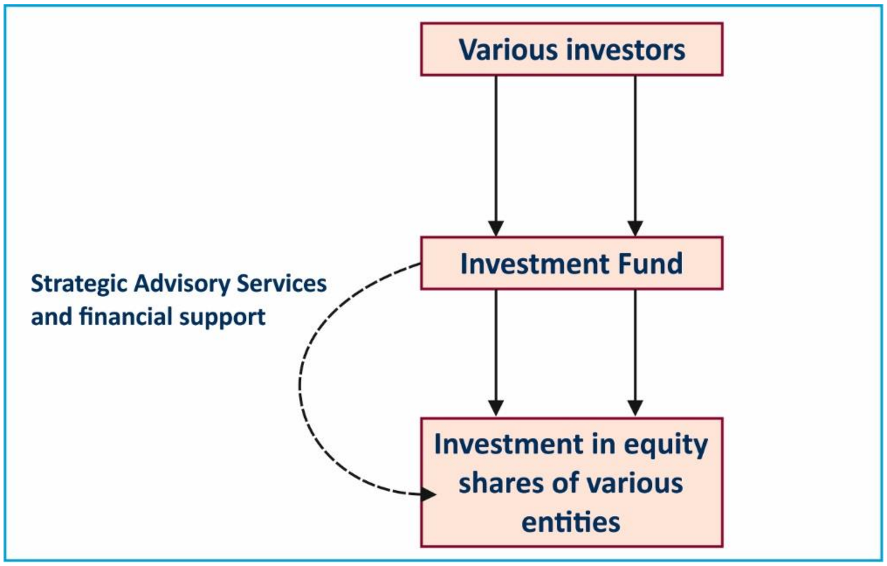
In given illustration, the asset manager has greater exposure to variability of returns of the fund from its 40 per cent equity interest, which is subordinate to the debt instruments. Holding 40 per cent of the equity creates exposure to losses and rights to returns of the investee, which are of such significance that it indicates that the asset manager is a principal and not mere an agent.

Therefore, it is concluded that the asset manager controls the investee Noor Ltd.

INVESTMENT ENTITIES

illustration 31: Business purpose of an investment entity

An asset manager has set up and investment fund for the purpose of acquiring capital contributions from various investors (by issuing them units in the fund) and investing those contributions in the equity share capital of various entities for the purpose of earning capital appreciation on those investments. Following is the existing structure of the fund.


Various investors
Investment Fund
Strategic Advisory Services and financial support
Investment in equity shares of various entities

Apart from the investments in various entities, the investment fund also provides its investee the strategic advisory services so that it can result in increase in the capital appreciation from investments in those investees. It also provides its investees financial support in the form of loan to provide them with funds for acquiring capital assets. The investment fund does not hold such investments for a period longer than 5 years. The investment fund measures and evaluate the performance of the investments on fair value basis.

Whether the investment fund can be treated as an investment entity?

Solution: Out of the three elements of the definition of an investment entity, the investment fund fulfils the two elements very clearly i.e. it obtains fund from more than one investor for providing investment management services and measures and evaluates its investments on fair value basis.

The typical characteristics of an investment entity are also present in the structure of the investment fund i.e. more than one investment, more than one investor, investors are unrelated and investment fund issues units in the fund to the investors.

With respect to the business objective of the investment fund, the objective is to earn capital appreciation from its investments. The strategic advisory services and financial support provided to investees are extended with the intention of earning higher capital appreciation from the investees.

However, judgement should to be applied that these do not represent substantial business activity or a separate substantial source of income for the investment fund. If the investment fund concludes that these services and financial support to investees are not substantial business activity and substantial source of income for the investment fund, then only the investment fund can be treated as an investment entity.

Illustration 32: Exit strategies of an investment entity

ABC Ltd. Is established with primary objective of investing in the equity shares of various entities across various industries based on the detailed research about each industry and entities within that industry being done by the investment manager of the company.

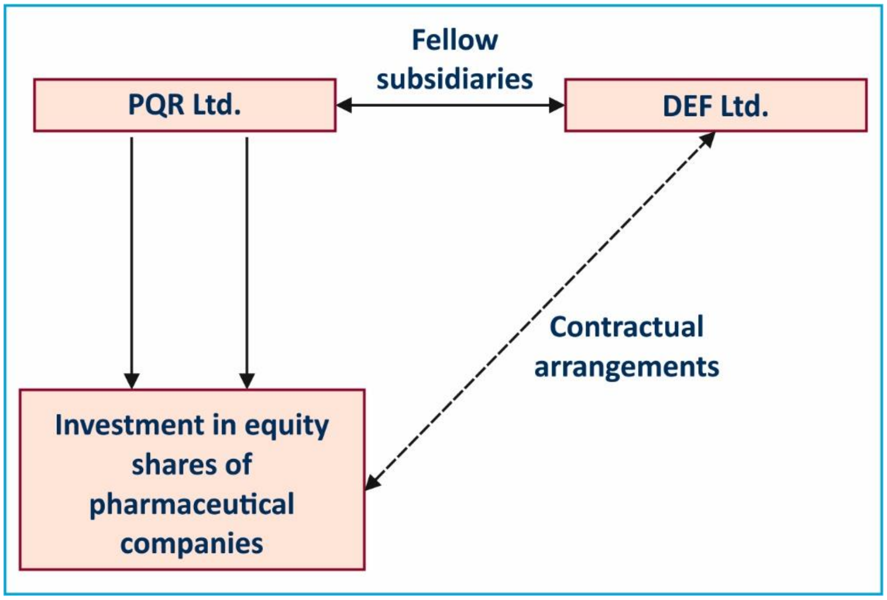
The investment manager decides the timing as to when the investments should be made considering the current market situation. Sometimes, the investment manager decides to invest the idle funds into short-term to medium-term debt instruments with fixed maturity. The exit strategies are in place for the investments done in equity shares but the same is not there for investments done in debt instruments.

Determine whether the entity fulfils the exit strategy condition of being classified as investment entity?

Solution: The exit strategies are in place for investments done in equity shares. But not in place for investments done in debt instruments. However, it should be noted that the debt instruments have fixed maturity period and they cannot be held for indefinite period. Hence, there is no need for having exit strategies for such instruments. Accordingly, the exit strategy condition is fulfilled for being classified as investment entity.

Illustration 33: Earnings from investments of an investment entity

PQR Ltd. Is established with primary objective of investing in the equity shares of various pharmaceutical companies which are involved in the research and development of medicine for a critical illness. DEF Ltd. Is a follow subsidiary of PQR Ltd. And DEF Ltd. Has entered into contractual arrangements with all the investees of PQR Ltd. That in case they are successful in developing the medicine then they will transfer the patent and distribution rights for that medicine to DEF Ltd. At less then market price. This arrangement is explained in following diagram



Determine whether PQR Ltd. Can be classified as investment entity?

Solution: PQR Ltd. And DEF Ltd. Are part of same group. Further, DEF Ltd. Have exclusive right to acquire the patent and distributions rights from the investees of PQR Ltd. And that too at less then the market price. Hence, the related party of PQR Ltd. Is in position to obtain benefits other than capital appreciation and investment income from the investees that are not available to other parties unrelated to the investee. Accordingly, PQR Ltd. Cannot be classified as investment entity.

Illustration 34

HTF Ltd. Was formed by T Ltd. To invest in technology start-up companies for capital appreciation. T Ltd. Holds a 70 percent interest in HTF Ltd. And controls HTF Ltd. The other 30 percent ownership interest in HTF Ltd. Is owned by 10 unrelated investors. T Ltd. Holds options to acquire investments held by HTF Ltd., at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of T Ltd. No plans for exiting the investments have been identified by HTF Ltd. HTF Ltd. Is managed by an investment adviser that acts as agent for the investors in HTF Ltd.

Determine whether HTF Ltd. Is an investment entity or not.

Solution: Even though HTF Ltd.'s business purpose is investing for capital appreciation and it provides investment management services to its investors, HTF Ltd. Is not an investment entity because of the following arrangements and circumstances:

a) T Ltd., the parent of HTF Ltd. Holds options to acquire investments in investees held by HTF Ltd. If the assets developed by the investees would benefit the operations of T Ltd. This provides a benefit in addition to capital appreciation or investment income; and

b) the investment plans of HTF Ltd. Do not include exit strategies for its investments, which are equity investments. The options held by T Ltd. Are not controlled by HTF Ltd. And do not constitute an exit strategy.

DIFFERENT REPORTING DATES

Illustration 35:

How should assets and liabilities be classified into current or non-current in consolidated financial statements when parent and subsidiary have different reporting dates?

Solution

Paragraphs B92 and B93 of Ind AS 110 require subsidiaries with reporting period end different from parent, to provide additional information or details of significant transactions or events if it is impracticable to provide additional information to enable the parent entity to consolidate such financial information at group's reporting period end.

The appropriate classification of the assets and liabilities as current or non-current in the consolidated financial statements has to be determined by reference to the reporting period end of the group. Accordingly, when a subsidiary's financial statements are for a different reporting period end, it is necessary to review the subsidiary's balance sheet to ensure that items are correctly classified as current or non-current as at the end of the group's reporting period.

For example, a subsidiary with the financial year end of 31st December, 2011 has a payable outstanding that is due for payment on 1st January, 2013, and has accordingly classified it as non-current in its balance sheet. The financial year end of the parent's consolidated financial statements is 31st March 31, 2013. Due to the time lag, the subsidiary's payable falls due within 12 months from the end of the parent's reporting period.

Accordingly, in this case, the payable should be classified as a current liability in the consolidated financial statements of the parent because the amount is repayable within nine months of the end of the parent's reporting period.

INDIRECT INTEREST IN A SUBSIDIARY.

Illustration 36:

A parent company (entity A) has an 80% owned subsidiary (entity B). Entity B makes an acquisition for cash of a third company (entity C), which it then wholly owns. Goodwill of ₹ 1,00,000 arises on the acquisition of entity C.

How should that goodwill be reflected in consolidated financial statement of entity A? Should it be reflected as:

a. 100% of the goodwill with 20% then being allocated to the non- controlling interest; or

b. 80% of the goodwill that arises?

Solution: Assuming that entity B prepares consolidated financial statements, 100% of the goodwill would be recognized on the acquisition of entity C in those financial statements. Entity A should reflect 100% of goodwill and allocate 20% to the non- controlling interest in its consolidated financial statements. This is because the non- controlling interest is a party to the transaction and the goodwill forms part of the net assets of the sub group (in this case, the sub group being the group headed by entity B).

FOREIGN SUBSIDIARY

Illustration 37

A Limited, an Indian Company has a foreign subsidiary, B Inc. Subsidiary B Inc. has taken a long term loan from a foreign bank, which is repayable after in the year 20X9. However, during the year ended 31st March, 2012, it breached one of the conditions of the loan, as a consequence of which the loan became repayable on demand on the reporting date. Subsequent to year end but before the approval of the financial statements, B Inc. rectified the breach and the bank agreed not to demand repayment and to let the loan run for its remaining period to maturity as per the original loan terms. While preparing its standalone financial statements as per IFRS, B Inc. has classified this loan as a current liability in accordance with IAS 1, Presentation of Financial Statements.

Whether A limited is required to classify such loan as current while preparing its consolidated financial statement under Ind AS?

Solution:

As per paragraph 74 of Ind AS 1, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

The above position under Ind AS 1 differs from the corresponding position under IAS 1. As per paragraph 74 of IAS 1, when an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

Accordingly, the loan liability recognised as current liability by B Inc. in its standalone financial statements prepared as per IFRS, should be aligned as per Ind AS in the consolidated financial statements of A Limited and should be classified as non-current in the consolidated financial statements of A Limited in accordance with Ind AS 1.

DISPOSAL OF SHARES

Illustration 38

Entity A sells a 30% interest in its wholly-owned subsidiary to outside investors in an arm's length transaction for ₹ 500 crore in cash and retains a 70% controlling interest in the subsidiary. At the time of the sale, the carrying value of the subsidiary's net assets in the consolidated financial statements of Entity A is ₹ 1,300 crore, additionally, there is a goodwill of ₹ 200 crore that arose on the subsidiary's acquisition. Entity A initially accounted for NCI representing present ownership interests in the subsidiary at fair value and it recognises subsequent changes in NCI in the subsidiary at NCI's proportionate share in aggregate of net identifiable assets and associated goodwill. How should Entity A account for the transaction?

Solution:

As per paragraph 23 of Ind AS 110, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). Thus, changes in ownership interest that do not result in loss of control do not impact goodwill associated with the subsidiary or the statement of profit and loss.

Paragraph B96 of Ind AS 110 states that when the proportion of the equity held by non- controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

IND AS 111: JOINT ARRANGEMENTS

Illustration 39: Joint control

ABC Ltd. and DEF Ltd. have entered into a contractual arrangement to manufacture a product and sell that in retail market. As per the terms of the arrangement, decisions about the relevant activities require consent of both the parties. The parties share the returns of the arrangement equally amongst them. Whether the arrangement can be treated as joint arrangement?

Solution: The arrangement is a joint arrangement since both the parties are bound by the contractual arrangement and the decisions about relevant activities require unanimous consent of both the parties.

Illustration 40: Implicit joint control

PQR Ltd. and XYZ Ltd. established an arrangement in which each has 50% of the voting rights and the contractual arrangement between them specifies that at least 51% of the voting rights are required to make decisions about the relevant activities. Whether the arrangement can be treated as joint arrangement?

Solution: In this case, the parties have implicitly agreed that they have joint control of the arrangement because decisions about the relevant activities cannot be made without both parties agreeing.

Illustration 41: Implicit joint control

A Ltd., B Ltd. and C Ltd. established an arrangement whereby A Ltd. has 50% of the voting rights in the arrangement, B Ltd. has 30% and C has 20%. The contractual arrangement between A Ltd., B Ltd. and C Ltd. specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

Solution: In this case, even though A can block any decision, it does not control the arrangement because it needs the agreement of B. The terms of their contractual arrangement requiring at least 75% of the voting rights to make decisions about the relevant activities imply that A Ltd. and B Ltd. have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A Ltd. and B Ltd. agreeing.

Illustration 42: Explicit joint control

An arrangement has three parties: X Ltd. has 50% of the voting rights in the arrangement and Y Ltd. and Z Ltd. each have 25%. The contractual arrangement between them specifies that at least 75% of the voting rights are required to make decisions about the relevant activities of the arrangement. Whether the arrangement can be treated as joint arrangement?

Solution: In this case, even though X Ltd. can block any decision, it does not control the arrangement because it needs the agreement of either Y Ltd. or Z Ltd. In this question, X Ltd., Y Ltd. and Z Ltd. collectively control the arrangement. However, there is more than one combination of parties that can agree to reach 75% of the voting rights (i.e. either X Ltd. and Y Ltd. or X Ltd. and Z Ltd.). In such a situation, to be a joint arrangement the contractual arrangement between the parties would need to specify which combination of the parties is required to agree unanimously to decisions about the relevant activities of the arrangement.

Illustration 43: Explicit joint control

An arrangement has A Ltd. and B Ltd. each having 35% of the voting rights in the arrangement with the remaining 30% being widely dispersed. Decisions about the relevant activities require approval by a majority of the voting rights. Whether the arrangement can be treated as joint arrangement?

Solution: A Ltd. and B Ltd. have joint control of the arrangement only if the contractual arrangement specifies that decisions about the relevant activities of the arrangement require both A Ltd. and B Ltd. agreeing.

Illustration 44: Joint control through board representation

Electronics Ltd. is established by two investors R Ltd. and S Ltd. The investors are holding 60% and 40% of the voting power of the investee respectively.

As per the articles of association of Electronics Ltd., both the investors have right to appoint 2 directors each on the board of Electronics Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether Electronics Ltd. is controlled by a single investor or is jointly controlled by both the investors.

Solution: The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor. Hence, Electronics Ltd. is jointly controlled by both the investors. R Ltd. holding majority of the voting rights is not relevant in this case since the voting rights do not given power over the relevant activities of the investee.

Illustration 45: Chairman with casting vote

MN Software Ltd. is established by two investors M Ltd. and N Ltd. Both the investors are holding 50% of the voting power each of the investee.

As per the articles of association of MN Software Ltd., both the investors have right to appoint 2 directors each on the board of the company. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. The decision about relevant activities of the entity will be taken by board of directors through simple majority. Articles of association also provides that M Ltd. has right to appoint the chairman of the board who will have right of a casting vote in case of a deadlock situation.

Determine whether MN Software Ltd. is jointly controlled by both the investors.

Solution: The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 4 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by any one investor cannot take the decisions independently without the consent of at least one director appointed by other investor. However, the chairman of the board has right for a casting vote in case of a deadlock in the board. Hence, M Ltd. has the ability to take

decisions related to relevant activities through 2 votes by directors and 1 casting vote by chairman of the board. Therefore, M Ltd. individually has power over MN Software Ltd. and there is no joint control.

Illustration 46: Equal voting rights but no joint control

ABC Ltd. is established by two investors AB Ltd. and BC Ltd. Each investor is holding 50% of the voting power of the investee.

As per the articles of association of ABC Ltd., AB Ltd. and BC Ltd. have right to appoint 3 directors and 2 directors respectively on the board of ABC Ltd. The directors appointed by each investor will act in accordance with the directions of the investor who has appointed such director. Further, articles of association provides that the decision about relevant activities of the entity will be taken by board of directors through simple majority.

Determine whether ABC Ltd. is jointly controlled by both the investors.

Solution: The decisions about relevant activities are required to be taken by majority of board of directors. Hence, out of the 5 directors, at least 3 directors need to agree to pass any decision. Accordingly, the directors appointed by AB Ltd. can take the decisions independently without the consent of any of the directors appointed by BC Ltd. Hence, ABC Ltd. is not jointly controlled by both the investors. Equal voting rights held by both the investors is not relevant in this case since the voting rights do not given power over the relevant activities of the investee.

Illustration 47: Joint control over specific asset

X Ltd. and Y Ltd. entered into a contractual arrangement to buy a piece of land to construct residential units on the said land and sell to customers.

As per the arrangement, the land will be further divided into three equal parts. Out of the three parts, both the parties will be responsible to construct residential units on one part each by taking decision about relevant activities independently and they will entitled for the returns generated from their own part of land. The third part of the land will be jointing managed by both the parties requiring unanimous consent of both the parties for all the decision making.

Determine whether the arrangement is a joint arrangement or not.

Solution: The two parts of the land which are required to be managed by both the parties independently on their own would not fall within the definition of a joint arrangement. However, the third part of the land which is required to be managed by both the parties with unanimous decision making would meet the definition of a joint arrangement.

Illustration 48: Multiple relevant activities directed by different investors

Entity R and entity S established a new entity RS Ltd. to construct a national highway and operate the same for a period of 30 years as per the contract given by government authorities.

As per the articles of association of RS Ltd, the construction of the highway will be done by entity R and all the decisions related to construction will be taken by entity R independently. After the construction is over, entity S will operate the highway for the period of 30 years and all the decisions related to operating of highway will be taken by entity S independently. However, decisions related to funding and capital structure of RS Ltd. will be taken by both the parties with unanimous consent.

Determine whether RS Ltd. is a joint arrangement between entity R and entity S?

Solution: In this case, the investors should evaluate which of the decisions about relevant activities can most significantly affect the returns of RS Ltd. If the decisions related to construction of highway or operating the highway can affect the returns of the RS Ltd. most significantly then the investor directing those decision has power over RS Ltd. and there is no joint arrangement. However, if the decisions related to funding and capital structure can affect the returns of the RS Ltd. most significantly then RS Ltd. is a joint arrangement between entity R and entity S.

Illustration 49: Informal agreement for sharing of control

An entity has four investors A, B, C and D holding 10%, 20%, 30% and 40% voting power respectively. The articles of association requires decisions about relevant activities to be taken by majority voting rights. However, investor A, B and C have informally agreed to vote together. This informal agreement has been effective in recent meetings of the investors to take decisions about relevant activities. Whether A, B and C have joint control over the entity?

Solution: In this case, three investors have informally agreed to make unanimous decisions. These three investors together also have majority voting rights in the entity. Hence, investor A, B and C have joint control over the entity. The agreement between investor A, B and C need not be formally documented as long as there is evidence of its existence in recent meetings of the investors.

Illustration 50: Party with protective rights

D Ltd., E Ltd. and F Ltd. have established a new entity DEF Ltd. As per the arrangement, unanimous consent of all three parties is required only with respect to decisions related to change of name of the entity, amendment to constitutional documents of the entity to enter into a new business, change in the registered office of the entity, etc. Decisions about other relevant activities require consent of only D Ltd. and E Ltd. Whether F Ltd. is a party with joint control of the arrangement?

Solution: Consent of F Ltd. is required only with respect to the fundamental changes in DEF Ltd. Hence these are protective rights. The decisions about relevant activities are taken by D Ltd. and E Ltd. Hence, F Ltd. is not a party with joint control of the arrangement.

Illustration 51: Resolution of disputes without unanimous consent

Entity A and Entity B established a contractual arrangement whereby the decision related to relevant activities are required to be taken by unanimous consent of both the parties. However, in case of any dispute with any vendor or customer of the arrangement, entity A has right to take necessary decisions for the resolution of disputes including decisions of going for the arbitration or filing a suit in court of law. Whether the arrangement is a joint arrangement?

Solution: The arrangement is a joint arrangement since the contractual arrangement requires decisions about relevant activities to be taken by unanimous consent of both the parties. The right available with entity A to take decisions for resolution of disputes will not prevent the arrangement from being a joint arrangement.

Illustration 52: Joint operation

P Ltd. and Q Ltd. are two construction entities and they have entered into a contractual arrangement to jointly construct a metro rail project.

The construction of metro rail project involves various activities such as construction of infrastructure (like metro station, control room, pillars at the centre of the road, etc.) for the metro, laying of the tracks, acquiring of the coaches of the metro, etc. The total length of the metro line to be constructed is 50 kms. As per the arrangement, both the parties are responsible to construct 25 kms each. Each party is required to incur its own cost, use its own assets, incur the liability and has right to the revenue from their own part of the work.

Determine whether the arrangement is a joint operation or not?

Solution: The arrangement is a joint operation since the arrangement is not structured through a separate vehicle and each party has rights to the assets, and obligations for the liabilities relating to their own part of work in the joint arrangement.

Illustration 53: Joint operation by sharing an asset

RS Ltd. and MN Ltd. entered into a contractual arrangement to run a business of providing cars of hire. The cars will be owned by both the parties jointly. The expenses to run the car (like driver salary, petrol, maintenance, insurance, etc.) and revenues from the business will be shared between both the parties as agreed in the contractual arrangement. Determine whether the arrangement is a joint operation or not?

Solution: The arrangement is a joint operation since the arrangement is not structured through a separate vehicle.

Illustration 54: Legal form indicates the arrangement to be a joint venture

Entity X and Entity Y are engaged in the business of Engineering, Procurement and Construction (EPC) for its customers. Both the parties have jointly won a contract from a customer for executing an EPC contract and for that the parties have established a new entity XY Ltd. The contract will be executed through XY Ltd.

All the assets required for the execution of the contract will be acquired and liabilities relating to the execution will be incurred by XY Ltd. in its own name. Entity X and entity Y will have share in the net profits of XY Ltd. in the ratio of their shareholding i.e. 50% each. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Solution: The legal form of the separate vehicle is a company. The legal form of the separate vehicle causes the separate vehicle to be considered in its own right. Hence, it indicates that the arrangement is a joint venture. In this case, the parties should further evaluate the terms of contractual arrangements and other relevant facts and circumstance to conclude whether the arrangement is a joint venture or a joint operation.

Illustration 55: Legal form indicates the arrangement to be a joint operation

Two entities have established a partnership firm with each party having 50% share in the net profits of the firm. Assuming that the arrangement meets the definition of a joint arrangement, determine whether the joint arrangement is a joint operation or a joint venture?

Solution: In this case, the parties to the arrangement should evaluate whether the legal form creates separation between the partners and the partnership firm. If the parties conclude that they have rights in the assets and obligations for the liabilities relating to the partnership firm then this would be a joint operation. If the assessment of legal form of the partnership firm indicates that the firm is a joint operation then there is no need to evaluate any other factors and it is concluded that the partnership firm is a joint operation.

Illustration 56: Assessing the terms of the contractual arrangement

Continuing with the illustration 16 above, assume that Entity X and Entity Y have entered into a separate agreement whereby they have agreed that each party has an interest in the assets of the XY

Ltd. and each party is liable for the liabilities of XY Ltd. in a specified proportion. Determine whether the joint arrangement is a joint operation or a joint venture?

Solution: In this case, the terms of the separate agreement may cause the arrangement to be a joint operation

Illustration 57: Assessing other facts and circumstances

Two parties structure a joint arrangement in an incorporated entity i.e. Entity A in which each party has a 50% ownership interest. The purpose of the arrangement is to manufacture materials

required by the parties for their own, individual manufacturing processes. The arrangement ensures that the parties operate the facility that produces the materials to the quantity and quality specifications of the parties. The legal form of Entity A (an incorporated entity) through which the activities are conducted initially indicates that the assets and liabilities held in Entity A are the assets and liabilities of Entity A. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of Entity A. There are following other relevant facts and circumstances applicable in this case:

- The parties agreed to purchase all the output produced by Entity A in a ratio of 50:50. Entity A cannot sell any of the output to third parties, unless this is approved by the two parties to the arrangement. Because the purpose of the arrangement is to provide the parties with output they require, such sales to third parties are expected to be uncommon and not material.
- The price of the output sold to the parties is set by both parties at a level that is designed to cover the costs of production and administrative expenses incurred by Entity A. On the basis of this operating model, the arrangement is intended to operate at a break-even level.

Based on the above fact pattern, determine whether the arrangement is a joint operation or a joint venture?

Solution: The legal form of Entity A and the terms of the contractual arrangement indicate that the arrangement is a joint venture. However, the other relevant facts and circumstances mentioned above indicates that:

- the obligation of the parties to purchase all the output produced by Entity A reflects the exclusive dependence of Entity A upon the parties for the generation of cash flows and, thus, the parties have an obligation to fund the settlement of the liabilities of Entity A.
- the fact that the parties have rights to all the output produced by Entity A means that the parties are consuming, and therefore have rights to, all the economic benefits of the assets of Entity A.

These facts and circumstances indicate that the arrangement is a joint operation. The conclusion about the classification of the joint arrangement in these circumstances would not change if, instead of the parties using their share of the output themselves in a subsequent manufacturing process, the parties sold their share of the output to third parties.

If the parties changed the terms of the contractual arrangement so that the arrangement was able to sell output to third parties, this would result in Entity A assuming demand, inventory and credit risks. In that scenario, such a change in the facts and circumstances would require reassessment of the classification of the joint arrangement. Such facts and circumstances would indicate that the arrangement is a joint venture.

Illustration 58: Multiple joint arrangements under single framework agreement

AB Ltd. and CD Ltd. have entered into a framework agreement to manufacture and distribute a new product i.e. Product X. The two activities to be performed as per the framework agreement are i) Manufacture of Product X and ii) Distribution of Product X. The manufacturing of the product will not be done through a separate vehicle. The parties will purchase the necessary machinery in their joint name. For the distribution of the product, the parties have established a new entity ABCD Ltd. All the goods manufactured will be sold to ABCD Ltd. as per price mutually agreed by the parties. Then ABCD Ltd. will do the marketing and distribution of the product. Both the parties will have joint control over ABCD Ltd.

The legal form of ABCD Ltd. causes it to be considered in its own right (ie the assets and liabilities held in ACD Ltd. are the assets and liabilities of ABC Ltd. and not the assets and liabilities of the parties). Further, the contractual arrangement and other relevant facts and circumstances also do not indicate otherwise.

Determine whether various arrangements under the framework agreement are joint operation or joint venture?

Solution: The manufacturing of Product X is not done through a separate vehicle and the assets used to manufacture the product are jointly owned by both the parties. Hence, the manufacturing activity is a joint operation.

The distribution of Product X is done through a separate vehicle i.e. ABCD Ltd. Further, AB Ltd. and CD Ltd. do not have rights to the assets, and obligations for the liabilities, relating to ABCD Ltd. Hence ABCD Ltd. is a joint venture.

IND AS 28: INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

Illustration 59: Significant influence

E Ltd. holds 25% of the voting power of an investee. The balance 75% of the voting power is held by three other investors each holding 25%.

The decisions about the financing and operating policies of the investee are taken by investors holding majority of the voting power. Since, the other three investors together hold majority voting power, they generally take the decisions without taking the consent of E Ltd. Even if E Ltd. proposes any changes to the financing and operating policies of the investee, the other three investors do not vote in favour of those changes. So, in effect the suggestions of E Ltd. are not considered while taking decisions related to financing and operating policies.

Determine whether E Ltd. has significant influence over the investee?

Solution: Since E Ltd. is holding more than 20% of the voting power of the investee, it indicates that E Ltd. might have significant over the investee. However, the other investors in the investee prevent E Ltd. from participating in the financing and operating policy decisions of the investee. Hence, in this case, E Ltd. is not in a position to have significant influence over the investee.

Illustration 60: Representation on board

Kuku Ltd. holds 12% of the voting shares in Boho Ltd. Boho Ltd.'s board comprise of eight members and two of these members are appointed by Kuku Ltd. Each board member has one vote at meeting. is Boho Ltd an associate of Kuku Ltd?

Solution: Boho Ltd is an associate of Kuku Ltd as significant influence is demonstrated by the presence of directors on the board and the relative voting rights at meetings.

It is presumed that entity has significant influence where it holds 20% or more of the voting power of the investee, but it is not necessary to have 20% representation on the board to demonstrate significant influence, as this will depend on all the facts and circumstances. One board member may represent significant influence even if that board member has less than 20% of the voting power. But for significant influence to exist it would be necessary to show based on specific facts and circumstances that this is the case, as significant influence would not be presumed.

Illustration 61: Participation in policy-making processes

M Ltd. holds 10% of the voting power an investee. The balance 90% voting power is held by nine other investors each holding 10%.

The decisions about the relevant activities (except decision about taking borrowings) of the investee are taken by the members holding majority of the voting power. The decisions about taking borrowings are required to be taken by unanimous consent of all the investors. Further, decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee.

Determine whether M Ltd. has significant influence over the investee?

Solution: In this case, though M Ltd. is holding less than 20% of the voting power of the investee, M Ltd.'s consent is required to take decisions about taking borrowings which is one of the relevant activities. Further, since the decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee, it cannot be said that all the investors have joint control over the investee.

Hence, it can be said that M Ltd. has significant influence over the investee.

Illustration 62: Material transactions between the entity and its investee

RS Ltd. is an entity engaged in the business of pharmaceuticals. It has invested in the share capital of an investee XY Ltd. and is holding 15% of XY Ltd.'s total voting power.

XY Ltd. is engaged in the business of producing packing materials for pharmaceutical entities. One of the incentives for RS Ltd. to invest in XY Ltd. was the fact that XY Ltd. is engaged in the business of producing packing materials which is also useful for RS Ltd. Since last many years, XY Ltd.'s almost 90% of the output is procured by RS Ltd.

Determine whether RS Ltd. has significant influence over XY Ltd.?

Solution: Since 90% of the output of XY Ltd. is procured by RS Ltd., XY Ltd. would be dependent on RS Ltd. for the continuation of its business. Hence, even though RS Ltd. is holding only 15% of the voting power of XY Ltd. it has significant influence over XY Ltd.

Illustration 63: Interchange of managerial personnel

Entity X and entity Y operate in the same industry, but in different geographical regions. Entity X acquires a 10% shareholding in entity Y as a part of a strategic agreement. A new production process is key to serve a fundamental change in the strategic direction of entity Y. The terms of agreement provide for entity Y to start a new production process under the supervision of two managers from entity X. The managers seconded from entity X, one of whom is on entity X's board, will oversee the selection and recruitment of new staff, the purchase of new equipment, the training of the workforce and the negotiation of new purchase contracts for raw materials. The two managers will report directly to entity Y's board and as well as to entity X. Analyse.

Solution: The secondment of the board member and a senior manager from entity X to entity Y gives entity X a range of power over a new production process and may evidence that entity X has significant influence over entity Y. This assessment takes into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.

Illustration 64: Provision of essential technical information

R Ltd. is a tyre manufacturing entity. The entity has entered into a technology transfer agreement with another entity Y Ltd. which is also involved in the business of tyre manufacturing. R Ltd. is an established entity in this business whereas Y Ltd. is a relatively new entity.

As per the agreement, R Ltd. has granted to Y Ltd. a license to use its the technical information and know-how which are related to the processes for the manufacture of tyres. Y Ltd. is dependent on the technical information and know-how supplied by R Ltd. because of

its lack of expertise and experience in this business. Further, R Ltd. has also invested in 10% of the equity share capital of Y Ltd.

Determine whether R Ltd. has significant influence over Y Ltd.?

Solution: Y Ltd. obtains essential technical information for the running of its business from R Ltd. Hence R Ltd. has significant influence over Y Ltd. despite of holding only 10% of the equity share capital of Y Ltd.

Illustration 65: Potential voting rights

An entity which is currently holding 10% of the voting power of an entity has an option of purchase additional 15% voting power of the investee from other investors. However, the entity currently does not have financial ability to purchase additional 15% voting power of the investee. Determine whether the entity has significant influence over the investee?

Solution: Considering the potential voting rights, the entity can have more than 20% of the voting power of the investee and hence it is presumed that the entity has significant influence over the investee. The fact that the entity does not have financial ability to purchase such additional voting power is not considered in such assessment (It should be noted that under Ind AS 110, potential voting rights which an entity cannot exercise because of its financial ability are not considered as substantive and hence not factored in the assessment. However, under Ind AS 28, there is no such requirement given. Hence the potential voting rights, even if they are not substantive as per Ind AS 110, are included in the assessment of significant influence.)

Illustration 66: Exemption from applying equity method

MNO Ltd. holds 15% of the voting power of DEF Ltd. PQR Mutual Fund (which is a subsidiary of MNO Ltd.) also holds 10% voting power of DEF Ltd. Hence, MNO Ltd. holds total 25% voting power of DEF Ltd. (15% held by own and 10% held by subsidiary) and accordingly has significant influence over DEF Ltd. How should MNO Ltd. account for investment in DEF Ltd. in its consolidated financial statements?

Solution: The 15% interest which is held directly by MNO Ltd. should be measured as per equity method of accounting. However, with respect to the 10% interest which is held through a mutual fund, MNO Ltd. can avail the exemption from applying the equity method to that 10% interest and instead

Illustration 67:

X Ltd. owns 20% of the voting rights in Y Ltd. and is entitled to appoint one director to the board, which consist of five members. The remaining 80% of the voting rights are held by two entities, each of which is entitled to appoint two directors.

A quorum of four directors and a majority of those present are required to make decisions. The other shareholders frequently call board meeting at the short notice and make decisions in the absence of X Ltd's representative. X Ltd has requested financial information from Y Ltd, but this information has not been provided. X Ltd's representative has attended board meetings, but suggestions for items to be included on the agenda have been ignored and the other directors oppose any suggestions made by X Ltd. Is Y Ltd an associate of X Ltd.? **[MTP May 2019]**

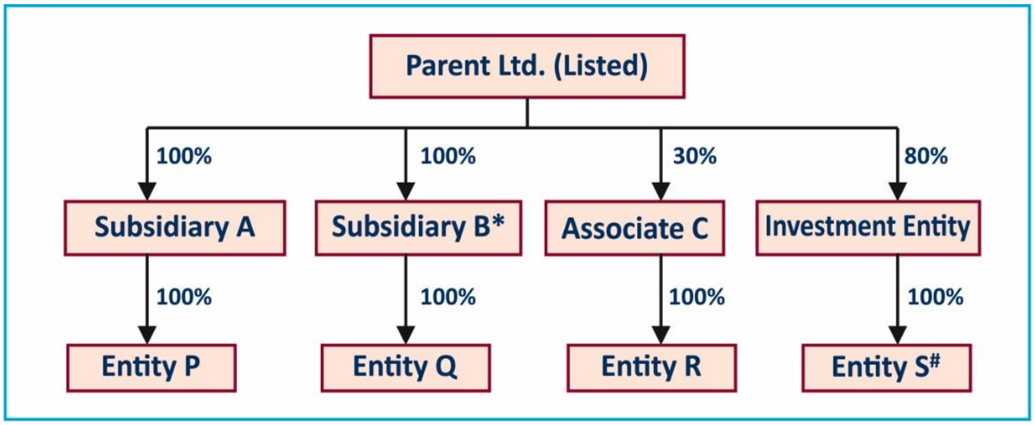
Answer: Despite the fact that the X Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent X Ltd. from exerting significant influence. Whilst it appears the X Ltd should have the power to participate in the financial and operating policy decision, the other shareholders prevent X Ltd's efforts and stop X Ltd from actually having any influence.

In this situation, Y Ltd would not be an associate of X Ltd.

IND AS 27: SEPARATE FINANCIAL STATEMENTS

Illustration 68:

Following chart represents the group structure of Parent Ltd. and table below it explains the above requirements related to separate financial statements



* Subsidiary B has availed the exemption from preparation of consolidated financial statements as per paragraph 4(a) of Ind AS 110

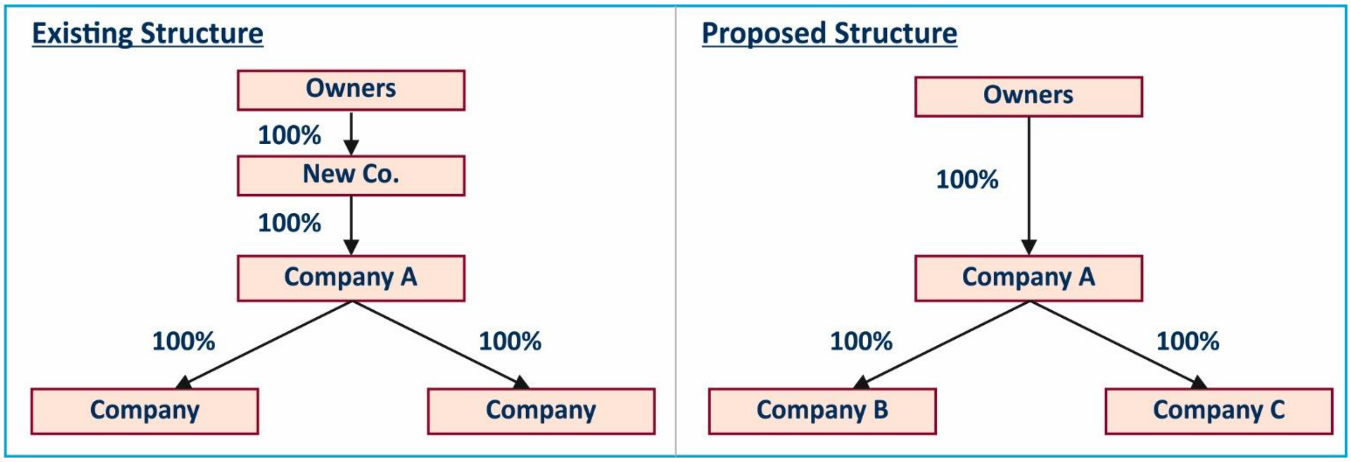
# Entity S does not provide services that relate to the Investment entity D's investment activities

All the above entities are incorporated as per Companies Act, 2013.

Name of the entity	Whether entity prepares consolidated financial statements?	Status for separate financial statements
Parent Ltd.	Yes	Will be prepared as it is required by Companies Act, 2013
Subsidiary A	Yes	Will be prepared as it is required by Companies Act, 2013
Subsidiary B	No	Will be prepared as it is required by Companies Act, 2013 (in this case, entity will present separate financial statements as its only financial statements)
Associate C	Yes	Will be prepared as it is required by Companies Act, 2013
Investment entity D	No	Will be prepared as it is required by Companies Act, 2013. Entity will present separate financial statements as its only financial statements
Entity P	No	These entities will prepare their financial statements as required by Companies Act 2013, however, they will not be termed as separate financial statements since these entities do not have subsidiary, associate or joint venture.
Entity Q	No	
Entity R	No	
Entity S	No	

Illustration 69: Reorganisation of the group structure

Following is the existing and proposed group structure of an original parent A Ltd.



As per the above structure, the Owners of Company A will transfer all their shareholding in Company A to New Co. In exchange of such shares, New Co. will issue its equity shares to the Owners. New Co. will issue the shares to the owners in the same ratio of their existing holding in Company A so that they have same absolute and relative interests in the net assets of the group immediately before and after the reorganisation. The assets and liabilities of the group immediately before the and after the proposed restructuring will also be the same.

The cost of the investment in Company A in the books of the Owners is ₹ 10 lakh. Total equity of Company A (i.e. equity share capital and other equity attributable to the owners) as per its separate financial statements on the date of proposed restructuring is ₹ 15 lakh.

After the proposed restructuring, New Co. wants to record its investment in Company A at cost. Determine how it should measure the cost of investment in Company A?

Solution: In current case, New Co. should measure the cost of investment in Company A at the carrying amount of its share of the equity items shown in the separate financial statements of Company A at the date of the restructuring because:

a) New Co. obtains control of Company A by issuing equity instruments to the Owners in exchange for their existing equity instruments of Company A;

b) the assets and liabilities of the group immediately before and the proposed restructuring will be same; and

c) the Owners will have the same absolute and relative interests in the net assets of the group immediately before and after the proposed restructuring.

Hence, New Co. will measure the cost of investment in Company A at ₹ 15 lakh.

Illustration 70:

A company, AB Ltd. holds investments in subsidiaries and associates. In its separate financial statements, AB Ltd. wants to elect to account its investments in subsidiaries at cost and the investments in associates as financial assets at fair value through profit or loss (FVTPL) in accordance with Ind AS 109, Financial Instruments. Whether AB Limited can carry investments in subsidiaries at cost and investments in associates in accordance with Ind AS 109 in its separate financial statements? **[RTP Nov 2020]**

Answer: Paragraph 10 of Ind AS 27, Separate Financial Statements inter -alia provides that, when an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109, Financial Instruments in its separate financial statements. Further, the entity shall apply the same accounting for each category of investments.

It may be noted that although the 'category' is used in number of Standards, it is not defined in any of the Ind AS. It seems that subsidiaries, associates and joint ventures would qualify as separate categories. Thus, the same accounting policies are applied for each category of investments - i.e. each of subsidiaries, associates and joint ventures. However, paragraph 10 of Ind AS 27 should not be read to mean that, in all circumstances, all investments in associates are one 'category' of investment and all investments in joint ventures or an associate are one 'category' of investment. These categories can be further divided into sub-categories provided the sub-category can be defined clearly and objectively and results in information that is relevant and reliable. For example, an investment entity parent can have investment entity subsidiary (at fair value through profit or loss) and non-investment entity subsidiary (whose main purpose is to provide services that relate to the investment entity's investment activities) as separate categories in its separate financial statements. In the present case, investment in subsidiaries and associates are considered to be different categories of investments. Further, Ind AS 27 requires to account for the investment in subsidiaries, joint ventures and associates either at cost, or in accordance with Ind AS 109 for each category of Investment. Thus, AB Limited can carry its investments in subsidiaries at cost and its investments in associates as financial assets in accordance with Ind AS 109 in its separate financial statements.

PRACTICE QUESTIONS

FUNDAMENTAL QUESTION ON CONSOLIDATION

Q1: Balance Sheet as on 31.3.06

	H Ltd.	**S Ltd.**		**H Ltd.**	**S Ltd.**
Equity Share Capital (₹10)	2,00,000	1,00,000	Fixed Assets	6,00,000	7,00,000
Profit & Loss A/c	3,00,000	4,00,000	Investment in S (70%)	80,000	--
Creditors	2,00,000	2,90,000	Current Assets	20,000	90,000
	7,00,000	**7,90,000**		**7,00,000**	**7,90,000**

Investments were purchased on 31.3.2006. Prepare Consolidated Balance sheet.

[For Answer – Refer Class Notes]

Q2: Balance Sheet as on 31.3.06

	H Ltd.	**S Ltd.**		**H Ltd.**	**S Ltd.**
Equity Share Capital (₹10)	2,00,000	1,00,000	Fixed Assets	6,00,000	7,00,000
Profit & Loss A/c	3,00,000	4,00,000	Investment in S (70%)	80,000	--
Creditors	2,00,000	2,90,000	Current Assets	20,000	90,000
	7,00,000	**7,90,000**		**7,00,000**	**7,90,000**

Investments were purchased by H Ltd. in S Ltd. on 31.03.05. Balance in Profit and Loss Account of S Ltd. as on that date was ₹ 2,50,000. **[Other Sources]**

[For Answer – Refer Class Notes]

Q3: Balance Sheet as on 31.3.06

	H Ltd.	**S Ltd.**		**H Ltd.**	**S Ltd.**
Equity Share Capital (₹10)	1,00,000	50,000	Fixed Assets	1,00,000	80,000
Profit & Loss A/c	80,000	50,000	Investment in S (70%)	75,000	--
Creditors	85,000	1,40,000	Current Assets	90,000	1,60,000
	2,65,000	**2,40,000**		**2,65,000**	**2,40,000**

Investments were purchased by H Ltd. in S Ltd. on 1.10.05. Balance in Profit and Loss Account of S Ltd. as on 1.04.05 was ₹ 26,000.

[For Answer – Refer Class Notes]

Q4: Assume same Balance Sheet as given in above Example but with following information.

1. Investments were purchased on 1.1.2006
2. There was Abnormal loss on 1.9.05 for ₹6,000 (No insurance claim available)
3. Balance in Profit & Loss Account of S Ltd. 1.4.05 ₹ 18,000.

Prepare Consolidated Balance Sheet **[Other Sources]**

[For Answer – Refer Class Notes]

Q5: Assume same Balance Sheet as given in Example 3 with following points:

1. Investments were purchase on 1.5.2005
2. Profit earned during the year includes abnormal gain of ₹5,000 on 15-09-05 and Abnormal loss ₹ 1,500 on 01.01.2006.
3. Balance in Profit & Loss Account on 01.01.2005 was ₹ 12,000 (Dr. Balance.)

Prepare Consolidated Balance Sheet. **[Other Sources]**

[For Answer – Refer Class Notes]

Q6: Extract of balance sheet of S Ltd.

	31/03/14	**31/03/15**
Equity Share capital	1,00,000	1,00,000
Profit and Loss Account	1,00,000	1,50,000

Additional Information:

1. Dividend paid by S Ltd. on 30/10/14 the year for 2013-2014 is ₹ 20,000.
2. Shares in S Ltd. were purchased by H Ltd. on 1/10/14

Prepare Statement of Net Assets for S Ltd. **[Other Sources]**

[For Answer – Refer Class Notes]

Q7: Extract of balance sheet of S Ltd.

	31/03/14	**31/03/15**
Equity Share capital	1,00,000	1,00,000
Profit and Loss Account	50,000	90,000
General Reserve	15,000	70,000
Dividend Equalisation Reserve	10,000	15,000

Additional Information:

1. During the year dividend paid by S Ltd. for the year 2013-14 is ₹ 15,000 and for the year 2014-15 is ₹ 20,000
2. Shares in S Ltd. were purchased by H Ltd. on 01/01/15

Prepare Statement of Net Assets for S Ltd. **[Other Sources]**

[For Answer – Refer Class Notes]

Q8: Balance Sheet as on 31.3.16.

	H Ltd.	**S Ltd.**		**H Ltd.**	**S Ltd.**
Equity Share Capital (₹10)	5,00,000	3,00,000	Fixed Assets	4,00,000	3,00,000
General reserve	1,00,000	70,000	Investment in equity		
Profit & Loss A/c	2,00,000	1,00,000	shares of S Ltd. (70%)	2,70,000	--
Creditors	1,00,000	30,000	Current Assets	2,30,000	2,00,000
	9,00,000	**5,00,000**		**9,00,000**	**5,00,000**

Additional Information:

1. Shares in S Ltd. were purchased by H Ltd. on 30/06/15
2. Balance in General Reserve and profit and Loss account as on 1/4/15 is ₹ 20,000 and 70,000.
3. During the year dividend @ 10% was paid by S Ltd. for the year 2014-15 from its pre acquisition profit.
4. There was an abnormal loss on 1/5/15 for S ltd. of ₹ 10,000. (Insurance claim received is ₹ 4,000)
5. When the shares were purchased, agreed value of fixed assets of S Ltd. was ₹ 4,00,000 although no effect has been given thereto in accounts. Depreciation has been charged @ 10% p.a on the book value (on reducing balance method)

Prepare CBS. **[Other Sources]**

[For Answer – Refer Class Notes]

Q9: Extract of balance sheet of S Ltd.

	31/03/14	**31/03/15**
Equity Share capital	1,00,000	1,00,000
Profit and Loss Account	1,00,000	1,20,000
Fixed assets	70,000	63,000

Additional Information:

1. H Ltd. acquired 70% ordinary shares of ₹ 10 each of S Ltd. on 1st July 2014 @ ₹ 2,00,000.
2. During the year S Ltd. declared and distributed final dividend of ₹ 50,000.
3. There was an abnormal loss on 30/09/14 for S ltd. of ₹ 20,000.
4. When the shares were purchased, agreed value of fixed assets of S Ltd. was ₹ 80,000 although no effect has been given thereto in accounts.

Prepare

a) Statement of Net Assets for S Ltd, if depreciation has been charged @ 10% p.a. on the book value as on 1-4-2014 (on straight line method)

b) Statement of Net Assets for S Ltd., if depreciation has been charged @ 10% p.a on the book value (on reducing balance method) **[Other Sources]**

[For Answer – Refer Class Notes]

Q10. Balance Sheet as on 31.3.16

	H Ltd.	**S Ltd.**
Non-Current assets	4,30,000	7,00,000
Investment in S (80%)	2,50,000	--
Current Assets	20,000	90,000
	7,00,000	**7,90,000**
Equity Share Capital (₹10)	2,00,000	1,00,000
Other Equity	3,00,000	1,00,000
Liabilities	2,00,000	5,90,000
	7,00,000	**7,90,000**

Investments were purchased on 31.3.2016. Calculate Goodwill or Gain on bargain purchase

a) if Fair value of Non-controlling Interests is ₹ 62,500

b) If Fair value of Non-controlling Interest is not Given **[Other Sources]**

[For Answer – Refer Class Notes]

Q11: Seeta Ltd. acquires Geeta Ltd. by purchasing 70% of its equity for ₹ 15 lakh in cash. The fair value of NCI is determined as ₹ 6.9 lakh. Management have elected to adopt full goodwill method and to measure NCI at fair value. The net aggregate value of the identifiable assets and liabilities, as measured in accordance with the standard is determined as ₹ 22 lakh. (Tax consequences being ignored).

Ans: The bargain purchase gain is calculated as follows:

	(₹ in lakh)
Fair value of consideration transferred	15.00
Fair value of NCI	6.90
Fair value of previously held equity interest	n/a
	21.90

Less: Recognised value of 100% of the net identifiable assets, measured in

accordance with the standards	(22.00)
Gain on bargain purchase	(0.10)

The recognized amount of the identifiable net assets is greater than the fair value of the consideration transferred plus fair value of NCI. Therefore, a bargain purchase gain of ₹ 0.10 lakh is either recognised in OCI and accumulated in equity as capital reserve or directly in equity as capital reserve.

The journal entry recorded on the acquisition date for 70% interest is as follows:

		Dr. (₹ in lakh)	**Cr. (₹ in lakh)**
Identifiable net assets	Dr.	22.00	
To Cash			15.00
To Gain on bargain purchase			0.10
To NCI			6.90

Since NCI is required to be recorded at fair value, a bargain purchase is recognized for ₹ 0.1 lakh.

[ICAI SM]

Q12: Continuing the facts as stated in the above illustration, except that Seeta Ltd. chooses to measure NCI using a proportionate share method for this business combination. (Tax consequences have been ignored). **[ICAI SM]**

Ans: This method calculates the bargain purchase same as under the fair value method, except that NCI is measured as the proportionate share of the identifiable net assets.

The bargain purchase gain is as follows:	**(₹ in lakh)**
Fair value of consideration transferred	15.00
Fair value of NCI (30% of ₹ 22.0 lakh)	6.60
Fair value of previously held equity interest	N/A
	21.60
Less: Recognised value of 100% of the net identifiable assets	(22.00)
Gain on bargain purchase	(0.40)

As the recognized amount of the identifiable net assets is greater than the fair value of consideration transferred, plus the recognized amount of NCI (at proportionate share), a bargain purchase gain of ₹ 0.4 lakh is recognized in the income statement.

The journal entry recorded on the acquisition date for 70% interest is as follows:

Identifiable net assets	Dr.	22.0	
To Cash			15.0
To Gain on bargain purchase			0.4
To NCI			6.6

Under the proportionate share method, NCI is recorded at its proportionate share of its net identifiable assets and not at fair value.

Q13: X Ltd. acquired Y Ltd. on payment of ₹ 25 crore cash and transferring a retail business, the fair value of which is ₹ 15 crore. Assets acquired and liabilities assumed in the acquisition are ₹ 36 crore. Find out the Goodwill. **[ICAI SM]**

Ans:

	(All figures are ₹ in crores)
Fair value of the consideration paid (₹ 25 cr + ₹ 15 cr)	40
Fair value of assets acquired net of fair value of liabilities assumed	(36)
Goodwill	4

Q14: Raja Ltd. purchased 60% shares of Ram Ltd. paying ₹ 525 lakh. Number of issued capital of B Ltd. is 1 lakh. Fair value of identifiable assets of B Ltd. is ₹ 640 lakh and that of liabilities is ₹ 50 lakh.

As on the date of acquisition, market price per share of Ram Ltd. is ₹ 775. Find out the value of goodwill **[ICAI SM]**

Ans:

	(₹ in lakh)
Fair value of consideration paid	525
Fair value of non-controlling interest (40% x 1 lakh x ₹ 775)	310
	835
Fair value of identified assets	640
Less: Fair value of liabilities	(50)
Fair value of Net Identified Assets	590
Goodwill	245

Note: When goodwill is measured taking non-controlling interest at fair value, it is often termed as full goodwill.

On the other hand, it is possible to measure non-controlling at the proportionate value of net assets.

	Amount in lakhs
Fair value of consideration paid	525
Proportionate value of non-controlling interest (40% x 590 lakh)	236

		761
Fair value of identified assets	640	
Minus fair value of liabilities	(50)	
Fair value of Net assets		590
Goodwill		171

When non-controlling interest is measured at proportionate share of net asset, the goodwill is popularly termed as partial goodwill.

Q15: From the following data, determine in each case:

(1) Non-controlling interest at the date of acquisition and at the date of consolidation using proportionate share method.

(2) Goodwill or Gain on bargain purchase.

(3) Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own retained earnings to be ₹ 2,00,000 in each case

Case	Subsidiary Company	% of shares owned	Cost	Date ofAcquisition1.04.20X1		Consolidation date31.03.20X2	
				Share Capital	Retained Earnings	Share Capital	Retained earnings
				[A]	[B]	[C]	[D]
1	A	90%	1,40,000	1,00,000	50,000	1,00,000	70,000
2	B	85%	1,04,000	1,00,000	30,000	1,00,000	20,000
3	C	80%	56,000	50,000	20,000	50,000	30,000
4	D	100%	1,00,000	50,000	40,000	50,000	56,000

The company has adopted an accounting policy to measure Non-controlling interest at NCI's proportionate share of the acquiree's identifiable net assets. **[ICAI SM]**

Ans:

1) Non-controlling Interest = the equity in a subsidiary not attributable, directly or indirectly, to a parent. Equity is the residual interest in the assets of an entity after deducting all its liabilities i.e. in this given case Share Capital + Statement of Profit & Loss (Assuming it to be the net aggregate value of identifiable assets in accordance with Ind AS)

	% Shares Owned by NCI [E]	Non-controlling interest as at the date of acquisition [E] x [A + B]	Non-controlling interest as at the date of consolidation [E] X [C + D]
Case 1 [100 - 90]	10%	15,000	17,000
Case 2 [100 - 85]	15%	19,500	18,000
Case 3 [100 - 80]	20%	14,000	16,000
Case 4 [100 - 100]	Nil	Nil	Nil

2) Calculation of Goodwill or Gain on bargain purchase

	Consideration [G]	Non-controlling interest [H]	Net Identifiable assets [A] + [B] = [I]	Goodwill [G] + [H] – [I]	Gain on bargain Purchase [I] – [G] – [H]
Case 1	1,40,000	15,000	1,50,000	5,000	-
Case 2	1,04,000	19,500	1,30,000	-	6,500
Case 3	56,000	14,000	70,000	Nil	Nil
Case 4	1,00,000	0	90,000	10,000	-

3) The balance in the Statement of Profit & Loss on the date of acquisition (1.04.20X1) is acquisition date profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s Profit.

On 31.03.20X2 in each case the following amount shall be added or deducted from the balance of holding Co.'s Retained earnings.

	% Share Holding [K]	Retained earnings as on 31.03.20X1 [L]	Retained earnings as on consolidation Date [M]	Retained earnings post-acquisition [N] = [M] – [L]	Amount to be added/(deducted) from holding's Retained earnings [O] = [K] x [N]
1	90%	50,000	70,000	20,000	18,000
2	85%	30,000	20,000	(10,000)	(8,500)
3	80%	20,000	30,000	10,000	8,000
4	100%	40,000	56,000	16,000	16,000

DIVIDEND FROM SUBSIDIARY COMPANY

Q16: H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹ 4,80,000 on 1st November, 20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Statement of Profit and

Loss of this company for year ended 31st March 20X2 showed an opening balance as on 1st April 20X1 of ₹ 2,00,000 and profit for the year 31st March 20X2 of ₹ 2,00,000. After the end of the year in the ensuing annual general meeting, it declared a dividend of 40%. Discuss the treatment in the books of H Ltd., in respect of the dividend. **[ICAI SM]**

Ans: H Ltd.'s share of dividend = ₹ 5,00,000 x 40% x 60% = ₹ 1,20,000

		₹	₹
Bank A/c To Profit & Loss A/c	Dr.	1,20,000	1,20,000

Q17: XYZ Ltd. purchased 80% shares of ABC Ltd. on 1st April, 20X1 for ₹ 1,40,000. The issued capital of ABC Ltd., on 1st April, 20X1 was ₹ 1,00,000 and the balance in the statement of Profit & Loss was ₹ 60,000.

For the year ending on 31st March, 20X2 ABC Ltd. has earned a profit of ₹ 20,000 and at the same time, declared and paid a dividend of ₹ 30,000.

Assume, the fair value of Non-controlling interest is same as the fair value on a per-share basis of the purchased interest.* All net assets are identifiable net assets, there are no non-identifiable assets. The fair value of identifiable net assets is ₹ 1,50,000

Show by an entry how the dividend should be recorded in the books of XYZ Ltd. What is the amount of non-controlling interest as on 1st April, 20X1 and 31st March, 20X2 using Fair Value method. Also pass a Journal entry on the acquisition Date.

*This assumption is only for illustration purpose. However, in the practical scenarios, the fair value of NCI will be lower than the fair value of CI (Controlling Interest) since the consideration paid for acquiring controlling interest will include control premium. **[ICAI SM]**

Ans: XYZ Ltd.'s share of dividend = ₹ 30,000 x 80% = ₹ 24,000

		₹	₹
Bank A/c To Profit & Loss A/c	Dr.	24,000	24,000

Calculation of Non- controlling interest and Journal Entry

NCI on 1st April 20X1 = 20% of Fair value on a per-share basis of the purchased interest.

= 20% x ₹ 1,75,000 (W.N 1) = ₹ 35,000

The journal entry recorded on the acquisition date for the 80% interest acquired is as follows:

		₹	₹
Identifiable net assets	Dr.	1,50,000	
Goodwill (Balancing Figure)	Dr.	25,000	
To Cash			1,40,000

To NCI			35,000

Working Note 1

Fair value on a per-share basis of the purchased interest / Fair Value of Identifiable net assets

= Consideration transferred x 100/80 = 1,40,000 x 100/80 = ₹ 1,75,000

NCI on 31st March 20X2 = NCI on 31st March 20X1 + Share of NCI in Profits of 20X1- 20X2

= 35,000 + (20,000 x 20%) = ₹ 39,000

Note: Dividend as per Ind AS will be recognized only when approval by the shareholder is received in the annual general meeting.

ELIMINATION OF INTRA GROUP PROFIT

Elimination of intra-group profit on sale of assets by a subsidiary to its parent

Q18: A parent owns 60% of a subsidiary. The subsidiary sells some inventory to the parent for ₹ 35,000 and makes a profit of ₹ 15,000 on the sale. The inventory is in the parent's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry. **[ICAI SM]**

Ans: The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's balance sheet at ₹ 20,000 (₹ 35,000 - ₹ 15,000). The consolidated income statement will show a corresponding reduction in profit of ₹ 15,000.

The double entry on consolidation is as follows:

		₹ '000	₹'000
Consolidated Revenue	Dr	35	
To Cost of sales			20
To Inventory			15

The reduction of group profit of ₹ 15,000 is allocated between the parent company and non-controlling interest in the ratio of their interests – 60% and 40%.

Elimination of intra-group profit on sale of assets by a parent to its subsidiary

Q19: In the above illustration, assume that it is the parent that makes the sale. The parent owns 60% of a subsidiary. The parent sells some inventory to the subsidiary for ₹ 35,000 and makes a profit of ₹ 15,000. On the sale the inventory is in the subsidiary's balance sheet at the year end. Examine the treatment of intra-group transaction and pass the necessary journal entry.

[ICAI SM]

Ans: The parent must eliminate 100% of the unrealized profit on consolidation. The inventory will, therefore, be carried in the group's balance sheet at ₹ 20,000. (₹ 35,000 – ₹ 15,000). The consolidated income statement will show a corresponding reduction in profit of ₹ 15,000.

The double entry on consolidation is follows:

		₹'000	₹'000
Consolidated Revenue A/c	Dr	35	
To Cost of sales A/c			20
To Inventory A/c			15

In this case, since it is the parent that has made the sale, the reduction in profit of ₹15,000 is allocated entirely to the parent company.

Inventories of subsidiary out of purchases from the parent

Q20: A Ltd, a parent company sold goods costing ₹ 200 lakh to its 80% subsidiary B Ltd. at ₹ 240 lakh. 50% of these goods are lying at its stock. B Ltd. has measured this inventory at cost i.e. at ₹ 120 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate. **[ICAI SM]**

Ans: A Ltd., shall reduce the inventories of ₹ 120 lakh of B Ltd., by ₹ 20 lakh in CFS. This will increase expenses and reduce consolidated profit by ₹ 20 lakh. It shall also create deferred tax asset of ₹ 6 lakh since accounting base of inventories (₹ 100 lakh) is lower than its tax base (₹ 120 lakh).

Inventories of the parent out of purchase from subsidiary

Q21: Ram Ltd., a parent company purchased goods costing ₹ 100 lakh from its 80% subsidiary Shyam Ltd. at ₹ 120 lakh. 50% of these goods are lying at the godown. Ram Ltd. has measured this inventory at cost i.e. at ₹ 60 lakh. Show the necessary adjustment in the consolidated financial statements (CFS). Assume 30% tax rate. **[ICAI SM]**

Ans: Ram Ltd., shall reduce the inventories of ₹ 60 lakh of Shyam Ltd., by ₹ 10 lakh in CFS This will increase expenses and reduce consolidated profit by ₹ 10 lakh. It shall also create deferred tax asset of ₹ 3 lakh since accounting base of inventories (₹ 50lakh) is lower than its tax base (₹ 60 lakh).

Q22: Airtel Telecommunications Ltd. owns 100% share capital of Airtel Infrastructures Pvt. Ltd. On 1 April 20X1 Airtel Telecommunications Ltd. acquired a building from Airtel Infrastructures Pvt. Ltd., for ₹ 11,00,000 that the group plans to use as its new headquarters office.

Airtel Infrastructures Pvt. Ltd. had purchased the building from a third party on 1 April 20X0 for ₹ 10,25,000. At that time the building was assessed to have a useful life of 21 years and a residual value of ₹ 5,00,000. On 1 April 20X1 the carrying amount of the building was ₹ 10,00,000 in Airtel Infrastructures Pvt. Ltd.'s individual accounting records.

The estimated remaining useful life of the building measured from 1 April 20X1 is 20 years and the residual value of the building is now estimated at ₹ 3,50,000. The method of depreciation is straight-line.

Pass necessary accounting entries in individual and consolidation situations **[ICAI SM]**

Ans: Journal Entries in Airtel Infrastructures Pvt. Ltd.

1.	Assets (Building) A/c	Dr.	10,25,000
	To Cash		10,25,000
2.	Depreciation (P/L) A/c	Dr.	25,000
	To Asset (Building)		25,000
3.	Cash A/c	Dr.	11,00,000
	To Asset (Building)		10,00,000
	To Gain on sale of asset (P/L)		1,00,000

Journal Entries in Airtel Telecommunications Ltd.

1	Asset (Building) A/c	Dr.	11,00,000
	To Cash		11,00,000
2	Depreciation (P/L) A/c	Dr.	37,500
	To Assets (Building)		37,500

Journal entry for consolidation:

1	Gain on sale of asset (P/L)	Dr.	1,00,000
	To Asset (Building) A/c		1,00,000
2	Asset (Building) A/c	Dr.	5,000 (WN 1)
	To Consolidated P&L		5,000

Working Note:

To be depreciated on original value	(10,00,000-3,50,000)/20	32,500
Depreciation charged	(11,00,000-3,50,000)/20	37,500
Reversal of depreciation		**5,000**

Particulars	**Consolidated financial statements**	**Individual Financial statements**	
		Airtel Telecommunications Ltd.	**Airtel Infrastructures Pvt. Ltd.**
31st March 20X1	10,00,000	0	10,00,000

1st April 20X1 purchase sale	0	11,00,000	(10,00,000)
Depreciation	(32,500)	(37,500)	0
31st March 20X2	9,67,500	10,62,500	0

DEFERRED TAX ON INITAL RECOGNITION OF INA

Q23: On 1 July 20X1, FA Ltd acquired 75% of the equity shares of Bolton Ltd and gained control of Bolton Ltd. Bolton Ltd has 12 million equity shares in issue. Details of the purchase consideration are as follows:

- On 1 July 20X1, FA Ltd issued two shares for every three shares acquired in Bolton Ltd. On 1 July 20X1, the market value of an equity share in FA Ltd was ₹6.50 and the market value of an equity share in Bolton Ltd was ₹ 6.00.
- On 30 June 20X2, FA Ltd will make a cash payment of ₹ 7.15 million to the former shareholders of Bolton Ltd. who sold their shares to FA Ltd on 1 July 20X1. On 1 July 20X1, FA Ltd would have needed to pay interest at an annual rate of 10% on borrowings
- On 30 June 20X3, FA Ltd may make a cash payment of ₹ 30 million to the former shareholders of Bolton Ltd who sold their shares to FA on 1 July 20X1. This payment is contingent upon the revenues of FA Ltd. growing by 15% over the two-year period from 1 July 20X1 to 30 June 20X3. On 1 July 20X1, the fair value of this contingent consideration was ₹ 25 million. On 31 March 20X2, the fair value of the contingent consideration was ₹ 22 million.

On 1 July 20X1, the carrying values of the identifiable net assets of Bolton Ltd in the books of that company totalled ₹ 60 million. On 1 July 20X1, the fair values of these net assets totalled ₹ 70 million. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31 March 20X2, Bolton Ltd had a poorer than expected operating performance. Therefore on 31 March 20X2, it was necessary for FA Ltd to recognize an impairment of the goodwill arising on acquisition of Bolton Ltd, amounting to 10% of its total computed value.

Compute the impairment of goodwill on acquisition of Bolton Ltd under both the methods permitted in the relevant Ind AS for the initial computation of the non-controlling interest in Bolton Ltd at the date of acquisition. **[MTP May 2020]**

Ans: Method I : NCI measured at Fair value
Method II: NCI measured at proportionate share of identifiable net assets

	Method I	Method II
	₹'000	₹'000
Cost of investment		
Share exchange (12 million x 75% x2/3 x₹6·50)	39,000	39,000

Deferred consideration (7.15 million/1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value – 3 million x ₹6·00	18,000	
% of net assets – 68,000 (W.N.1) x 25%	17,000	
	88,500	87,500
Net assets at date of acquisition (W.N.1)	(68,000)	(68,000)
Goodwill on acquisition	20,500	19,500
Impairment – 10%	2,050	1,950

Where the NCI is measured at fair value, the impairment should be attributed partly to retained earnings and partly to NCI. The allocation is normally based on the group structure (75/25 in this case).

Where the NCI is measured at % of net assets, the impairment should be attributed wholly to retained earnings.

Working Notes:

Net assets at date of acquisition

	₹ '000
Fair value at acquisition date	70,000
Deferred tax on fair value adjustments (20% x (70,000 – 60,000))	(2,000)
	68,000

IMPAIRMENT TESTING OF SUBSIDIARY IN CFS

Q24: Sun ltd is an entity with various subsidiaries. The entity closes its books of account at every year ended on 31st March. On 1st July 20X1 Sun ltd acquired an 80% interest in Pluto ltd. Details of the acquisition were as follows:

- Sun ltd acquired 800,000 shares in Pluto ltd by issuing two equity shares for every five acquired. The fair value of Sun Ltd's share on 1st July 20X1 was ₹ 4 per share and the fair value of a Pluto's share was ₹ 1·40 per share. The costs of issue were 5% per share.
- Sun ltd incurred further legal and professional costs of ₹ 100,000 that directly related to the acquisition.
- The fair values of the identifiable net assets of Pluto Ltd at 1st July 20X1 were measured at ₹ 1·3 million. Sun ltd initially measured the non-controlling interest in Pluto ltd at fair value. They used the market value of a Pluto ltd share for this purpose. No impairment of goodwill arising on the acquisition of Pluto ltd was required at 31st March 20X2 or 20X3.

Pluto ltd comprises three cash generating units A, B and C. When Pluto ltd was acquired the directors of Sun ltd estimated that the goodwill arising on acquisition could reasonably be allocated to units A:B:C on a 2:2:1 basis. The carrying values of the assets in these cash generating units and their recoverable amounts are as follows:

Unit	Carrying value (before goodwill allocation)	Recoverable amount
	₹ '000	₹ '000
A	600	740
B	550	650
C	450	400

Required:

(i) Compute the carrying value of the goodwill arising on acquisition of Pluto Ltd in the consolidated Balance Sheet of Sun ltd at 31st March 20X4 following the impairment review.

(ii) Compute the total impairment loss arising as a result of the impairment review, identifying how much of this loss would be allocated to the non-controlling interests in Pluto ltd.

[ICAI SM]

Ans:

1. **Computation of goodwill on acquisition**

Particular	Amount (₹'000)
Cost of investment (8,00,000 x 2/5 x ₹4)	1,280
Fair value of non-controlling interest (2,00,000 x ₹1·4)	280
Fair value of identifiable net assets at date of acquisition	(1,300)
So goodwill equals	260

Acquisition costs are not included as part of the fair value of the consideration given under Ind AS 103, Business Combination.

2. Calculation of impairment loss

Unit	Carrying value			Recoverable Amount	Impairment Loss
	Before Allocation	Allocation of goodwill (2:2:1)	After Allocation		
A	600	104	704	740	Nil
B	550	104	654	650	4
C	400*	52	452	400	52

* After writing down assets in the individual CGU to recoverable amount

3. **Calculation of closing goodwill**

Goodwill arising on acquisition (W1)	260
Impairment loss (W2)	(56)
So closing goodwill equals	204

4. **Calculation of overall impairment loss**

on goodwill (W3)	56
on assets in unit C (450 – 400)	50
So total loss equals	106

₹ 21·2 (20%) of the above is allocated to the NCI with the balance allocated to the shareholders of Sun ltd.

Q25: Parent acquires an 80% ownership interest in Subsidiary for ₹ 2,100 on April 1, 20X1. At that date, Subsidiary's net identifiable assets have a fair value of ₹ 1,500. Parent chooses to measure the non-controlling interests as the proportionate interest of Subsidiary's net identifiable assets. The assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Because other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ₹ 500 related to those synergies has been allocated to other cash-generating units within Parent. On March 31, 20X2, Parent determines that the recoverable amount of cash-generating unit Subsidiary is ₹ 1,000. The carrying amount of the net assets of Subsidiary, excluding goodwill, is ₹ 1,350. Allocate the impairment loss on March 31, 20X2.

[ICAI SM]

Ans: Non-controlling interests is measured as the proportionate interest of Subsidiary's net identifiable assets, i.e., ₹ 300 (20% of ₹ 1,500). Goodwill is the difference between the aggregate of the consideration transferred and the amount of the non-controlling interests (₹ 2,100 + ₹ 300) and the net identifiable assets (₹ 1,500), i.e., ₹ 900.

Since, the assets of Subsidiary together are the smallest group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets, therefore, Subsidiary is a cash-generating unit. Because other cash-generating units of Parent are expected to benefit from the synergies of the combination, the goodwill of ₹ 500 related to those synergies has been allocated to other cash-generating units within Parent. Because the cash-generating unit comprising Subsidiary includes goodwill within its carrying amount, it should be tested for impairment annually, or more frequently if there is an indication that it may be impaired.

Testing Subsidiary (cash-generating unit) for impairment

Goodwill attributable to non-controlling interests is included in Subsidiary's recoverable amount of ₹ 1,000 but has not been recognised in Parent's consolidated financial statements. Therefore, the carrying amount of Subsidiary should be grossed up to include goodwill attributable to the non-controlling interests, before being compared with the recoverable amount of ₹ 1,000. Goodwill attributable to Parent's 80% interest in Subsidiary at the acquisition date is ₹ 400 after allocating ₹ 500 to other cash-generating units within Parent.

Therefore, goodwill attributable to the 20% non-controlling interests in Subsidiary at the acquisition date is ₹ 100.

Testing subsidiary for impairment on March 31, 20X2

On March 31, 20X2	Goodwill of subsidiary (₹)	Net identifiable assets (₹)	Total (₹)
Carrying amount	400	1,350	1,750
Unrecognised non-controlling interests	100	-	100
Adjusted carrying amount	500	1,350	1,850
Recoverable amount			1,000
Impairment loss			850

Allocating the impairment loss

The impairment loss of ₹ 850 should be allocated to the assets in the unit by first reducing the carrying amount of goodwill.

Therefore, ₹ 500 of the ₹ 850 impairment loss for the unit is allocated to the goodwill. If the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss should be allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated. In this case, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80% ownership interest in Subsidiary, Parent recognises only 80% of that goodwill impairment loss (i.e., ₹ 400).

The remaining impairment loss of ₹ 350 is recognised by reducing the carrying amounts of Subsidiary's identifiable assets.

Allocation of the impairment loss for Subsidiary on March 31, 20X2

On March 31, 20X2	Goodwill of subsidiary (₹)	Net identifiable assets (₹)	Total (₹)
Carrying amount	400	1,350	1,750
Impairment loss	(400)	(350)	(750)
Carrying amount after impairment loss	-	1,000	1,000

NEGATIVE NCI

Q26: A Ltd. acquired 70% of equity shares of B Ltd. on 1.04.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and other equity of ₹ 80,000. In the four consecutive years B Ltd. fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5-20X6, B Ltd. experienced turnaround and registered an annual profit of ₹ 50,000. In the next two years i.e. 20X6-20X7 and 20X7-20X8, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the non- controlling interests and cost of control at the end of each year for the purpose of consolidation. Assume that the assets are at fair value. **[ICAI SM]**

Ans:

Year	Profit/loss	Non controlling Interest (30%)	Additional Consolidated P & L (Dr.) Cr.	NCI's share of Losses Borne By A Ltd.	Goodwill
At the time					
Of Acquisition in 20X1 20X1-20X2		3,24,000 (W.N.)			
	(2,50,000)	(75,000)	(1,75,000)		2,44,000
					(W.N.)
		2,49,000			
20X2-20X3	(4,00,000)	(1,20,000)	(2,80,000)		2,44,000
		1,29,000			
20X3-20X4	(5,00,000)	(1,50,000)	(3,50,000)		2,44,000
		(21,000)			
20X4-20X5	(1,20,000)	(36,000)	(84,000)		2,44,000
		(57,000)			
20X5-20X6	50,000	15,000	35,000		2,44,000
		(42,000)			
20X6-20X7	1,00,000	30,000	70,000		2,44,000
		(12,000)			
20X7-20X8	1,50,000	45,000	1,05,000		2,44,000
		33,000			

Working Note:

Calculation of Non-controlling interest:	
Share Capital	10,00,000
Other equity	80,000
Total	10,80,000
NCI (30% x 10,80,000)	3,24,000

NCI is measured at NCI's proportionate share of the acquiree's identifiable net assets. (Considering the carrying amount of share capital & other equity to be fair value).

Calculation of Goodwill: ₹

Consideration	10,00,000
Non-controlling interest	3,24,000
Less: Net Assets	(10,80,000)
Goodwill	2,44,000

QUESTIONS ON CONSOLIDATED BALANCE SHEET

Q27: On 31 March 20X2, Blue Heavens Ltd. acquired 75% ordinary shares carrying voting rights of Orange County Ltd. for ₹ 4,500 lakh in cash and it controlled Orange County Ltd. from that date.

The acquisition-date statements of financial position of Blue Heavens Ltd. and Orange County Ltd. and the fair values of the assets and liabilities recognised on Orange County Ltd. statement of financial position were:

	Blue Heavens Ltd	Orange County	
	Carrying Amount ₹ (lakh)	Carrying Amount ₹ (lakh)	Fair Value ₹ (lakh)
Assets			
Non-current assets			
Building and other PPE	7,000	3,000	3,300
Investment in Orange County Ltd.	4,500		
Current assets			
Inventories	700	500	600
Trade receivables	300	250	250
Cash	3,000	700	700
Total assets	15,500	4,450	
Equity and liabilities			
Equity			
Share capital	5,000	2,000	
Retained earnings	10,200	2,300	
Current liabilities			
Trade payables	300	150	150
Total liabilities and equity	15,500	4,450	

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd. **[ICAI SM]**

Ans: Working for the acquisition date fair value of Orange County Ltd. net assets: Acquisition date fair value of acquiree (Orange County Ltd.) assets

Buildings and other PPE	3,300
Inventories	600
Trade receivables	250
Cash	700
Less: fair value of trade payables	(150)
Fair value of net assets acquired	4,700

Non-controlling interest

= 25 % × Orange County Ltd. identifiable net assets at fair value of ₹ 4,700 = ₹ 1,175.

Blue Heavens Ltd.'s consolidated balance sheet at 31 March 20X2 will be calculated as follows:

(in lakhs)

	Blue Heavens Ltd.	**Orange County Ltd.**	**Consolidation adjustments**	**Consolidated Blue Heavens Ltd.**
	Carrying amount	**Carrying amount**		
Assets				
Non-current assets				
Goodwill			975 (WN 1)	975
Buildings and other PPE	7,000	3,000	300	10,300
Financial Assets				
Investment in Orange County Ltd.	4,500		(4,500)	
Current assets				
Inventories	700	500	100	1,300
Financial Assets				
Trade receivables	300	250		550
Cash	3,000	700		3,700
Total assets	**15,500**	**4,450**		**16,825**
Equity and liabilities				
Equity				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	10,200	2,300	(2,300)	10,200
Non-controlling interest			1,175	1,175
Current liabilities				
Financial Liabilities				
Trade payables	300	150		450

Total liabilities and equity	15,500	4,450		16,825

1. Working for goodwill: (₹ in lakhs)

Consideration paid	4,500
Non- controlling interest	1,175
Less: Acquisition date fair value of Orange County Ltd. net assets	
(cal. as above)	4,700
Goodwill	975

(Goodwill recognized in the consolidated balance sheet relates solely to the acquirer's proportion of the subsidiary; it does not include the non-controlling interest's share).

Q28: Facts are same as in above Question , Blue Heavens Ltd. acquires 75% of Orange County Ltd. Blue Heavens Ltd. pays ₹ 4,500 lakhs for the shares. At 31 March 20X3, i.e one year after Blue Heavens Ltd. acquired Orange County Ltd., the individual statements of financial position and statements of comprehensive income of Blue Heavens Ltd. and Orange County Ltd. are:

	Blue Heavens Ltd.	Orange County Ltd.
	Carrying Amount ₹(lakh)	Carrying Amount ₹(lakh)
Assets		
Non-current assets		
Building and other PPE	6,500	2,750
Investment in Orange County Ltd.	4,500	
	11,000	2,750
Current assets		
Inventories	800	550
Trade receivables	380	300
Cash	4,170	1,420
	5,350	2,270
Total assets	16,350	5,020
Equity and liabilities		
Equity		
Share capital	5,000	2,000
Retained earnings	11,000	2,850
	16,000	4,850
Current liabilities		
Trade payables	350	170
	350	170
Total liabilities and equity	16,350	5,020

Statements of comprehensive income for the year ended 31 March 20X3:

	Blue Heavens Ltd.	Orange County Ltd.
	Carrying Amount ₹(lakh)	Carrying Amount ₹(lakh)
Revenue	3,000	1,900
Cost of sales	(1,800)	(1,000)
Gross profit	1,200	900
Administrative expenses	(400)	(350)
Profit for the year	800	550

Note: Blue Heavens Ltd. estimates that goodwill has impaired by 98. The fair value adjustment to buildings and other PPE is in respect of a building; all buildings have an estimated remaining useful life of 20 years from 31 March 20X2 and estimated residual values of zero. Blue Heavens Ltd. uses the straight-line method for depreciation of PPE. All the inventory held by Orange County Ltd. at 31stMarch 20X2 was sold during 20X3.

Prepare the Consolidated Balance Sheet as on March 31, 20X2 of group of entities Blue Heavens Ltd. and Orange County Ltd. **[ICAI SM]**

Ans: Alternative I for calculation of Non-controlling Interest:

The Non-controlling Interest proportion of Orange County Ltd. is 25%.

At 31 March 20X3, the NCI in the consolidated balance sheet would be calculated as:

₹ (lakh)

NCI at date of acquisition (31 March 20X2) (see solution to Question 27)	1,175
NCI's share of profit for the year ended 31 March 20X3, being 25%	
Of ₹ 435 lakh (being ₹ 550 profit of Orange County Ltd. as per	
Orange County Ltd. financial statements less ₹ 100 group inventory	
Fair value adjustment less ₹ 15 group depreciation on building	
fair value adjustment)*	109
NCI as at 31 March 20X3	1,284

*In calculating the NCI's share of profit for the year ended 31 March 20X3, no deduction is made for goodwill amortization because, as explained above, the goodwill arising on consolidation relates solely to the acquirer's proportion of the subsidiary and does not include the non-controlling interest's share.

Alternative II for calculation of Non-controlling Interest:

As an alternative to the above three-step approach, at 31 March 20X3 the NCI in the consolidated balance sheet is calculated as 25% (the NCI's proportion) of ₹ 5,135, which is ₹ 1,284. ₹ 5,135 is Orange County Ltd. net assets at 31 March 20X3 as shown in Orange County Ltd. balance sheet (₹ 4,850, being ₹ 5,020 assets less ₹ 170 liabilities) plus the fair value adjustment to those assets as made in preparing the group balance sheet (₹ 285, being the fair value adjustment in respect of Orange County Ltd. building, ₹ 300, less one year's depreciation of that adjustment, ₹ 15).

Blue Heavens Ltd. consolidated statement of comprehensive income for the year ended 31 March 20X3 will be computed as follows:

	Blue Heavens Ltd.	Orange County Ltd.	Consolidate adjustments	Consolidated
Revenue	3,000	1,900		4,900
Cost of sales	(1,800)	(1,000)	(100) (WN 1)	(2,900)
Profit for the year	1,200	900		2,000
Administrative expenses	(400)	(350)	(113) (WN 2)	(863)
Total comprehensive income for the year	800	550		1,137

Total comprehensive income attributable to:

Owners of the parent (75%)	1,028
Non-controlling interest (25%)	109
	1,137

Consolidation involves:

- Adding the statement of comprehensive income of the parent and its subsidiary together line by line
- Recognising the fair value adjustments and/ or amortisation thereof together with amortisation of the goodwill asset that arose on acquisition of the subsidiary.

Blue Heavens Ltd. consolidated balance sheet at 31 March 20X3 will be computed as follows:
(₹ in lakh)

	Blue Heavens Ltd.	Orange County Ltd.	Consolidation adjustments	Consolidated Blue Heavens Ltd.
	Carrying amount	Carrying amount		
Assets				
Non-current assets Goodwill			975-98 (WN 3)	877
Buildings and other PPE	6,500	2,750	285 (WN 4)	9,535
Financial Assets Investment in Entity B	4,500		(4,500)	
Current assets Inventories	800	550		1,350
Financial Assets				
Trade receivables	380	300		680

Cash	4,170	1420		5,590
Total assets	**16,350**	**5,020**		**18,032**
Equity and liabilities **Equity**				
Share capital	5,000	2,000	(2,000)	5,000
Other Equity	11,000	2,850	(2,622) (WN 5)	11,228
Non-controlling interest			1,284	1,284
Current liabilities **Financial Liabilities** Trade payables	350	170		520
Total liabilities and equity	**16,350**	**5,020**		**18,032**

Consolidation involves:

- Adding the balance sheet of the parent and its subsidiary together line by line.
- Eliminating the carrying amount of the parent's investment in the subsidiary (because it is replaced by the goodwill and the fair value of the assets, liabilities and contingent liabilities acquired) and the pre-acquisition equity of the subsidiary (because that equity was not earned or contributed by the group but is part of what was purchased), and recognising the fair value adjustments together with the goodwill asset that arose on acquisition of the subsidiary as adjusted to reflect the first year post-acquisition
- Recognising the non-controlling interest in the net assets of Entity B.

Working Notes:

- **Cost of sales adjustment:**

  ₹ 100 = fair value adjustment in respect of inventories at 31 March 20X2.

- **Administrative expenses adjustment:**

  ₹ 113 = Impairment of goodwill ₹ 98 (WN 3) + additional depreciation on building ₹15 (WN 4).

  For simplicity it is assumed that all the goodwill impairment and the additional depreciation on buildings (on account of fair value adjustment) is adjusted against administrative expenses.

- **Working for goodwill:**

  Goodwill at the acquisition date, ₹ 975, less accumulated impairment, ₹ 98 = ₹ 877.

- **Working for building consolidation adjustment:**

  The fair value adjustment at 31 March 20X2 in respect of Orange County Ltd. building was ₹ 300, that is, the carrying amount at 31 March 20X2 was ₹ 300 lower than was recognized in the group's consolidated balance sheet. The building is being depreciated over 20 years from 31 March 20X2. Thus, at 31 March 20X3 the adjustment required on consolidation to the balance sheet will be ₹ 285, being ₹ 300 × 19/20 years' estimated useful life remaining. The additional depreciation recognized in the consolidated statement of comprehensive income is ₹ 15 (being ₹ 300 x 1/20).

- **Reserves adjustment:**

  ₹ 2,300 adjustment at the acquisition date (Illustration 27) plus ₹ 98 (WN 3) impairment of goodwill

  plus ₹ 15 (WN 4) additional depreciation on building

  plus ₹ 100 (WN 1) fair value adjustment in respect of inventories

  plus ₹ 109 NCI's share of Orange County Ltd. profit for the year (as included in the consolidated statement of comprehensive income)

  = ₹ 2,622.

Q29: X Ltd. acquired 1,600 ordinary shares of ₹ 100 each of Y Ltd. on 1st July 1999. On December 31, 1999 the Balance Sheet of the two companies were as given below:

Liabilities	**X Ltd.** **₹**	**Y Ltd.** **₹**	**Assets**	**X Ltd.** **₹**	**Y Ltd.** **₹**
Capital (Share			Land & Building	1,50,000	1,80,000
of ₹ 100 each fully paid)	5,00,000	2,00,000	Plant &	2,40,000	1,35,000
Reserves	2,40,000	1,00,000	Machinery		
P & L A/c	57,200	82,000	Investment in	3,40,000	---
Bank Overdraft	80,000	---	Y Ltd. at cost	1,20,000	36,400
Bills Payable	---	8,400	Stock	44,000	40,000
Creditors	47,100	9,000	Sundry Debtors	15,800	---
			Bills Receivable	14,500	8,000
			Cash		
	9,24,300	**3,99,400**		**9,24,300**	**3,99,400**

The Profit and Loss Account of Y Ltd. showed a credit balance of ₹ 30,000 on 1st January, 1999 out of which a dividend of 10% was paid on 1st August; X Ltd. has credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 1999 was considered as worth ₹ 1,80,000 on 1st July, 1999; this figure is to be considered while consolidating the Balance Sheets. Prepare consolidated Balance Sheet as on December 31, 1999. **[ICAI SM – Old Syllabus]**

[For Answer – Refer Class Notes]

Q30: The Balance Sheet of Sun Ltd. and Moon Ltd. as on 31-03-2000 are given below:

Liabilities	**Sun Ltd.**	**Moon Ltd.**	**Assets**	**Sun Ltd.**	**Moon Ltd.**
Share Capital (₹ 10)	120000	100000	Fixed Assets	44,000	84,000
General reserve	20000	36000	Investment in		
P & L A/c	12000	20000	Moon Ltd. 8,000		

Bills payable	2000	5000	Shares @ ₹ 11	88,000	---
Sundry creditors	4000	7000	Sundry Debtors	6,000	15,000
			Bills Receivable	4,000	16,000
			Stock in Trade	10,000	40,000
			Cash at bank	6,000	13,000
	158000	**168000**		**158000**	**168000**

Note: Contingent Liability of Sun Ltd. Bills Discounted not yet Matured ₹ 2,500

Shares were purchased on 01-04-1997. When the shares were purchased General Reserve and Profit and Loss Account of Moon Ltd. stood at ₹ 30,000 and ₹ 16,000 respectively.

Dividends have been paid @ 10% every year after acquisition of shares, first dividend being paid out of pre-acquisition profits. No dividend has been proposed for 1999-2000 as yet and no provision need be made in consolidated Balance Sheet. Sun Ltd. has credited dividend received to Profit and Loss Account.

When the shares were purchased, agreed re-valuations of fixed assets of Moon Ltd. was ₹ 1,08,000 although no effect has been given thereto in accounts.

Depreciation has been charged @ 10% p.a. on the book value as on 1-4-1997, (on straight line method), there being no addition or sale then.

Out of current profit ₹ 2,000 has been transferred to general reserve every year.

Bills receivable of Sun Ltd. include ₹ 2,000 bills accepted by Moon Ltd. and bills discounted by Sun Ltd. not yet matured include ₹ 1,500 accepted by Moon Ltd.

Sundry creditors of Sun Ltd. include ₹ 2,000 due to Moon Ltd. whereas Sundry Debtors of Moon Ltd. include ₹ 4,000 due from Sun Ltd. It is found that Sun Ltd. has remitted a cheque of ₹ 2,000 which has not yet been received by Moon Ltd.

Prepare consolidated Balance Sheet as at 31-3-2000 of Sun Ltd. and it Subsidiary.

[ICAI SM – Old Syllabus]

[For Answer – Refer Class Notes]

Q31: On 1st January 1987, A Ltd. acquired 8,000 shares of ₹ 10 each of B Ltd. at ₹ 90,000. The respective Balance Sheets as on 31st December, 1989 are given below:

Liabilities	**A Ltd.**	**B Ltd.**	**Assets**	**A Ltd.**	**B Ltd.**
Share Capital (₹ 10)	1,00,000	1,00,000	Fixed Assets	60,000	1,10,000
Reserve	40,000	26,000	Investments	1,00,000	15,000
P & L A/c	36,000	35,000	Debtors	25,000	20,000
Creditors	71,000	48,000	Stock	30,000	40,000
			Bank	32,000	24,000
	2,47,000	**2,09,000**		**2,47,000**	**2,09,000**

Additional Information:

1. At the time of acquiring shares, B Ltd. had ₹ 24,000 in Reserve and ₹ 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 & Loss Account of A Ltd.

3. Proposed Dividends of the both the companies for 1989 are 10% on paid up share capital excluding bonus.

4. On 1st January, 1987, Building of B Ltd. which stood in the books at ₹ 1,50,000 was revalued at ₹ 1,60,000 but no adjustment has been made in the books Depreciation has been charged @ 10% p.a. on reducing balance method.

5. In 1989 A Ltd. Purchased from B Ltd. goods for ₹ 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.

[ICAI SM – Old Syllabus]

[For Answer – Refer Class Notes]

Q32: Ram Ltd. acquired 60% ordinary shares of ₹ 100 each of Krishan Ltd. on 1st October 20X1. On March 31, 20X2 the summarised Balance Sheets of the two companies were as given below:

	Ram Ltd.	**Krishan Ltd.**
Assets		
Property, Plant Equipment		
Land & Buildings	3,00,000	3,60,000
Plant & Machinery	4,80,000	2,70,000
Investment in Krishan Ltd.	8,00,000	-
Inventory	2,40,000	72,800
Financial Assets		
Trade Receivable	1,19,600	80,000
Cash	29,000	16,000
Total	**19,68,600**	**7,98,800**
Equities & Liabilities		
Equity Capital (Shares of ₹ 100 each fully paid)	10,00,000	4,00,000
Other Equity		
Other Reserves	6,00,000	2,00,000
Retained earnings	1,14,400	1,64,000
Financial Liabilities		
Bank Overdraft	1,60,000	-
Trade Payable	94,200	34,800
Total	**19,68,600**	**7,98,800**

The Retained earnings of Krishan Ltd. showed a credit balance of ₹ 60,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; Ram Ltd. has credited the dividend received to its Retained earnings; Fair Value of P& M as on 1st October 20X1 was ₹ 4,00,000; The rate of depreciation on plant & machinery is 10%.

Following are the changes in Fair value as per respective IND AS from book value as on 1st October 20X1 which is to be considered while consolidating the Balance Sheets.

Liabilities	Amount	Assets	Amount
Trade Payables	20,000	Land & Buildings	2,00,000
		Inventories	30,000

Note:

1. It may be assumed that the inventory is still unsold on balance sheet date and the Trade Payables are also not yet settled.

2. Also assume that the Other Reserves as on 31st March 20X2 are the same as was on 1st April 20X1.

Prepare consolidated Balance Sheet as on March 31, 20X2. **[May 2018]**

Ans: Consolidated Balance Sheet of Ram Ltd. and its subsidiary, Krishan Ltd. as on 31st March, 20X2

Particulars	**Note No.**	**₹**
Assets		
Non-current assets		
Property, Plant & Equipment	1	17,20,000
Goodwill	2	1,65,800
Current Assets		
Inventories	3	3,42,800
Financial Assets		
Trade Receivables	4	1,99,600
Cash & Cash equivalents	5	45,000
Total Assets		24,73,200
Equity and Liabilities		
Equity		
Equity Share Capital	6	10,00,000
Other Equity	7	7,30,600
Non-controlling Interest (WN 5)		4,33,600
Current Liabilities		
Financial Liabilities		
Trade Payables	8	1,49,000
Short term borrowings	9	1,60,000
Total Equity & Liabilities		24,73,200

Statement of Changes in Equity:

1. **Equity share Capital**

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
10,00,000	0	10,00,000

2. Other Equity

	Share application Money	Equity component	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning of the reporting period				0	6,00,000	6,00,000
Total comprehensive income for the year			0	1,14,400		1,14,400
Dividends			0	(24,000)		(24,000)
Total						
comprehensive income attributable to parent			0	40,200		40,200
Gain on Bargain purchase				0		0
Balance at the end of reporting period				1,30,600	6,00,000	7,30,600

Working Notes:

1. **Adjustments of Fair Value**

   The Plant & Machinery of Krishan Ltd. would stand in the books at ₹ 2,85,000 on 1st October, 20X1, considering only six months' depreciation on ₹ 3,00,000 total depreciation being ₹ 30,000. The value put on the assets being ₹ 4,00,000 there is an appreciation to the extent of ₹ 1,15,000.

2. **Acquisition date profits of Krishan Ltd.**

Reserves on 1.4. 20X1		2,00,000
Profit & Loss Account Balance on 1.4. 20X1		60,000
Profit for 20X1-20X2: Total (₹ 1,64,000 less ₹ 20,000) x 6/12 i.e. 72,000; upto 1.10. 20X1		72,000
Total Appreciation		3,25,000
		6,57,000
Holding Co. Share (60%)		3,94,200

3. Post-acquisition profits of Krishan Ltd.

Profit after 1.10. 20X1 [1,64,000-20,000]x 6/12	72,000
Less: 10% depreciation on ₹ 4,00,000 for 6 months less depreciation already charged for 2nd half of 20X1-20X2 on ₹ 3,00,000 (20,000-15,000)	(5,000)
Total	67,000
Share of holding Co. (60%)	40,200

4. Non-controlling Interest

Par value of 1600 shares	1,60,000
Add: 2/5 Acquisition date profits (6,57,000 – 40,000)	2,46,800
Add: 2/5 Post-acquisition profits [WN 4]	26,800
	4,33,600

5. Goodwill:

Amount paid for 2,400 shares		8,00,000
Par value of shares	2,40,000	
Acquisition date profits share of Ram Ltd.	3,94,200	(6,34,200)
Goodwill		1,65,800

6. Value of Plant & Machinery:

Ram Ltd.		4,80,000
Krishan Ltd.	2,70,000	
Add: appreciation on 1.10. 20X1	1,15,000	
	3,85,000	
Add: Depreciation for 2nd half charged on pre-revalued value	15,000	
Less: Depreciation on ₹ 4,00,000 for 6 months	(20,000)	3,80,000
		8,60,000

7. Profit & Loss account consolidated

Ram Ltd. (as given)	1,14,400	
Less: Dividend	(24,000)	90,400
Share of Ram Ltd. in post-acquisition profits		40,200
		1,30,600

Q33: DEF Ltd. acquired 100% ordinary shares of ₹ 100 each of XYZ Ltd. on 1st October 20X1. On March 31, 20X2 the summarised Balance Sheets of the two companies were as given below

	DEF Ltd.	XYZ Ltd.
Assets		
Property Plant Equipment		
Land & Buildings	15,00,000	18,00,000

Plant & Machinery	24,00,000	13,50,000
Investment in XYZ Ltd.	34,00,000	-
Inventory	12,00,000	3,64,000
Financial Assets		
Trade Receivable	5,98,000	4,00,000
Cash	1,45,000	80,000
Total	**92,43,000**	**39,94,000**
Equities & Liabilities		
Equity Capital (Shares of ₹ 100 each fully paid)	50,00,000	20,00,000
Other Equity		
Other reserves	24,00,000	10,00,000
Retained Earnings	5,72,000	8,20,000
Financial Liabilities		
Bank Overdraft	8,00,000	-
Trade Payable	4,71,000	1,74,000
Total	**92,43,000**	**39,94,000**

The retained earnings of XYZ Ltd. showed a credit balance of ₹ 3,00,000 on 1st April 20X1 out of which a dividend of 10% was paid on 1st November; DEF Ltd. has recognised the dividend received to profit or loss account; Fair Value of P& M as on 1st October 20X1 was ₹ 20,00,000. The rate of depreciation on plant & machinery is 10%.

Following are the increases on comparison of Fair value as per respective Ind AS with Book value as on 1st October 20X1 which are to be considered while consolidating the Balance Sheets.

Liabilities	**Amount**	**Assets**	**Amount**
Trade Payables	1,00,000	Land & Buildings	10,00,000
		Inventories	1,50,000

Note:

1. It may be assumed that the inventory is still unsold on balance sheet date and the Trade Payables are also not yet settled.
2. Also assume that the Other Reserves of both the companies as on 31st March 20X2 are the same as was on 1st April 20X1.
3. All fair value adjustments have not yet started impacting consolidated post-acquisition profits.

Prepare consolidated Balance Sheet as on March 31, 20X2. **[ICAI SM]**

Ans: Consolidated Balance Sheet of DEF Ltd. and its subsidiary, XYZ Ltd. as on 31st March, 20X2

Particulars	Note No.	₹
I. Assets		
(1) Non-current assets		
(i) Property Plant & Equipment	1	86,00,000
(2) Current Assets		
(i) Inventories	2	17,14,000
(ii) Financial Assets		
(a) Trade Receivables	3	9,98,000
(b) Cash & Cash equivalents	4	2,25,000
Total Assets		**1,15,37,000**
II. Equity and Liabilities		
(1) Equity		
(i) Equity Share Capital	5	50,00,000
(ii) Other Equity	6	49,92,000
(2) Current Liabilities		
(i) Financial Liabilities		
(a) Trade Payables	7	7,45,000
(b) Short term borrowings	8	8,00,000
Total Equity & Liabilities		**1,15,37,000**

Notes to Accounts

			₹
1.	**Property Plant & Equipment**		
	Land & Building	43,00,000	
	Plant & Machinery	43,00,000	86,00,000
2.	**Inventories**		
	DEF Ltd.	12,00,000	
	XYZ Ltd.	5,14,000	17,14,000
3.	Trade Receivables		
	DEF Ltd.	5,98,000	
	XYZ Ltd.	4,00,000	9,98,000
4.	Cash & Cash equivalents		
	DEF Ltd.	1,45,000	
	XYZ Ltd.	80,000	2,25,000
7.	Trade payable		
	DEF Ltd.	4,71,000	

	XYZ Ltd.	2,74,000	7,45,000
8.	Shorter-term borrowings		
	Bank overdraft		8,00,000

Statement of Changes in Equity:

A. Equity share Capital

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
50,00,000	0	50,00,000

B. **Other** Equity

	Share application money pending allotment	Equity component of compound financial instrument	Reserves & Surplus			Total
			Capital reserve	Retained Earnings	Other Reserves	
Balance at the beginning				0	24,00,000	24,00,000
Total comprehensive income for the year			0	5,72,000		5,72,000
Dividends			0	(2,00,000)		(2,00,000)
Total comprehensive income						
attributable to parent			0	3,35,000		3,35,000
Gain on Bargain purchase			18,85,000			18,85,000
Balance at the end of			18,85,000	7,07,000	24,00,000	49,92,000

reporting period						

It is assumed that there exists no clear evidence for classifying the acquisition of the subsidiary as a bargain purchase and, hence, the bargain purchase gain has been recognised directly in capital reserve. If, however, there exists such a clear evidence, the bargain purchase gain would be recognised in other comprehensive income and then accumulated in capital reserve. In both the cases, closing balance of capital reserve will be ₹ 18,85,000.

Working Notes:

1. **Adjustments of Fair Value**

   The Plant & Machinery of XYZ Ltd. would stand in the books at ₹ 14,25,000 on 1st October, 20X1, considering only six months' depreciation on ₹ 15,00,000 total depreciation being ₹ 1,50,000. The value put on the assets being ₹ 20,00,000 there is an appreciation to the extent of ₹ 5,75,000.

2. **Acquisition date profits of XYZ Ltd.**

Reserves on 1.4. 20X1		10,00,000
Profit & Loss Account Balance on 1.4. 20X1		3,00,000
Profit for 20X2: Total ₹ 8,20,000 less ₹ 1,00,000 (3,00,000 – 2,00,000) i.e. ₹ 7,20,000; for 6 months ie. upto 1.10.20X1		3,60,000
Total Appreciation including machinery appreciation (10,00,000 1,50,000 + 5,75,000 – 1,00,000)		16,25,000
Share of DEF Ltd.		32,85,000

3. **Post-acquisition profits of XYZ Ltd.**

Profit after 1.10. 20X1 [8,20,000-1,00,000]x 6/12	3,60,000
Less: 10% depreciation on ₹ 20,00,000 for 6 months less depreciation already charged for 2nd half of 20X1-20X2 on ₹ 15,00,000 (1,00,000-75,000)	(25,000)
Share of DEF Ltd.	3,35,000

4. **Consolidated total comprehensive income**

DEF Ltd.	
Retained earnings on 31.3.20X2	5,72,000
Less: Retained earnings as on 1.4.20X1	(0)
Profits for the year 20X1-20X2	5,72,000
Less: Elimination of intra-group dividend	(2,00,000)
Adjusted profit for the year	3,72,000
XYZ Ltd.	

Adjusted profit attributable to DEF Ltd. (W.N.3)	3,35,000
Consolidated profit or loss for the year	7,07,000

5. **No Non-controlling Interest as 100% shares of XYZ Ltd. are held by DEF Ltd.**

6. **Gain on Bargain Purchase**

Amount paid for 20,000 shares		34,00,000
Par value of shares	20,00,000	
DEF Ltd.'s share in acquisition date profits of XYZ Ltd.	32,85,000	(52,85,000)
Gain on Bargain Purchase		18,85,000

7. **Value of Plant & Machinery**

DEF Ltd. XYZ Ltd.		24,00,000
	13,50,000	
Add: Appreciation on 1.10. 20X1	5,75,000	
	19,25,000	
Add: Depreciation for 2nd half charged on pre-revalued value	75,000	
Less: Depreciation on ₹ 20,00,000 for 6 months	(1,00,000)	19,00,000
		43,00,000

8. **Consolidated retained earnings**

	DEF Ltd.	XYZ Ltd.	Total
As given	5,72,000	8,20,000	13,92,000
Consolidation Adjustments:			
(i) Elimination of pre-acquisition element [3,00,000 + 3,60,000]	0	(6,60,000)	(6,60,000)
(ii) Elimination of intra-group dividend	(2,00,000)	2,00,000	0
(iii) Impact of fair value adjustments	0	(25,000)	(25,000)
Adjusted retained earnings consolidated	3,72,000	3,35,000	7,07,000

9. **Assumptions:**

   1. Investment in XYZ Ltd is carried at cost in the separate financial statements of DEF Ltd.

   2. Appreciation of ₹10 lakhs in land & buildings is entirely attributable to land element only.

3. Depreciation on plant and machinery is on WDV method.

4. Acquisition-date fair value adjustment to inventories of XYZ Ltd. existing at the balance sheet date does not result in need for any write-down.

Q34: H Ltd. acquires 80% shares of S Ltd and pays ₹ 30,000 lakhs for the shares on 31/03/02. At 31 March 2003, i.e one year after H Ltd acquired S Ltd, the individual statements of financial position and statements of comprehensive income of H Ltd. and S Ltd. are:

	H Ltd.	S Ltd.
	Carrying Amount ₹(lakh)	Carrying Amount ₹(lakh)
Assets		
Non-current assets		
Building and other PPE	40,000	12,000
Investment in S Ltd.	30,000	
Other current assets	4,000	12,000
Current assets		
Inventories	800	600
Trade receivables	1,000	1,000
Cash	1,200	1,600
Total assets	77,000	27,200
Equity and liabilities		
Equity		
Share capital	40,000	2,000
Other Equity	16,000	21,200
Current liabilities		
Trade payables	21,000	4,000
Total liabilities and equity	77,000	27,200

Statements of comprehensive income for the year ended 31 March 20X3:

	H Ltd.	**S Ltd.**
	Carrying Amount ₹(lakh)	**Carrying Amount ₹(lakh)**
Revenue	20,000	16,000
Total Revenue	20,000	16,000
Expense		
Purchase	10,000	6,000
Changes in Inventory	2,000	1,400
Employee benefit Expenses	4,000	600
Depreciation and amortization	2,000	800
Total Expense	18,000	8,800

Profit for the year	2,000	7,200

Statement of Changes in Equity for the year ended 31 March 20X3

H Ltd.	**General Reserve**	**Profit &Loss**	**Total**
Balance as on 1.4.20X2	4,000	10,000	14,000
Profit for the year 20X2-20X3		2,000	2,000
Balance as on 31.3.20X3	**4,000**	**12,000**	**16,000**
S Ltd			
Balance as on 1.4.20X2	2,000	12,000	14,000
Profit for the year 20X2-20X3		7,200	7,200
Balance as on 31.3.20X3	**2,000**	**19,200**	**21,200**

Note:

a) Fair value of NCI on the date of acquisition is ₹ 6,400 lacs.

b) On 31/03/2002, Building of S Ltd. which stood in the books at ₹ 15,000 lacs was revalued at ₹ 15,400 but no adjustment has been made in the books Depreciation has been charged @ 20% p.a. on reducing balance method.

c) On 31/03/2002, Inventory of S Ltd. which stood in the books at ₹ 1,000 lacs was valued at ₹ 1,200 but no adjustment has been made in the books. 60% of such goods has been sold during the year 2002-03

d) In 2002-03 S Ltd. Purchased from H Ltd. goods for ₹ 1,000 lacs on which H Ltd. made a profit of 20% on sales, 25% of such goods are lying unsold on 31st March, 2003. Creditor of S Ltd include ₹ 200 lacs payable to H Ltd.

e) The consolidated goodwill has been impaired by 10%.

Prepare the Consolidated Balance Sheet as on March 31, 20X3 of group of entities.

[Other Sources]

[For Answer – Refer Class Notes]

STEP ACQUISITIONS

Q35: Entity D has a 40% interest in entity E. The carrying value of the equity interest, which has been accounted for as an associate in accordance with IND AS 28 is ₹40 lakh. Entity D purchases the remaining 60% interest in entity E for ₹600 lakh in cash. The fair value of the 40% previously held equity interest is determined to be ₹400 lakh., the net aggregate value of the identifiable assets and liabilities measured in accordance with Ind AS 103 is determined to be identifiable ₹880 lakh. The tax consequences have been ignored. How does entity D account for the business combination? **[ICAI SM]**

Ans: The journal entry recorded on the date of acquisition of the 60% controlling interest is as follows:

(₹ in lakh)

Identifiable net assets	Dr.	880	
Goodwill	Dr.	120	
To Cash			600
To Associate interest			40
To Gain on equity interest (to be recognized in income statement)			360

Goodwill is calculated as follows:	**₹ in lakh**
Fair value of consideration transferred	600
Fair value of previously held equity interest	400
	1,000
Less: Recognised value of 100% of the identifiable net assets	(880)
Goodwill recognised	120

The gain on the 40% previously held equity interest is recognized in the income statement. The fair value of the previously held equity interest less the carrying value of the previously held equity interest is ₹ 360 lakh (400 – 40).

CHANGES IN PROPORTION OF NCI

Sale of a 20% interest in a wholly- owned subsidiary

Q36: Entity P sells a 20% interest in a wholly- owned subsidiary to outside investors for ₹ 100 lakh in cash. The carrying value of the subsidiary's net assets is ₹ 300 lakh, including goodwill of ₹ 65 lakh from the subsidiary's initial acquisition. Pass journal entries to record the transaction.

[ICAI SM]

Ans: The accounting entry recorded on the disposition date for the 20% interest sold as follows:

		₹ in Lakh	**₹ in lakh**
Cash	Dr.	100	
To Non-controlling interest (20% * 300 lakh)			60
To Other Equity (Gain on sale of interest in subsidiary)			40

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (60 lakhs) is adjusted and fair value of consideration received (100 lakhs) to be attributed to parent in other equity ie. 40 lakhs.

Acquisition of a 20% interest in a subsidiary

Q37: Entity A acquired 60% of entity B two years ago for ₹ 6,000. At the time entity B's fair value was ₹ 10,000. It had net assets with a fair value of ₹ 6,000 (which for the purposes of this example was the same as book value). Goodwill of ₹ 2,400 was recorded (being ₹ 6,000 – (60% * ₹

6,000). On 1 October 20X0, entity A acquires a further 20% interest in entity B, taking its holding to 80%. At that time the fair value of entity B is ₹ 20,000 and entity A pays ₹ 4,000 for the 20% interest. At the time of the purchase the fair value of entity B's net assets is ₹ 12,000 and the carrying amount of the non- controlling interest is ₹ 4,000. Pass journal entries to record the transaction. **[ICAI SM]**

Ans: The accounting entry recorded for the purpose of the non- controlling interest is as follows:

		₹	₹
Non-controlling interest	Dr.	2,000	
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	2,000	
To Cash			4,000

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (₹ 2,000) is adjusted and fair value of consideration received (₹ 4,000) to be attributed to parent in other equity ie. ₹ 2,000.

Q38: A Ltd. acquired 10% additional shares of its 70% subsidiary. The following relevant information is available in respect of the change in non-controlling interest on the basis of Balance sheet finalized as on 1.4. 20X0:

	₹ in thousand
Separate financial statements	As on 31.3.20X0
Investment in subsidiary (70% interest) – at cost	14,000
Purchase price for additional 10% interest	2,600
Consolidated financial statements	
Non-controlling interest (30%)	6,600
Consolidated profit & loss account balance	2,000
Goodwill	600

The reporting date of the subsidiary and the parent is 31 March, 20X0. Prepare note showing adjustment for change of non-controlling interest. Should goodwill be adjusted for the change?

[ICAI SM]

Ans: The following accounting entries are passed:

		₹ '000	₹ '000
Other Equity (Loss on acquisition of interest in subsidiary)	Dr.	400	
Non-controlling interest	Dr.	2,200	
To Bank			2,600

As per para B96 of Ind AS 110, where proportion of the equity of NCI changes, then group shall adjust controlling and non-controlling interest and any difference between NCI (₹ 22,00,000) is adjusted and fair value of consideration received (₹ 26,00,000) to be attributed to parent in other equity ie. ₹ 4,00,000. Consolidated goodwill is not adjusted.

Reduce interest in subsidiary

Q39: Amla Ltd. purchase a 100% subsidiary for ₹ 10,00,000 at the end of 20X1 when the fair value of the subsidiary's Lal Ltd. net asset was ₹ 8,00,000.

The parent sold 40% of its investment in the subsidiary in March 20X4 to outside investors for ₹ 9,00,000. The parent still maintains a 60% controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is ₹ 18,00,000 (including net assets of ₹ 16,00,000 & goodwill of ₹ 2,00,000).

Calculate gain or loss on sale of interest in subsidiary as on 31st March 20X4. **[ICAI SM]**

Ans: As per Ind AS 110, a change in ownership that does not result in a loss of control. The identifiable net assets (including goodwill) remain unchanged and any difference between the amount by which the non-controlling interest is recorded (including the non controlling interest portion of goodwill) and a fair value of the consideration received is recognized directly in equity and attributed to the controlling interest. For disposals that do not result in the loss of control, the change in the non-controlling interest is recorded at its proportionate interest of the carrying value of the subsidiary.

Gain on the sale of the investment of ₹ 5,00,000 in parent's separate financial statements calculated as follows:

	₹'000
Sale proceeds	900
Less: cost on investment in subsidiary (₹ 10,00,000 X 40%)	(400)
Gain on sale in the parent's separate financial statement	500

As discussed above, the group's consolidated income statement for 31st March 20X4 would show no gain on the sale of the interest in the subsidiary. Instead, the difference between the fair value of the consideration received and the amount by which the non controlling interest is recorded is recognized directly in equity.

	₹'000
Sale proceeds	900
Less: recognition of non controlling interest (₹ 18,00,000 X 40%)	720
Credit to other equity	180

The entry recognized in the consolidated accounts under Ind AS 110 is :

		₹'000	**₹'000**
Cash	Dr.	900	
To Non controlling interest(1,800 X 40%)			720
To Other Equity (Gain on sale of interest on subsidiary)			180

The difference between the gain in the parent's income statement and the increase reported in the group's consolidated equity is ₹ 3,20,000. This difference represents the share of post acquisition profits retained in the subsidiary ₹ 3,20,000 [(that is, 18,00,000 – 10,00,000) X 40%] that have been reported in the groups income statement upto the date of sale.

The non-controlling interest immediately after the disposal will be 40% of the net carrying value of the subsidiary's net assets including goodwill in the consolidated balance sheet of ₹ 18,00,000, that is, ₹ 7,20,000.

Q40: A ltd. acquired 70% of shares of B ltd. On 1.4.20X0 when fair value of net assets of B Ltd. was ₹ 200 lakh. During 20X0-20X1, B ltd. made profit of ₹ 10 lakh. Stand-alone and consolidated balance sheets as on 31.3. 20X1 are as follows: **(₹ in lakhs)**

	A	B	Group
Assets			
Goodwill			10
PPE	627	200	827
Financial Assets:			
Investments	150		
Cash	200	30	230
Other Current Assets	23	70	93
	1,000	**300**	**1,160**
Equity and Liabilities			
Share Capital	200	100	200
Other Equity	800	200	870
Non-controlling interest			90
	1,000	**300**	**1,160**

A ltd. acquired another 10% stake in B ltd on 1.4. 20X0 at ₹ 32 lakh. The proportionate carrying amount of the non-controlling interest is ₹ 30 lakh. Show the stand alone and consolidated balance sheet of the group immediately after the change in non-controlling interest.**[ICAI SM]**

Ans: **(₹ in lakhs)**

	A	B	Workings	Group
Assets				
Goodwill				10
PPE	627	200		827
Financial Assets:				
Investments (150 + 32)	182	0		
Cash* (200 - 32)	168	30	(200+30)-32	198
Other Current Assets	23	70		93
	1,000	300		1,128
Share Capital	200	100		200
Other Equity	800	200	870-2	868
Non-controlling interest			90-30	60

	1,000	300		1,128

*Cash has been adjusted through Individual Balance Sheet.

Q41: P Ltd. acquires 80% shares of S Ltd on 1/4/2016 for ₹ 10,00,000. At 31/03/17 the individual statements of financial position of H Ltd. and S Ltd. are:

Particulars	**P Ltd**	**S Ltd.**
	(₹)	(₹)
Assets		
Non-Current Assets		
PPE	10,00,000	8,00,000
Investment in shares of S Ltd	10,00,000	--
Current Assets	12,00,000	10,00,000
Total Assets	32,00,000	18,00,000
Equities & Liabilities		
Equity		
Share Capital	14,00,000	8,00,000
Other Equity		
Retained Earnings	10,00,000	2,00,000
Current liabilities		
Trade Payables	8,00,000	8,00,000
Total Equity & Liabilities	32,00,000	18,00,000

Additional information:

1. Fair value of NCI on the date of acquisition of shares i.e., on 1/4/2016 is ₹ 2,00,000.
2. When shares were acquired by P Ltd. in S Ltd., S Ltd had ₹ 40,000 Retained earnings.
3. P ltd. sold 10 % shares of S Ltd. on 31/03/2017 for ₹ 90,000 which is not yet adjusted in the separate financial statement of P Ltd.

Prepare Stand alone and consolidated Balance Sheet after disposal as on 31st March, 2017.

Other Sources]

[For Answer – Refer Class Notes]

LOSS OF CONTROL

Calculation of gain on outright sale of subsidiary

Q42: A parent purchased an 80% interest in a subsidiary for ₹ 1,60,000 on 1 April 20X1 when the fair value of the subsidiary's net assets was ₹ 1,75,000. Goodwill of ₹ 20,000 arose on consolidation under the partial goodwill method. An impairment of goodwill of ₹ 8,000 was charged in the consolidated financial statements to 31 March 20X3. No other impairment charges have been recorded. The parent sold its investment in the subsidiary on 31 March 20X4 for ₹ 2,00,000. The book value of the subsidiary's net assets in the consolidated financial statements on the date of the sale was ₹ 2,25,000 (not including goodwill of ₹ 12,000). When the subsidiary met the criteria to be classified as held for sale under Ind AS 105, no write down was required because the expected fair value less cost to sell (of 100% of the subsidiary) was greater than the carrying value.

The parent carried the investment in the subsidiary at cost, as permitted by Ind AS 27.

Calculate gain or loss on disposal of subsidiary in parent's separate and consolidated financial statements as on 31st March 20X4. **[ICAI SM]**

Ans: The parent's separate statement of profit and loss for 20X3-20X4 would show a gain on the sale of investment of ₹ 40,000 calculated as follow:

	₹ '000
Sale proceeds	200
Less: cost of investment in subsidiary	(160)
Gain on sale in parent's account	40

However, the group's statement of profit & loss for 20X3-20X4 would show a gain on the sale of subsidiary of ₹ 8,000 calculated as follows:

	₹'000
Sale proceeds	200
Less: share of net assets at date of disposal (₹ 2,25,000 X 80%)	(180)
Goodwill on consolidation at date of sale (W.N 1)	(12)
	(192)
Gain on sale in the group's account	8

Working Note 1

The goodwill on consolidation (assuming partial goodwill method) is calculated as follows:

	₹'000
Fair value of consideration at the date of acquisition	160
Non- controlling interest measured at proportionate share of the acquiree's	
identifiable net assets (1,75,000 X 20%)	35
Less: fair value of net assets of subsidiary at date of acquisition	(175)
	(140)
Goodwill arising on consolidation	20
Impairment at 31 March 20X3	(8)
Goodwill at 31 March 20X4	12

Partial disposal where subsidiary becomes an associate

Q43: AT Ltd. purchased a 100% subsidiary for ₹ 50,00,000 on 31st March 20X1 when the fair value of the BT Ltd. whose net assets was ₹ 40,00,000. Therefore, goodwill is ₹10,00,000. The AT Ltd. sold 60% of its investment in BT Ltd. on 31st March 20X3 for ₹ 67,50,000, leaving the AT Ltd. with 40% and significant influence. At the date of disposal, the carrying value of net assets of BT Ltd., excluding goodwill is ₹ 80,00,000. Assume the fair value of the investment in associate BT Ltd. retained is proportionate to the fair value of the 60% sold, that is ₹ 45,00,000.

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd's separate and consolidated financial statements as on 31st March 20X3. **[ICAI SM]**

Ans: AT Ltd.'s statement for profit or loss of 20X2-20X3 would show a gain on the sale of investment of ₹ 37,50,000 calculated as follows:

	₹' lakhs
Sale proceeds	67.5
Less: cost on investment in subsidiary (₹ 50,00,000 X 60%)	(30.0)
Gain on sale in the parent's financial statement	37.5

In the consolidated financial statements, the group will calculate the gain or loss on disposal differently. The carrying amount of all of the assets including goodwill is derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

The gain on the disposal will, therefore, be calculated as follows:

	₹' lakhs
Sale proceeds	67.5
Fair value of 40% interest retained	45.0
	112.5
Less: Net assets disposed, including goodwill (80,00,000+ 10,00,000)	(90.0)
Gain on sale in the group's financial statements	22.5

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of ₹ 13,50,000 [₹ 67,50,000 – (₹ 90,00,000 X 60%)] on the portion sold. However, it also includes a gain on remeasurement of the 40% retained interest of ₹ 9,00,000 (₹ 36,00,000* to ₹ 45,00,000). The entity will need to disclose the portion of the gain that is attributable to remeasuring any remaining interest to fair value, that is, ₹ 9,00,000.

* 90,00,000x 40%= 36,00,000

Partial disposal where 10% investment in former subsidiary is retained.

Q44: The facts of this example as same as example 31, except that the group AT Ltd. disposes of a 90% interest for ₹ 85,50,000, leaving the AT Ltd. with a 10% investment. The fair value of the remaining interest is ₹ 9,50,000 (assumed for simplicity to be pro rata to the fair value of the 90% sold).

Calculate gain or loss on sale of proportion of BT Ltd. in AT Ltd.'s separate and consolidated financial statements as on 31st March 20X1. **[ICAI SM]**

Ans: The parent's AT Ltd. income statement in its separate financial statements for 20X1 would show a gain on the sale of the investment of ₹ 40,50,000 calculated as follows:

	₹ in lakhs
Sale proceeds	85.5
Less: cost on investment in subsidiary (₹ 50,00,000 X 90%)	(45.0)
Gain on sale in the parent's financial statement	40.5

In the consolidated financial statements, all of the assets, including goodwill are derecognized when control is lost. This is compared to the proceeds received and the fair value of the investment retained.

	₹ in lakhs
Sale proceeds	85.5
Fair value of 10% interest retained	9.5
	95.0
Less: Net assets disposed, including goodwill (80,00,000+ 10,00,000)	(90.0)
Gain on sale in the group's financial statements	5.0

The gain on loss of control would be recorded in profit or loss. The gain or loss includes the gain of ₹ 4,50,000 related to the 90% portion sold [₹ 85,50,000 – (₹ 90,00,000 X 90%)] as well as ₹ 50,000 related to the remeasurement to fair value of 10% retained interest (₹ 9,00,000 to ₹ 9,50,000)

Subsidiary issues shares to a third party and parent loses control

Q45: In March 20X1 a group had a 60% interest in subsidiary with share capital of 50,000 ordinary shares. The carrying amount of goodwill is ₹ 20,000 at March 20X1 calculated using the partial goodwill method. On 31 March 20X1, an option held by the minority shareholders exercised the option to subscribe for a further 25,000 ordinary shares in the subsidiary at ₹ 12 per share, raising ₹ 3,00,000. The net assets of the subsidiary in the consolidated balance sheet prior to the option's exercise were ₹ 4,50,000, excluding goodwill.

Calculate gain or loss on loss of interest in subsidiary due to option exercised by minority shareholder. **[ICAI SM]**

Ans: Shareholdings

	Before		After	
	No	%	No	%
Group	30,000	60	30,000	40

Other party	20,000	40	45,000	60
	50,000	100	75,000	100
Net assets	₹'000	%	₹'000	%
Group's share	270	60	300	40
Other party's share	180	40	450	60
	450	100	750	100

Calculation of group gain on deemed disposal	**₹'000**
Fair value of 40% interest retained (₹12 X 30,000)**	360
Less:	
Net assets derecognized	(450)
Non-controlling interest derecognized	180
Goodwill	(20)
Gain on deemed disposal	70

** Note: For simplicity, it has been assumed the fair value per share is equal to the subscription price.

As control of the subsidiary is lost, the retained interest is recognized at its fair value at the date control is lost. The resulting remeasurement gain is recognized in profit and loss.

Q46: Reliance Ltd. has a number of wholly-owned subsidiaries including Reliance Jio Infocomm Ltd. at 31st March 20X2.

Reliance Ltd. consolidated statement of financial position and the group carrying amount of Reliance Jio Infocomm Ltd. assets and liabilities (ie the amount included in that consolidated statement of financial position in respect of Reliance Jio Infocomm Ltd. assets and liabilities) at 31st March 20X2 are as follows

Particulars	**Consolidated (₹ In '000)**	**Group carrying amount of Reliance Jio Infocomm Ltd. asset and liabilities Ltd. (₹ In '000)**
Assets		
Non-current Assets		
- Goodwill	190	90
- Buildings	1,620	670
Current Assets		
- Inventories	70	20
- Trade Receivables	850	450
- Cash	1,550	500
Total Assets	4,280	1,730
Equities & Liabilities		
Equity		
- Share Capital	800	
Other Equity		

- Retained Earnings	2,130	
	2,930	
Current liabilities		
- Trade Payables	1,350	450
Total Equity & Liabilities	4,280	450

Prepare consolidated Balance Sheet after disposal as on 31st March, 20X2 when Reliance Ltd. group sold 90% shares of Reliance Jio Infocomm Ltd. to independent party for ₹ 1000 (' 000).

[ICAI SM]

Ans: When 90% shares sold to independent party Consolidated Balance Sheet of Reliance Ltd. and its remaining subsidiaries as on 31st March, 20X2

Particulars	Note No.	(₹ In '000)
Assets		
Non-current assets		
Property Plant & Equipment	1	950
Goodwill	2	100
Financial Assets		
Investments	3	128
Current Assets		
Inventories	4	50
Financial Assets		
Trade Receivables	5	400
Cash & Cash equivalents	6	2,050
Total Assets		3,678
Equity and Liabilities		
Equity		
Equity Share Capital	7	800
Other Equity	8	1,978
Current Liabilities		
Financial Liabilities		
Trade Payables	9	900
Total Equity & Liabilities		3,678

Statement of changes in Equity:

1. **Equity share Capital**

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
800	0	800

2. **Other Equity**

	Share	Equity	Reserves & Surplus	Total

	application money	component	Capital reserve	Retained Earnings	Securities Premium	
Balance at the beginning				2,130		2,130
Total comprehensive income for the year			0			
Dividends			0			
Total comprehensive			0			
Incom attributable to parent						
Loss on disposal of Reliance Jio Infocomm Ltd.				(152)		(152)
Balance at the end of reporting period			0	1,978		1,978

Working Notes:

1. When 90% being sold, the carrying amount of all assets and liabilities attributable to Reliance Jio Infocomm Ltd. were eliminated from the consolidated balance sheet and further financial asset is recognized for remaining 10%.

2. Carrying value of remaining investment (in '000):

Net Assets of Reliance Ltd. *Less*: 90% disposal	1,280 (1152)
Financial Asset	128

3. Cash on hand (in '000):

Cash before disposal of Reliance Jio Infocomm Ltd. *Less*: Reliance Jio Infocomm Ltd. Cash *Add*: Cash realized from disposal	1,550 (500) 1,000
Cash on Hand	2,050

4. Gain/ Loss on disposal of entity (in '000):

Proceeds from disposal *Less*: Proportionate (90%) Net assets of Reliance Jio Infocomm Ltd. (90% of 1,280)	1,000 (1,152)
Loss on disposal	(152)

5. Retained Earnings (in '000):

Retained Earnings before disposal *Less*: Loss on disposal	2,130 (152)
Retained earnings after disposal	1,978

Q47: P Ltd. acquires 80% of the share capital of S Ltd two years ago, when the reserve of S Ltd. stood at ₹ 1,25,000. P Ltd. paid initial cash consideration of ₹1 million. Additionally P ltd. issue 2,00,000 shares at nominal value of ₹ 1 and current market value of ₹ 1.80. It was also agreed that P Ltd. would pay a further ₹ 5,00,000 in three year time. Current interest rate are 10% pa. The appropriate discount factor for ₹ 1 receivable three years from now is 0.751. The shares and deferred consideration have not been recorded.

At 31/12/2004 the individual statements of financial position of P Ltd. and S Ltd. are:

Particulars	**P Ltd**	**S Ltd.**
	(₹ In 000)	**(₹ in 000)**
Assets		
Non-Current Assets		
PPE	5,500	1,500
Investment in shares of S Ltd	1,000	
Current Assets		
Inventory	550	100
Receivable	400	200
Cash	200	50
Total Assets	**7,650**	**1,850**
Equities & Liabilities		
Equity		
Share Capital	2,000	500
Other Equity		
Retained Earnings	1,400	300
Non-current Liability	3,000	400
Current liabilities	1,250	650
Total Equity & Liabilities	**7,650**	**1,850**

Additional Information

a) At acquisition the fair value of S ltd. plant exceeded its book value by ₹ 2,00,000. The plant had a remaining useful life of five year at this date

b) For many years S Ltd has been selling some of its product under the brand name of M Ltd. at the date of acquisition the directors of P Ltd valued this brand at ₹ 2,50,000 with a remaining useful life of 10 years. The brand is not included in S balance Sheet.

c) The consolidated goodwill has been impaired by ₹ 2,58,000.

d) The P Ltd. Group values the NCI using the fair value method. At acquisition the fair value of 20% NCI was ₹ 3,80,000.

e) On 1/1/2005 P Ltd. sold 60% of shares of S Ltd. to independent party for ₹ 60 per share.

Prepare Consolidated Balance Sheet immediately before and after disposal of shares.

[For Answer – Refer Class Notes]

Q48: As at the beginning of its current financial year, AB Limited holds 90% equity interest in BC Limited. During the financial year, AB Limited sells 70% of its equity interest in BC Limited to PQR Limited for a total consideration of ₹ 56 crore and consequently loses control of BC Limited. At the date of disposal, fair value of the 20% interest retained by AB Limited is ₹ 16 crore and the net assets of BC Limited are fair valued at ₹ 60 crore.

These net assets include the following:

(a) Debt investments classified as fair value through other comprehensive income (FVOCI) of ₹ 12 crore and related FVOCI reserve of ₹ 6 crore.

(b) Net defined benefit liability of ₹ 6 crore that has resulted in a reserve relating to net measurement losses of ₹ 3 crore.

(c) Equity investments (considered not held for trading) of ₹ 10 crore for which irrevocable option of recognising the changes in fair value in FVOCI has been availed and related FVOCI reserve of ₹ 4 crore.

(d) Net assets of a foreign operation of ₹ 20 crore and related foreign currency translation reserve of ₹ 8 crore.

In consolidated financial statements of AB Limited, 90% of the above reserves were included in equivalent equity reserve balances, with the 10% attributable to the non-controlling interest included as part of the carrying amount of the non-controlling interest. **[ICAI SM]**

Ans: Paragraph 25 of Ind AS 110 states that if a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.

(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest."

Paragraph B98(c) of Ind AS 110 states that on loss of control over a subsidiary, a parent shall reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind AS, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis specified in paragraph B99.

As per paragraph B99, if a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.

Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

In view of the basis in its consolidated financial statements, AB Limited shall:

(a) re-classify the FVOCI reserve in respect of the debt investments of ₹5.4 crore (90% of ₹ 6 crore) attributable to the owners of the parent to the statement of profit or loss in accordance with paragraph B5.7.1A of Ind AS 109, Financial Instruments which requires that the cumulative gains or losses previously recognised in OCI shall be recycled to profit and loss upon derecognition of the related financial asset. This is reflected in the gain on disposal. Remaining 10% (i.e., ₹ 0.6 crore) relating to non-controlling interest (NCI) is included as part of the carrying amount of the non-controlling interest that is derecognised in calculating the gain or loss on loss of control of the subsidiary;

(b) transfer the reserve relating to the net measurement losses on the defined benefit liability of ₹ 2.7 crore (90% of ₹3 crore) attributable to the owners of the parent within equity to retained earnings. It is not reclassified to profit or loss. The remaining 10% (i.e., ₹ 0.3 crore) attributable to the NCI is included as part of the carrying amount of NCI that is derecognised in calculating the gain or loss on loss of control over the subsidiary. No amount is reclassified to profit or loss, nor is it transferred within equity, in respect of the 10% attributable to the non- controlling interest.

(c) reclassify the cumulative gain on fair valuation of equity investment of ₹3.6 crore (90% of ₹ 4 crore) attributable to the owners of the same parent from OCI to retained earnings under equity as per paragraph B5.7.1 of Ind AS 109, Financial Instruments, which provides that in case an entity has made an irrevocable election to recognise the changes in the fair value of an investment in an equity instrument not held for trading in OCI, it may subsequently transfer the cumulative amount of gains or loss within equity. Remaining 10% (i.e., ₹ 0.4 crore) related to the NCI are derecognised along with the balance of NCI and not reclassified to profit and loss.

(d) reclassify the foreign currency translation reserve of ₹7.2 crore (90% × ₹ 8 crore) attributable to the owners of the parent to statement of profit or loss as per paragraph 48 of Ind AS 21, The Effects of Changes in Foreign Exchange Rates, which specifies that the cumulative amount of exchange differences relating to the foreign operation, recognised in OCI, shall be reclassified from equity to profit or loss on the disposal of foreign operation. This is reflected in the gain on disposal. Remaining 10% (i.e., ₹ 0.8 crore) relating to the NCI is included as part of the carrying amount of the NCI that is derecognised in calculating the gain or loss on the loss of control of subsidiary, but is not reclassified to profit or loss in pursuance of paragraph 48B of Ind AS 21, which provides that the cumulative exchange differences relating to that foreign operation attributed to NCI shall be derecognised on disposal of the foreign operation, but shall not be reclassified to profit or loss

The impact of loss of control over BC Limited on the consolidated financial statements of AB Limited is summarised below: (Rupees in crore)

Particular	Amount (Dr)	Amount (Cr)	PL Impact	RE Impact
Gain /Loss on Disposal on Investments				
Bank	56			
Non-controlling interest (Derecognised)	6			
Investment at FV (20% Retained)	16			
Gain on Disposal (PL) balancing figure		18	18	
De-recognition of total net assets of subsidiary		60		
Reclassification of FVTOCI reserve on debt instruments to profit or loss				
FVTOCI reserve on debt instruments (6 cr. x 90%)	5.4			
To Profit and loss		5.4	5.4	
Reclassification of net measurement loss reserve to profit or loss				
Reserve and Surplus	2.7			-2.7
To Net measurement loss reserve (FVTOCI) [(3 cr. x 90%)]		2.7		
Reclassification of FVTOCI reserve on equity instruments to retained earnings				
FVTOCI reserve on equity instruments (4 cr.x 90%)	3.6			
To Reserve and Surplus		3.6		3.6
Foreign currency translation reserve reclassified to profit or loss				
Foreign currency translation reserve (FVOCI) [8 cr. x 90%]	7.2			
To Profit and loss		7.2	7.2	
Total			30.6	0.9

CHAIN HOLDING

Q49: Prepare the Consolidated Balance Sheet as on 31st March, 20X2 of a group of companies comprising P Limited, S Limited and SS Limited. Their balance sheets on that date are given below

₹in lakhs

	P Ltd.	S Ltd.	SS Ltd.
Assets			
Non-Current Assets			
Property, Plant and Equipment	320	360	300

Investment :			
32 lakhs shares in S Ltd.	340		
24 lakhs shares in SS Ltd.		280	
Current Assets			
Inventories	220	70	50
Financial Assets			
Trade Receivables	260	100	220
Bills Receivable	72	-	30
Cash in hand and at Bank	228	40	40
Equity and Liabilities	1440	850	640
Shareholder's Equity			
Share capital (₹ 10 per Share)	600	400	320
Other Equity			
Reserves	180	100	80
Retained earnings	160	50	60
Current Liabilities			
Financial Liabilities			
Trade Payables	470	230	180
Bills Payable			
P Ltd.		70	
SS Ltd.	30		
	1440	**850**	**640**

The following additional information is available:

(i) P Ltd. holds 80% shares in S Ltd. and S Ltd. holds 75% shares in SS Ltd. Their holdings were acquired on 30th September, 20X1.

(ii) The business activities of all the companies are not seasonal in nature and therefore, it can be assumed that profits are earned evenly throughout the year.

(iii) On 1st April, 20X1 the following balances stood in the books of S Limited and SS Limited.

₹ in lakhs

	S Limited	**SS Limited**
Reserves	80	60
Retained earnings	20	30

(iv) ₹ 10 lakhs included in the inventory figure of S Limited, is inventory which has been purchased from SS Limited at cost plus 25%. The sale of goods by SS Ltd. is done after acquisition of shares by S Ltd.

(v) The parent company has adopted an accounting policy to measure non-controlling interest at fair value (quoted market price) applying Ind AS 103. Assume market prices of S Limited and SS Limited are the same as respective face values.

[MTP May 2020]

Ans: Consolidated Balance Sheet of the Group as on 31st March, 20X2

Particulars	Note No.	(₹ in lakh)
ASSETS		
Non-current assets		
Property, plant and equipment	1	980
Current assets		
(a) Inventory	2	338
(b) Financial assets		
Trade receivables	3	580
Bills receivable	4	2
Cash and cash equivalents	5	308
Total assets		**2,208**
EQUITY & LIABILITIES		
Equity attributable to owners of the parent		
Share capital		600
Other Equity		
Reserves (W.N.5)		194
Retained Earnings (W.N.5)		179.8
Capital Reserve (W.N.3)		188
Non-controlling interests (W.N.4)		166.2
Total equity		**1,328**
LIABILITIES		
Non-current liabilities		Nil
Current liabilities		
(a) Financial Liabilities		
(i) Trade payables	6	880
Total liabilities		880
Total equity and liabilities		**2,208**

Notes to Accounts **(₹ in lakh)**

1.	**Property, Plant & Equipment**		
	P Ltd.	320	
	S Ltd.	360	
	SS Ltd.	300	980
2.	**Inventories**		
	P Ltd.	220	
	S Ltd. (70-2)	68	
	SS Ltd.	50	338
3.	**Trade Receivables**		
	P Ltd.	260	
	S Ltd.	100	
	SS Ltd.	220	580
4.	**Bills Receivable**		
	P Ltd. (72-70)	2	
	SS Ltd. (30-30)	-	2
5.	**Cash & Cash equivalents**		
	P Ltd.	228	
	S Ltd.	40	
	SS Ltd.	40	308
6.	**Trade Payables**		
	P Ltd.	470	
	S Ltd.	230	
	SS Ltd.	180	880

Working Notes:

1. Analysis of Reserves and Surplus **(₹ in lakh)**

		S Ltd.		**SS Ltd.**
Reserves as on 31.3.20X1		80		60
Increase during the year 20X1-20X2	20		20	
Increase for the half year till 30.9.20X1		10		10
Balance as on 30.9.20X1 (A)		**90**		**70**
Total balance as on 31.3.20X2		100		80
Post-acquisition balance		**10**		**10**

		S Ltd.		**SS Ltd.**
Retained Earnings as on 31.3.20X1		20		30
Increase during the year 20X1-20X2	30		30	
Increase for the half year till 30.9.20X1		15		15
Balance as on 30.9.20X1 (B)		**35**		**45**
Total balance as on 31.3.20X2		50		60
Post-acquisition balance		15		15
Less: Unrealised Gain on inventories (10 x 25%)		-		(2)
Post-acquisition balance for CFS		**15**		**13**

Total balance on the acquisition date ie.30.9.20X1 (A +B)		**125**		**115**

2. Calculation of Effective Interest of P Ltd. in SS Ltd.

Acquisition by P Ltd. in S Ltd.	= 80%
Acquisition by S Ltd. in SS Ltd.	= 75%
Acquisition by Group in SS Ltd. (80% x 75%)	= 60%
Non-Controlling Interest	= 40%

3. Calculation of Goodwill / Capital Reserve on the acquisition date

	S Ltd.	SS Ltd.
Investment or consideration	340	(280 × 80%) 224
Add: NCI at Fair value		
(400 x 20%)	80	
(320 x 40%)	----------	128
	420	352
Less: Identifiable net assets (Share capital + Increase in the Reserves and Surplus till acquisition date)	(400+125) (525)	(320+115) (435)
Reserves and Surplus till acquisition date)	(400 + 125) (525)	(320 + 115) (435)
Capital Reserve	105	83
Total Capital Reserve (105 + 83)	188	

4. Calculation of Non-Controlling Interest

	S Ltd.	SS Ltd.
At Fair Value (See Note 3)	80	128
Add: Post Acquisition Reserves (See Note 1)	(10× 20%) 2	(10× 40%) 4
Add: Post Acquisition Retained Earnings (See Note 1)	(15× 20%) 3	(13× 40%) 5.2
Less: NCI share of investment in SS Ltd.	(280x20%) (56)*	______
	29	137.2
Total (29+ 137.2)	166.2	

* **Note:** The Non-controlling interest in S Ltd. will take its proportion in SS Ltd. so they have to bear their proportion in the investment by S Ltd. (in SS Ltd.) also.

5. Calculation of Consolidated Other Equity

	Reserves	Retained Earnings
P Ltd.	180	160

Add: Share in S Ltd.	(10 x 80%) 8	(15× 80%) 12
Add: Share in SS Ltd.	(10× 60%)6	(13× 60%)7.8
	194	179.8

Q50: The balance sheet of three companies Anand Ltd., Bajaj Ltd. and Charan Ltd. as on 31st December 2001 are given below:

Liabilities	**Anand Ltd. ₹**	**Bajaj Ltd. ₹**	**Charan Ltd. ₹**
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
Sundry Creditors	20,000	25,000	15,000
Anand Ltd.		10,000	8,000
TOTAL	**2,40,000**	**1,75,000**	**1,15,500**
Assets			
Good will	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	---
Due from Bajaj Ltd.	12,000	---	---
Charan Ltd.	8,000	---	---
Current Assets	25,000	58,000	45,500
	2,40,000	**11,75,000**	**1,15,500**

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

	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 5% 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 ₹ 10,000 which is sold to Bajaj Ltd. for ₹ 12,000, Bajaj Ltd. then sold the machine to Anand Ltd., for ₹ 13,000, the transactions being completed on 31st December, 2001.

Prepare the consolidated Balance Sheet of the Group as on 31st December, 2001. **[Other Sources]**

[For Answer – Refer Class Notes]

SAME REPORTING DATES

Q51: Consider the following summarised balance sheets:

	A Ltd.	B Ltd.		A Ltd.	B Ltd.
	(As on	(As on		(As on	(As on
	31.3.20X2)	31.12.20X1)		31.3.20X2)	31.12.20X1)
Share Capital			Fixed Assets	6,50,000	4,05,000
(Shares of ₹ 10 each)	10,00,000	5,00,000	Investment:		
Reserves and Surplus	4,50,000	2,05,000	40,000 Shares in B Ltd.	8,00,000	—
Secured Loan:					
13% Loan	—	3,00,000	13% Loan Receivable From B Ltd.	1,50,000	—
Current Liabilities:			Current Assets:		
Trade payables	3,80,000	80,000	Inventory	2,00,000	3,50,000
Other liabilities	2,00,000	40,000	Trade Receivables	1,50,000	2,65,000
			Cash and Bank	80,000	1,05,000
	20,30,000	**11,25,000**		**20,30,000**	**11,25,000**

On 5th January 20X2, certain inventory of B Ltd. costing ₹ 20,000 were completely destroyed by fire. The insurance company paid 75% of the claim.

On 20th January, 20X2, A Ltd. sold goods to B Ltd. costing ₹ 1,50,000 at an invoice price of cost plus 20%. 50% of those goods were resold by B Ltd. to A Ltd. within 31st March, 20X2 (these were then sold by A Ltd. to a third party before 31st March, 20X2). As on 31st March, 20X2, B Ltd. owes ₹ 60,000 to A Ltd. in respect of those goods. Pre-acquisition profits of B Ltd. were ₹ 75,000.

Prepare consolidated balance sheet as on 31st March, 20X2 after making necessary adjustments in the balance sheet of B Ltd. **[ICAI SM – Old Syllabus]**

Ans: Consolidated Balance Sheet of A Ltd. and its subsidiary B Ltd. As on 31st March, 2017

Particulars	Note No.	(₹)
1. Assets		
(1) Non-current assets		
PPE		10,55,000

- Goodwill		3,40,000
- **Financial Assets**		
Loan (1,50,000 – 1,50,000)		-
(2) Current assets		
- Inventories (2,00,000 +4,20,000 – 15,000)		6,05,000
- **Financial Assets**		
Trade receivables (1,50,000 +2,65,000 – 60,000)		3,55,000
- Cash & Cash equivalents (80,000 +1,10,250)		1,90,250
Total		25,45,250
I. Equity and Liabilities		
- **Equity**		
Share Capital		10,00,000
Other Equity (W.N.5.)		5,51,200
NCI (W.N 3.)		1,44,050
(3) Non-current liabilities		
- Financial Liability		
Borrowings **(3,00,000 – 1,50,000)**		1,50,000
(4) Current Liabilities		
- Financial Liability		
Trade Payables (3,80,000 + 1,40,000 – 60,0000)		4,60,000
- Other current liabilities (₹ 2,00,000 + ₹ 40,000)		2,40,000
Total		25,45,250

Working Notes:

1. Adjustments to be made in the balance sheet items of B Ltd.:

Assets side	₹
Inventories:	
As given on 31.12.2016	3,50,000
Add : Unsold Inventory out of goods purchased from A Ltd.	90,000
	4,40,000
Less: Loss of Inventory by fire	(20,000)
Cash & Bank balance:	4,20,000
As given on 31.12.2016	1,05,000
Add: Insurance claim received [20,000 × 75 %]	15,000
Less: Interest Paid on Loan (3,00,000 x 13% x 3/12)	9,750
	1,10,250
Liabilities side:	₹
Trade payables:	

As given on 31.12.2016	80,000
Add: Owings to A Ltd. on 31.3.2017	60,000
	1,40,000
Reserves and Surplus:	
As given on 31.12.2016	2,05,000
Less: Abnormal Loss on goods destroyed [20,000 – 15,000]	(5,000)
	2,00,000
Add: Profit from sale of goods purchased from A Ltd.	30,000
Less: Interest Expense	9,750
	2,20,250

2. Goodwill / capital reserve on consolidation:

	₹	₹
Amount paid for 40,000 Shares		8,00,000
Less: Nominal value of proportionate share capital	4,00,000	
Share of pre-acquisition profits (80% of ₹ 75,000)	60,000	(4,60,000)
Goodwill		3,40,000

3. NCI: (10,000 / 50,000 shares) = 20%

	₹
Initial Value of NCI by Using PSINA Method (5,00,000 +75,000) x 20%	1,15,000
Add: 20% of Reserves & Surplus of B Ltd. 20% of (2,20,250 -75,000)	29,050
	1,44,050

4. Other Equity of A Ltd.:

Balance as on 31.3.2017	4,50,000
Add: Share of revenue reserves of B Ltd.	
([80% of ₹ (2,20,250 -75,000))]	1,16,200
	5,66,200
Less: Unrealised profit on Inventory (90,000x1/6]	(15,000)
	5,51,200

UNIFORM ACCOUNTING POLICIES

Q52: Consider the following balance sheets of subsidiary B Ltd.:

	2004	2005		2004	2005
	₹	₹		₹	₹
Share-Capital			Fixed Assets		
Issued & subscribed			Cost	3,20,000	3,20,000
5,000 equity shares			Less:		

			Accumulated		
of ₹ 100 each	5,00,000	5,00,000	depreciation	48,000	96,000
Reserves & Surplus				2,72,000	2,24,000
Revenue reserves	2,86,000	7,14,000	Investments at cost	—	4,00,000
Current Liabilities &					
Provisions:			Current Assets:		
Sundry Creditors	4,90,000	4,94,000	Stock	5,97,000	7,42,000
Bank overdraft	—	1,70,000	Sundry Debtors	5,94,000	8,91,000
Provision for taxation	3,10,000	4,30,000	Prepaid Expenses	72,000	48,000
			Cash at Bank	51,000	3,000
	15,86,000	**23,08,000**		**15,86,000**	**23,08,000**

Consider also the following information:

(a) B Ltd. is a subsidiary of A Ltd. Both the companies follow calendar year as the accounting year.

(b) A Ltd. values stocks on LIFO basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd. its value of stock is required to be reduced by ₹ 12,000 at the end of 2004 and ₹ 34,000 at the end of 2005.

(c) Both the companies use straight-line method of depreciation. However A Ltd. charges depreciation @ 10%.

(d) B Ltd. deducts 1% from sundry debtors as a general provision against doubtful debts.

(e) Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 2004 and ₹ 30,000 in 2005, being part of initial advertising expenditure of ₹ 90,000 in 2004 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 2004.

Restate the balance sheet of B Ltd. as on 31st December, 2005 after considering the above information for the purpose of consolidation. Such restatement is necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform. **[ICAI SM – Old Syllabus]**

Ans: Adjusted revenue reserves of B Ltd.:

	₹	₹
Revenue reserves as given		7,14,000
Less: Reduction in value of Inventory	34,000	
Advertising expenditure to be written off	30,000	(64,000)
Adjusted revenue reserve		6,50,000

Restated Balance Sheet of B Ltd.as at 31st December, 2005

Particulars	Note No.	(₹)
II. Assets		
(1) Non-current assets		
- PPE		2,24,000
- Financial Assets		
Investment		4,00,000
(2) Current assets		
- Inventories [7,42,000 – 34,000]		7,08,000
- Financial Assets		
Trade Receivables		8,91,000
Cash & Cash Equivalents		3,000
- Other current assets (48,000 – 30,000)		18,000
Total		22,44,000
I. Equity and Liabilities		
- Equity		
Equity Share Capital		5,00,000
Other Equity		6,50,000
2. Current Liabilities		
- Financial Liability		
Borrowings		1,70,000
Trade Payables		4,94,000
- Provision		4,30,000
Total		22,44,000

Note: Rate of depreciation and provision for doubtful debt are accounting estimates and therefore adjustment is not required to ensure uniform accounting policies.

CONSOLIDATED SOPL

Q53: Given below are the Profit & Loss Account of H Ltd. and its subsidiary Ltd. for the year ended 31st March, 2015:

	H Ltd. (₹ In Lacs)	**S. Ltd. (₹ In lacs)**
Incomes:		
Sales and other income	5,000	1,000
Increase in stock	1,000	200
	6,000	1,200
Expenses:		
Raw material consumed	800	200
Wages and Salaries	800	150
Production expenses	200	100
Administrative Expenses	200	100
Selling and Distribution Expenses	200	50
Interest	100	50

Depreciation	100	50
	2,400	700
Profit before tax Provision for tax	3,600 1,200	500 200
Profit after tax	2,400	300

Other information:

1. H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. The share were acquired on 1/4/2013

2. Goodwill impairment at 31/03/2014 amounted to ₹ 100 lacs. A further impairment of ₹ 40 lacs was found necessary at year end.

3. H Ltd. sold goods to S Ltd. of ₹ 120 lacs at cost plus 20%. Stock of S Ltd. includes such goods valuing ₹ 24 lacs. Administrative Expenses of S Ltd. include ₹ 5 lacs paid to H Ltd. As consultancy fees. Selling and Distribution expenses of H Ltd. include ₹ 10 lacs paid to S Ltd. as commission.

4. Additional fair value depreciation for the current year amounted to ₹ 10 Lacs.

Prepare Consolidated Profit & Loss Account **[ICAI SM]**

Ans:

Consolidated Profit & Loss Account of H Ltd. and its subsidiary S Ltd.

for the year ended on 31st March, 2015

	Particulars	**Note No.**	**₹ in Lacs**
I.	Revenue from operations	1	5,865
II.	Total revenue		5,865
III.	Expenses		
	Cost of Material purchased/Consumed	3	1,180
	Changes of Inventories of finished goods	2	(1,196)
	Employee benefit expense	4	950
	Finance cost	6	150
	Depreciation and amortization expense	7	200
	Other expenses	5	535
	Total expenses		1,819
IV.	Profit before Tax (II-III)		4,046
V.	Tax Expenses	8	1,400
VI.	Profit After Tax		2,646
	Attributable to Parent		2,596
	Attributable to NCI	9	50
	Notes to Accounts	**₹ in Lacs**	**₹ in Lacs**
1.	Revenue from Operations		
	Sales and other income		

	H Ltd.	5,000	
	S Ltd.	1,000	
			6,000
	Less: Inter-company Sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Increase in Inventory		
	H Ltd.	1,000	
	S Ltd.	200	
			1,200
	Less: Unrealised profits ₹ 24 lacs × 20/120	(4)	1,196
			7,061
3.	Cost of Material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
			1,000
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct Expenses		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
4.	Employee benefits and expenses		
	Wages and Salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Other Expenses		
	Administrative Expenses		
	H Ltd.	200	
	S Ltd.	100	
			300
	Less: Consultancy fees received by H Ltd. from S Ltd.	(5)	295
	Selling and Distribution Expenses:		
	H Ltd.	200	
	S Ltd.	50	
			250
	Less: Commission received from S Ltd. from H Ltd.	(10)	240
			535
6.	Finance Cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150

7.	Depreciation and Amortisation		
	Depreciation:		
	H Ltd.	100	
	S Ltd.	50	
	Additional impairment of goodwill	40	
	Additional depreciation	10	200
8.	Provision for tax		
	H Ltd.	1,200	
	S. Ltd.	200	1,400
9	Calculation of profit attributable to NCI		
	Profit of Subsidiary		300
	Less: goodwill impairment		40
	Less: Additional depreciation		10
			250
	Profit attributable to NCI 250 X 20%		50

CONTROL

Q54: Angel Ltd. has adopted Ind AS with a transition date of 1st April, 2017. Prior to Ind AS adoption, it followed Accounting Standards notified under Companies (Accounting Standards) Rules, 2006 (hereinafter referred to as "IGAAP").

It has made investments in equity shares of Pharma Ltd., a listed company engaged in the business of pharmaceuticals. The shareholding pattern of Pharma Ltd. is given below:

Shareholders (refer Note 1)	**Percentage shareholding as on 1st April, 2017**
Angel Ltd.	21%
Little Angel Ltd. (refer Note 2)	24%
Wealth Master Mutual Fund (refer Note 3)	3%
Individual public shareholders (refer Note 4)	52%

Notes:

(1) None of the shareholders have entered into any shareholders' agreement.

(2) Little Angel Ltd. is a subsidiary of Angel Ltd. (under Ind AS) in which Angel Ltd. holds 51% voting power.

(3) Wealth Master Mutual Fund is not related party of either Little Angel Ltd. or Pharma Ltd.

(4) Individual public shareholders represent 17,455 individuals. None of the individual shareholders hold more than 1% of voting power in Pharma Ltd.

All commercial decisions of Pharma Ltd. are taken by its directors who are appointed by a simple majority vote of the shareholders in the annual general meetings ("AGM "). The following table shows the voting pattern of past AGMs of Pharma Ltd.:

Shareholders	AGM for the financial year:		
	2013-14	2014-15	2015-16
Angel Ltd.	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions	Attended and voted in favour of all the resolutions
Little Angel Ltd.	Attended and voted as per directions of Angel Ltd.	Attended and voted as per directions of Angel Ltd	Attended and voted as per directions of Angel Ltd
Wealth Master Mutual Fund	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the reappointment of the retiring directors	Attended and voted in favour of all the resolutions except for the Reappointment of the retiring directors
Individuals	7% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.	8% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.	6% of the individual shareholders attended the AGM. All the individual shareholders voted in favour of all the resolutions, except that 50% of the individual Shareholders voted against the resolution to appoint the retiring directors.

Pharma Ltd. has obtained substantial long term borrowings from a bank. The loan is payable in 20 years from 1st April, 2017. As per the terms of the borrowing, following actions by Pharma Ltd. will require prior approval of the bank:

- Payment of dividends to the shareholders in cash or kind;
- Buyback of its own equity shares;
- Issue of bonus equity shares;
- Amalgamation of Pharma Ltd. with any other entity; and
- Obtaining additional loans from any entity.

Recently, the Board of Directors of Pharma Ltd. proposed a dividend of ₹ 5 per share. However, when the CFO of Pharma Ltd. approached the bank for obtaining their approval, the bank rejected the proposal citing concerns over the short-term cash liquidity of Pharma Ltd. Having learned about the developments, the Directors of Angel Ltd. along with the Directors of Little Angel Ltd. approached the bank with a request to re-consider its decision. The Directors of Angel Ltd. and Little Angel Ltd. urged the bank to approve a reduced dividend of at least ₹ 2 per share. However, the bank categorically refused to approve any payout of dividend.

Under IGAAP, Angel Ltd. has classified Pharma Ltd. as its associate. As the CFO of Angel Ltd., you are required to comment on the correct classification of Pharma Ltd. on transition to Ind AS. **[RTP May 2019]**

Ans: To determine whether Pharma Limited can be continued to be classified as an associate on transition to lnd AS, we will have to determine whether Angel Limited controls Pharma Limited as defined under Ind AS 110.

An investor controls an investee if and only if the investor has all the following:

(a) Power over investee

(b) Exposure, or rights, to variable returns from its involvement with the investee

(c) Ability to use power over the investee to affect the amount of the investor's returns.

Since Angel Ltd. does not have majority voting rights in Pharma Ltd. we will have to determine whether the existing voting rights of Angel Ltd. are sufficient to provide it power over Pharma Ltd.

Analysis of each of the three elements of the definition of control:

Elements / conditions	Analysis
Power over investee	Angel Limited along with its subsidiary Little Angel Limited (hereinafter referred to as "the Angel group") does not have majority voting rights in Pharma Limited. Therefore, in order to determine whether Angel group have power over Pharma Limited. we will need to analyse whether Angel group, by virtue of its non- majority voting power, have *practical ability to unilaterally direct the relevant activities* of Pharma Limited. In other words, we will need to analyse whether Angel group has *de facto* power over Pharma Limited. Following is the analysis of *de facto* power of Angel over Pharma Limited: The public shareholding of Pharma Limited (that is, 52% represents thousands of shareholders none individually holding material shareholding, The actual participation of Individual public shareholders in the general meetings is minimal (that is, in the range of 6% to 8%).

	Even the public shareholders who attend the meeting do not consult with each other to vote. Therefore, as per guidance of Ind AS 110, the public shareholders will not be able to outvote Angel group (who is the largest shareholder group) in any general meeting. Based on the above-mentioned analysis, we can conclude that Angel group has *de facto* power over Pharma Limited.
Exposure, or rights, to variable returns from its involvement with the investee	Angel group has exposure to variable returns from its involvement with Pharma Limited by virtue of its equity stake.
Ability to use power over the investee to affect the amount of the investor's returns	Angel group has ability to use its power (in the capacity of a principal and not an agent) to affect the amount of returns from Pharma Limited because it is in the position to appoint directors of Pharma Limited who would take all the decisions regarding relevant activities of Pharma Limited. Here, it is worthwhile to evaluate whether certain rights held by the bank would prevent Angel Limited's ability to use the power over Pharma Limited to affect its returns. It is to be noted that, all the rights held by the bank in relation to Pharma Limited are protective in nature as they do not relate to the relevant activities (that is, activities that significantly affect he Pharma Limited's returns) of Pharma Limited. As per Ind AS 110, protective rights are the rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate. Therefore, the protective rights held by the bank should not be considered while evaluating whether or not Angel Group has control over Pharma Limited.

Conclusion: Since all the three elements of definition of control is present, it can be concluded that Angel Limited has control over Pharma Limited.

Since it has been established that Angel Limited has control over Pharma Limited, upon transition to Ind AS, Angel Limited shall classify Pharma Limited as its subsidiary.

JOINT OPERATION

Q55: P and Q form a joint arrangement PQ using a separate vehicle. P and Q each own 50% of the Capital in PQ. However, the contractual terms of the joint arrangement state that P has the rights to all of Machinery and the obligation to pay Bank Loan in PQ. P and Q have rights to all other assets in PQ, and obligations for all other liabilities in PQ in proportion to their capital share (i.e., 50%).

PQ's balance sheet is as follows (in ₹):

Balance sheet			
Liabilities	**₹**	**Assets**	**₹**
Capital	1,50,000	Machinery	2,50,000
Bank Loan	75,000	Cash	50,000
Other Loan	75,000		
	3,00,000		3,00,000

What would you record in P's financial statements to account for its rights and obligations in PQ? **[ICAI SM]**

Ans: Under Ind AS 111, P should record the following in its financial statements, to account for its rights in the assets of PQ and its obligations for the liabilities of PQ.

Machinery	2,50,000
Cash	25,000
Bank Loan	75,000
Other Loan	37,500

Q56: AB Limited and BC Limited establish a joint arrangement through a separate vehicle PQR, but the legal form of the separate vehicle does not confer separation between the parties and the separate vehicle itself. Thus, both the parties have rights to the assets and obligations for the liabilities of PQR. As neither the contractual terms nor the other facts and circumstances indicate otherwise, it is concluded that the arrangement is a joint operation and not a joint venture.

Both the parties own 50% each of the equity interest in PQR. However, the contractual terms of the joint arrangement state that AB Limited has the rights to all of Building No. 1 owned by PQR and the obligation to pay all of the debt owed by PQR to a lender XYZ. AB Limited and BC Limited have rights to all other assets in PQR, and obligations for all other liabilities of PQR in proportion of their equity interests (i.e. 50% each).

PQR's balance sheet is as follows (all amounts in INR):

Liabilities and equity	**Amount**	**Assets**	**Amount**

Debt owed to XYZ	240	Cash	40
Employee benefit plan obligation	100	Building 1	240
Equity	140	Building 2	200
Total	480	Total	480

How would AB Limited present its interest in PQR in its financial statements? **[ICAI SM]**

Ans: Paragraph 20 of Ind AS 111 states that "a joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly."

The rights and obligations, as specified in the contractual arrangement, that an entity has with respect to the assets, liabilities, revenue and expenses relating to a joint operation might differ from its ownership interest in the joint operation. Thus a joint operator needs to recognise its interest in the assets, liabilities, revenue and expenses of the joint operation on the basis (bases) specified in the contractual arrangement, rather than in proportion of its ownership interest in the joint operation.

Thus, AB Limited would record the following in its financial statements, to account for its rights to the assets of PQR and its obligations for the liabilities of PQR.

	Amount
Assets	
Cash	20
Building 1*	240
Building 2	100
Liabilities	
Debt (third party)^	240
Employees benefit plan obligation	50

^AB Limited has obligation for the debt owed by PQR to XYZ in its entirety.

*Since AB Limited has the rights to all of Building No. 1, it records the amount in its entirety

Q57: On 1st April 2017 Alpha Ltd. commenced joint construction of a property with Gama Ltd. For this purpose, an agreement has been entered into that provides for joint operation and ownership of the property. All the ongoing expenditure, comprising maintenance plus borrowing costs, is to be shared equally. The construction was completed on 30th September 2017 and utilisation of the property started on 1st January 2018 at which time the estimated useful life of the same was estimated to be 20 years.

Total cost of the construction of the property was ₹ 40 crores. Besides internal accruals, the cost was partly funded by way of loan of ₹ 10 crores taken on 1st January 2017. The loan carries interest at an annual rate of 10% with interest payable at the end of year on 31st December each year. The company has spent ₹ 4,00,000 on the maintenance of such property.

The company has recorded the entire amount paid as investment in Joint Venture in the books of accounts. Suggest the suitable accounting treatment of the above transaction as the accounting entries as per applicable Ind AS. **[RTP Nov 2018]**

Ans: As provided in Ind- AS 111 - Joint Arrangements - this is a joint arrangement because two or more parties have joint control of the property under a contractual arrangement. The arrangement will be regarded as a joint operation because Alpha Ltd. and Gama Ltd. have rights to the assets and obligations for the liabilities of this joint arrangement. This means that the company and the other investor will each recognise 50% of the cost of constructing the asset in property, plant and equipment.

The borrowing cost incurred on constructing the property should under the principles of Ind AS 23 ‘Borrowing Costs’, be included as part of the cost of the asset for the period of construction.

In this case, the relevant borrowing cost to be included is ₹ 50,00,000 (₹ 10,00,00,000 x 10% x 6/12).

The total cost of the asset is ₹ 40,50,00,000 (₹ 40,00,00,000 + ₹ 50,00,000)

₹ 20,25,00,000 crores is included in the property, plant and equipment of Alpha Ltd. and the same amount in the property, plant and equipment of Gama Ltd.

The depreciation charge for the year ended 31 March 2018 will therefore be ₹ 1,01,25,000 (₹ 40,50,00,000 x 1/20 x 6/12) ₹ 50,62,500 will be charged in the statement of profit or loss of the company and the same amount in the statement of profit or loss of Gama Ltd. (finance cost for the second half year of ₹ 50,00,000 plus maintenance costs of ₹ 4,00,000) will be charged to the statement of profit or loss of Alpha Ltd. and Gama Ltd. in equal proportions- ₹ 27,00,000 each.

Q58: Entity X is owned by three institutional investors – A Limited, B Limited and C Limited – holding 40%, 40% and 20% equity interest respectively. A contractual arrangement between A Limited and B Limited gives them joint control over the relevant activities of Entity X. It is determined that Entity X is a joint operation (and not a joint venture). C Limited is not a party to the arrangement between A Limited and B Limited. However, like A Limited and B Limited, C Limited also has rights to the assets, and obligations for the liabilities, relating to the joint operation in proportion of its equity interest in Entity X.

Would the manner of accounting to be followed by A Limited and B Limited on the one hand and C Limited on the other in respect of their respective interests in Entity X be the same or different? **[ICAI SM]**

Ans: In its separate financial statements, a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:

(a) a joint operation in accordance with paragraph 23;

(b) a joint venture in accordance with Ind AS 109, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 10 of Ind AS 27."

Paragraphs 20 and 21 of Ind AS 111 state that a joint operator shall recognise in relation to its interest in a joint operation:

(a) its assets, including its share of any assets held jointly;

(b) its liabilities, including its share of any liabilities incurred jointly;

(c) its revenue from the sale of its share of the output arising from the joint operation;

(d) its share of the revenue from the sale of the output by the joint operation; and

(e) its expenses, including its share of any expenses incurred jointly.

A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the Ind ASs applicable to the particular assets, liabilities, revenues and expenses."

Paragraph 23 of Ind AS 111 states that a party that participates in, but does not have joint control of a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 20–22 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation.

If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the Ind ASs applicable to that interest.

In the given case, all three investors (A Limited, B Limited and C Limited) share in the assets and liabilities of the joint operation in proportion of their respective equity interest. Accordingly, both A Limited and B Limited (which have joint control) and C Limited (which does not have joint control) shall apply paragraphs 20-22 in accounting for their respective interests in Entity X in their respective separate financial statements as well as consolidated financial statements.

Accounting for sales or contributions of assets to a joint operation

Q59: A Ltd. is one of the parties to a joint operation holding 60% interest in a joint operation and the balance 40% interest is held by another joint operator. A Ltd. has contributed an asset held by it to the joint operation for the activities to be conducted in joint operation. The carrying value of the asset sold was ₹ 100 and the asset was actually sold for ₹ 80 i.e. at a loss of ₹ 20. How should A Ltd. account for the sale of asset to joint operation in its books?

Ans: A Ltd. should record the loss on the transaction only to the extent of other party's interest in the joint operation.

The total loss on the transaction is ₹ 20. Hence, A Ltd. shall record loss on sale of asset to the extent of ₹ 8 (₹ 20 x 40%) which is the loss pertaining to the interest of other party to the joint operation. The loss of ₹ 12 (₹ 20 - ₹ 8) shall not be recognised as that is unrealised loss.

Further, while accounting its interest in the joint operation, A Ltd. shall record its share in that asset at value of ₹ 60 [A Ltd. share of asset ₹ 48 (₹ 80 x 60%) plus unrealised loss of ₹ 12].

The journal entry for the transaction would be as follows:

Bank	Dr.	₹ 32	
Loss on sale	Dr.	₹ 8	
To Asset			₹ 40

Accounting for purchases of assets from a joint operation

Q60: A Ltd. is one of the parties to a joint operation holding 60% interest in the joint operation and the balance 40% interest is held by another joint operator. A Ltd. has purchased an asset from the joint operation. The carrying value of the asset in the books of joint operation was ₹ 100 and the asset was actually purchased for ₹ 80 i.e. at a loss of ₹ 20. How should A Ltd. account for the purchase of asset from joint operation in its books?

Ans: A Ltd. should not record its share of the loss until the asset is resold to a third party.

The joint operation has sold the asset at ₹ 80 by incurring a loss of ₹ 20. Hence, A Ltd. shall record the asset at ₹ 92 [Purchase price ₹ 80 + A Ltd.'s share in loss ₹ 12 (₹ 20 x 60%)].

Further, while accounting its interest in the joint operation, A Ltd. shall not record any share in the loss incurred in sale transaction by the joint operation.

The journal entry for the transaction would be as follows:

Asset	Dr.	₹ 32	
To Bank			₹ 32

INVESTMENT IN ASSOCIATES AND JOINT VENTURE

Accounting entries related investment in associate / joint venture

Q61: On the first day of a financial year, A Ltd. invested in the equity share capital of B Ltd. at a cost of ₹ 1,00,000 to acquire 25% share in the voting power of B Ltd. A Ltd. has concluded that B Ltd. is an associate of A Ltd. At the end of the year, B Ltd. earned profit of ₹ 10,000 and other comprehensive income of ₹ 2,000. In that year, B Ltd. also declared dividend to the extent of ₹ 4,000. Pass necessary entries in the books of A Ltd. to account for the investment in associate.

Ans: Following entries would be passed in the books of A Ltd.:

1) Initial entry to record investment done in associate

Investment in B Ltd. A/c	Dr.	1,00,000
To Bank A/c		1,00,000

2) Recording of share in the profit of the associate

Investment in B Ltd. A/c	Dr.	2,500
To Share in profit of investee (P&L)		2,500

[A Ltd. share in profit would be ₹ 2,500 (₹ 10,000 x 25%)]

3) Recording of share in the other comprehensive income (OCI) of the associate

Investment in B Ltd. A/c	Dr.	500
To Share in OCI of investee (OCI)		500

[A Ltd. share in OCI would be ₹ 500 (₹ 2,000 x 25%)]

4) Recording of dividend distributed by associate

Dividend income A/c (P&L)	Dr	1,000
To Investment in B Ltd. A/c		1,000

[A Ltd. share in dividend would be ₹ 1,000 (₹ 4,000 x 25%)]

Q62: B Ltd acquired a 30% interest in D Ltd and achieved significant influence. The cost of the investment was ₹ 2,50,000. The associate has net assets of ₹ 5,00,000 at the date of acquisition. The fair value of those net assets is ₹ 6,00,000 as a fair value of property, plant & equipment is ₹ 1,00,000 higher than its book value. This property, plant & equipment has a remaining useful life of 10 years.

After acquisition D Ltd recognize profit after tax of ₹ 1,00,000 and paid a dividend out of these profits of ₹ 9,000. D Ltd has also recognized exchange losses of ₹ 20,000 directly in other comprehensive income. Calculate B Ltd's interest in D Ltd at the end the year by using equity method. **[ICAI SM]**

Ans:

B Ltd's interest in D Ltd at the end the year is calculated as follows:	₹
Balance on requisition under the equity method (including goodwill of ₹ 70,000)	
(₹ 2,50,000 – (30% X ₹ 6,00,000))	2,50,000
B Ltd's share of D Ltd's after tax profit (30% X ₹1,00,000)	30,000
Elimination of dividend received by B Ltd from D Ltd (30% X ₹9,000)	(2,700)
B Ltd's share of D Ltd's exchange differences (30% X ₹20,000)	(6,000)
B Ltd's share of amortisation of fair value uplift (30% X ₹10,000)	(3,000)
B Ltd's interest in D Ltd at the end of the year under the equity method	
(including goodwill)	2,68,300

D Ltd has net assets at the end of the year of ₹ 5,71,000 (that is, net assets at the start of the year of ₹ 5,00,000 , plus profit during the year of ₹ 1,00,000 , less dividend of ₹ 9,000 , less foreign exchange losses of ₹ 20,000).

B Ltd's interest in D Ltd at the end of the year is made up of:

B Ltd's share of D Ltd's net assets (30%X ₹5,71,000)	1,71,300
Goodwill	70,000
B Ltd's share of D Ltd's fair value adjustments (the initial fair value difference of	
₹1,00,000 has been reduced by ₹10,000 due to depreciation in the year)	
(30% X ₹90,000)	27,000
B Ltd's interest in D Ltd	2,68,300

Exemption from applying equity method

Q63: MNO Ltd. holds 15% of the voting power of DEF Ltd. PQR Mutual Fund (which is a subsidiary of MNO Ltd.) also holds 10% voting power of DEF Ltd. Hence, MNO Ltd. holds total 25% voting power of DEF Ltd. (15% held by own and 10% held by subsidiary) and accordingly has significant influence over DEF Ltd. How should MNO Ltd. account for investment in DEF Ltd. in its consolidated financial statements?

Ans: The 15% interest which is held directly by MNO Ltd. should be measured as per equity method of accounting. However, with respect to the 10% interest which is held through a mutual fund, MNO Ltd. can avail the exemption from applying the equity method to that 10% interest and instead

Acquisition of interest in an associate

Q64: Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for ₹ 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. was ₹ 3,00,000 and the fair value was ₹ 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of ₹ 40,000 and other comprehensive income of ₹ 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year.

Ans:

1. Goodwill / capital reserve on the date of acquisition

The cost of the investment is higher than the net fair value of the investee's identifiable assets and liabilities. Hence there is goodwill. Amount of goodwill is calculated as follows

	₹
Cost of acquisition of investment	1,25,000
Blue Ltd.'s share in fair value of net assets of Green Ltd. on the date of acquisition (4,00,000 *25%)	(1,00,000)
Goodwill	**25,000**

Above goodwill will be recorded as part of carrying amount of the investment.

2. Share in profit and other comprehensive income of Gren Ltd.

	₹
Share in profit of Green Ltd. (40,000 x 25%)	10,000
Adjustment for depreciation based on fair value (1,00,000 ÷ 20) x 25%	(1,250)
Share in profit after adjustment	8,750
Share in other comprehensive income (10,000 x 25%)	2,500

3. Closing balance of investment at the end of the year

	₹
Cost of acquisition of investment (including goodwill of ₹ 25,000)	1,25,000
Share in profit after adjustments	8,750
Share in other comprehensive income	2,500
Closing balance of investment	**1,36,250**

Q65: KL Ltd. has invested in 50% voting power of a joint venture MN Ltd. MN Ltd. has also issued 10% cumulative preference shares to other investors worth ₹ 10,00,000. During the year, MN Ltd. earned profit of ₹ 4,00,000. Also, MN Ltd. has not declared any dividend on the preference shares for current year. Calculate KL Ltd.'s share in the net profit of MN Ltd. for the year.

Ans: If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity should compute its share of profit or loss after adjusting for dividend on such shares, whether or not the dividends have been declared.

In current case, KL Ltd.'s share in net profit of MN Ltd. would be as follows.

	₹
Profit of MN Ltd. for the year	4,00,000
Dividend on cumulative preference shares (10,00,000*10%)	(1,00,000)
Net profit attributable to the holders of equity share	3,00,000
KL Ltd.'s 50% share in net profit of MN Ltd.	1,50,000

Upstream and downstream transaction between an entity and its associate

Q66: **Scenario A** M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of ₹ 10,00,000. This included profit of 10% on the transaction price i.e. profit of ₹ 1,00,000. Out the above inventory, M Ltd. sold inventory of ₹ 6,00,000 to outside customers. Hence, the inventory of ₹ 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Ans: **Scenario A** Firstly, as part of its equity method accounting for investment in N Ltd., M Ltd. will pass this journal entry:

Investment in N Ltd.	Dr.	40,000
To Share in profit of N Ltd.		40,000

Out of the inventory of ₹ 10,00,000, M Ltd. has sold inventory worth ₹ 6,00,000 to outside customers. Hence, the profit of ₹ 60,000 (6,00,000 *10% profit margin) on such inventory is realised. However, the inventory worth ₹ 4,00,000 is still held by M Ltd. which consists profit of ₹ 40,000 (4,00,000*10%). Hence, M Ltd.'s share in such profit i.e. ₹ 16,000 (40,000*40%) is considered as unrealised.

Accordingly, after recording of share in total profit of N Ltd., M Ltd. should pass following adjustment entry to reverse the unrealised profit margin:

Share in profit of N Ltd.	Dr. 16,000
To Inventory	16,000

In subsequent period, when this inventory of ₹ 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ₹ 16,000 will be treated as realised and hence the above entry will be reversed in that period.

Note: in the separate financial statements of M Ltd., inventory is carried at ₹ 4,00,000 whereas in its consolidated financial statements, inventory is carried at ₹ 3,84,000 (due to elimination entry above in respect of unrealized profit). In the subsequent period, when the inventory is sold, Inventory Account is credited by ₹ 4,00,000 whereas for the purpose of consolidated financial statements, it should have been credited by only ₹ 3,84,000. The difference is adjusted by debiting back ₹ 16,000 to the Inventory Account and a corresponding recognition of share in profit of associate.]

Scenario B Out of the inventory of ₹ 10,00,000, N Ltd. has sold inventory worth ₹ 6,00,000 to outside customers. Hence, the profit of ₹ 60,000 (6,00,000 x 10% profit margin) on such inventory is realised. However, the inventory worth ₹ 4,00,000 is still held by N Ltd. which consists profit of ₹ 40,000 (4,00,000*10%). Out of this profit of ₹ 40,000, profit to the extent of other investor's interest in the investee is treated as realised profit i.e. ₹ 24,000 (40,000*60%) is treated as realised profit. Balance profit of ₹ 16,000 (40,000*40%) is considered as unrealised. Hence, M Ltd. should pass following adjustment entry to reverse the unrealised profit:

Sales	Dr.	160,000
To Cost of material consumed		144,000
To Investment in N Ltd.		16,000

In subsequent period, when this inventory of ₹ 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ₹ 16,000 will be treated as realised and hence the above entry will be reversed in that period.

Impairment loss on downstream and upstream transaction between an entity and its joint venture

Q67: **Scenario A:** X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of ₹ 8,00,000. The asset's carrying value in X Ltd.'s books was ₹ 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Scenario B Assume the same facts as per Scenario A except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd. Determine how should X Ltd. account for the above transaction in its books.

Ans: **Scenario A** X Ltd. should record full loss of ₹ 2,00,000 (10,00,000 – 8,00,000) in its books as that would represent the impairment loss because the market value has actually declined. This loss would have been recorded even if X Ltd. would have first impaired the asset and then sold to Y Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Bank A/c	Dr.	8,00,000	
Loss on sale of asset	Dr.	2,00,000	
To Asset			10,00,000

Scenario B X Ltd. should record loss to the extent of its share in Y Ltd. Hence, X Ltd.'s share in loss i.e. ₹ 1,00,000 [(10,00,000 – 8,00,000) x 50%] should be recorded by X Ltd. in its books. The loss should be recorded since the market value of the asset has actually declined and this would represent impairment. This loss would have been recorded even if Y Ltd. would have first recorded an impairment loss of ₹ 2,00,000 and then sold to X Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Asset	Dr.	8,00,000	
Share in loss of Y Ltd.	Dr.	1,00,000	

To Bank			8,00,000
To Investment in Y Ltd.			1,00,000

Loss making associate and long-term interests

Q68: An entity has following three type interests in an associate:

- Equity shares: 25% of the equity shares to which equity method of accounting is applied
- Preference shares: Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.
- Long-term loan: The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.

At the start of year 1, the carrying value of each of the above interests is as follows:

- Equity shares – ₹ 10,00,000
- Preference shares – ₹ 5,00,000
- Long-term loan – ₹ 3,00,000

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit / loss of associate for year 1-5.

s.

End of Year	*Increase / (Decrease) in fair value of preference shares as per Ind AS 109*	*Impairment loss / (reversal) on long-term loan as per Ind AS 109*	*Entity's share in profit / (loss) of associate*
1	*(50,000)*	*(50,000)*	*(16,00,000)*
2	*(50,000)*	*-*	*(2,00,000)*
3	*1,00,000*	*50,000*	*-*
4	*50,000*	*-*	*10,00,000*
5	*30,000*	*-*	*10,00,000*

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.

Based on above, determine the closing balance of each of the above interests at the end of each year.

Ans: **Year 1** Below table summarises the closing balance of each of the interest at the end of year 1:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	10,00,000	NA	10,00,000	(10,00,000)	-
Preference shares	5,00,000	(50,000)	4,50,000	(4,50,000)	-
Long-term loan	3,00,000	(50,000)	2,50,000	(1,50,000)	1,00,000
Total	**18,00,000**	**(1,00,000)**	**17,00,000**	**(16,00,000)**	**1,00,000**

The entire loss of ₹ 16,00,000 is recognised. Hence, there is no unrecognised loss at the end of year 1.

Year 2 Below table summarises the closing balance of each of the interest at the end of year 2:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	-	-
Preference shares	-	(50,000)	(50,000)	50,000 *	-
Long-term loan	1,00,000	-	1,00,000	(1,00,000)	-
Total	**1,00,000**	**(1,00,000)**	**17,00,000**	**(50,000)**	**-**

* Recognition of changes in fair value as per Ind AS 109 has resulted in the carrying amount of Preference shares being negative ₹ 50,000. Consequently, the entity shall reverse a portion of the associate's losses previously allocated to Preference shares.

Out of the total loss of ₹ 2,00,000 for the year, loss of only ₹ 50,000 is recognized. Hence, there is unrecognized loss to the extent of ₹ 1,50,000 at the end of year 2.

Year 3 Below table summarises the closing balance of each of the interest at the end of year 3:₹

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	-	-
Preference shares	-	1,00,000	1,00,000	(1,00,000)	-
Long-term loan	-	50,000	50,000	(50,000)	-
Total	**-**	**1,50,000**	**1,50,000**	**(1,50,000)**	**-**

The share in profit / loss for the year is nil. However, there was previously unrecognised loss of ₹ 1,50,000 which is allocated in current year. After recognising the above loss, there is no unrecognised loss at the end of year 3.

Year 4 Below table summarises the closing balance of each of the interest at the end of year 4:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	2,00,000	2,00,000
Preference shares	-	50,000	50,000	5,00,000	5,50,000
Long-term loan	-	-	-	3,00,000	3,00,000
Total	**-**	**50,000**	**50,000**	**10,00,000**	**10,50,000**

The entity's share in profit of associate for the year is ₹ 10,00,000. The entity shall allocate such profit to each of the instruments in order of their seniority in liquidation. The entity should limit the amount of profit to be allocated to preference shares and long-term loan to the extent of losses previously allocated to them. Hence, the entity has allocated ₹ 5,00,000 to preference shares and ₹ 3,00,000 to long-term debt.

There is no unrecognised loss at the end of year 4.

Year 5 Below table summarises the closing balance of each of the interest at the end of year 5:

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	2,00,000	NA	2,00,000	10,00,000	12,00,000
Preference shares	5,50,000	30,000	5,80,000	-	5,80,000
Long-term loan	3,00,000	-	3,00,000	-	3,00,000
Total	**10,50,000**	**30,000**	**10,80,000**	**10,00,000**	**20,80,000**

The entity's share in profit of associate for the year is ₹ 10,00,000. The entire profit is allocated to equity shares since there is no loss previously allocated to either preference shares or long-term loan.

There is no recognized loss at the end of year 5.

Year 1 to 5 The interest accrual on long-term loan would be done in each year at 10% p.a. This will be done without taking into account any adjustment done in the carrying value of long-term loan as per Ind AS 28. Hence, the entity will accrue interest of ₹ 30,000 (3,00,000 x 10%) in each year.

Recording in profit or loss of the gain / loss on discontinuation of equity method

Q69: CD Ltd. held 50% of the voting power of RS Ltd. which is a joint venture of CD Ltd. The carrying value of the investment in RS Ltd. is ₹ 1,00,000. Now out of the 50% stake, CD Ltd. has sold 20% stake in RS Ltd. to a third party for a consideration of ₹ 80,000. The fair value of the retained 30% interest is ₹ 1,20,000. Determine how much gain / loss should be recorded in profit or loss of CD Ltd.

Ans: CD Ltd. Shall record in profit or loss difference between below:

- the fair value of any retained interest (i.e. ₹ 1,20,000) and any proceeds from disposing of a part interest in the joint venture (i.e. ₹ 80,000); and
- the carrying amount of the investment at the date the equity method was discontinued (i.e. 1,00,000).

Hence, CD Ltd. Shall record gain of ₹ 1,00,000 in profit or loss.

Investment in joint venture held for sale

Q70: Ram Ltd. holds 50% of the equity share capital of Shyam Ltd. The balance 50% equity share capital is held by another investor. Ram Ltd. has joint control over Shyam Ltd. and it is a joint venture of Ram Ltd., accounted using equity method. Now Ram Ltd. is planning to sell 10% of the equity share capital of Shyam Ltd. to a third party. Such 10% investment meets the criteria of an asset held for sale and has been measured and disclosed accordingly. Now determine how should Ram Ltd. account 40% interest retained in Shyam Ltd.

Ans: Till the time 10% stake is sold, Ram Ltd. shall account for the retained interest of 40% as per equity method. After the sale of 10% investment, if Ram Ltd. still has joint control over Shyam Ltd. (e.g. through contractual arrangement) then it shall continue to measure that investment using equity method. However, if Ram Ltd. is not going to have joint control over Shyam Ltd. post the disposal of 10% investment then retained investment of 40% shall be accounted as per Ind AS 109.

Q71: P Ltd. owns 80% of S and 40% of A. A is an associate. Balance Sheet of four companies as on 31.03.09 are: (₹ in lakhs)

	P Ltd.	S	A
Investment in S	800	-	-
Investment in A	600	-	-
Property, plant and equipment	1600	800	1000
Current assets	2200	3300	3650
Total	**5200**	**4100**	**4650**
Liabilities:			
Share capital Re. 1			
Equity share	1000	400	800

Retained earnings	4000	3400	3600
Creditors	200	300	250
Total	**5200**	**4100**	**4650**

1. P Ltd. acquired shares in 'S' many years ago when 'S' retained earnings were ₹ 520 lakhs.
2. P Ltd. acquired its shares in 'A' on 01.04.08 when 'A' retained earnings were ₹ 400 lakhs.
3. During the year, P Ltd sold goods to A for 10 lacs at a mark up of 25%. At year end, A Ltd. still holds one quarter of these goods in inventory.
4. As a result of trading, P Ltd was owed ₹ 2,50,000 by a at reporting date. This agrees with the amount included in A Ltd's Trade receivables.
5. At year end it was determined that the investment in the associates was impaired by ₹ 35 lacs.
6. NCI are valued using the fair value method. The fair value of NCI at the date of acquisition was ₹ 200 lacs.

Prepare the Consolidated Balance Sheet of P Ltd. **[ICAI SM – Old Syllabus]**

[For Answer – Refer Class Notes]

Q72: Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-04-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹50,000 on 12-08-20X1. East India reported earnings of ₹3,00,000 for the financial year ending on 31-03-20X2 and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

(i) Separate financial statements of Bright Ltd. as on 31-03-20X2;

(ii) Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

(iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial statements? **[ICAI SM – Old Syllabus]**

Ans: Carrying amount of investment in Separate financial statements of Bright Ltd. as on 31-03-20X2:

	₹
Cost of Investment	2,00,000
Less: Dividend Received (credited to PL as per IND AS 27)	-
Carrying value as per Cost method	2,00,000

Carrying amount of investment in Consolidated financial statements of Bright Ltd. as on 31-03-20X2 as per equity method

	₹
Cost of Investment	2,00,000

Add: Share in Post-Acquisition Profit (3,00,000 x 30%)	90,000
Less: Dividend Received (50,000 x 30%)	(15,000)
Carrying value as per Equity method as on 31-03-20X2	2,75,000

Carrying amount of investment in Consolidated financial statements of Bright Ltd. as on 30-06-20X2 as per equity method

	₹
Carrying value of Investment as on 01-04-20X2	2,75,000
Less: Dividend Received (60,000 x 30%)	(18,000)
Carrying value as per Equity method as on 30-06-20X2	2,57,000

Q73: Eagle Ltd. had acquired 51% in Sparrow Ltd. for ₹ 75.80 lakhs on April 1st, 2010. On date of the acquisition Sparrow's Assets stood at ₹ 196 lakhs and liabilities at ₹ 16 lakhs. The Net asset position of Sparrow Ltd. as on 31st March, 2011 & 30th September 2011 were ₹ 280 lakhs &₹ 395 lakhs respectively, the increase resulting from profits earned during the period.

On 1st Oct, 2011, 25.5% holdings were sold for ₹ 125 lakhs. You are required to 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 & goodwill/capital reserve that arises on change in nature of the investment may also be worked out by you.

[ICAI SM – Old Syllabus]

Ans: Sparrow Ltd. became a subsidiary of Eagle Ltd. on 1st April 2010 when 51% thereof was acquired. The holding–subsidiary relationship continued till 30th September 2011 and from 1st October, 2011 the relationship between the two companies will change to Associate.

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

		₹
Fair Value of consideration received on sale of 25.5% holdings in Sparrow Ltd.		1,25,00,000
Fair Value of Investment retained as Associate 25.5% holdings in Sparrow Ltd. (assumed proportionate to fair value of investment sold)		1,25,00,000
		2,50,00,000
Less: Net Assets of sparrow Ltd. on the date of disposal	3,95,00,000	
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 financialstatements of Eagle Ltd.		1,85,45,000
Gain on loss of Control		64,55,000

Goodwill / Capital Reserve arising on the application of Equity Method on the date investee become an associate	₹
Fair Value of 25.5% holdings in Sparrow Ltd. as on 1st October, 2011 – Deemed cost	1,25,00,000
Less: Share in Fair value of INA of Sparrow Ltd., as at date of investment	
when subsidiary relationship is transformed to an associate (3,95,00,000x 25.5%)	(1,00,72,500)
Goodwill arising on such investment under Equity method as per IND AS 28	(24,27,500

Working Note:

Calculation of Goodwill / Gain on Bargain Purchase on the Date of Acquisition of Shares in Sparrow Ltd.

	₹
Net Assets on Acquisition date (₹ 1,96,00,000 – ₹ 16,00,000)	1,80,00,000
51% thereof	91,80,000
Less: Cost of investment	(75,80,000)
Gain on Bargain Purchase transferred to Capital Reserve on acquisition of Subsidiary	16,00,000

Q74: Entity A holds a 20% equity interest in Entity B (an associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of ₹ 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for ₹ 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of ₹ 100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements

Assets	₹	**Liabilities**	₹
Investment in B	200	Equity	200
Total	200	Total	200

B's consolidated financial statements

Assets	₹	**Liabilities**	₹
Assets (from C)	1000	Equity	1000
Total	1000	Total	1000

The financial statements of B after the transaction are summarised below:

After

B's consolidated financial statements

Assets	₹	Liabilities	₹
Assets (from C)	1000	Equity	1000
Cash	300	Equity transaction with	
		non- controlling interest	100
		Equity attributable to owners	1100
		Non-controlling interest	200
Total	1300	Total	1300

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now ₹ 220 (20% of ₹ 1,100) i.e., ₹ 20 in addition to its previous share.

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B? **[ICAI SM]**

Ans: Ind AS 28 defines the equity method as "a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income."

Paragraph 27 of Ind AS 28, states, inter alia, that when an associate or joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income, and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies.

The change of interest in the net assets / equity of the associate as a result of the investee's equity transaction is reflected in the investor's financial statements as 'share of other changes in equity of investee' (in the statement of changes in equity) instead of gain in Statement of profit and loss, since it reflects the post-acquisition change in the net assets of the investee as per paragraph 3 of Ind AS 28 and also faithfully reflects the investor's share of the associate's transaction as presented in the associate's consolidated financial statements.

Thus, in the given case, Entity A recognises ₹ 20 as change in other equity instead of in statement of profit and loss and maintains the same classification as of its associate, Entity B, i.e., a direct credit to equity as in its consolidated financial statements.

Q75. X Limited was holding 100% of the equity share capital of Y Limited and Y Limited was treated as a subsidiary by X Limited. Now, Y Limited issues convertible preference shares to Z Limited. As per the issue document of convertible preference shares, Z Limited also gets the rights to participate in the relevant activities of Y Limited whereby Z Limited's consent is also necessary to pass any decision by the equity shareholder of Y Limited (i.e. X Limited). Determine how should X Limited account for its investment in Y Limited in its consolidated financial statements after the issue of convertible preference shares by Y Limited to Z Limited?

Ans: As per the issue document of convertible preference shares, unanimous consent of both X Limited and Z Limited are required to pass any decision about the relevant activities of Y Limited. Hence, Y Limited is jointly controlled by X Limited and Z Limited and thereby, Y Limited becomes a joint arrangement between X Limited and Z Limited.

Y Limited is structured through a separate vehicle. The legal form of Y Limited, terms of the contractual arrangement or other facts and circumstances do not give X Limited and Z Limited rights to the assets, and obligations for the liabilities, relating to Y Limited. Hence, Y Limited is a joint venture between X Limited and Z Limited.

When the convertible preference shares are issued to Z Limited, X Limited losses control over Y Limited. Hence X Limited should derecognise the assets and liabilities of Y Limited from its consolidated financial statements. 100% equity shares in Y Limited is still held by X Limited. Hence such investment would be accounted at fair value on the date of loss of control by X Limited. The difference between the fair value of 100% equity shares retained in Y Limited and the carrying value of assets and liabilities of Y Limited derecognised is recognised in profit or loss of X Limited. After the loss of control, the investment in Y Limited is accounted as per equity method of accounting by X Limited whereby the investment value in Y Limited will be adjusted for the change in the X Limited's share of the net assets Y Limited post the date of loss of control. Also, the difference between the fair value of investment in Y Limited and fair value of net identifiable assets of Y Limited shall be goodwill or capital reserve.

Q76: M Limited holds 90% interest in subsidiary N Limited. N Limited holds 25% interest in an associate O Limited. As at 31 March 20X1, the net assets of O Limited was ₹ 300 lakhs including profit of ₹ 40 lakhs for the year ended 31 March 20X1. Calculate how the investment in O Limited will be accounted in the consolidated financial statements of M Limited?

Ans: Since N Limited is a subsidiary of M Limited, the consolidated financial statements of M Limited will include 100% amounts of the consolidated financial statements of N Limited (including investment in O Limited accounted for using equity method). Accordingly, the investment in O Limited will be accounted as follows in the consolidated financial statements of M Limited:

	₹' lakh	
Investment in O Limited (300 x 25%)		75
Share in profit of O Limited		
Attributable to M Limited (40 x 25% x 90%)	9	
Attributable to Non-controlling interest of N Limited (50 x 25% x 10%)	1	10

Q77: AB Limited holds 30% interest in an associate which it has acquired for a cost of ₹ 300 lakhs. On the date of acquisition of that stake, the fair value of net assets of the associate was ₹ 900 lakh. The value of goodwill on acquisition was ₹ 30 lakhs. After the acquisition, AB Limited accounted for the investment in the associate as per equity method of accounting and now the carrying value of such investment in the consolidated financial statements of AB Limited is ₹ 360 lakhs. The associate has now issued equity shares to some investors other than AB Limited for a consideration of ₹ 800 lakhs. This has effectively reduced the holding of AB Limited to 20%. Determine how AB Limited should account for such reduction in interest in the associate?

Ans: Because of the issue of shares by associate to other investors, AB Limited has effectively sold 10% (30 – 20) of its interest in the associate. The gain / loss on reduction in interest in associate in calculated as follows:

	₹' lakhs
AB Limited's share in the consideration received by the associate for issue of shares (800 x 20%) (1)	160
Less: Carrying value of interest sold (360 x 1/3)(2)	(120)
Gain on reduction in interest in associate(3)	**40**

Notes:

a) The share in the consideration received by associate on issue of shares (i.e. ₹ 160 lakhs) would be recorded as part of investment in associate.

b) The carrying amount of interest sold (i.e. ₹ 120 lakhs) will be derecognised, including proportionate goodwill of ₹ 10 lakhs (30 * 1/3).

c) Gain of ₹ 40 lakhs will be recorded in the profit or loss.

QUESTIONS FROM RTP/MTP/EXAMS/GFRS

Q78: On 1st April 2019, Investor Ltd. acquires 35% interest in another entity, XYZ Ltd. Investor Ltd. determines that it is able to exercise significant influence over XYZ Ltd. Investor Ltd. has paid total consideration of ₹ 47,50,000 for acquisition of its interest in XYZ Ltd. At the date of acquisition, the book value of XYZ Ltd.'s net assets was ₹ 90,00,000 and their fair value was ₹ 1,10,00,000. Investor Ltd. has determined that the difference of ₹ 20,00,000 pertains to an item of property, plant and equipment (PPE) which has remaining useful life of 10 years.

During the year, XYZ Ltd. made a profit of ₹ 8,00,000. XYZ Ltd. paid a dividend of ₹ 12,00,000 on 31st March, 2020. XYZ Ltd. also holds a long-term investment in equity securities. Under Ind AS, investment is classified as at FVTOCI in accordance with Ind AS 109 and XYZ Ltd. recognized an increase in value of investment by ₹ 2,00,000 in OCI during the year. Ignore deferred tax implications, if any.

Calculate the closing balance of Investor Ltd.'s investment in XYZ Ltd. as at 31st March, 2020 as per the relevant Ind AS. **[RTP Nov 2020]**

Ans: Calculation of Investor Ltd.'s investment in XYZ Ltd. under equity method:

	₹	₹

Acquisition of investment in XYZ Ltd.		
Share in book value of XYZ Ltd.'s net assets (35% of ₹90,00,000)	31,50,000	
Share in fair valuation of XYZ Ltd.'s net assets [35% of (₹ 1,10,00,000 – ₹90,00,000)]	7,00,000	
Goodwill on investment in XYZ Ltd. (balancing figure)	9,00,000	
Cost of investment		**47,50,000**
Profit during the year		
Share in the profit reported by XYZ Ltd. (35% of ₹8,00,000)	2,80,000	
Adjustment to reflect effect of fair valuation [35% of (₹20,00,000/10 years)]	(70,000)	
Share of profit in XYZ Ltd. 124ecognized in income by Investor Ltd.		**2,10,000**
Long term equity investment		
FVTOCI gain recognized in OCI (35% of ₹ 2,00,000)		70,000
Dividend received by Investor Ltd. during the year [35% of ₹12,00,000]		(4,20,000)
Closing balance of Investor Ltd.'s investment in XYZ Ltd.		**46,10,000**

Q79: An entity P (parent) has two wholly-owned subsidiaries - X and Y, each of which has an ownership interest in an 'associate', entity Z. Subsidiary X is a venture capital organisation. Neither of the investments held in associate Z by subsidiaries X and Y i s held for trading. Subsidiary X and Y account for their investment in associate Z at fair value through profit or loss in accordance with Ind AS 109 and using the equity method in accordance with Ind AS 28 respectively.

How should P account for the investment in associate Z in the following scenarios:

Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis - Subsidiary X and Y ownership interest in associate Z is 25% and 20% respectively.

Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis - Subsidiary X and Y ownership interest in associate Z is 10% each.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis - Subsidiary X and Y ownership interest in associate Z is 30% and 10% respectively.

Assume there is significant influence if the entity has 20% or more voting rights.

[RTP May 2020]

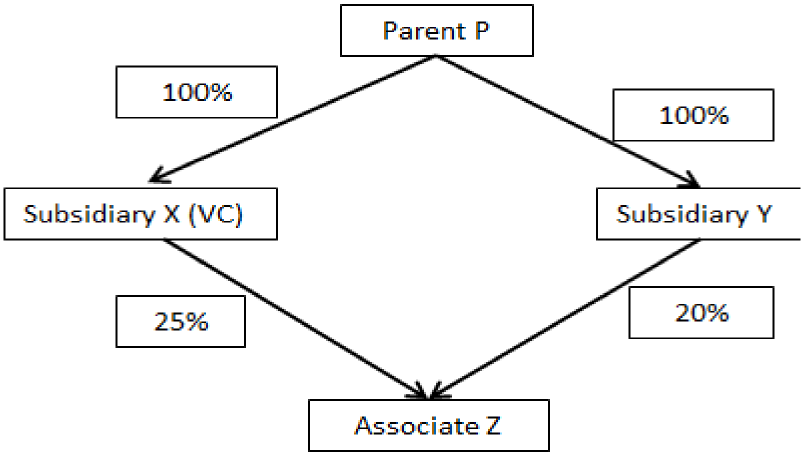
Ans: Paragraph 18 of Ind AS 28 states that, "when an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with Ind AS 109. An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture."

Paragraph 19 of Ind AS 28 provides that, "'when an entity has an investment i n an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109 regardless of whether the venture capital organisation has significant influence over that portion of the investment.

If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation".

Therefore, fair value exemption can be applied partially in such cases.

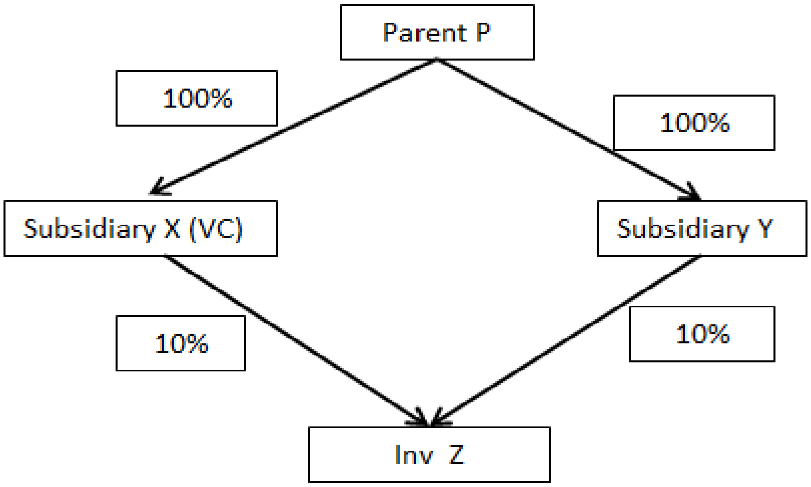
Scenario 1: Where both investments in the associate result in significant influence on a stand-alone basis.



In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 20% interest held by Y.

Under the partial use of fair value exemption, P may elect to measure the 25% interest held by X at fair value through profit or loss.

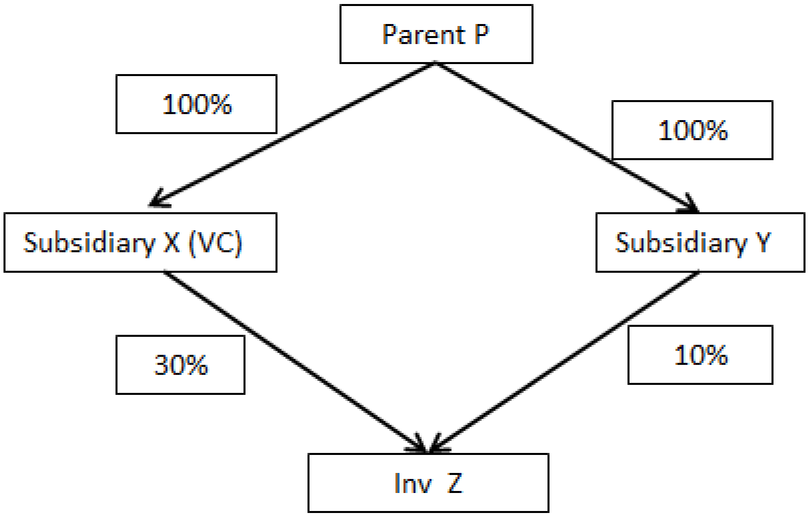
Scenario 2: When neither of the investments in the associate results in significant influence on a stand-alone basis, but do provide the parent with significant influence on a combined basis.



In the present case in accordance with the paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, P may elect to measure the 10% interest held by X at fair value through profit or loss.

Scenario 3: When one of the investments in the associate results in significant influence on a stand-alone basis and the other investment in the associate does not result in significant influence on a stand-alone basis



In the present case, in accordance with paragraph 19 of Ind AS 28, P must follow equity method of accounting for its 10% interest held by Y, even though Y would not have significant influence on a stand-alone basis.

Under the partial use of fair value exemption, the P may elect to measure the 30% interest held by X at fair value through profit or loss.

Q80: On 1st April, 2016, ABC acquired 90 million shares in PQR Limited by means of share exchange which has been classified as 'fair value through other comprehensive income' in separate financial statements of ABC Limited. The terms of the business combination were as follows:

- ABC Limited issued eight shares for every, nine shares acquired in PQR Limited. On 1st April, 2016, the market value of ABC Limited's share was ₹2.80 per share.

- ABC Limited will make a further cash payment to the former shareholders of PQR Limited on 30th June 2019. This payment will be based on the adjusted profits of PQR Limited for the three-year period upto 31st March 2019. On 1st April 2016, the fair value of this additional payment was estimated at ₹25 million. This estimate had increased to ₹ 28 million by 31st March 2017 due to changes in circumstances since the date of acquisition.

Investment in PQR Limited has not been recorded in the draft financial statements of ABC Limited presented at later part of the study.

It is the group policy to value the non-controlling interest in subsidiaries at the date of acquisition at fair value. The market value of an equity share in PQR Limited at 1 April 2016 can be used for this purpose. On 1 April 2016, the market value of a PQR Limited share was ₹2.60 per share.

On 1st April 2016, the individual financial statements of PQR Limited showed the following reserves balances:

– Retained earnings ₹86 million.

– Other components of equity ₹2·4 million.

The directors of ABC Limited carried out a fair value exercise to measure the identifiable assets and liabilities of PQR Limited at 1 April 2016. The following matters emerged:

- Property having a carrying value of ₹140 million (including depreciable assets ₹80 million) had an estimated market value of ₹160 million (including depreciable 1 assets ₹ 92 million). The remaining estimated economic life of the depreciable assets at 1st April 2016 was 16 years.

- Plant and equipment having a carrying value of ₹111 million had a market value of ₹120 million. The estimated future economic life of the plant and equipment at 1st April 2016 was three years. PQR Limited has not disposed of any of this plant and equipment since 1st April 2016.

- Intangible assets with an estimated market value of ₹8 million had not been recognised in the individual financial statements of PQR Limited. The estimated future economic lives of these intangible assets at 1st April 2016 was four years.

The fair value adjustments have not been reflected in the individual financial statements of PQR Limited. In the consolidated financial statements, the fair value adjustments will be regarded as temporary differences for the purposes of computing deferred tax. The rate of deferred tax to apply to temporary differences is 20%.

Impairment of the goodwill on acquisition of PQR Limited is not required since 1 April 2016.

Below are the separate financial statements of ABC and PQR Limited as on 31st March 2017:

	ABC Limited ₹'000	PQR Limited ₹'000
ASSETS		
Non-current assets:		
Property, plant and equipment	280,000	225,000
Investments	78,500	40,000
Current assets:	358,500	265,000
Inventories	85,000	56,000
Trade receivables	70,000	42,000
Cash and cash equivalents	14,000	11,000
	169,000	109,000
Total assets	527,500	374,000
EQUITY AND LIABILITIES		
Equity		
Share capital	160,000	120,000
Retained earnings	211,396	115,000
Other components of equity	5,604	4,000
Total equity	377,000	239,000
Non-current liabilities:		
Provision	1,500	Nil
Long-term borrowings	60,000	50,000
Deferred tax	22,000	25,000
Total non-current liabilities	83,500	75,000
Current liabilities:		
Trade and other payables	45,000	40,000
Short-term borrowings	22,000	20,000
Total current liabilities	67,000	60,000
Total equity and liabilities	527,500	374,000

Compute the amount of 'Goodwill' and 'Non- controlling interest' to be shown in the Consolidated financial statements of ABC Limited as on 31st March 2017 on acquisition of PQR Ltd.

Ans: COMPUTATION OF GOODWILL ON CONSOLIDATION

(a) Goodwill on consolidation	**₹ in ₹ 000**
Cost of investment:	
Share exchange (90 million x 8/9 x ₹2·80)	2,24,000
Contingent consideration	25,000
Fair value of non-controlling interest at date of acquisition (30 million x ₹2·60)	78,000
	3,27,000
Net assets at 1 April 2016 (Refer W.N.)	(2,38,000)
Goodwill	89,000
(b) Non-controlling interest in PQR Limited	**₹ in ₹000**
Fair value at date of acquisition	78,000
25% of post-acquisition increase in net assets [(2,64,000 – 2,38,000 x 25%] (Refer W.N))	6,500
	84,500

WORKING NOTE – NET ASSETS – PQR LIMITED

	1 April, 2016 ₹ in ₹000	**31 March, 2017 ₹ in ₹000**
Share capital	120,000	120,000
Other components of equity	2,400	4,000
Retained earnings	86,000	115,000
Property adjustment	20,000	20,000
Extra depreciation ((92,000 – 80,000)/16)		(750)
Plant and equipment adjustment	9,000	9,000
Extra depreciation ((120,000 –111,000)/3)		(3,000)
Intangible asset adjustment	8,000	8,000
Extra amortisation (8,000/4)		(2,000)
Deferred tax on fair value adjustments		
(20,000+9,000+8,000) x 20%	(7,400)	

(20,000+9,000+8,000)- (750+3,000+2,000) x 20%	______	(6,250)
Net assets for the consolidation	2,38,000	2,64,000

Q81: Sumeru Limited holds 35% of total equity shares of Meru Limited, an associate company. The value of Investments in Meru Limited on March 31, 2018 is ₹ 3 crores in the consolidated financial statements of Sumeru Limited.

Sumeru Limited sold goods worth ₹ 3,50,000 to Meru Limited. The cost of goods sold is ₹ 3,00,000. Out of these goods worth ₹ 1,00,000 were in the closing stock of Meru Limited.

During the year ended March 31, 2019 the profit and loss statement of Meru Limited showed a loss of ₹ 1 crore.

(A) What is the value of investment in Meru Limited as on March 31, 2019 in the consolidated financial statements of Sumeru Limited, if equity method is adopted for valuing the investments in associates?

(B) Will your answer be different if Meru Limited had earned a profit of ₹ 1.50 crores and declared a dividend of ₹ 75 lakhs to the equity shareholders of the Company?

[GFRS]

Ans: (a) Value of investment in Meru Ltd. as on 31st March, 2019 as per equity method in the consolidated financial statements of Sumeru Ltd.

	₹
Cost of Investment	3,00,00,000
Less: Share in Post-Acquisition Loss (1,00,00,000 x 35%)	(35,00,000)
Less: Unrealised gain on inventory left unsold with Meru Ltd.	
[{(50,000/3,00,000) x 1,00,000} x 35%]	(5,833)
Carrying value as per Equity method	2,64,94,167

(b) Value of investment in Meru Ltd. as on 31st March, 2019 as per equity method in the consolidated financial statements of Sumeru Ltd.

	₹
Cost of Investment	3,00,00,000
Add: Share in Post-Acquisition Profit (1,50,00,000x 35%)	52,50,000
Less: Unrealised gain on inventory left unsold with Meru Ltd.	
[{(50,000/3,00,000) x 1,00,000} x 35%]	(5,833)
Less: Dividend (75,00,000 x 35%)	(26,25,000)
Carrying value as per Equity method	3,26,19,167

Note: In the absence of clarity in the information that whether unsold inventory is the cost value for Sumeru or Meru Ltd., the above solution has been given considering that ₹1,00,000 is the cost price of the inventory for Sumeru Ltd.

Alternatively, if it is considered as cost price to Meru Ltd. then the solution will be as follows:

(a) Value of investment in Meru Ltd. as on 31st March, 2019 as per equity method in the consolidated financial statements of Sumeru Ltd.

	₹
Cost of Investment	3,00,000
Less: Share in Post-Acquisition Loss (1,00,00,000 X 35%)	(35,00,000)
Less: Unrealised gain on inventory left unsold with Meru Limited [{(50,000 / 3,50,000)X 1,00,000}X 35%]	(5,000)
Carrying value as per Equity method	2,64,95,000

(b) Value of investment in Meru Limited as on 31st March, 2019 as per equity method in the consolidated financial statements of Sumeru Limited.

	₹
Cost of Investment	3,00,00,000
Add: Share in Post-Acquisition Profit (1,50,00,000x 35%)	52,50,000
Less: Unrealised gain on inventory left unsold with Meru Ltd.	
[{(50,000/3,50,000) x 1,00,000} x 35%]	(5,000)
Less: Dividend (75,00,000 x 35%)	(26,25,000)
Carrying value as per Equity method	3,26,20,000

EXTRA QUESTIONS

Property, plant and equipment (PPE) sold by parent to subsidiary

Q82: A Ltd. (which is involved in the business of selling capital equipment) a parent company sold a capital equipment costing ₹ 100 lakh to its 80% subsidiary B Ltd. At ₹ 120 lakh. The capital equipment is recorded as PPE by B Ltd. The useful life of the PPE on the date of transfer was 10 years. Show the necessary adjustment in the consolidated financial statements (CFS).

Ans: A Ltd. shall reduce the value of PPE of ₹ 120 lakh of B Ltd., by ₹ 20 lakh in CFS This will increase expenses and reduce consolidated profit by ₹ 20 lakh. Further, A Ltd. should also reduce the depreciation charge of B Ltd. to the extent of value of PPE reduced as above. Hence, A Ltd. should reduce the depreciation by ₹ 2 lakh (₹ 20 lakh ÷ 10 years). Further, the sales and cost of goods sold recorded by parent A Ltd. shall also be eliminated.

The double entry on consolidation is as follows:

	₹ lakh

	Dr.	Cr.
Consolidated revenue Dr.	120	
To Cost of sales		100
To PPE		18
To Depreciation		2

Loss control of a subsidiary in two transactions

Q83: MN Ltd. was holding 80% stake in UV Ltd. Now, MN Ltd. has disposed of the entire stake in UV Ltd. in two different transactions as follows:

- Transaction 1: Sale of 25% stake for a cash consideration of ₹ 2,50,000
- Transaction 2: Sale of 55% stake for a cash consideration of ₹ 5,50,000

Both the transactions have happened within a period of one month. In accordance with the guidance given in Ind AS 110, both the transactions have to be accounted as a single transaction.

The net assets of UV Ltd. and non-controlling interest on the date of both the transactions was ₹ 9,00,000 and ₹ 1,80,000 respectively (assuming there were no earnings between the period of two transactions).

How MN Ltd. should account the transaction?

Ans: MN Ltd. will account for the transaction as follows:

		₹
Recognise:		
Fair value of consideration (2,50,000 + 5,50,000)		8,00,000
Derecognise:		
Net assets of UV Ltd.	(9,00,000)	
Non-controlling interest	1,80,000	(7,20,000)
Gain to be recorded in profit or loss		**80,000**

If MN Ltd. loses control over UV Ltd. on the date of transaction 1, then the above gain is recorded on the date of transaction 1 and MN Ltd. will stop consolidating UV Ltd. from that date. The consideration of ₹ 5,50,000 receivable in transaction 2 will be shown as consideration receivable.

If MN Ltd. loses control over UV Ltd. on the date of transaction 2, then the above gain is recorded on the date of transaction 2 and MN Ltd. will stop consolidating UV Ltd. from that date. The consideration of ₹ 2,50,000 received in transaction 1 will be shown as advance consideration received.

An entity ceases to be an investment entity

Q84: A Limited ceased to be in investment entity from 1st April 20X1 on which date it was holding 80% of B Limited. The carrying value of such investment in B Limited (which was measured at fair value through profit or loss) was ₹ 4,00,000. The fair value of non-controlling interest on the date of change in status was ₹ 1,00,000. The value of subsidiary's identifiable net assets as per Ind AS 103 was ₹ 4,50,000 on the date of change in status. Determine the value of goodwill and pass the journal entry on the date of change in status of investment entity. (Assume that non-controlling interest is measured at fair value method)

Ans:

Goodwill calculation:	₹
Deemed consideration (i.e. fair value of subsidiary on the date of change in status)	4,00,000
Fair value of non-controlling interest	1,00,000
	5,00,000
Value of subsidiary's identifiable net assets as per Ind AS 103	(4,50,000)
Goodwill	**50,000**

Journal entry		₹	
		Dr.	Cr.
Net identifiable assets	Dr.	4,50,000	
Goodwill	Dr.	50,000	
To Investment in B Limited (on date of change in status)			4,00,000
To Non-controlling interest			1,00,000

An entity becomes an investment entity

Q85: CD Ltd. purchased a 100% subsidiary for ₹ 20,00,000 on 31st March 20X1 when the fair value of the net assets of KL Ltd. was ₹ 16,00,000. Therefore, goodwill was ₹ 4,00,000. CD Ltd. becomes an investment entity on 31st March 20X3 when the carrying value of its investment in KL Ltd. (measured at fair value through profit or loss) was ₹ 25,00,000. At the date of change in status, the carrying value of net assets of KL Ltd. excluding goodwill was ₹ 19,00,000.

Calculate gain or loss with respect to investment in KL Ltd. on the date of change in investment entity status of CD Ltd.

Ans: The gain on the disposal will be calculated as follows:

	₹
Fair value of retained interest (100%)	25,00,000
Less: Net assets disposed, including goodwill (19,00,000 + 4,00,000)	(23,00,000)
Gain on the date of change in investment entity status of CD Ltd.	2,00,000

Q86: On 1st April 2017, A Limited acquired 80% of the share capital of S Limited. On acquisition date the share capital and reserves of S Ltd. stood at ₹ 5,00,000 and ₹ 1,25,000 respectively. A Limited paid initial cash consideration of ₹ 10,00,000.

Additionally, A Limited issued 2,00,000 equity shares with a nominal value of ₹ 1 per share at current market value of ₹ 1.80 per share.

It was also agreed that A Limited would pay a further sum of ₹ 5,00,000 after three years. A Limited's cost of capital is 10%. The appropriate discount factor for ₹ 1 @ 10% receivable at the end of

1st year: 0.91

2nd year: 0.83

3rd year: 0.75

The shares and deferred consideration have not yet been recorded by A limited. Below are the Balance Sheet of A Limited and S Limited as at 31st March, 2019:

	A Limited (₹ 000)	S Limited (₹ 000)
Non-current assets:		
Property, plant & equipment	5,500	1,500
Investment in S Limited at cost	1,000	
Current assets:		
Inventory	550	100
Receivables	400	200
Cash	200	50
	7,650	1,850
Equity:		
Share capital	2,000	500
Retained earnings	1,400	300
	3,400	800
Non-current liabilities	3,000	400
Current liabilities	1,250	650
	7,650	1,850

Further information:

(i) On the date of acquisition the fair values of S Limited's plant exceeded its book value by ₹ 2,00,000. The plant had a remaining useful life of five years at this date;

(ii) The consolidated goodwill has been impaired by ₹ 2,58,000; and

(iii) The A Limited Group, values the non-controlling interest using the fair value method. At the date of acquisition, the fair value of the 20 % non-controlling interest was ₹ 3,80,000.

You are required to prepare Consolidated Balance Sheet of A Limited as at 31st March, 2019. (Notes to Account on Consolidated Balance Sheet is not required).

Exam Paper January 2021 (15 Marks)

Ans: Consolidated Balance Sheet of A Ltd. and its subsidiary, S Ltd. as at 31st March, 2019

Particulars	₹ in 000s
I.Assets	
(1) Non-current assets	
(i) Property Plant & Equipment (W.N.4)	7,120.00
(ii) Intangible asset – Goodwill (W.N.3)	1,032.00
(2) Current Assets	
(i) Inventories (550 + 100)	650.00
(ii) Financial Assets	
(a) Trade Receivables (400 + 200)	600.00
(b) Cash & Cash equivalents (200 + 50)	250.00
Total Assets	9,652.00
II. Equity and Liabilities	
(1) Equity	
(i) Equity Share Capital (2,000 + 200)	2,200.00
(ii) Other Equity	
(a) Retained Earnings (W.N.6)	1190.85
(b) Securities Premium	160.00
(2) Non-Controlling Interest (W.N.5)	347.40
(3) Non-Current Liabilities (3,000 + 400)	3,400.00
(4) Current Liabilities (W.N.8)	2,353.75
Total Equity & Liabilities	9,652.00

Notes:

1. Since the question required not to prepare Notes to Account, the column of Note to Accounts had not been drawn.

2. It is assumed that shares were issued during the year 2018-2019 and entries are yet to be made.

Working Notes:

1. **Calculation of purchase consideration at the acquisition date i.e. 1st April, 2017**

	₹ in 000s
Payment made by A Ltd. to S Ltd.	

Cash	1,000.00
Equity shares (2,00,000 shares x ₹ 1.80)	360.00
Present value of deferred consideration (₹ 5,00,000 x .75)	375.00
Total consideration	1,735.00

2. **Calculation of net assets i.e. net worth at the acquisition date i.e. 1st April, 2017**

	₹ in 000s
Share capital of S Ltd.	500.00
Reserves of S Ltd.	125.00
Fair value increase on Property, Plant and Equipment	200.00
Net worth on acquisition date	825.00

3. **Calculation of Goodwill at the acquisition date i.e. 1st April, 2017 and 31st March, 2019**

	₹ in 000s
Purchase consideration (W.N.1)	1,735.00
Non-controlling interest at fair value (as given in the question)	380.00
	2,115.00
Less: Net worth (W.N.2)	(825.00)
Goodwill as on 1st April 2017	1,290.00
Less: Impairment (as given in the question)	258.00
Goodwill as on 31st March 2019	1,032.00

4. **Calculation of Property, Plant and Equipment as on 31st March 2019**

			₹ in 000s
A Ltd.			5,500
S Ltd.		1,500	
Add : Net fair value gain not recorded yet	200.00		
Less : Depreciation [(200/5) × 2]	(80.00)	120.00	1,620.00
			7,120.00

5. **Calculation of Post-acquisition gain (after adjustment of impairment on goodwill) and value of NCI as on 31st March 2019**

	₹ in 000s	₹ in 000s
	NCI (20%)	A Ltd. (80%)

Acquisition date balance		380.00	Nil
Closing balance of Retained Earnings	300.00		
Less: Pre-acquisition balance	(125.00)		
Post-acquisition gain	175.00		
Less: Additional Depreciation on PPE [(200/5) x 2]	(80.00)		
Share in post-acquisition gain	95.00	19.00	76.00
Less: Impairment on goodwill	258.00	(51.60)	(206.40)
		347.40	(130.40)

6. Consolidated Retained Earnings as on 31st March 2019

	₹ in 000s
A Ltd.	1,400.00
Add: Share of post-acquisition loss of S Ltd. (W.N.5)	(130.40)
Less: Finance cost on deferred consideration (37.5 + 41.25) (W.N.7)	(78.75)
Retained Earnings as on 31st March 2019	1,190.85

7. Calculation of value of deferred consideration as on 31 st March 2019

	₹ in 000s
Value of deferred consideration as on 1st April 2017 (W.N.1)	375.00
Add: Finance cost for the year 2017-2018 (375 x 10%)	37.50
	412.50
Add: Finance cost for the year 2018-2019 (412.50 x 10%)	41.25
Deferred consideration as on 31st March 2019	453.75

8. Calculation of current Liability as on 31st March 2019

	₹ in 000s
A Ltd.	1,250.00
S Ltd.	650.00
Deferred consideration as on 31st March 2019 (W.N.7)	453.75
Current Liability as on 31st March 2019	2,353.75

NOTES

CHAPTER 27

RELATED PARTY DISCLOSURES (IND AS 24)

CONCEPTS BASED EXAMPLES

Examples: Para 9 (a)

1. Mr. A holds 51% in equity share capital of A Limited. A Limited has no other form of share capital. As Mr. A controls A Limited, he is a related party.

2. Mrs. A is wife of Mr. A. Mr. A holds 51% of equity shares of A Limited. A Limited has no other form of share capital. Mr. A controls A Limited. Since Mr. A is a related party, Mrs. A is also a related party of A Limited.

3. Mr. D is a director of A Limited. Being a member of key management personnel of A Limited, he is related to A Limited.

4. Mr. D is a director of H Limited. S Limited is a subsidiary of H Limited. Mr. D is related to S Limited.

Example: Para 9 (b)

5. SA Limited and SB Limited are subsidiaries of H Limited. SA Limited, SB Limited and H Limited are related to each other.

6. AS Limited is an associate of S Limited. S Limited is a subsidiary of H Limited. SH Limited is another subsidiary of H Limited. AS Limited and SH Limited are related parties.

7. H Limited has entered into 2 joint ventures, JHA Limited (joint venture with A Limited) and JHB Limited (joint venture with B Limited). JHA Limited and JHB Limited are related parties.

8. JH Limited is a joint venture of H Limited. AH limited is an associate of H Limited. JH Limited and AH Limited are related parties.

9. Mr. A controls A Limited (the reporting entity). He also controls B Limited. A Limited and B Limited are related to each other.

10. Mr. A controls A Limited (the reporting entity). He is a non-executive director in B Limited. A Limited and B Limited are related parties.

11. A Ltd is a parent company with 3 subsidiary companies B Ltd. C Ltd & D Ltd. It also has an associate company E Ltd. Subsidiary F Ltd of E Ltd provides key management personnel services to A Ltd. F Ltd. is in a related party relationship with A, B, C D & E Ltd.

12. R Limited has an associate B Limited. B Limited has a subsidiary S Limited, a joint venture J Limited and an associate A Limited. R Limited is the reporting entity. It identifies B Limited and S Limited as its related parties. J Limited and A Limited are not related parties of R Limited.

Example 11: Not a Related Party

13. Mr. A is a director in X Limited. He is also a director in Y Limited. He has no other interest in either of these companies. There are no transactions between these two entities. X Limited and Y Limited are not related parties.

14. Mr. A is a director in X Limited. He is also a director in Y Limited. He has no other interest in either of these companies. Y Limited purchases the entire production of X Limited. The transactions are always at arm's length. X Limited and Y Limited may be related parties as it is quite possible that Y Limited may be able to exercise control/significant control over X Limited. As per this Standard substance is more important than mere legal form.

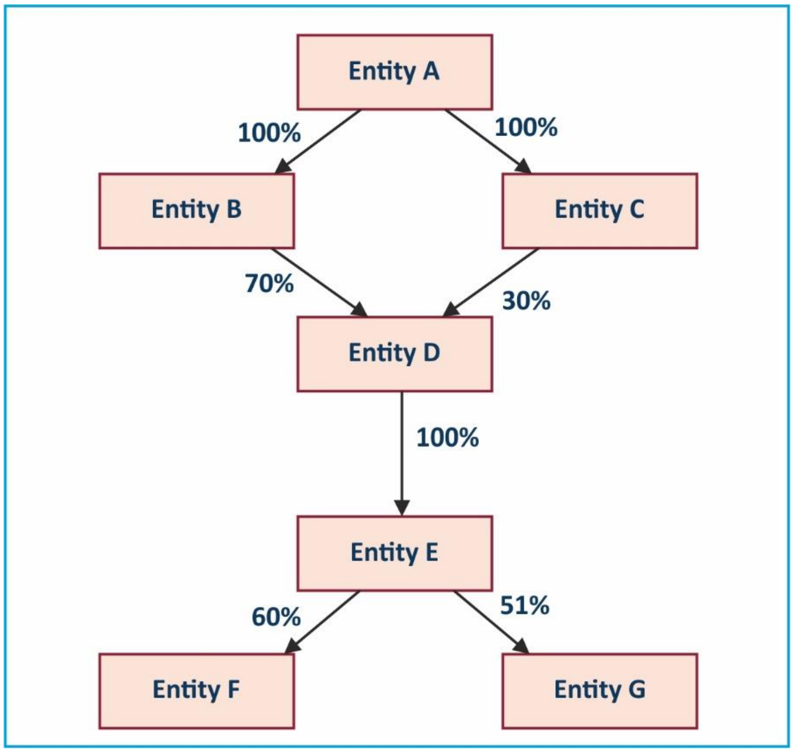
15. JV Limited is an equal joint venture of J Limited and V Limited. J Limited and V Limited are not related parties.

16. A Bank and B Bank has provided finance to XY Limited. By virtue of loan agreement, they occupy a non-executive observer seat on the Board of Directors of XY Limited. A Bank and B Bank are not related parties of XY Limited.

17. A Limited is an auto ancillary of an automobile company. It supplies all its production to the automobile company. Automobile company has no other interest in A Limited. A Limited and automobile company are not related parties.

Example: Disclosures

18. Entity E owns 60 per cent of entity F and 51 per cent of entity G. Entity E is wholly owned by entity D. Entity D is owned 70 per cent by entity B and 30 per cent by entity C. Entities B and C are wholly owned by entity A. All the entities prepare general purpose financial statements in accordance with the IND AS.



Extract from Note “Related party transactions” in entity E’s financial statements

Entity E is the parent of subsidiaries entity F (60 per cent ownership interest) and entity G (51 per cent ownership interest).

Entity D is the sole owner and immediate parent of entity E.

Entity A is the ultimate parent of entity E.

19. The facts are the same as in above example. However, in this example, neither entity A nor entity D produces financial statements available for public use.

Extract from Note “Related party transactions” in entity E’s financial statements

Entity E is the parent of subsidiaries entity F (60 per cent ownership interest) and entity G (51 per cent ownership interest).

Entity D is the sole owner and immediate parent of entity E. Entity A is the ultimate parent. However, neither entity A nor entity D produces financial statements available for public use.

Entity B (in which holds 70per cent ownership interest in Entity D) is entity E’s next most senior parent that produces financial statements available for public use.

20. The facts are the same as in above example. However, in this example, only entity A does not produce financial statements available for public use.

Extract from Note “Related party transactions” in entity E’s financial statements

Entity E is the parent of subsidiaries entity F (60 per cent ownership interest) and entity G (51 per cent ownership interest).

Entity D is the sole owner and immediate parent of entity E. Entity A is the ultimate parent. However, entity A does not produce financial statements available for public use.

21. The facts are the same as in above example. However, in this example, only entity D does not produce financial statements available for public use.

Extract from Note “Related party transactions” in entity E’s financial statements

Entity E is the parent of subsidiaries entity F (60 per cent ownership interest) and entity G (51 per cent ownership interest).

Entity D is the sole owner and immediate parent of entity E. However, entity D does not produce financial statements available for public use. Entity A is the ultimate parent.

22. A Holding Company entered into business transactions valuing ₹ 100 Crore, with its subsidiary during the financial year 2003-2004. The Holding Company divested its holding in the subsidiary before 31st March, 2004 and as such no related party relationship exists at the end of the year. Should the holding company disclose the relationship and the related transactions in its annual accounts?

The issue revolves round whether a related party transactions should be reported by a Parent, in its separate financial statement – even if, on balance sheet date the relationship does not exist. Paragraph 23 of AS 18 provides a clear answer to this issue. If there have been transactions between related parties, during the existence of a related party relationship, the reporting enterprise, should disclose details of transactions.

In the instant case, the relationship is one of Control. The transaction took place, during the existence of Related Party Relationship. Hence, the parent is required to disclose the details of transaction, of a sum of ₹ 100 crore worth of business transactions in its separate financial statements.

23. A Limited has a corporate communications department, which centralises the public relations function for the whole group of A Limited and its subsidiaries. No charges are, however, levied by A Limited on its subsidiaries and accordingly, these transactions are not given accounting recognition. Would these constitute related party transactions requiring disclosure under this Statement in the stand-alone financial statements of A Limited?

These transactions would require disclosure under this Statement in the stand-alone financial statements of A Limited. As per paragraph 10 of the Statement, a related party transaction is "a transfer of resources or obligations between related parties, regardless of whether or not a price is charged". In the above example, there is a transfer of resources from A Limited to its subsidiaries, though no price is charged for the same.

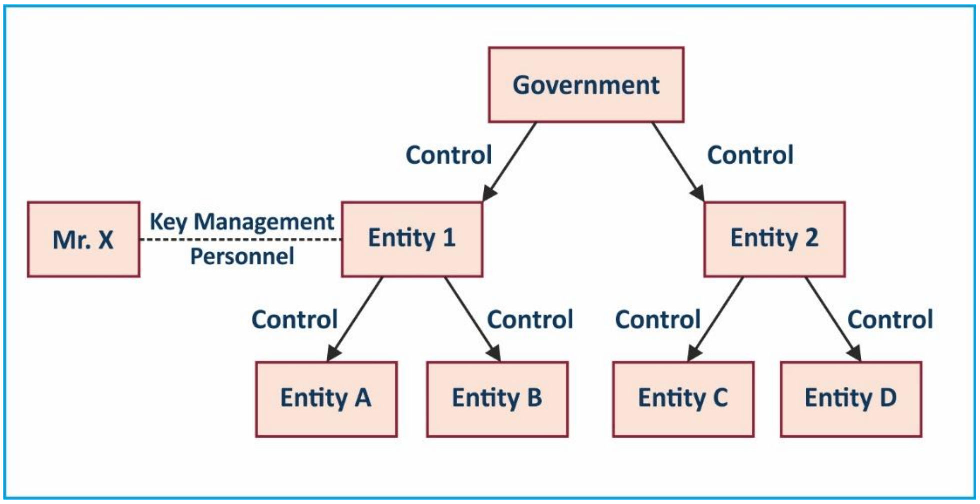
24. In 20X1 an entity sold a homogeneous good to a related party at the same price (published list price) and under the same conditions (cash on delivery) that it sold that good to all of its other customers.

The entity may state in its disclosures that the related party transaction was made on terms equivalent to those that prevail in an arm's-length transactions. These terms are substantiated by similar transactions with unrelated parties.

25. The facts are the same as in above example. However, in this example, the related party was granted a 10 per cent trade discount that is not available to independent third parties.

The entity must not state that the related party transactions were made on terms equivalent to those that prevail in an arm's-length transactions. The assertion would be false.

26. Government G directly or indirectly controls entities 1 and 2 and entities A, B, C and D. Mr X is a member of the key management personnel of entity 1.



For entity A's financial statements, the exemption in paragraph 25 applies to:

(a) transactions with Government G; and

(b) transactions with entities 1, 2, B, C and D.

However, that exemption does not apply to transactions with Mr X (see paragraphs 9(a)(iii)).

Despite the exemption, entity A must disclose that its parent is entity 1 and its ultimate controlling party is Government G.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited Required: Examine related party relationships of various entities.

Ans:

- In Separate Financial Statements of P Limited, SA Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SA Limited, P Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SB Limited, P Limited, SA Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SC Limited, P Limited, SA Limited, SB Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of associates A1 Limited, A2 Limited and A3 Limited; P Limited, SA Limited, SB Limited and SC Limited are related parties.
- A1 Limited, A2 Limited and A3 Limited are not related to each other.
- In Consolidated Financial Statements of P Limited, A1 Limited, A2 Limited and A3 Limited are not part of the Group since Group includes only parent and subsidiaries.

Q2: Mr. X has a 100% investment in A Limited. He is also a member of the key management personnel (KMP) of C Limited. B Limited has a 100% investment in C Limited.

Required

(a) Examine related party relationships from the perspective of C Limited for A Limited.

(b) Examine related party relationships from the perspective of C Limited for A Limited if Mr. X is a KMP of B Limited and not C Limited.

(c) Will the outcome in (a) & (b) would be different if Mr. X has joint control over A Limited.

(d) Will the outcome in (a) & (b) would be different if Mr. X has significant influence over A Limited.

Ans: (a) A Limited is related to C Limited because Mr. X controls A Limited and is a member of KMP of C Limited.

(b) Still A Limited will be related to C Limited.

(c) No, Still A Limited will be related to C Limited.

(d) Yes, A Ltd. is not controlled by Mr. X. Therefore, despite Mr. X being KMP of C Ltd., A Ltd., having significant influence of Mr. X, will not be considered as related party of C Limited.

Q3: Mr. X has an investment in A Limited and B Limited.

Required

(i) Examine when can related party relationship be established

(a) from the perspective of A Limited's financial statements:

(b) from the perspective of B Limited's financial statements:

(ii) Will A Limited and B Limited be related parties if Mr. X has only significant influence over both A Limited and B Limited

Ans: (i)

(a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Mr. X has control, joint control or significant influence over Entity B.

(b) If Mr. X controls or jointly controls A Limited, A Limited is related to Entity B when Mr. X has control, joint control or significant influence over Entity B.

(ii) No, A Ltd. & B Ltd., will not be considered as related party since no direct or indirect control is exercised on each other in any of the manner.

Q4: Government G directly controls Entity 1 and Entity 2. It indirectly controls Entity A and Entity B through Entity 1, and Entity C and Entity D through Entity 2. Person X is a member of the key management personnel in Entity 1.

Required

Examine the entity to whom the exemption for disclosure to be given and for transaction with whom.

Ans: For Entity A's financial statements, the exemption of Ind AS 24 applies to:

(a) transactions with Government G; and

(b) transactions with Entities 1 and 2 and Entities B, C and D. However, that exemption does not apply to transactions with Person X.

Q5: Power Limited is a producer of electricity. Transmission Limited regularly purchases electricity from Power Limited. Power Limited whose financial year ends on March 31, 20X2, acquired 100% shareholding of Transmission Limited on July 15, 20X1. However, the entire shareholding is disposed of on March 21, 20X2. Power Limited and Transmission Limited had transactions when Transmission Limited was a subsidiary of Power Limited and also in the period when it was not a subsidiary of Power Limited.

Required

What related party disclosures should Power Limited make in its financial statements for the year ended March 31, 20X2 with respect to transactions with Transmission Limited.

Ans: Power Limited should in its financial statements for the year ended March 31, 20X2 make related party disclosures for the period from July 15, 20X1 to March 21, 20X2 when Transmission Limited was its subsidiary.

Q6: Mr. X is a domestic partner of Ms. Y. Mr. X has an investment in A Limited and Ms. Y has an investment in B Limited.

Required

(a) Examine when can a related party relationship is established, from the perspective of A Limited's financial statements:

(b) Examine when can related party relationship is established, from the perspective of B Limited's financial statements:

(c) Will A Limited and B Limited be related parties if Mr. X has only significant influence over A Limited and Ms. Y also has significant influence over B Limited:

Ans: (a) If Mr. X controls or jointly controls A Limited, B Limited is related to A Limited when Ms. Y has control, joint control or significant influence over B Limited.

(b) If Mr. X controls or jointly controls A Limited , A Limited is related to B Limited when Ms. Y has control, joint control or significant influence over B Limited.

(c) No, Significant influence does not lead to direct/indirect control between the A Ltd. & B Ltd.

Q7: A Limited has both (i) joint control over B Limited and (ii) joint control or significant influence over C Limited

Required

(a) Examine related party relationship from the perspective of C Limited's financial statements:

(b) Examine related party relationship from the perspective of B Limited's financial statements:

Ans: (a) C Limited is related to B Limited

(b) B Limited is related to C Limited

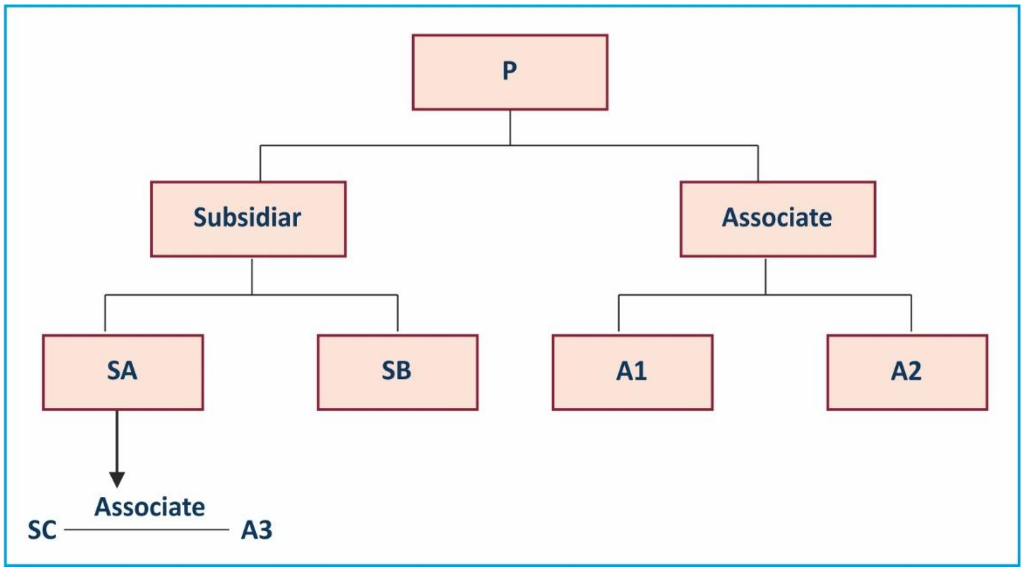
NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q8: Associates and subsidiaries

Entity P Limited has a controlling interest in subsidiaries SA Limited and SB Limited and SC Limited. SC Limited is a subsidiary of SB Limited. P Limited also has significant influence over associates A1 Limited and A2 Limited. Subsidiary SC Limited has significant influence over associate A3 Limited

Examine related party relationships of various entities.

Ans:



- In Separate Financial Statements of P Limited, SA Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SA Limited, P Limited, SB Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SB Limited, P Limited, SA Limited, SC Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of SC Limited, P Limited, SA Limited, SB Limited, A1 Limited, A2 Limited and A3 Limited are all related parties.
- In the Individual Financial Statements of associates A1 Limited, A2 Limited and A3 Limited; P Limited, SA Limited, SB Limited and SC Limited are related parties.
- A1 Limited, A2 Limited and A3 Limited are not related to each other.
- For Parent's consolidated financial statements, A1 Limited, A2 Limited and A3 Limited are related to the Group

Q9: Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 20X2 to the managing director Mr. Y for approval. Mr. Y, who is not an accountant, had raised following query from Mr. X after going through the draft financial statements:

One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period 20X1-20X2. Mr. Y owns 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

Provide answers to the query raised by the Managing Director Mr. Y as per Ind AS.

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

Related parties are generally characterised by the presence of control or influence between the two parties.

Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in Notes to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

Q10: S Ltd., a wholly owned subsidiary of P Ltd is the sole distributor of electricity to consumers in a specified geographical area. A manufacturing facility of P Ltd is located in the said geographical area and, accordingly, P Ltd is also a consumer of electricity supplied by S Ltd. The electricity tariffs for the geographical area are determined by an independent rate-setting authority and are applicable to all consumers of S Ltd, including P Ltd. Whether the above transaction is required to be disclosed as a related party transaction as per Ind AS 24, Related Party Disclosures in the financial statements of S Ltd.?

Ans: As per paragraph 9(b)(i) of Ind AS 24, each parent, subsidiary and fellow subsidiary in a 'group' is related to the other members of the group. Thus, in the case under discussion, P Ltd is a related party of S Ltd from the perspective of financial statements of S Ltd.

Paragraph 11 of Ind AS 24 states as follows:

"In the context of this Standard, the following are not related parties:

a) two entities simply because they have a director or other member of management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.

b) two joint venturers simply because they share joint control of a joint venture.

c) (i) providers of finance,(ii) trade unions, (iii) public utilities, and (iv) departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).

d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence."

Being engaged in distribution of electricity, S Ltd is a public utility. Had the only relationship between S Ltd and P Ltd been that of a supplier and a consumer of electricity, P Ltd would not have been regarded as a related party of S Ltd. However, as per the facts of the given case, this is not the only relationship between S Ltd and P Ltd. Apart from being a supplier of electricity to P Ltd., S Ltd is also a subsidiary of P Ltd; this is a relationship that is covered within the related party relationships to which the disclosure requirements of the standard apply. In view of the above, the supply of electricity by S Ltd to P Ltd is a related party transaction that attracts the disclosure requirements contained in paragraph 18 and other relevant requirements of the standard. This is notwithstanding the fact that P Ltd is charged the electricity tariffs determined by an independent rate-setting authority (i.e., the terms of supply to P Ltd are at par with those applicable to other consumers)

Ind AS 24 does not exempt an entity from disclosing related party transactions merely because they have been carried out on an arm's length basis.

QUESTIONS FROM RTP/MTP/EXAMS

Q11: ABC Ltd. is a long-standing customer of XYZ Ltd. Mrs. P whose husband is a director in

XYZ Ltd. purchased a controlling interest in entity ABC Ltd. on 1st June, 2017. Sales of products from XYZ Ltd. to ABC Ltd. in the two-month period from 1st April 2017 to 31st May 2017 totalled ₹ 8,00,000. Following the shares purchased by Mrs. P, XYZ Ltd. began to supply the products at a discount of 20% to their normal selling price and allowed ABC Ltd. three months' credit (previously ABC Ltd. was only allowed one month's credit, XYZ Ltd.'s normal credit policy). Sales of products from XYZ Ltd. to ABC Ltd. in the ten-month period from 1st June 2017 to 31st March 2017 totalled ₹ 60,00,000. On 31st March 2018, the trade receivables of XYZ Ltd. included ₹ 18,00,000 in respect of amounts owing by ABC Ltd.

Analyse and show how the above event would be reported in the financial statements of XYZ Ltd. for the year ended 31 March 2018 and mention the disclosure requirements also as per Ind AS. **[RTP Nov 2018]**

Ans: XYZ Ltd. would include the total revenue of ₹ 68,00,000 (₹ 60,00,000 + ₹ 8,00,000) from ABC Ltd. received / receivable in the year ended 31st March 2018 within its revenue and show ₹ 18,00,000 within trade receivables at 31st March 2018.

Mrs. P would be regarded as a related party of XYZ Ltd. because she is a close family member of one of the key management personnel of XYZ Ltd.

From 1st June 2017, ABC Ltd. would also be regarded as a related party of XYZ Ltd. because from that date ABC Ltd. is an entity controlled by another related party.

Because ABC Ltd. is a related party with whom XYZ Ltd. has transactions, then XYZ Ltd. should disclose:

– The nature of the related party relationship.

– The revenue of ₹ 60,00,000 from ABC Ltd. since 1st June 2017.

– The outstanding balance of ₹ 18,00,000 at 31st March 2018.

In the current circumstances it may well be necessary for XYZ Ltd. to also disclose the favourable terms under which the transactions are carried out.

Q12: Mr. Atul is an independent director of a company X Ltd. He plays a vital role in the Management of X Ltd. and contributes in major decision making process of the organisation. X Ltd. pays sitting fee of ₹ 2,00,000 to him for every Board of Directors' (BOD) meeting he attends. Throughout the year, X Ltd. had 5 such meetings which was attended by Mr. Atul.

Similarly, a non-executive director, Mr. Naveen also attended 5 BOD meetings and charged ₹ 1,50,000 per meeting. The Accountant of X Ltd. believes that they being not the employees of the organisation, their fee should not be disclosed as per related party transaction in accordance with Ind AS 24.

Examine whether the sitting fee paid to independent director and non-executive director is required to be disclosed in the financial statements prepared as per Ind AS?

[RTP May 2018]

Ans: As per paragraph 9 of Ind AS 24, Related Party Disclosures, "Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity."

Accordingly, key management personnel (KMP) includes any director of the entity who are having authority and responsibility for planning, directing and controlling the activities of the entity. Hence, independent director Mr. Atul and non-executive director Mr. Naveen are covered under the definition of KMP in accordance with Ind AS.

Also as per paragraph 7 and 9 of Ind AS 19, 'Employee Benefits', an employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of the Standard, Employees include directors and other management personnel.

Therefore, contention of the Accountant is wrong that they are not employees of X Ltd.

Paragraph 17 of Ind AS requires disclosure about employee benefits for key management personnel. Therefore, an entity shall disclose key management personnel compensation in total i.e. disclosure of directors' fee of (₹ 10,00,000 + ₹ 7,50,000) ₹ 17,50,000 is to be made as employees benefits (under various categories).

Since short-term employee benefits are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related services, the sitting fee paid to directors will fall under it (as per Ind AS 19) and is required to be disclosed in accordance with the paragraph 17 of Ind AS 24.

Q13: An Indian company has a parent company out side India. Parent company negotiates software licenses with end vendor and based on number of licences, parent company get its reimbursement from Indian company. Say, license cost of ₹ 12 Lac is charged for calendar year of 2018. Parent company generates is invoice in February'18. Indian company accounts full invoice in February'18 and then for Indian financial year, accounts Reimbursement expense of ₹ 3. 00 Lac during FY 1718 (for licencing cost relating to period January'18 to March'18) and

Prepaid expenses of ₹ 9 Lac for licensing cost reimbursement relating to April'18 to December'18. Prepaid expense is subsequently reversed and expense of ₹ 9 Lac is accounted for in FY 18-19.

What amount should be disclosed at Related party transaction? **[MTP May 2019]**

Ans: Paragraph 9 of Ind AS 24 Related Party Disclosures defines Related Party Transactions as under:

"A related party transaction is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged."

Paragraph 6 of Ind AS 24 states as under:

"6 A related party relationship could have an effect on the profit or loss and financial position of an entity..."

In the given case, there is a transfer of resources to the extent of ₹12 lac from the company to the parent towards software license. Of this transfer of resources, the company has consumed the benefits relating to ₹3 lac of software license cost which is recognise in profit or loss. The benefits relating to ₹9 lac of software license cost will be consumed in the next reporting period and therefore is recognised in balance sheet as prepaid expenses.

Paragraph 18 of Ind AS 24 states as under:

"18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments necessary for users to understand the potential effect of the relationship of the financial statements. At a minimum, disclosures shall include:

a. The amount of the transactions;

b. The amount of outstanding balances, including commitments, and;

   (i) Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

   (ii) Details of any guarantees given or received;

c. Provisions for doubtful debts related to the amount of outstanding balances; and

d. The expense recognised during the period in respect of bad and doubtful debts due from related parties."

Therefore, the company has to disclose:

1. The amount of transaction with the parent of ₹12 lac towards software license;
2. Outstanding balance of ₹9 lac presented as prepaid expense along with the terms and conditions and state that the same will be settled in the next reporting period by receipt of software licensing services.
3. The amount of ₹3 lac recognised as software license expense in profit or loss for the benefits consumed during the period to make it understandable to users.

Paragraph 113 of Ind AS 1 Presentation of Financial Statements states as under:

"113 An entity shall present notes in a systematic manner. An entity shall cross-reference each line items in the balance sheet and in the statement of profit and loss, and in the statement of changes in equity and of cash flows to any related information in the notes."

Therefore, the company shall cross-reference the software license expense recognised in profit or loss and prepaid expenses recognised in balance sheet to the notes disclosing related party transactions.

Q14: Uttar Pradesh State Government holds 60% shares in PQR Limited and 55% shares in ABC Limited. PQR Limited has two subsidiaries namely P Limited and Q Limited. ABC Limited has two subsidiaries namely A Limited and B Limited. Mr. KM is one of the Key management personnel in PQR Limited. ·

(a) Determine the entity to whom exemption from disclosure of related party transactions is to be given. Also examine the transactions and with whom such exemption applies.

(b) What are the disclosure requirements for the entity which has availed the exemption?

RTP Nov 2019]

Ans: (a) As per para 18 of Ind AS 24, 'Related Party Disclosures', if an entity had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements.

However, as per para 25 of the standard a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with:

(i) a government that has control or joint control of, or significant influence over, the reporting entity; and

(ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity

According to the above paras, for Entity P's financial statements, the exemption in paragraph 25 applies to:

(i) transactions with Government Uttar Pradesh State Government; and

(ii) transactions with Entities PQR and ABC and Entities Q, A and B.

Similar exemptions are available to Entities PQR, ABC, Q, A and B, with the transactions with UP State Government and other entities controlled directly or indirectly by UP State Government. However, that exemption does not apply to transactions with Mr. KM. Hence, the transactions with Mr. KM needs to be disclosed under related party transactions.

(b) It shall disclose the following about the transactions and related outstanding balances referred to in paragraph 25:

(a) the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);

(b) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

(i) the nature and amount of each individually significant transaction; and

(ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Q15: Mr. X owns 95% of entity A and is its director. He is also beneficiary of a trust that owns 100% of entity B, of which he is a director.

Whether entities A and B are related parties?

Would the situation be different if:

a. Mr. X resigned as a director of entity A, but retained his 95% holding?

b. Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust? **[RTP Nov 2020]**

Ans: Entities A and B are related parties, because the director (Mr. X) controls entity A and is a member of the key management personnel of entity B.

Answers to different given situations would be as under:

a) **Mr. X resigned as a director of entity A, but retained his 95% holding**

Mr. X continues to control entity A through his 95% holding even though he is not (nominally) a director of the entity. Entities A and B are related if Mr. X controls the trust. Mr. X controls entity A and also, through the trust, controls entity B. Entities A and B are controlled by the same person, and so they are related parties.

Mr. X might still be a member of 'key management personnel' even though he is not (nominally) a director of entity A. Key management personnel includes, but is not restricted to, directors, which include those who are executive 'or otherwise' provided they had authority and responsibility for planning, directing and controlling the activities of the entity. There could be two reasons why entities A and B would continue to be related parties: Mr. X being a member of 'Key management personnel' of entity A and Mr. X controlling entity A.

b) **Mr. X resigned as a director of entities A and B and transferred the 95% holding in entity A to the trust.**

If Mr. X controls the trust, he controls entities A and B through the trust, so they will be related parties (see reason in (a) above)

Mr. X is a member of ‘key management personnel’ of the two entities (see (a) above) if, as seems likely, he continues to direct their operating and financial policies. The substance of the relationship and not merely the legal form should be considered. If Mr X is regarded as a member of the key management personnel of, say, entity A, entity B is a related party, because he exercises control or significant influence over entity B by virtue of his control over the trust.

NOTES

CHAPTER 28

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES (IND AS 21)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: Future Ltd. sells a revitalising energy drink that is sold throughout the world. Sales of the energy drink comprise over 90% of the revenue of Future Ltd. For convenience and consistency in pricing, sales of the energy drink are denominated in USD. All financing activities of Future Ltd. are in its local currency (L$), although the company holds some USD cash reserves. Almost all of the costs incurred by Future Ltd. are denominated in L$ What is the functional currency of Future Ltd.?

Ans: The functional currency of Future Ltd. is the L$ Looking at the primary indicators, the facts presented indicate that the currency that mainly influences the cost of producing the energy drink is the L$. As stated in the fact pattern, pricing of the product in USD is done for convenience and consistency purposes; there is no indication that the sales price is influenced by the USD.

Q2: Small India Private Limited, a subsidiary of Big Inc., takes orders from Indian customers for Big's merchandise and then bills and collects for the sale of the merchandise. Small also has a local warehouse in India to facilitate timely delivery and ensures that it remits to its parent all cash flows that it generates as the operations of Small are primarily financed by Big Inc. What is Small's functional currency?

Ans: Small, although based in India with its cash inflows generated within India, is essentially a "pass through company" established by its parent. Small is totally reliant on Big for financing and goods to be sold, despite the fact that goods are sold within India and in Indian Rupees. Therefore, Small is not a self contained entity within India, but rather an entity that relies on its parent. This reliance translates into a reliance on the parent's functional currency, the US Dollar. Therefore, the primary economic environment is US and thus the functional currency is the US Dollar. Therefore, Small India Private Limited would have the US Dollar as it functional currency and hence any receivables or payables of the branch or subsidiary denominated in currencies other than the US Dollar would be remeasured into the US Dollar at the current rate, and changes in the exchange rate would result in an exchange gain or loss to be included in net income.

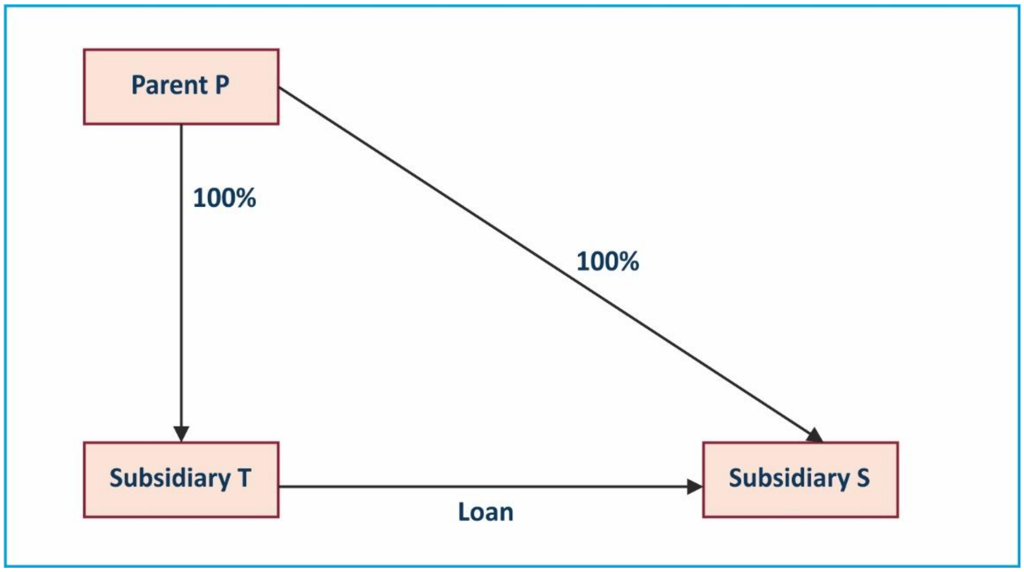
Q3: Functional currency of parent P is EURO while the functional currency of its subsidiary S is USD. P sells inventory to S for EURO 300. At the reporting date, though the amount is yet to be received from S, the payment is expected to be made in the foreseeable future. In addition to the trading balances between P and S, P has lent an amount of EURO 500 to S that is not expected to be repaid in the foreseeable future. Should the exchange difference be recognised in the profit and loss account?

Ans: The exchange gain or loss incurred by P on the trading balance should be recognised in profit or loss. Even if repayment was not due for three years (for example) or even longer, but if repayment is still planned, then the gain or loss should be recognised in profit or loss.

The amount lent by P should be regarded as part of its permanent funding to S. Thus, the exchange gain or loss incurred by P on the EURO 500 loan should be recognised in profit or loss in P's separate financial statements, but recognised in other comprehensive income and presented within equity in the consolidated financial statements.

Q4: Modifying the above illustration, suppose that for tax reasons, the 'permanent' funding extended to S is made via another entity in the group, T, rather than from P directly i.e., on the directions of P, T gives the loan to S. Where should the exchange differences be recognised?

Ans:



Any exchange difference in respect of the loan is recognised in other comprehensive income in the consolidated financial statements because from the group's point of view the funding relates to an investment in a foreign operation. This is the case irrespective of the currency in which the loan is denominated. So if the loan is denominated in T's functional currency, and this is different from that of S, then exchange differences still should be recognised in other comprehensive income in the consolidated financial statements.

Q5: The functional and presentation currency of parent P is USD while the functional currency of its subsidiary S is EURO. P sold goods having a value of USD 100 to S when the exchange rate was USD 1 = Euro 2. At year-end, the amount is still due and the exchange rate is USD 1 = Euro 2.2. How should the exchange differences be accounted for in the consolidated financial statements?

Ans: At year-end, S should revalue its accounts payable to EURO 220, recognising a loss of 20 in its standalone profit or loss. Thus, in the books of S, the balance payable to P will appear at EURO 220 while in the books of P the balance receivable from S will be USD 100.

For consolidation purposes, the assets and liabilities of S will be translated to USD at the closing rate i.e., USD 100 which will get eliminated against the receivable in the books of P but the

EURO 20 exchange loss recorded in the subsidiary's statement of profit and loss has no equivalent gain in the parent's financial statements. Therefore, the EURO 20 loss will remain in the consolidated statement of profit and loss.

The reason for this is that the intra-group balance represents a commitment to translate Euro into USD and this is similar to holding a foreign currency asset in the parent company. The subsidiary must go out and buy USD to settle the obligation to the parent, so the Group as a whole has an exposure to foreign currency risk.

Q6: Parent P acquired 90 percent of subsidiary S some years ago. P now sells its entire investment in S for ₹ 1,500 lakhs. The net assets of S are 1,000 and the NCI in S is ₹ 100 lakhs. The cumulative exchange differences that have arisen during P's ownership are gains of ₹ 200 lakhs, resulting in P's foreign currency translation reserve in respect of S having a credit balance of ₹180 lakhs, while the cumulative amount of exchange differences that have been attributed to the NCI is ₹ 20 lakhs

Calculate P's gain on disposal.

Ans: P's gain on disposal would be calculated in the following manner:

	(₹ in Lakhs)
Sale proceeds	1500
Net assets of S	(1000)
NCI derecognised	100
Foreign currency translation reserve	180
Gain on disposal	780

Q7: Infotech Global Ltd. has a functional currency of USD and needs to translate its financial statements into the functional and presentation currency of Infotech Inc. (L$).

The following is the statement of financial position of Infotech Global Ltd. prior to translation:

	USD	**L$**
Property, plant and equipment	50,000	
Receivables	9,35,000	
Total assets	9,85,000	
Issued capital	50,000	30,055
Opening retained earnings	28,000	15,274
Profit for the year	20,000	
Accounts payable	8,40,000	
Accrued liabilities	47,000	
Total equity and liabilities	9,85,000	

Required:

Translate the statement of financial position of Infotech Global Ltd. into L$ ready for consolidation by Infotech Inc. (Share capital and opening retained earnings have been pre-populated.)

Prepare a working of the cumulative balance of the foreign currency translation reserve.

Additional information:

Relevant exchange rates are:

Rate at beginning of the year L$ 1 = USD 1.22

Average rate for the year L$ 1 = USD 1.175

Rate at end of the year L$ 1 = USD 1.13

Ans: Translation of the financial statements

	USD	**Rate**	**L$**
Property, plant and equipment	50,000	1.13	44,248
Receivables	9,35,000	1.13	8,27,434
Total assets	9,85,000		8,71,682
Issued capital	50,000	—	30,055
Opening retained earnings	28,000	—	15,274
Profit for the year	20,000	1.175	17,021
Accounts payable	8,40,000	1.13	7,43,363
Accrued liabilities	47,000	1.13	41,593
Total equity and liabilities USD	9,85,000		8,47,306
Foreign Currency Translation Reserve			24,376
(proof below)			
Total equity and liabilities L$			8,71,682

Working of the cumulative balance of the FCTR

Particulars	**Actual translated amount in L$**	**Amount**	**Difference translated at closing rate of 1.13**
Issued capital	30,055	44,247	14,192
Opening retained earnings	15,274	24,779	9,505
Profit for the year	17,021	17,699	678
[Difference of 1 is rounding]	62,350	86,725	24,375

Q8: A is an Oman based company having a foreign operation, B, in India. The foreign operation was primarily set up to execute a construction project in India. The functional currency of A is OMR.

78% of entity B 's finances have been raised in USD by way of contribution from A. B's bank accounts are maintained in USD as well as INR. Cash flows generated by B are transferred to A on a monthly basis in USD in respect of repayment of finance received from A.

Revenues of B are in USD. Its competitors are globally based. Tendering for the construction project happened in USD.

B incurs 70% of the cost in INR and remaining 30% costs in USD.

Since B is located in India can it can presume its functional currency to be INR?

Ans: No, B cannot presume INR to be its functional currency on the basis of its location. It needs to consider various factors listed in Ind AS for determination of functional currency.

Primary indicators:

1. the currency that mainly influences

   (a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

   (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

2. Other factors that may provide supporting evidence to determine an entity's functional currency are (Secondary indicators):

   (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and

   (b) the currency in which receipts from operating activities are usually retained.

3. If an entity is a foreign operation, additional factors set out in Ind AS 21 should be considered to determine whether its functional currency is the same as that of the reporting entity of which it is a subsidiary, branch, associate or joint venture:

   (a) Whether the activities of foreign operations are carried out as an extension of that reporting entity, rather than being carried out with a significant degree of autonomy;

   (b) Whether the transactions with the reporting entity are a high or a low proportion of the foreign operation's activities;

   (c) Whether cash flows from the activities of the foreign operations directly affect the cash flows of the reporting entity and are readily available for remittance to it

   (d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligation without funds being made available by the reporting entity.

On the basis of additional factors mentioned in point 3 above, B cannot be said to have functional currency same as that of A Ltd.

Hence primary and secondary indicators should be used for the determination of functional currency of B giving priority to primary indicators. The analysis is given below:

Its significant revenues and competitive forces are in USD.

Its significant portion of cost is incurred in INR. Only 30% costs are in USD. 78% of its finances have been raised in USD.

It retains its operating cash flows partially in USD and partially in INR.

Keeping these factors in view, USD should be considered as the functional currency of B.

Q9: S Ltd is a company based out of India which got listed on Bombay Stock Exchange in the financial year ended 31st March, 2011. Since then the company's operations have increased considerably. The company was engaged in the business of trading of motor cycles. The company only deals in imported Motor cycles. These motor cycles are imported from US.

After importing the motor cycles, these are sold across India through its various distribution channels. The company had only private customers earlier but the company also started corporate tie-up and increased its customer base to corporates also. The purchase of the motor cycles is in USD because the vendor(s) from whom these motor cycles are purchased those are all located in US.

All other operating expenses of the company are incurred in India only because of its location and they generally happen to be in INR

Currently, its customers are both corporate and private in the ratio of 70:30 approximately. The USD denominated prices of motor cycles in India are different from those in other countries.

The company is also expecting that in the coming years, its customers base will increase significantly in India and the current proportion may also change.

Currently, the invoices are raised to the corporate customers in USD for the purpose of hedging. However, private customers don't accept the same arrangement and hence invoices are raised to them in INR.

What would be the functional currency of this company?

Ans: The functional currency of S Ltd is INR.

Following factors need to be considered for determination of functional currency: Primary indicators

1. the currency that mainly influences

   (a) sales prices for its goods and services. This will often be the currency in which sales prices are denominated and settled; and of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

   (b) labour, material and other costs of providing goods and services. This will often be the currency in which these costs are denominated and settled.

2. Other factors that may provide supporting evidence to determine an entity's functional currency are (Secondary indicators):

   (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and

   (b) the currency in which receipts from operating activities are usually retained.

Primary and secondary indicators should be used for the determination of functional currency of S Ltd. giving priority to primary indicators.

The analysis is given below:

Ind AS 21 gives greater emphasis to the currency of the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated.

Sales prices for motor cycles are mainly influenced by the competitive forces and regulations in India. The market for motor cycles depends on the economic situation in India and the company is in competition with importers of other motor cycle brands.

Even though 70% of the revenue of the company is denominated in USD, Indian economic conditions are the main factors affecting the prices. This is evidenced by the fact that USD denominated sales prices in India are different from USD denominated sales prices for the same motor cycles in other countries.

Management is able to determine the functional currency because the revenue is clearly influenced by the Indian economic environment and expenses are mixed.

On the basis of above analysis, INR should be considered as the functional currency of the company.

Q10: M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and the operations of M Ltd are very large and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 2011. The cost of these bottles was ₹ 830 lacs in the books of M Ltd at the time of sale. At the year-end i.e. 31st March, 2011, all these bottles were lying as closing stock with G Ltd. What should be the accounting treatment for the above? Following additional information is available:

Exchange rate on 1st February, 2011	1 Euro = ₹ 83
Exchange rate on 31st March, 2011	1 Euro = ₹ 85

Ans: Accounting treatment in the books of M Ltd

M Ltd will recognize sales of ₹ 996 lacs (12 lacs Euro X 83) Profit on sale of inventory = 996 lacs – 830 lacs = ₹ 166 lacs. Accounting treatment in the books of G Ltd

G Ltd will recognize inventory on 1February, 2011 of Euro 12 lacs which will also be its closing stock at year end.

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above mentioned sale / purchase between M Ltd and G Ltd will get eliminated.

The closing stock of G Ltd will be translated at year end resulting in amount of closing stock of ₹ 1,020 lacs (12 lacs Euro X 85).

The restated amount of closing stock includes three components–

- Restated amount of cost of inventory for ₹ 850 lacs
- Profit element of ₹ 166 lacs; and
- Translated amount of profit element of ₹ 4 lacs.

At the time of consolidation, the two elements amounting to ₹ 170 lacs will be eliminated from the closing stock.

Q11: Entity A, whose functional currency is ₹, has a foreign operation, Entity B, with a Euro functional currency. Entity B issues to A perpetual debt (i.e. it has no maturity) denominated in euros with an annual interest rate of 6 per cent. The perpetual debt has no issuer call option or holder put option. Thus, contractually it is just an infinite stream of interest payments in Euros.

In A's consolidated financial statements, can the perpetual debt be considered, in accordance with Ind AS 21.15, a monetary item "for which settlement is neither planned nor likely to occur in the foreseeable future" (i.e. part of A's net investment in B), with the exchange gains and losses on the perpetual debt therefore being recorded in equity?

Ans: Yes, as per Ind AS 21 net investment in a foreign operation is the amount of the reporting entity’s interest in the net assets of that operation.

As per para 15 of Ind AS 21, an entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity’s net investment in that foreign operation. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Analysis on the basis of above mentioned guidance

Through the origination of the perpetual debt, A has made a permanent investment in B. The interest payments are treated as interest receivable by A and interest payable by B, not as repayment of the principal debt. Hence, the fact that the interest payments are perpetual does not mean that settlement is planned or likely to occur. The perpetual debt can be considered part of A's net investment in B.

In accordance with para 15 of Ind AS 21, the foreign exchange gains and losses should be recorded in equity at the consolidated level because settlement of that perpetual debt is neither planned nor likely to.

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q12. M Ltd is engaged in the business of manufacturing of bottles for pharmaceutical companies and non-pharmaceutical companies. It has a wholly owned subsidiary, G Ltd, which is engaged in the business of pharmaceuticals. G Ltd purchases the pharmaceutical bottles from its parent company. The demand of G Ltd is very high and the operations of M Ltd are very large and hence to cater to its shortfall, G Ltd also purchases the bottles from other companies. Purchases are made at the competitive prices.

M Ltd sold pharmaceuticals bottles to G Ltd for Euro 12 lacs on 1st February, 20X1. The cost of these bottles was ₹ 830 lacs in the books of M Ltd at the time of sale. At the year-end i.e. 31st March, 20X1, all these bottles were lying as closing stock with G Ltd.

Euro is the functional currency of G Ltd. while Indian Rupee is the functional currency of M Ltd. Following additional information is available:

Exchange rate on 1st February, 20X11 Euro = ₹ 83

Exchange rate on 31st March, 20X11 Euro = ₹ 85

Provide the accounting treatment for the above in books of M Ltd. and G Ltd. Also show its impact on consolidated financial statements. Support your answer by Journal entries, wherever necessary, in the books of M Ltd.

Ans: Accounting treatment in the books of M Ltd (Functional Currency INR)

M Ltd will recognize sales of ₹ 996 lacs (12 lacs Euro x 83) Profit on sale of inventory = 996 lacs – 830 lacs = ₹ 166 lacs.

On balance sheet date receivable from G Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 24 lacs. (i.e. (85 - 83) x 12 Lacs)

Journal Entries

	₹ (in Lacs)	₹ (in Lacs)
G Ltd. A/c Dr.	996	
To Sales		996
(Being revenue recorded on initial recognition)		
G Ltd. A/c Dr.	24	
To Foreign exchange difference (unrealised)		24
(Being foreign exchange difference recorded at year end)		

Accounting treatment in the books of G Ltd (Functional currency EURO)

G Ltd will recognize inventory on 1st February, 20X1 of Euro 12 lacs which will also be its closing stock at year end.

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above mentioned sale / purchase between M Ltd and G Ltd will get eliminated.

The closing stock of G Ltd will be recorded at lower of cost or NRV.

	Euro (in lacs)	**Rate**	**₹ (in lacs)**
Cost	12	83	**996**
NRV (Assumed Same)	12	85	1020

Therefore, no write off is required.

The amount of closing stock includes two components–

- Cost of inventory for ₹ 830 lacs; and
- Profit element of ₹ 166 lacs; and

At the time of consolidation, the two elements amounting to ₹ 166 lacs will be eliminated from the closing stock.

Journal Entry

	₹ (in Lacs)	₹ (in Lacs)
Consolidated P&L A/c Dr. To Inventory (Being profit element of intragroup transaction eliminated)	166	 166

QUESTIONS FROM RTP/MTP/EXAMS

Q13: On 1st January, 2018, P Ltd. purchased a machine for $ 2 lakhs. The functional currency of P Ltd. is Rupees. At that date the exchange rate was $1= ₹ 68. P Ltd. is not required to pay for this purchase until 30th June, 2018. Rupees strengthened against the $ in the three months following purchase and by 31st March, 2018 the exchange rate was $1 = ₹ 65. CFO of P Ltd. feels that these exchange fluctuations wouldn't affect the financial statements because P Ltd. has an asset and a liability denominated in rupees. which was initially the same amount. He also feels that P Ltd. depreciates this machine over four years so the future year-end amounts won't be the same.

Examine the impact of this transaction on the financial statements of P Ltd. for the year ended 31st March, 2018 as per Ind AS. **[RTP Nov 2018]**

Ans: As per Ind AS 21 'The Effects of Changes in Foreign Exchange Rates' the asset and liability would initially be recognised at the rate of exchange in force at the transaction date ie 1st January, 2018. Therefore, the amount initially recognised would be ₹ 1,36,00,000 ($ 2,00 000 x ₹ 68).

The liability is a monetary item so it is retranslated using the rate of exchange in force at 31st March, 2018. This makes the closing liability of ₹ 1,30,00,000 ($ 2,00,000 x ₹ 65).

The loss on re-translation of ₹ 6,00,000 (₹ 1,36,00,000 – ₹ 1,30,00,000) is recognised in the Statement of profit or loss.

The machine is a non-monetary asset carried at historical cost. Therefore, it continues to be translated using the rate of ₹ 68 to $ 1.

Depreciation of ₹ 8,50,000 (₹ 1,36,00,000 x ¼ x 3/12) would be charged to profit or loss for the year ended 31st March, 2018.

The closing balance in property, plant and equipment would be ₹ 1,27,50,000 (₹ 1,36,00,000 – ₹ 1,30,00,000). This would be shown as a non-current asset in the statement of financial position.

Q14: On 30th January, 20X1, A Ltd. purchased a machinery for $ 5,000 from USA supplier on credit basis. A Ltd.'s functional currency is Rupees. The exchange rate on the date of transaction is 1

$ = ₹ 60. The fair value of the machinery determined on 31st March, 20X1 is $ 5,500. The exchange rate on 31st March, 20X1 is 1$ = ₹ 65. The payment to overseas supplier done on 31st March 20X2 and the exchange rate on 31st March 20X2 is 1$ = ₹ 67. The fair value of the machinery remain unchanged for the year ended on 31st March 20X2. Prepare the Journal entries for the year ended on 31st March 20X1 and year 20X2 according to Ind AS 21. Tax rate is 30%

[RTP May 2018]

Ans: Journal Entries

Purchase of Machinery on credit basis on 30th January 20X1:

	₹	₹
Machinery A/c (5,000 x $ 60) Dr.	3,00,000	3,00,000
To Creditor - Machinery		
(Initial transaction will be recorded at exchange rate on the date of transaction)		

Exchange difference arising on translating monetary item on 31st March 20X1:

		₹	₹
Profit & Loss A/c [(5,000 x $ 65) – (5,000 x $ 60)]	Dr.	25,000	
To Creditor - Machinery			20,000
Machinery A/c	Dr.	30,000	
To Revaluation Surplus (OCI)			30,000
[Being Machinery revalued to USD 5,500; (₹ 60 x (USD 5,500 - USD 5,000)]			
Machinery A/c	Dr.	27,500	
To Revaluation Surplus (OCI)			27,500
(Being Machinery measured at the exchange rate on 31-03-20X1 [USD 5,500 x (₹ 65 - ₹60)]			
Revaluation Surplus (OCI)	Dr.	17,250	
To Deferred Tax Liability			17,250
(DTL created @ of 30% of the total OCI amount)			

Exchange difference arising on translating monetary item and settlement of creditors on 31st March 20X2:

	₹	₹
Creditor - Machinery A/c (5,000 x $65) Dr.	3,25,000	
Profit & loss A/c [(5,000 x ($ 67 -$ 65)] Dr.	10,000	
To Bank A/c		3,35,000
Machinery A/c [(5,500 x ($ 67 - $ 65)) Dr.	11,000	

To Revaluation Surplus (OCI)		11,000
Revaluation Surplus (OCI) Dr.	3,300	
To Deferred Tax Liability		3,300
(DTL created @ of 30% of the total OCI amount)		

Q15: Supplier, A Ltd., enters into a contract with a customer, B Ltd., on 1st January, 2018 to deliver goods in exchange for total consideration of USD 50 million and receives an upfront payment of USD 20 million on this date. The functional currency of the supplier is INR. The goods are delivered and revenue is recognised on 31st March, 2018. USD 30 million is received on 1st April, 2018 in full and final settlement of the purchase consideration.

State the date of transaction for advance consideration and recognition of revenue. Also state the amount of revenue in INR to be recognized on the date of recognition of revenue. The exchange rates on 1st January, 2018 and 31st March, 2018 are ₹ 72 per USD and ₹ 75 per USD respectively. **[RTP May 2019]**

Ans: This is the case of Revenue recognised at a single point in time with multiple payments. As per the guidance given in Appendix B to Ind AS 21:

A Ltd. will recognise a non-monetary contract liability amounting ₹ 1,440 million, by translating USD 20 million at the exchange rate on 1st January, 2018 ie ₹ 72 per USD.

A Ltd. will recognise revenue at 31st March, 2018 (that is, the date on which it transfers the goods to the customer).

A Ltd. determines that the date of the transaction for the revenue relating to the advance consideration of USD 20 million is 1st January, 2018. Applying paragraph 22 of Ind AS 21, A Ltd. determines that the date of the transaction for the remainder of the revenue as 31st March, 2018.

On 31st March, 2018, A Ltd. will:

- derecognise the non-monetary contract liability of USD 20 million and recognise USD 20 million of revenue using the exchange rate as at 1st January, 2018 ie ₹ 72 per USD; and
- recognise revenue and a receivable for the remaining USD 30 million, using the exchange rate on 31st March, 2018 ie ₹ 75 per USD.
- The receivable of USD 30 million is a monetary item, so it should be translated using the closing rate until the receivable is settled.

Q16: Global Limited, an Indian company acquired on 30th September, 20X1 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Global Limited is Rupees and its financial year end is 31st March, 20X2.

(i) The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30th September, 20X1.

The exchange rates as at 30th September, 20X1 was ₹ 82 / EURO and at 31st March, 20X2 was ₹ 84 / EURO.

What is the value at which the goodwill has to be recognised in the financial statements of Global Limited as on 31st March, 20X2?

(ii) Mark Limited sold goods costing 2.4 million EURO to Global Limited for 4.2 million EURO during the year ended 31st March, 20X2. The exchange rate on the date of purchase by Global Limited was ₹ 83 / EURO and on 31st March, 20X2 was ₹ 84 / EURO. The entire goods purchased from Mark Limited are unsold as on 31st March, 20X2. Determine the unrealised profit to be eliminated in the preparation of consolidated financial statements. **[RTP Nov 2019]**

Ans:

(i) Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42. In this case the amount of goodwill will be as follows:

Net identifiable asset	Dr.	23 million	
Goodwill(bal. fig.)	Dr.	1.4 million	
To Bank			17.5 million
To NCI (23 x 30%)			6.9 million

Thus, goodwill on reporting date would be 1.4 million EURO x ₹ 84 = ₹ 117.6 million

(ii)

Particulars	**EURO in million**
Sale price of Inventory	4.20
Unrealised Profit [a]	1.80

Exchange rate as on date of purchase of Inventory [b]₹ 83 / Euro Unrealized profit to be eliminated [a x b] ₹ 149.40 million

As per para 39 of Ind AS 21 "income and expenses for each statement of profit and loss presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions".

In the given case, purchase of inventory is an expense item shown in the statement profit and loss account. Hence, the exchange rate on the date of purchase of inventory is taken for calculation of unrealized profit which is to be eliminated on the event of consolidation.

Q17: On 1st April, 20X1, Makers Ltd. raised a long term loan from foreign investors. The investors subscribed for 6 million Foreign Currency (FCY) loan notes at par. It incurred incremental issue costs of FCY 2,00,000. Interest of FCY 6,00,000 is payable annually on 31st March, starting from 31st March, 20X2. The loan is repayable in FCY on 31st March, 20X7 at a premium and the effective annual interest rate implicit in the loan is 12%. The appropriate measurement basis for this loan is amortised cost. Relevant exchange rates are as follows:

- 1st April, 20X1 - FCY 1 = ₹ 2.50.

- 31st March, 20X2 – FCY 1 = ₹ 2.75.
- Average rate for the year ended 31st Match, 20X2 – FCY 1 = ₹ 2.42. The functional currency of the group is Indian Rupee.

What would be the appropriate accounting treatment for the foreign currency loan in the books of Makers Ltd. for the FY 20X1-20X2? Calculate the initial measurement amount for the loan, finance cost for the year, closing balance and exchange gain / loss. **[RTP May 2020]**

Ans: Initial carrying amount of loan in books

Loan amount received	=	60,00,000 FCY
Less: Incremental issue costs	=	2,00,000 FCY
		58,00,000 FCY

Ind AS 21, "The Effect of Changes in Foreign Exchange Rates" states that foreign currency transactions are initially recorded at the rate of exchange in force when the transaction was first recognized.

Loan to be converted in INR= 58,00,000 FCY x ₹ 2.50/FCY = ₹ 1,45,00,000

Therefore, the loan would initially be recorded at ₹ 1,45,00,000.

Calculation of amortized cost of loan (in FCY) at the year-end:

Period	Opening Financial Liability (FCY) A	Interest @ 12% (FCY) B	Cash Flow (FCY) C	Closing Financial Liability (FCY) A+B-C
20X1-20X2	58,00,000	6,96,000	6,00,000	58,96,000

The finance cost in FCY is 6,96,000

The finance cost would be recorded at an average rate for the period since it accrues over a period of time.

Hence, the finance cost for FY 20X1-20X2 in INR is ₹ 16,84,320 (6,96,000 FCY x ₹ 2.42 / FCY)

The actual payment of interest would be recorded at 6,00,000 x 2.75 = INR 16,50,000

The loan balance is a monetary item so it is translated at the rate of exchange at the reporting date.

So the closing loan balance in INR is 58,96,000 FCY x INR 2.75 / FCY = ₹ 1,62,14,000

The exchange differences that are created by this treatment are recognized in profit and loss.

In this case, the exchange difference is

₹ [1,62,14,000 - (1,45,00,000 + 16,84,320 – 16,50,000)] = ₹ 16,79,680.

This exchange difference is taken to profit and loss.

Q18: An Indian entity, whose functional currency is rupees, purchases USD dominated bond at its fair value of USD 1,000. The bond carries stated interest @ 4.7% p.a. on its face value. The said interest is received at the year end. The bond has maturity period of 5 years and is redeemable at its face value of USD 1,250. The fair value of the bond at the end of year 1 is USD 1,060. The exchange rate on the date of transaction and at the end of year 1 are USD 1 = ₹ 40 and USD 1 = ₹ 45, respectively. The weighted average exchange rate for the year is 1 USD = ₹ 42.

The entity has determined that it is holding the bond as part of an investment portfolio whose objective is met both by holding the asset to collect contractual cash flows and selling the asset. The purchased USD bond is to be classified under the FVTOCI category.

The bond results in effective interest rate (EIR) of 10% p.a.

Calculate gain or loss to be recognised in Profit & Loss and Other Comprehensive Income for year 1. Also pass journal entry to recognise gain or loss on above. (Round off the figures to nearest rupees) **[RTP Nov 2020]**

Ans: Computation of amounts to be recognized in the P&L and OCI:

Particulars	*USD*	*Exchange rate*	₹
Cost of the bond	1,000	40	40,000
Interest accrued @ 10% p.a.	100	42	4,200
Interest received (USD 1,250 x 4.7%)	(59)	45	(2,655)
Amortized cost at year-end	1,041	45	46,845
Fair value at year end	1,060	45	47,700
Interest income to be recognized in P & L			4,200
Exchange gain on the principal amount [1,000 x (45-40)]			5,000
Exchange gain on interest accrual [100 x (45 - 42)]			300
Total exchange gain/loss to be recognized in P&L			5,300
Fair value gain to be recognized in OCI [45 x (1,060 - 1,041)]			855

Journal entry to recognize gain/loss

Bond (₹ 47,700 –₹40,000)	Dr.	7,700	
Bank (Interest received)	Dr.	2,655	
To Interest Income (P & L)			4,200
To Exchange gain (P & L)			5,300
To OCI (fair value gain)			855

Q19: Monsoon Limited acquired, on 30 September, 20X2, 70% of the share capital of Mark Limited, an entity registered as company in Germany. The functional currency of Monsoon Limited is Indian Rupee and its financial year ends on 31 March, 20X3.

The fair value of the net assets of Mark Limited was 23 million EURO and the purchase consideration paid is 17.5 million EURO on 30 September, 20X2.

The exchange rates as on 30 September, 20X2 was ₹ 82 per EURO and at 31 March, 20X3 was ₹ 84 per EURO.

On acquisition of Mark limited, what is the value at which the goodwill / capital reserve has to be recognized in the financial statements of Monsoon Limited as on 31 March 20X3?

RTP May 2021

Ans: Para 47 of Ind AS 21 requires that goodwill arose on business combination shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.

In this case, the amount of goodwill will be as follows:

Net identifiable asset	Dr.	₹ 23 million	
Goodwill (bal. fig.)	Dr.	₹ 1.4 million	
To Bank (Purchase consideration)			₹ 17.5 million
To NCI (23 x 30%)			₹ 6.9 million

Thus, goodwill on reporting date in the books of Monsoon Limited would be

= 1.4 million EURO x ₹ 84 = ₹ 117.6 million.

CHAPTER 29

BUSINESS COMBINATION AS PER IND AS103

Example 1 – Identification of Business

An entity (Entity S) sells its radio broadcasting assets to another entity (Entity R). The acquired set of activities and assets sold comprise the broadcasting licence, the broadcasting equipment and a broadcasting studio.

At the acquisition date, the fair value for each of the assets sold is considered similar. No processes needed to broadcast the radio shows are sold, and there are no employees or other assets, activities or processes included. Entity S has stopped using the acquired set of activities and assets before the date they are sold to Entity R.

Entity R decides to apply the optional concentration test and determines that:

- the broadcasting equipment and the studio are not a single identifiable asset because the equipment is not attached to the studio and can be separated without being costly or causing a loss of use or fair value of either asset.
- the licence is an intangible asset, and the broadcasting equipment and studio are both tangible assets belonging in different classes. As a result, the assets are not considered similar to each other.
- there is a similar fair value for each of the single identifiable assets. Thus, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.

Therefore, the concentration test is failed. Entity R therefore assesses whether the acquired set of activities and assets meets the minimum requirements to be considered a business.

The acquired set of activities and assets does not have outputs, because Entity S has stopped broadcasting. Thus, Entity R applies the relevant criteria in IND AS 103 to determine whether the process is substantive. As the set does not include an organised workforce, the relevant criteria have not been met.

Therefore, Entity R concludes that the acquired set of activities and assets is not a business.

Example 2 – Identification of Business

An entity (Entity A) purchases another legal entity (Entity Solar Cell). Entity Solar Cell carries out research and development activities on several solar projects that it is involved in and are currently in progress. It has scientists who possess the skills knowledge and experience needed to perform these activities. It also has tangible assets which include lab equipment and a factory and laboratory to perform such activities. Currently the product is not ready to be marketed and no sales have been made. All of the assets acquired are deemed to individually have a similar fair value.

Entity A elects to apply the concentration test and concludes that the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.

Therefore, Entity A assesses whether the set meets the minimum requirements to be considered a business.

Entity A determines that no processes have been documented for Entity Solar Cell. However, the organised workforce that has been purchased has proprietary knowledge of the ongoing projects. Therefore, Entity A believes that the workforce provides intellectual capacity which provides the processes needed that can be used as inputs to create outputs.

Entity A then determines whether the acquired processes are substantive. There are no outputs derived from the acquired set of activities and assets.

So Entity A applies the relevant criteria in IND AS 3 and concludes that the processes are substantive because:

- the processes purchased are essential to be able to develop or convert the acquired inputs into outputs; and
- the acquired inputs include:
  - an organised workforce that has the necessary skills, knowledge, or experience to perform the necessary duties associated with the processes acquired; and
  - other inputs that the organised workforce could develop or convert into outputs. Those inputs include the research and development projects that are in progress.

Finally, Entity A determines that the substantive processes and inputs it has acquired significantly contribute to the ability to create outputs. Therefore, Entity A concludes that the acquired set of activities and assets is a business.

Example 3 – Identification of Business

An entity (Entity D) acquires a legal entity that has:

- the rights to a research and development project that is in progress of its final testing phase to develop a drug to treat pneumonia (Project X). Project X includes the underlying knowledge, formula procedures, designs and protocols expected to be needed to complete this phase.
- a contract that provides the outsourcing of clinical trials. The contract does not state which vendor, should be used, there are several vendors that could provide these services, and the contract uses current market prices. Therefore, the contract has a zero-fair value. There is no option for Entity D to renew the contract.

Entity D has not acquired any employees, other assets, other processes or other activities.

Entity D elects to apply the optional concentration test and determines that:

- Project X is a single identifiable asset because it would be recognised and measured as a single identifiable intangible asset in a business combination.

- because the acquired contract has a zero-fair value, substantially all of the fair value of the gross assets acquired is concentrated in Project X.

As a result, Entity D concludes that the acquired set of activities and assets is not a business.

Example 4 – Identification of Business

An entity (Entity B) purchases from another entity (Entity S) the worldwide rights to Product 123, including all related intellectual property. In addition, Entity B also purchases all the existing customer contracts and customer relationships, inventories of finished goods, customer incentive programmes, raw material supply contracts, specialised equipment specific to manufacturing Product 123 and documented manufacturing processes and protocols to produce Product 123. Entity B does not acquire any employees, other assets, other processes or other activities. None of the identifiable assets purchased has a fair value that comprises substantially all of the fair value of the gross assets acquired.

As the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets, the optional concentration test would not be met.

As a result, Entity B assesses whether the acquired set of activities and assets meets the minimum requirements to be considered a business.

Entity B considers whether the acquired process is substantive. The acquired set of activities and assets has outputs, and so Entity B considers the relevant criteria in IND AS 103.

The acquired set of activities and assets does not include an organised workforce, however Entity B concludes that the manufacturing processes acquired significantly contribute to the ability to continue producing outputs and are unique to Product 123.

Therefore, Entity B concludes that the acquired processes are substantive.

In addition, Entity B determines the substantive processes and inputs together significantly contribute to the ability to create outputs. As a result, Entity B concludes that the acquired set of activities and assets is a business.

Example 5 – Identification of Business

An entity (Entity P) holds a 30% interest in another entity (Entity C). At a subsequent date (the acquisition date), Entity P acquires a further 45% interest in Entity C and obtains control of it. Entity C's assets and liabilities on the acquisition date are the following:

1 a building with a fair value of CU600

2 an identifiable intangible asset with a fair value of CU350

3 cash and cash equivalents with a fair value of CU150

4 deferred tax assets of CU200

5 financial liabilities with a fair value of CU750

6 deferred tax liabilities of CU200 arising from temporary differences associated with the building and the intangible asset.

Entity P pays CU225 for the additional 45% interest in Entity C. Entity P determines that at the acquisition date the fair value of Entity C is CU500, that the fair value of the non-controlling interest in

Entity C is CU125 (25% x CU500) and that the fair value of the previously held interest is CU150 (30% x CU500).

When performing the optional concentration test, Entity P needs to determine the fair value of the gross assets acquired.

Using the following calculation, Entity P determines that the fair value of the gross assets acquired is CU1,000, calculated as follows:

- the total (CU1,250) obtained by adding:
  - — the consideration paid (CU225), plus the fair value of the non-controlling interest (CU125) plus the fair value of the previously held interest (CU150); to
  - — the fair value of the liabilities assumed (other than deferred tax liabilities) (CU750); less
- the cash and cash equivalents acquired (CU150);

  less
- deferred tax assets acquired (CU100) (in practice, it would be necessary to determine the amount of deferred tax assets to be excluded only if including the deferred tax assets could lead to the concentration test not being met).

Alternatively, the fair value of the gross assets acquired (CU1,000) is also determined by:

- the fair value of the building (CU600); plus
- the fair value of the identifiable intangible asset (CU350); plus
- the excess (CU50) of:
  - — the sum (CU500) of the consideration transferred (CU225), plus the fair value of the non-controlling interest (CU125), plus the fair value of the previously held interest (CU150);

    over
  - — the fair value of the net identifiable assets acquired (CU450 = CU600 + CU350 + CU150 + CU100 – CU750).

The excess referred to above is determined in a manner similar to the initial measurement of goodwill as stated in the Standard. Including this amount in determining the fair value of the gross assets acquired means that the concentration test is based on an amount that is affected by the value of any substantive processes acquired.

The fair value of the gross assets acquired is determined after making the following exclusions for items that are independent of whether any substantive process was acquired:

- the fair value of the gross assets acquired does not include the fair value of the cash and cash equivalents acquired (CU150) and does not include deferred tax assets (CU100) and
- the deferred tax liability is not deducted in determining the fair value of the net assets acquired (CU450) and does not need to be determined. As a result, the excess (CU50) calculated above does not include goodwill resulting from the effects of deferred tax liabilities.

Example 6: On Concentration test

Entity A holds 20% interest in Entity B. Subsequently Entity A, further acquires 50% share in Entity B by paying ₹ 300 Crores.

The fair value of assets acquired and Liabilities assumed are as follows:

Building	- ₹ 1000 Crores
Cash and Cash Equivalent -	₹ 200 Crores
Financial Liabilities	- ₹ 800 Crores
DTL	- ₹ 150 crores

Fair value of Entity B is ₹ 400 Crores and Fair value of NCI is ₹ 120 Crores (400 x 30%) Fair value of Entity A's previously held interest is ₹ 80 Crores (400 x 20%)

Entity A needs to determine whether acquisition is an asset acquisition as per concentration test.

- Fair value of consideration transferred (including fair value of non-controlling interest and fair value of previously interest held) = 300 + 120 + 80 = ₹ 500 Crores
- Fair value of liability assumed (excluding deferred tax) – ₹ 800 crores
- Cash and cash equivalent – ₹ 200 crores.

Fair value of gross assets acquired - ₹ 1,100 Crores

In the above scenario, substantially all fair value of gross assets acquired is concentrated in a single identifiable asset i.e. building. Hence it should be asset acquisition. (1,000 / 1,100 = 91% of value of gross assets is concentrated into single identifiable asset i.e. building). A Judgement is required to conclude on the word substantially as the same is not defined in the standard.

In our view we have considered 91% of the value as substantial to conclude the above transaction as asset acquisition.

Example 7: Simple-business combination

Company X is a liquor manufacturer and has traded for a number of years. The company produces a wide variety of liquor and employs a workforce of machine operators, testers, and other operational, marketing and administrative staff. It owns and operates a factory, warehouse, machinery and holds raw material inventory and finished products.

On 1st January, 20X1, Company Y pays USD 80 million to acquire 100% of the ordinary voting shares of Company X. No other type of shares has been issued by the Company X. On the same day, the four main executive directors of the Company Y take on the same roles in the Company X.

In this case, it is clear that the Company X is a business. It operates a trade with a variety of assets that are used by its employees in a number of related activities. These assets and activities are necessarily integrated in order to create and sell the company's products. As per definition the above acquisition includes an inputs (including four main executive directors of Company X) and thus it can be concluded as the significant process acquired along with the other inputs.

Thus, Company Y obtains control on 1st January, 20X1 by acquiring 100% of the voting rights.

Example 8: Investment in a development stage entity

Company D is a development stage entity that has not started revenue-generating operations. The workforce consists mainly of research engineers who are developing a new technology that has a pending patent application. Negotiations to license this technology to a number of customers are at an advanced stage. Company D requires additional funding to complete development work and commence planned commercial production.

The value of the identifiable net assets in Company D is ₹ 750 million. Company A pays ₹ 600 million in exchange for 60% of the equity of Company D (a controlling interest).

Although Company D is not yet earning revenues (an example of 'outputs') there are a number of indicators that it has a sufficiently integrated set of activities and assets that are capable of being managed to produce a return for investors. In particular, Company D:

- employs specialist engineers developing the know-how and design specifications of the technology.
- is pursuing a viable plan to complete the development work and commence production.
- has identified and will be able to access customers willing to buy the outputs.

In addition, Company A has paid a premium (or goodwill) for its 60% interest. In the absence of evidence to the contrary, Company D is presumed to be a business.

Example 9: Acquisition of an entity holding investment properties

Company A acquires 100% of the equity and voting rights of Company P, a subsidiary of a property investment group. Company P owns three investment properties. The properties are single-tenant industrial warehouses subject to long-term leases. The leases oblige Company P to provide basic maintenance and security services, which have been outsourced to third party contractors. The administration of Company P's leases was carried out by an employee of its former parent company on a part-time basis but this individual does not transfer to the new owner.

In most cases, an asset or group of assets and liabilities that are being capable of generating revenues, combined with all or many of the activities necessary to earn those revenues, would constitute a business. However, investment property is a specific case in which earning a return for investors is a defining characteristic of the asset. Accordingly, revenue generation and activities that are specific and ancillary to an investment property and its tenancy agreements should therefore be given a lower 'weighting' in assessing whether the acquiree is a business.

Further process (i.e. Basic maintenance, security services and administration) is not critical to the ability to continue producing outputs. Also process (i.e. Basic maintenance, security services and administration) is not unique and it can be replaced easily without significant cost.

In our view the purchase of investment property with tenants and services that are purely ancillary to the property and its tenancy agreements should generally be accounted for as an asset purchase.

Example 10: Acquisition of an entity holding investment properties

Company A acquires 100% of the equity and voting rights of Company Q, which owns three investment properties. The properties are multi-tenant residential condominiums subject to short- term rental agreements that oblige Company Q to provide substantial maintenance and security services, which are outsourced with specialist providers. Company Q has five employees who deal directly with the tenants and with the outsourced contractors to resolve any non-routine security or maintenance requirements. These employees are involved in a variety of lease management tasks (e.g. identification and selection of tenants; lease negotiation and rent reviews) and marketing activities to maximise the quality of tenants and the rental income.

In this case, Company Q consists of a group of revenue-generating assets, together with employees and activities that clearly go beyond activities ancillary to the properties and their tenancy agreements.

Further process (i.e. identification and selection of tenants; lease negotiation and rent reviews) is critical to the ability to continue producing outputs (i.e. in terms to maximise quality of tenants and the rental income).

The assets and activities are clearly integrated so Company Q is considered a business.

Example 11: Seller retains some activities and assets

Company S is a manufacturer of a wide range of products. The company's payroll and accounting system is managed as a separate cost centre, supporting all the operating segments and the head office functions.

Company A agrees to acquire the trade, assets, liabilities and workforce of the operating segments of Company S but does not acquire the payroll and accounting cost centre or any head office functions. Company A is a competitor of Company S.

In this case, the activities and assets within the operating segments are capable of being managed as a business and so Company A accounts for the acquisition as a business combination. The payroll, accounting cost centre and administrative head office functions are typically not used to create outputs and so are generally not considered an essential element in assessing whether an integrated set of activities and assets is a business or not.

Example 12: Acquisition of a shell company

Company A is a property development company with a number of subsidiary companies, each of which holds a single development. After completion of the development, Company A sells its equity investment because the applicable tax rate is lower than that applicable to the sale of the underlying property.

Company A is planning to start the development of a large new retail complex. Rather than incorporating a new company, Company A acquires the entire share capital of a 'shell' company.

The shell company does not contain an integrated set of activities and assets and so does not constitute a business. Consequently, Company A should account for the purchase of the shell company in the same way as the incorporation of a new subsidiary. In the consolidated financial statements, any costs incurred will be accounted for in accordance with their nature and applicable Ind AS. No goodwill is recognised.

Example 13: Identification of acquirer

Company A and Company B operate in power industry and both entities are operating entities. Company A has much larger scale of operations than Company B. Company B merges with Company A such that the shareholders of Company B would receive 1 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 20% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 80% of the capital in Company A.

In this transaction, Company A is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, by merging the entire shareholding of Company B, Company A has acquired control over Company B. Further, the shareholders of erstwhile Company B do not obtain control over Company A on account of shares received as part of purchase consideration, as they hold only 20% of the paid-up capital of Company A.

Example 14: Identification of acquirer

Company A and Company B operate in power industry and both entities are operating entities. Company A has much smaller scale of operations than Company B. Company B merges Company A such that the shareholders of Company B would receive 10 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 70% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 30% of capital of Company A. Post-acquisition, the management of Company B would manage the operations of the combined entity.

In this transaction, Company B is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, after merger, the shareholders of erstwhile Company B would have a controlling interest and management of the combined entity. As such, in substance, Company B has acquired control over Company A.

It is important to note that the Company B would be considered as an acquirer for accounting purposes only (i.e., accounting acquirer). For legal purposes as well as for reporting purposes, it is the Company A that would be considered as an acquirer (i.e., legal acquirer).

Appropriate identification of an acquirer is relevant, as the net assets of the accounting acquiree (rather than that of the accounting acquirer) are recognised at fair value.

Example 15: New parent pays cash to effect a business combination

Company A decided to spin-off two of its existing businesses (currently housed in two separate entities, Company B and Company C). To facilitate the spin-off, Company A incorporates a new entity (Company D) with nominal equity and appoints independent directors to the board of Company D. Company D signs an agreement to purchase Companies B and C in cash, conditional on obtaining sufficient funding. To fund these acquisitions, Company D issues a prospectus offering to issue shares for cash.

At the conclusion of the transaction, Company D has owned 99% by the new investors with Company A retaining only a 1% non-controlling interest.

In this situation, a set of new investors paid cash to obtain control of Company D in an arm's length transaction. Company D is then used to effect the acquisition of 100% ownership of

Companies B and C by paying cash. Company A relinquishes its control of Companies B and C to the new owners of Company D.

Although Company D is a newly formed entity, Company D is identified as the acquirer not only because it paid cash but also because the new owners of Company D have obtained control of Companies B and C from Company A.

Example 16 – Determination of acquisition Date

Company A acquired 80% equity interest in Company B for cash consideration. The relevant dates are as under:

Date of shareholder agreement	1st June, 20X1
Appointed date as per shareholder agreement	1st April, 20X1
Date of obtaining control over the board representation	1st July, 20X1
Date of payment of consideration	15th July, 20X1

Date of transfer of shares to Company A	1st August, 20X1

In this case, as the control over financial and operating policies are acquired through obtaining board representation on 1st July, 20X1, it is this date that is considered as the acquisition date. It may be noted that the appointed date as per the agreement is not considered as the acquisition date, as the Company A did not have control over Company B as at that date

Example 17: Contingent Consideration

Company A acquires Company B in April, 20X1 for cash. The acquisition agreement states that an additional ₹ 20 million of cash will be paid to B's former shareholders if B succeeds in achieving certain specified performance targets. A determines the fair value of the contingent consideration liability to be 15 million at the acquisition date. At a later date, the probability of meeting the said performance target becomes lower.

As certain consideration is based on achieving certain performance parameters in future, the consideration is contingent on achieving those parameters. As such, the transaction involves contingent consideration. Further, since the consideration is to be settled for a variable amount in cash, such consideration would be in the nature of financial liability rather than equity.

As at the acquisition date, the acquirer should consider the acquisition date fair value of contingent consideration as part of business combination. Accordingly, such recognition would increase goodwill (or reduce gain on bargain purchase, as the case may be).

In the above example, if the chance of meeting the performance criteria becomes less probable, then in such a case, the contingent consideration in the nature of financial liability should be remeasured and the impact for the change in the fair value should be recognised in statement of profit and loss.

Example 18 – Contingent Liability

A suit for damages worth ₹ 10 million was filed on Company B for alleged breach of certain contract provisions. Company B had disclosed the same as a contingent liability in its financial statements, as it considered that it is a present obligation for which it was not probable that the amount would be payable. Company A acquire Company B and determines the fair value of the contingent liability to be ₹ 2 million.

Company A would recognise ₹2 million in its financial statements as part of acquisition accounting, even if it is not probable that payment will be required to settle the obligation

Example 19: Separability criteria for intangible assets

Customer and subscriber lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

Example 20: Bargain Purchase

Entity X is one of the largest liquor manufacturing company in the world and it acquires another Entity Y which has significant presence in India and UK. However, the competition commission in UK has issued orders to sell one division of the UK assets of Entity Y in order to comply with the local competition regulation in UK within a specified timeline. Entity Z another boutique liquor manufacturer realises the opportunity and purchase the assets of Entity Y from Entity X.

In the given case above it is more likely than not that there could be an element of bargain purchase as the Entity X was under compulsion to sell the assets within a specified timeline

ILLUSTRATIONS BASED QUESTIONS

Illustration 1:

Company A is a pharmaceutical company. Since inception, the Company had been conducting in-house research and development activities through its skilled workforce and recently obtained an intellectual property right (IPR) in the form of patents over certain drugs. The Company's has a production plant that has recently obtained regulatory approvals. However, the Company has not earned any revenue so far and does not have any customer contracts for sale of goods. Company B acquires Company A.

Does Company A constitute a business in accordance with Ind AS 103?

Answer: The definition of business requires existence of inputs and processes. In this case, the skilled workforce, manufacturing plant and IPR, along with strategic and operational processes constitutes the inputs and processes in line with the requirements of Ind AS 103.

When the said inputs and processes are applied as an integrated set, the Company A will be capable of producing outputs; the fact that the Company A currently does not have revenue is not relevant to the analysis of the definition of business under Ind AS 103. Basis this and presuming that Company A would have been able to obtain access to customers that will purchase the outputs, the present case can be said to constitute a business as per Ind AS 103.

Illustration 2 :

Modifying the above illustration, if Company A had revenue contracts and a sales force, such that Company B acquires all the inputs and processes other than the sales force, then whether the definition of the business is met in accordance with Ind AS 103?

Answer: Though the sales force has not been taken over, however, if the missing inputs (i.e., sales force) can be easily replicated or obtained by the market participant to generate output, it may be concluded that Company A has acquired business. Further, if Company B is also into similar line of business, then the existing sales force of the Company B may also be relevant to mitigate the missing input. As such, the definition of business is met in accordance with Ind AS 103.

Illustration 3 :

Veera Limited and Zeera Limited are both in the business of manufacturing and selling of Lubricant. Shareholders of Veera Limited and Zeera Limited agreed to join forces to benefit from lower delivery and distribution costs. The business combination is carried out by setting up a new entity called Meera Limited that issues 100 shares to Veera Limited shareholders and 50 shares to Zeera Limited shareholders in exchange for the transfer of the shares in those entities. The number of shares reflects the relative fair values of the entities before the combination. Also respective company's shareholders get the voting rights in Meera Limited based on their respective shareholdings. Determine the acquirer by applying the principles of Ind AS 103 'Business Combinations'

[RTP Nov 2020]

Answer: As per para B15 of Ind AS 103, in a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called 'reverse acquisitions', the issuing entity is the acquiree. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

The relative voting rights in the combined entity after the business combination - The acquirer is usually the combining entity whose owners as a group retain or receive the largest portion of the voting rights in the combined entity.

Based on above mentioned para, acquirer shall be the either of the combining entities (i.e. Veera Limited or Zeera Limited) whose owners as a Group retain or receive the largest portion of the voting rights in the combined entity.

Hence in the above scenario Veera Limited shareholder gets 67% Share [(100/150) x100] and Zeera Limited shareholder gets 33.33% share in Meera Limited. Hence Veera Limited is acquirer as per the principles of Ind AS 103.

Illustration 4: Acquisition date

On April 1 Company X agrees to acquire the share of Company B in an all equity deal. As per the binding agreement Company X will get the effective control on 1 April however the consideration will be paid only when the shareholders' approval is received. The shareholders meeting is scheduled to happen on 30 April. If the shareholder approval is not received for issue of new shares, then the consideration will be settled in cash. What is the acquisition date?

Answer: The acquisition date in the above example is 1 April. In the above scenario even if the shareholder doesn't approve the shares consideration can be settled through payment of cash.

Illustration 5 : Business Combination without a Court approved scheme

ABC Ltd. acquired all the shares of XYZ Ltd. The negotiations had commenced on 1st January, 20X1 and the agreement was finalised on 1st March, 20X1. While ABC Ltd. obtains the power to control XYZ Ltd.'s operations on 1st March, 20X1, the agreement states that the acquisition is effective from 1st January, 20X1 and that ABC Ltd. is entitled to all profits after that date. In addition, the purchase price is based on XYZ Ltd.'s net asset position as at 1st January, 20X1.

What is the date of acquisition?

Answer: Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further paragraphs 6 and 7 of Ind AS 110, Consolidated Financial Statements, inter alia, state that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Thus, an investor controls an investee if and only if the investor has all the following:

- power over the investee;
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect the amount of the investor's returns.

Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

Therefore, in this case, notwithstanding that the price is based on the net assets as at 1st January, 20X1 and that XYZ Ltd.'s shareholders do not receive any dividends after that date, the date of acquisition for accounting purposes will be 1st March, 20X1. It is only on 1st March, 20X1 and not 1st January, 20X1, that ABC Ltd. has the power to direct the relevant activities of XYZ Ltd. so as to affect its returns from its involvement with XYZ Ltd. Accordingly, the date of acquisition is 1st March, 20X1.

Illustration 6: Acquisition date- Regulatory approval

ABC Ltd. and XYZ Ltd. are manufacturers of rubber components for a particular type of equipment. ABC Ltd. makes a bid for XYZ Ltd.'s business and the Competition Commission of India (CCI) announces that the proposed transaction is to be scrutinised to ensure that competition laws are not breached. Even though the contracts are made subject to the approval of the CCI, ABC Ltd. and XYZ Ltd. mutually agree the terms of the acquisition and the purchase price before competition authority clearance is obtained. Can the acquisition date in this situation be the date on which ABC Ltd. and XYZ Ltd. agree the terms even though the approval of CCI is awaited (Assume that the approval of CCI is substantive)?

Answer: Paragraph 8 of Ind AS 103 provides that acquisition date is the date on which the acquirer obtains control of the acquiree.

Further, paragraph 9 of Ind AS 103 clarifies that the date on which the acquirer obtains control of the acquiree is generally the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree—the closing date. However, the acquirer might obtain control on a date that is either earlier or later than the closing date.

For example, the acquisition date precedes the closing date if a written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date. An acquirer shall consider all pertinent facts and circumstances in identifying the acquisition date.

Since CCI approval is a substantive approval for ABC Ltd. to acquire control of XYZ Ltd.'s operations, the date of acquisition cannot be earlier than the date on which approval is obtained from CCI. This is pertinent given that the approval from CCI is considered to be a substantive process and accordingly, the acquisition is considered to be completed only on receipt of such approval.

Illustration 7: Acquisition date

On 9 April 20X2, Shyam Ltd. a listed company started to negotiate with Ram Ltd, which is an unlisted company about the possibility of merger. On 10 May 20X2, the board of directors of Shyam authorized their management to pursue the merger with Ram Ltd. On 15 May 20X2, management of Shyam Ltd offered management of Ram Ltd 12,000 shares of Shyam Ltd against their total share outstanding. On 31 May 20X2, the board of directors of Ram Ltd accepted the offer subject to shareholder vote. On 2 June 20X2 both the companies jointly made a press release about the proposed merger.

On 10 June 20X2, the shareholders of Ram Ltd approved the terms of the merger. On 15 June, the shares were allotted to the shareholders of Ram Ltd.

The market price of the shares of Shyam Ltd was as follows:

Date	Price
9 April	70
10 May	75
15 May	60
31 May	70
2 June	80
10 June	85
15 June	90

What is the acquisition date and what is purchase consideration in the above scenario?

Answer: As per paragraph 8 of Ind AS 103, the acquirer shall identify the acquisition date, which is the date on which it obtains control of the aquiree. In the above scenario, the acquisition date will the date on which the shares were allotted to the shareholders of Ram Ltd. Although the shareholder approval was obtained on 10 June but the shares were issued only on 15 June and accordingly the 90 will be considered as the market price.

Illustration 8: Acquisition date

Can an acquiring entity can account for a business combination based on a signed non-binding letter of intent where the exchange of consideration and other conditions are expected to be completed with 2 months?

Answer: No. as per the requirement of the standard a non- binding Letter of Intent (LOI) does not effectively transfer control and hence this cannot be considered as the basis for determining the acquisition date.

Illustration 9: Business Combination Achieved by Contract Alone

Sita Ltd and Beta Ltd decides to combine together for forming a Dual Listed Corporation (DLC). As per their shareholder's agreement, both the parties will retain original listing and Board of DLC will be comprised of 10 members out of which 6 members will be of Sita Ltd and remaining 4 board members will be of Beta Ltd.

The fair value of Sita Ltd is ₹ 100 crores and fair value of Beta Ltd is ₹ 80 crores. The fair value of net identifiable assets of Beta Limited is ₹ 70 crores. Assume non-controlling Interest (NCI) to be measured at fair value.

You are required to determine the goodwill to be recognised on acquisition.

Answer: Sita Ltd has more Board members and thereby have majority control in DLC. Therefore, Sita Ltd is identified as acquirer and Beta Ltd as acquiree.

Since no consideration has been transferred, the goodwill needs to be calculated as the difference of Part A and Part B:

Part A:		
Consideration paid by Acquirer.	-	Nil
Controlling Interest in Acquiree	–	₹ 80 crores
Acquirer's previously held interest -		Nil
Part B:		
Fair value of net identifiable asset	–	₹ 70 crores

Goodwill is recognised as ₹ 10 crores (80 – 70 crores) in business combination achieved through contract alone when NCI is measured at fair value.

Illustration 10: Identifying acquirer

Company A and Company B operate in power industry and both entities are operating entities. Company A has much larger scale of operations than Company B. Company B merges with Company A such that the shareholders of Company B would receive 1 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 20% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 80% of the capital in Company A.

Answer: In this transaction, Company A is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, by merging the entire shareholding of Company B, Company A has acquired control over Company B. Further, the shareholders of erstwhile Company B do not obtain control over Company A on account of shares received as part of purchase consideration, as they hold only 20% of the paid-up capital of Company A.

Illustration 11: Identifying acquirer

Company A and Company B operate in power industry and both entities are operating entities. Company A has much smaller scale of operations than Company B. Company B merges Company A such that the shareholders of Company B would receive 10 equity share of Company A for every 1 share held in Company B. Such issue of shares would comprise 70% of the issued share capital of the combined entity. After discharge of purchase consideration, the pre-merger shareholders of Company A hold 30% of capital of Company A. Post-acquisition, the management of Company B would manage the operations of the combined entity.

Answer: In this transaction, Company B is the acquirer for the purposes of accounting for business combination as per Ind AS 103. This is because, after merger, the shareholders of erstwhile Company B would have a controlling interest and management of the combined entity. As such, in substance, Company B has acquired control over Company A.

It is important to note that the Company B would be considered as an acquirer for accounting purposes only (i.e., accounting acquirer). For legal purposes as well as for reporting purposes, it is the Company A that would be considered as an acquirer (i.e., legal acquirer).

Appropriate identification of an acquirer is relevant, as the net assets of the accounting acquiree (rather than that of the accounting acquirer) are recognised at fair value.

Illustration 12: Potential voting rights

Company P Ltd., a manufacturer of textile products, acquires 40,000 of the equity shares of Company X (a manufacturer of complementary products) out of 1,00,000 shares in issue. As part of the same agreement, Company P purchases an option to acquire an additional 25,000 shares. The option is exercisable at any time in the next 12 months. The exercise price includes a small premium to the market price at the transaction date.

After the above transaction, the shareholdings of Company P’s two other original shareholders are 35,000 and 25,000. Each of these shareholders also has currently exercisable options to acquire 2,000 additional shares.

Solution: In assessing whether it has obtained control over Company X, Company P should consider not only the 40,000 shares it owns but also its option to acquire another 20,000 shares (a so-called potential voting right). In this assessment, the specific terms and conditions of the option agreement and other factors are considered:

- the options are currently exercisable and there are no other required conditions before such options can be exercised

- if exercised, these options would increase Company P's ownership to a controlling interest of over 50% before considering other shareholders' potential voting rights (65,000 shares out of a total of 1,25,000 shares)
- although other shareholders also have potential voting rights, if all options are exercised Company P will still own a majority (65,000 shares out of 1,29,000 shares)
- the premium included in the exercise price makes the options **out-of-the-money**. However, the fact that the premium is small and the options could confer majority ownership indicates that the potential voting rights have economic substance.

By considering all the above factors, Company P concludes that with the acquisition of the 40,000 shares together with the potential voting rights, it has obtained control of Company X.

Illustration 13: Options are out of the money

Entities A and B own 80 per cent and 20 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 per cent ownership interest and voting rights.

Answer: Though the options are out of the money, they are currently exercisable and if exercised, these options would increase Company P's ownership to 80 per cent ownership interest and voting rights. The existence of the potential voting rights determined that Entity A controls Entity C.

Illustration 14: Transaction which is not a part of Business combination

Progressive Ltd is being sued by Regressive Ltd for an infringement of its Patent. At 31 March 20X2, Progressive Ltd recognised a INR 10 million liability related to this litigation.

On 30 July 20X2, Progressive Ltd acquired the entire equity of Regressive Ltd for INR 500 million. On that date, the estimated fair value of the expected settlement of the litigation is INR 20 million.

Answer: In the above scenario the litigation is in substance settled with the business combination transaction and accordingly the INR 20 million being the fair value of the litigation liability will be considered as paid for settling the litigation claim and will be not included in the business combination. Accordingly, the purchase price will reduce by 20 million and the difference between 20 and 10 will be recorded in income statement of the Progressive limited as loss on settlement of the litigation.

Illustration 15: Transaction which is not a part of business combination

KKV Ltd acquires a 100% interest in VIVA Ltd, a company owned by a single shareholder who is also the KMP in the Company, for a cash payment of USD 20 million and a contingent payment of USD 2 million. The terms of the agreement provide for payment 2 years after the acquisition if the following conditions are met:

- the EBIDTA margins of the Company after 2 years after the acquisition is 21%.
- the former shareholder continues to be employed with VIVA Ltd for at least 2 years after the acquisition. No part of the contingent payment will be paid if the former shareholder does not complete the 2 year employment period.

Answer: In the above scenario the former shareholder is required to continue in employment and the contingent consideration will be forfeited if the employment is terminated or if he resigns. Accordingly, only USD 20 million is considered as purchase consideration and the contingent consideration is accounted as employee cost and will be accounted as per the other Ind AS standards.

Illustration 16: Purchase Consideration

COMPANY A acquires 100 per cent of the equity interests in COMPANY B, a company operating a clothes retailing business, in exchange for:

- cash of RS. 10,000, paid on the acquisition date;
- an office building (acquisition-date fair value measured using the price per square metre for the building derived from prices in observed transactions involving similar buildings in similar locations = RS. 50,000);
- two gold bars (acquisition-date fair value measured using the spot quotation by the London Bullion Market Association = RS. 1,000 per gold bar);
- 10 per cent of equity instruments of COMPANY A (share capital of COMPANY A consists of 10,000 ordinary, fully paid shares; the fair value of each at the acquisition date was RS. 10; and
- 1,000 shares of a third party (Entity C). Entity C's shares are actively traded on the London Stock Exchange (acquisition-date fair value = RS. 6 per share).

Answer:

Valuation input level	₹
Cash paid immediately	10,000
Fair value of the office building	50,000
Fair value of two gold bars	2,000
Equity instruments of COMPANY A	10,000
Equity instruments of Entity C	6,000
Total	78,000

Illustration 17: Purchase Consideration

On 1 January 20X1 COMPANY A acquired 100 per cent of the equity interests in COMPANY B in exchange for cash of ₹30,000 to be paid two years later on 31 December 20X2. COMPANY A's incremental borrowing rate is 5 per cent per year.

Answer: The cost of the business combination is ₹27,211 which is the present value of the ₹30,000 deferred payment discounted by 5 per cent per annum for two years.

Illustration 13

Should stamp duty paid on acquisition of land pursuant to a business combination be capitalised to the cost of the asset or should it be treated as an acquisition related cost and accordingly be expensed off?

Solution: As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception.

Note: The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

The stamp duty payable for transfer of assets in connection with the business combination is an acquisition-related cost as described under paragraph 53 of Ind AS 103. Stamp duty is a cost incurred by the acquirer in order to effect the business combination and it is not part of the fair value exchange between the buyer and seller for the business. In such cases, the stamp duty is incurred to acquire the ownership rights in land in order to complete the process of transfer of assets as part of the overall business combination transaction but it does not represent consideration paid to gain control over business from the sellers.

It may be noted that the accounting treatment of stamp duty incurred for separate acquisition of an item of property, plant and equipment (i.e. not as part of business combination) differs under Ind AS 16, Property, Plant and Equipment. Unlike Ind AS 16, the acquisition accounting as per Ind AS 103 requires assets and liabilities acquired in a business combination to be measured at fair value. While incurred in connection with a business combination, stamp duty does not increase the future economic benefits from the net assets comprising the business (which would be recognised at fair value) and hence cannot be capitalised. The examples of costs given in paragraph 53 is only an inclusive list; they are only indicative and do not preclude any other cost to be considered as acquisition-related cost. In the given case, the transfer of land and the related stamp duty is required to be accounted as part of the business combination transaction as per requirements of Ind AS 103 and not as a separate transaction under Ind AS.

Accordingly, stamp duty incurred in relation to land acquired as part of a business combination transaction are required to be recognised as an expense in the period in which the acquisition is completed and given effect to in the financial statements of the acquirer.

Illustration 18: NCI

Company A acquired 90% equity interest in Company B on April 1, 2010 for a consideration of ₹ 85 crores in a distress sale. Company B did not have any instrument recognised in equity. The Company appointed a registered valuer with whose assistance, the Company valued the fair value of NCI and the fair value identifiable net assets at ₹ 15 crores and ₹ 100 crores respectively.

Required: Find the value at which NCI has to be shown in the financial statements

Answer: In this case, Company A has the option to measure NCI as follows:

♦ Option 1: Measure NCI at fair value i.e., ₹ 15 crores as derived by the valuer;

- Option 2: Measure NCI as proportion of fair value of identifiable net assets i.e., ₹ 10 crores (100 crores x 10%)

Illustration 19: Step Acquisition

On April 1, 20X1, Company A acquired 5% of the equity share capital of Company B for 1,00,000. A accounts for its investment in B at Fair Value through OCI (FVOCI) under Ind AS 109, Financial Instruments: Recognition and Measurement. At March 31, 20X2, A carried its investment in B at fair value and reported an unrealised gain of ₹ 5,000 in other comprehensive income, which was presented as a separate component of equity. On April 1, 20X2, A obtains control of B by acquiring the remaining 95 percent of B.

Required: Comment on the treatment to be done based on the facts given in the question.

Answer: At the acquisition date A recognises the gain of ₹ 5,000 in OCI as the gain or loss is not allowed to be recycled to income statement as per the requirement of Ind AS 109. A's investment in B would be at fair value and therefore does not require remeasurement as a result of the business combination. The fair value of the 5 percent investment (1,05,000) plus the fair value of the consideration for the 95 percent newly acquired interest is included in the acquisition accounting.

Illustration 20:

ABC Ltd. acquires PQR Ltd. on 30th June, 20X1. The assets acquired from PQR Ltd. include an intangible asset that comprises wireless spectrum license. For this intangible asset, ABC Ltd. is required to make an additional one-time payment to the regulator in PQR's jurisdiction in order for the rights to be transferred for its use. Whether such additional payment to the regulator is an acquisition-related cost?

Solution

As per Ind AS 103, the acquisition-related costs incurred by an acquirer to effect a business combination are not part of the consideration transferred.

Paragraph 53 of Ind AS 103 states that, acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognised in accordance with Ind AS 32 and Ind AS 109.

The payment to the regulator represents a transaction cost and will be regarded as acquisition related cost incurred to effect the business combination. Applying the requirements of para 53 of Ind AS 103, it should be expensed as it is incurred. Transfer of rights in the instant case cannot be construed to be separate from the business combination because the transfer of the rights to ABC Ltd. is an integral part of the business combination itself.

It may be noted that had the right been acquired separately (i.e. not as part of business combination), the transaction cost is required to be capitalised as part of the intangible asset as per the requirements of Ind AS 38, Intangible Assets.

Illustration 21: Contingent consideration

A acquires B. The consideration is payable in 3 tranches:

- an immediate payment of ₹ 10,00,000;
- a further payment of ₹ 5,00,000 after one year if profit before interest and tax for the first year following acquisition exceeds ₹ 2,00,000; and
- a further payment of ₹ 5,00,000 after two years if profit before interest and tax for the second year following acquisition exceeds ₹ 2,20,000.

The two payments that are conditional upon reaching earnings targets are contingent consideration. At the date of acquisition, the fair value of these two payments is assessed as ₹ 2,50,000.

Answer: Consequently, on the date of acquisition, consideration of ₹ 12,50,000 is recognised.

Illustration 22: Contingent consideration

Entity ABC Ltd. acquired entity PQR Ltd. for INR 5 crores. To protect ABC for false representations and warranties (if any) asserted by the sellers of entity PQR Ltd. the acquisition agreement provides that ABC Ltd. will pay INR 4.5 crores at the acquisition date and place the balance INR 50 Lakhs in an escrow account (being a protective clause). If no violation of the representations and warranties is reported or noticed within one year of the acquisition date, the amount of INR 50 Lakhs in the escrow account will be released to the sellers. Should INR 50 Lakhs lying in escrow be accounted for as contingent consideration by entity ABC Ltd.?

Answer: Ind AS 103 defines contingent consideration as follows: Usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met.

In the present case, the funds lying in escrow are released to the sellers based on the validity of conditions that existed at the acquisition date and are not dependent on the future performance of entity PQR Ltd. Further, as the escrow arrangement is only protective in nature. Therefore, INR 50 Lakhs will not be considered as a contingent consideration. It is instead required to be treated as part of the consideration for the business combination on the date of acquisition and consequently should be considered for computation of goodwill in relation to the acquisition.

Illustration 23: Contingent consideration

ABC Ltd. agrees to acquire PQR Ltd. for INR 60 crores as per an agreement dated 15 March 2017. The acquisition is however subject to the successful completion of the closing conditions. As per the agreement between ABC Ltd. and PQR Ltd., to the extent the working capital (that is, inventory, receivables and payables) at the acquisition date (on successful completion of closing conditions) exceeds a specified minimum level of 10 crores, ABC Ltd. will pay additional consideration to the seller. For instance, if PQR's working capital is INR 11 crores, ABC will pay an additional INR 1 crores. Should ABC Ltd. account for the working capital adjustment as contingent consideration?

Answer: The working capital adjustment mentioned above in relation to ABC Ltd.’s acquisition of PQR Ltd. is a mechanism to determine the working capital as of the acquisition date. While the working capital computation may be completed post the acquisition date, the computation does not consider the impact of any future event, conditions, contingencies etc.

Accordingly, given that the working capital adjustment reflects the consideration to be paid as of the acquisition date, the same may not be treated as contingent consideration.

Illustration 24: Contingent consideration

ABC Ltd. (the acquiree) is owned by Mr. S who is also the chief executive officer of the company. ABC Ltd. is purchased by PQR Ltd. (the acquirer) in a business combination. As per the purchase agreement, PQR Ltd. will pay Mr. S an additional consideration for the acquisition based upon ABC Ltd achieving specific earnings before interest, tax, depreciation and amortisation (EBITDA) levels over the two-year period following the acquisition. The additional payment is based on PQR Ltd's belief that retaining the services of Mr. S for at least two years is critical to transition of ABC Ltd's ongoing business. Accordingly, any rights to the additional consideration will be forfeited, if Mr. S is not an employee of ABC Ltd. at the end of the two years. Should the arrangement be treated as remuneration for the post-combination services or does it represent contingent consideration for the acquisition of ABC Ltd.?

Answer: An acquirer may enter into an arrangement for payments to employees or selling shareholders of the acquiree that are contingent on a post-acquisition event. The accounting for such arrangements depends on whether the payments represent contingent consideration issued in the business combination (which are included in the acquisition accounting), or are separate transactions (which are accounted for in accordance with other relevant Ind AS).

Paragraph B55 of Ind AS 103 provides indicators to be evaluated when determining whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration. However, judgement will be required for such evaluation.

Further, paragraph B55 (a) of Appendix B to Ind AS 103, inter alia, provides an indication that a contingent consideration arrangement in which payments are automatically forfeited if employment terminates is remuneration for post combination services.

Therefore, in the given case, the arrangement should be treated as remuneration for the post-combination services as the right to the additional consideration will be forfeited if Mr. S quits before the stipulated period of time.

Illustration 25: Contingent consideration

ABC Ltd. acquires all of the outstanding shares of XYZ Ltd. in a business combination. XYZ Ltd. had three shareholders with equal shareholdings, two of whom were also senior-level employees of XYZ Ltd. and would continue as employee post acquisition of shares by ABC Ltd.

- The employee shareholders each will receive INR 60,00,000 plus an additional payment of INR 1,50,00,000 to 2,00,00,000 based on a multiple of earnings over the next two years.
- The non-employee shareholders each receive INR 1,00,00,000.

The additional payment of each of these employee shareholders will be forfeited if they leave the employment of XYZ Ltd. at any time during the two years following its acquisition by ABC Ltd. The salary received by them is considered reasonable remuneration for their services. How much amount is attributable to post combination services?

Answer: Paragraph B55(a) of Ind AS 103 provides an indication that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.

Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.

In accordance with the above, in the instant case, the additional consideration of INR 1,50,00,000 to INR 2,00,00,000 represents compensation for post-combination services, as the same represents that part of the payment which is forfeited if the former shareholder does not remain in the employment of XYZ for two years following the acquisition - i.e., only INR 60,00,000 is attributed to consideration in exchange for the acquired business.

Illustration 26: Consideration transferred- Deferred consideration

ABC Ltd. acquired the entire equity share capital of PQR Ltd. for INR 8 crores. ABC Ltd. paid INR 2 crores in cash and the balance INR 6 crores has been agreed to be paid to the seller in 5 years as a deferred consideration. How should the deferred consideration be valued for determining the consideration transferred in relation to computation of goodwill?

Answer: The deferred consideration issued is required to be measured at its fair value. The deferred consideration will be valued at its net present value determined with reference to an appropriate discount rate (e.g. the rate at which entity ABC Ltd. could issue the same amount of debt in a separate market transaction with the appropriate adjustment for credit rating) for the purpose of computation of the consideration transferred.

Subsequent unwinding of the discounting discussed above is required to be recognised as finance cost in the respective years' statement of profit and loss.

Illustration 27: Recognition of Intangible Assets

Company A, FMCG company acquires an online e-commerce company E, with the intention to start doing retailing. The e-commerce company has over the period have 10 million registered users. However, the e-commerce company E does not have any intention to sale the customer list. Should this customer list be recorded as an intangible in a business combination?

Answer: In this situation the customer database does not give rise to legal or contractual right. Accordingly, the assessment of its separability will be assessed. The database can be useful other players and E has the ability to transfer this to them. Accordingly, the intention not to transfer will not affect the assessment whether to record this as an intangible or not.

Illustration 28:

ABC Ltd. a pharmaceutical group acquires XYZ Ltd. another pharmaceutical business. XYZ Ltd. has incurred significant research costs in connection with two new drugs that have been undergoing clinical trials. Out of the two drugs, one drug has not been granted necessary regulatory approvals. However, ABC Ltd. expects that approval will be given within two years. The other drug has recently received regulatory approval. The drugs' revenue-earning potential was one of the principal reasons why entity ABC Ltd. decided to acquire entity XYZ Ltd. Whether the research and development on either of the drugs be recognised as an intangible asset in the books of ABC Ltd.?

Answer: Ind AS 38, Intangible Assets provides explicit guidance on recognition of acquired in-process research and development.

Paragraph 21 of Ind AS 38 provides guidance regarding general recognition conditions which require it to be probable that expected future economic benefits will flow to the entity before an intangible asset can be recognised and for the cost to be measured reliably.

As per paragraph 33 of Ind AS 38, both of the standard's general recognition criteria, i.e. probability of benefits and reliable measurement, are always considered to be satisfied for intangible assets acquired in a business combination.

The fair value of an intangible asset reflects expectations about the probability of these benefits, despite uncertainty about the timing or the amount of the inflow. There will be sufficient information to measure the fair value of the asset reliably if it is separable or arises from contractual or other legal rights. If there is a range of possible outcomes with different probabilities, this uncertainty is taken into account in the measurement of the asset's fair value.

Paragraph 34 of Ind AS 38, provides that in accordance with this Standard and Ind AS 103, an acquirer recognises at the acquisition date, separately from goodwill, an intangible asset of the acquiree, irrespective of whether the asset had been recognised by the acquiree before the business combination.

This means that the acquirer recognises as an asset separately from goodwill an in-process research and development project of the acquiree if the project meets the definition of an intangible asset. An acquiree’s in-process research and development project meets the definition of an intangible asset when it:

a) meets the definition of an asset; and

b) is identifiable, i.e. is separable or arises from contractual or other legal rights. In accordance with above,

i. The fair value of the first drug reflects the probability and the timing of the regulatory approval being obtained. As per the standard, the recognition criterion of probable future economic benefits is considered to be satisfied in respect of the asset acquired accordingly an asset is recognised. Subsequent expenditure on an in-process research or development project acquired separately is to be dealt with in accordance with paragraph 43 of Ind AS 38.

ii. The rights to the second drug also meet the recognition criteria in Ind AS 8 and are recognised. The approval means it is probable that future economic benefits will flow to ABC Ltd. This will be reflected in the fair value assigned to the intangible asset.

Thus, recognising in-process research and development as an asset on acquisition applies different criteria to those that are required for internal projects. The research costs of internal R&D projects may under no circumstances be capitalised as an intangible asset. It may be pertinent to note that entities will be required to recognise on acquisition some research and development expenditure that they would not have been able to recognise if it had been an internal project. Although the amount attributed to the project is accounted for as an asset, Ind AS 38 requires that any subsequent expenditure incurred after the acquisition of the project is to be accounted for in accordance with paragraphs 54 to 62 of Ind AS 38.

Illustration 29: Reacquired Right

Vadapav Limited is a successful company has number of own stores across India and also offers franchisee to other companies. Efficient Ltd is one of the franchisee of Vadapav Ltd and is and operates number of store in south India. Vadapav Ltd. decided to acquire Efficient Ltd due to its huge distribution network and accordingly purchased the outstanding shares on 1 April 20X2. On the acquisition date, Vadapav determines that the license agreement reflects current market terms.

Answer: Vadapav will record the franchisee right as an intangible asset (reacquired right) while doing purchase price allocation and since it is at market terms no gain or loss will be recorded on settlement.

Illustration 30: Contingent liability

A suit for damages worth ₹ 10 million was filed on Company B for alleged breach of certain contract provisions. Company B had disclosed the same as a contingent liability in its financial statements, as it considered that it is a present obligation for which it was not probable that the amount would be payable. Company A acquire Company B and determines the fair value of the contingent liability to be ₹ 2 million.

Answer: Company A would recognise ₹ 2 million in its financial statements as part of acquisition accounting, even if it is not probable that payment will be required to settle the obligation.

Illustration 31: Contingent liability

ABC Ltd. is in the process of acquiring PQR Ltd., an entity engaged in the business of software related products and services. PQR Ltd. has been sued for one of the software licenses it uses in its business. The entity's lawyer has advised that, in his opinion, it is probable that the case could be successfully defended. Accordingly, no provision has been included in the PQR Ltd.'s financial statements immediately prior to the acquisition. However, post-acquisition, ABC Ltd.'s management has decided that the case should be settled out of court in order to avoid a protracted court case. Should the acquirer recognise the contingent liability?

Answer: Ind AS 103 states that the requirements in Ind AS 37 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably.

Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Paragraph 56 provides guidance on the subsequent accounting for contingent liabilities.

In accordance with the above, in the given case, although the case is probable to be successfully defended, the contingent liability will have a fair value on the assumption that there is some risk that the case may not be successfully defended. To the extent that the fair value can be reliably measured, the contingent liability would be recognised as part of the business combination accounting.

The financial effect of the acquirer's decision not to defend the case would be reflected as a current – that is, post combination event.

Exceptions to recognition and measurement principles -

Illustration 32: Indemnification assets

a) ABC Ltd. acquired a beverage company PQR Ltd. from XYZ Ltd. At the time of the acquisition, PQR Ltd. is the defendant in a court case whereby certain customers of PQR Ltd. have alleged that its products contain pesticides in excess of the permissible levels that have caused them health damage.

PQR Ltd. is being sued for damages of INR 2 crores. XYZ Ltd. Has indemnified ABC Ltd. for the losses, if any, due to the case for amount up to INR 1 crore. The fair value of the contingent liability for the court case is INR 70 lakhs.

How should ABC Ltd. account for the contingent liability and the indemnification asset?

b) ABC Ltd. acquires PQR Ltd. in July 2017. PQR Ltd. is in dispute with local tax authorities over its tax return for 2015. ABC Ltd. receives an indemnity from the selling shareholder(s) of PQR Ltd. to cover the outcome of the tax dispute. ABC Ltd. ascertains that an outflow in relation to the tax case is probable and estimates the amount expected to be paid as INR 25 lakhs i.e., the full amount being claimed by the tax authorities. The fair value of the liability is INR 17.4 lakhs.

Paragraph 24 of Ind AS 103 requires the acquirer to recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with Ind AS 12, Income Taxes. Thus, ABC Ltd. recognised a liability of INR 25 lakhs. If the tax authorities require this amount to be paid, the seller of PQR Ltd. will pay ABC Ltd. the full INR 25 lakhs. ABC Ltd. considers the credit worthiness of selling shareholders' of PQR Ltd. to be such that the indemnification asset is fully collectible. How should indemnification asset be accounted for?

c) ABC Ltd. pays INR 50 crores to acquire PQR Ltd. from XYZ Ltd. PQR Ltd. manufactured products containing fiber glass and has been named in 10 class actions concerning the effects of these fiber glass. XYZ Ltd. agrees to indemnify ABC Ltd. for the adverse results of any court cases up to an amount of INR 10 crores. The class actions have not specified amounts of damages and past experience suggests that claims may be up to INR 1 crore each, but that they are often settled for small amounts. ABC Ltd. makes an assessment of the court cases and decides that due to the potential variance in outcomes, the contingent liability cannot be measured reliably and accordingly no amount is recognised in respect of the court cases. How should indemnification asset be accounted for?

Answer: An acquirer recognises indemnification asset at the same time and measures them on the same basis as the indemnified item, subject to contractual limitations and adjustments for collectability, if applicable.

a) In the current scenario, ABC Ltd. measures the identifiable liability of entity PQR Ltd. at INR 70 lakhs and also recognises a corresponding asset of INR 70 lakhs on its consolidated balance sheet. The net impact on goodwill from the recognition of the contingent liability and associated indemnification asset is nil. However, in the case where the liability's fair value is more than INR 1 crore (for example INR 1.2 crores), the asset will be limited to INR 1 crore.

b) ABC Ltd. recognises an indemnification asset of INR 25 lakhs which is measured on the same basis as the indemnified liability as no adjustment has been required for collectability or contractual limitations on the indemnified amount.

c) Since no liability is recognised in the given case, ABC Ltd. will also not recognise an indemnification asset as part of the business combination accounting.

Further, ABC Ltd. is required to make the necessary disclosures for contingent consideration arrangements and indemnification assets as required by paragraph B64 (g) of Ind AS 103.

Illustration 33: Measurement period

Suppose that AC acquires TC on 30 September 20X7. AC seeks an independent valuation for an item of property, plant and equipment acquired in the combination, and the valuation was not complete by the time AC authorised for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, AC recognised a provisional fair value for the asset of ₹ 30,000. At the acquisition date, the item of property, plant and equipment had a remaining useful life of five years. Five months after the acquisition date, AC received the independent valuation, which estimated the asset’s acquisition-date fair value as ₹, 40,000.

Answer: In its financial statements for the year ended 31 December 20X8, AC retrospectively adjusts the20X7 prior year information as follows:

(a) the carrying amount of property, plant and equipment as of 31 December 20X7 is increased by ₹ 9,500. That adjustment is measured as the fair value adjustment at the acquisition date of ₹ 10,000 less the additional depreciation that would have been recognised if the asset’s fair value at the acquisition date had been recognised from that date (₹ 500 for three months’ depreciation);

(b) the carrying amount of goodwill as of 31 December 20X7 is decreased by ₹, 10,000; and

(c) depreciation expense for 20X7 is increased by ₹ 500.

Illustration 34: Measurement period

A Ltd. prepares financial statements for annual periods ending on 31 December and does not prepare interim financial statements. A Ltd. was the acquirer in a business combination on 30 September 20X4. The entity sought an independent appraisal for an item of property, plant and equipment acquired in the combination. However, the appraisal was not finalised by the time the entity completed its 20X4 annual financial statements. The entity recognised in its 20X4 annual financial statements a provisional fair value for the asset of ₹ 30,000, and a provisional value for acquired goodwill of ₹ 100,000. The item of property, plant and equipment had a remaining useful life at the acquisition date of five years.

Four months after the acquisition date, the entity received the independent appraisal, which estimated the asset’s fair value at the acquisition date at ₹ 40,000. Give the treatment done by A Ltd.

Answer: As outlined in IND AS 103, the acquirer is required to recognise any adjustments to provisional values as a result of completing the initial accounting from the acquisition date.

Therefore, in the 20X5 financial statements, an adjustment is made to the opening carrying amount of the item of property, plant and equipment. That adjustment is measured as the fair value adjustment at the acquisition date of ₹ 10,000, less the additional depreciation that would have been recognised had the asset's fair value at the acquisition date been recognised from that date (₹ 500 for three months' depreciation to 31 December 20X4). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of ₹ 10,000, and the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of ₹ 500 relating to the year ended 31 December 20X4.

In accordance with IND AS 103, the entity discloses in its 20X4 financial statements that the initial accounting for the business combination has been determined only provisionally, and explains why this is the case. The entity discloses in its 20X5 financial statements the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, the entity discloses that:

- the fair value of the item of property, plant and equipment at the acquisition date has been increased by ₹ 10,000 with a corresponding decrease in goodwill; and
- the 20X4 comparative information is restated to reflect this adjustment and to include additional depreciation of ₹ 500 relating to the year ended 31 December 20X4

Illustration 35: Measurement period

A Ltd prepares financial statements for annual periods ending on 31 December and does not prepare interim financial statements. A Ltd. was the acquirer in a business combination on 30 September 20X1. As part of the initial accounting for that combination, the entity recognised goodwill of ₹ 100,000. The carrying amount of goodwill at 31 December 20X1 was ₹ 100,000.

During 20X2, the entity becomes aware of an error relating to the amount initially allocated to property, plant and equipment assets acquired in the business combination. In particular, ₹ 20,000 of the ₹ 100,000 initially allocated to goodwill should be allocated to property, plant and equipment assets that had a remaining useful life at the acquisition date of five years. Give the treatment done by A Ltd.

Answer: As outlined in IND AS 103, IND AS 8 requires the correction of an error to be accounted for retrospectively, and for the financial statements to be presented as if the error had never occurred by correcting the error in the comparative information for the prior period(s) in which it occurred.

Therefore, in the 20X2 financial statements, an adjustment is made to the opening carrying amount of property, plant and equipment assets. That adjustment is measured as the fair value adjustment at the acquisition date of ₹ 20,000 less the amount that would have been recognised as depreciation of the fair value adjustment (₹ 1,000 for three months' depreciation to 31 December 20X1). The carrying amount of goodwill is also adjusted for the reduction in value at the acquisition date of ₹ 20,000, and the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of ₹ 1,000 relating to the year ended 31 December 20X1.

In accordance with IND AS 8, the entity discloses in its 20X2 financial statements the nature of the error and that, as a result of correcting that error, an adjustment was made to the carrying amount of property, plant and equipment. The entity also discloses that:

- the fair value of property, plant and equipment assets at the acquisition date has been increased by ₹ 20,000 with a corresponding decrease in goodwill; and

- the 20X1 comparative information is restated to reflect this adjustment and to include additional depreciation of ₹ 1,000 relating to the year ended 31 December 20X1.

Illustration 36: Measurement period

Entity X acquired 100% shareholding of Entity Y on 1 April 20X1 and had complete the preliminary purchase price allocation and accordingly recorded net assets of INR 100 million against the purchase consideration of 150 million. Entity Y had significant carry forward losses on which deferred tax asset was not recorded due to lack of convincing evidence on the acquisition date. However, on 31 March 20X2, Entity Y won a significant contract which is expected to generate enough taxable income to recoup the losses. Accordingly, the deferred tax asset was recorded on the carry forward losses on 31 March 20X2. Whether the aforesaid losses can be adjusted with the Goodwill recorded based on the preliminary purchase price allocation?

Answer: No, as per the requirement of Ind AS 103, changes to the net assets are allowed which results from the discovery of a fact which existed on the acquisition date. However, change of facts resulting in recognition and de-recognition of assets and liabilities after the acquisition date will be accounted in accordance with other Ind AS. In the above scenario deferred tax asset was not eligible for recognition on the acquisition date and accordingly the new contract on 31 March 20X2 will tantamount to change of estimate and accordingly will not impact the Goodwill amount.

Illustration 37: Measurement period

Scenario 1: New information on the fair value of an acquired loan

Bank F acquires Bank E in a business combination in October 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives Borrower B's financial statements for the year ended September 30, 20X1, which indicate significant decrease in Borrower B's income from operations. Basis this, the fair value of the loan to B at the acquisition date is determined to be less than the amount recognised earlier on a provisional basis.

Scenario 2: Decrease in fair value of acquired loan resulting from an event occurring during the measurement period

Bank F acquires Bank E in a business combination in October 20X1. The loan by Bank E to Borrower B is recognised at its provisionally determined fair value. In December 20X1, F receives information that Borrower B has lost its major customer earlier that month and this is expected to have a significant negative effect on B's operations.

Required: Comment on the treatment done by Bank F.

Answer:

Scenario 1: The new information obtained by F subsequent to the acquisition relates to facts and circumstances that existed at the acquisition date. Accordingly, an adjustment (i.e., decrease) to in the provisional amount should be recognised for loan to B with a corresponding increase in goodwill.

Scenario 2: Basis this, the fair value of the loan to B will be less than the amount recognised earlier at the acquisition date. The new information resulting in the change in the estimated fair value of the loan to B does not relate to facts and circumstances that existed at the acquisition date, but rather is due to a new event i.e., the loss of a major customer subsequent to the acquisition date. Therefore, based on the new information, F should determine and recognise an allowance for loss on the loan in accordance with Ind AS 109, Financial Instruments: Recognition and Measurement, with a corresponding charge to profit or loss; goodwill is not adjusted.

Illustration 38: Measurement after acquisition accounting – Adjustments to provisional amounts

ABC Ltd. acquires XYZ Ltd. in a business combination on 15 January 2017. Few days before the date of acquisition, one of XYZ Ltd.'s customers had claimed that certain amounts were due by XYZ Ltd. under penalty clauses for completion delays included in the contract.

ABC Ltd. evaluates the dispute based on the information available at the date of acquisition and concludes that XYZ Ltd. was responsible for at least some of the delays in completing the contract. Based on the evaluation, ABC Ltd. recognises INR 1 crore towards this liability which is its best estimate of the fair value of the liability to the customer based on the information available at the date of acquisition.

In October 2017 (within the measurement period), the customer presents additional information as per which ABC Ltd. concludes the fair value of liability on the date of acquisition to be INR 2 crores.

ABC Ltd. continues to receive and evaluate information related to the claim after October 2017. Its evaluation doesn’t change till February 2018 (i.e. after the measurement period), when it concludes that the fair value of the liability for the claim at the date of acquisition is INR 1.9 crores. ABC determines that the amount that would be recognised with respect to the claim under Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets as at February 2018 is INR 2.2 crores.

How should the adjustment to the provisional amounts be made in the financial statements during and after the measurement period?

Answer:

- The consolidated financial statements of ABC Ltd. for the year ended 31 March 2017 should include INR 1 crore towards the contingent liability in relation to the customer claim.
- When the customer presents additional information in support of its claim, the incremental liability of INR 1crore (INR 2,00,00,000 – INR 1,00,00,000) will be adjusted as a part of acquisition accounting as it is within the measurement period. In its financial statements for the year ending on 31 March 2018, ABC will disclose the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, it will disclose that the comparative information for the year ending on 31 March 2017 is adjusted retrospectively to increase the fair value of the item of liability at the acquisition date by INR 1 crore, resulting in a corresponding increase in goodwill.
- The information resulting in the decrease in the estimated fair value of the liability for the claim in February 2018 was obtained after the measurement period. Accordingly, the decrease is not recognised as an adjustment to the acquisition accounting. If the amount determined in accordance with Ind AS 37 subsequently exceeds the previous estimate of the fair value of the liability, then ABC Ltd. recognises an increase in the liability. As the change has occurred after the end of the measurement period, the increase in the liability amounting to INR 20 lakhs (INR 2.2 crores– INR 2 crores) is recognised in profit or loss.

Illustration 39: Provisional accounting-Adjustment of comparatives

ABC Ltd. acquired XYZ Ltd. on 28 February 2017. As part of the acquisition accounting, ABC Ltd. recognised a provisional amount of INR 1 crore in respect of a patent developed by XYZ Ltd. However, the technology covered by the patent was new and ABC Ltd. expected the cash flows to be generated by the patent to increase beyond those being generated at the time. Accordingly, ABC Ltd. sought an independent valuation report from a third party consultant, which was not expected to be finalised for several months. ABC Ltd. assessed the useful life of the patent to be 10 years. Goodwill of INR 1.2 crores was recognised in the provisional accounting.

The consolidated financial statements of ABC Ltd. as at 31 March 2017 included appropriate disclosures about the provisional accounting. The valuation report is finalised subsequent to the issuance of the financial statements of the year 2016-17 but before the end of the measurement period. Based on the valuation, ABC Ltd. concludes that the fair value of the patent was INR 1.5 crores. Management does not revise the estimated useful life of the patent, which remains at 10 years.

Whether ABC Ltd. is required to restate the comparative information for the year 2016-17 presented in the financial statements of the year 2017-18?

Answer: Paragraph 45 of Ind AS 103 provides that if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer should report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer should retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

In accordance with above, the acquirer should revise comparative information for prior periods presented in financial statements as required, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

Based on above, the comparative information presented in the financial statements for the year 2017-18 needs to be restated for the measurement period adjustment as follows:

	31 March 2017	**As stated originally Revised**
Profit or loss (patent amortisation)	83,333(1)	125,000 (2)
Goodwill	1,20,00,000	70,00,000 (3)
Patent	99,16,667 (4)	1,48,75,000 (5)

Notes:

1. 1,00,00,000 x 1 /10 x 1 / 12

2. 1,50,00,000 x 1 / 10 x 1 / 12

3. 1,20,00,000 – 50,00,000

4. 1,00,00,000 – 83,333

5. 1,50,00,000 – 125,000

Illustration 40: Gain on bargain purchase

Company A acquires 70 percent of Company S on January 1, 20X1 for consideration transferred of ₹ 5 million. Company A intends to recognise the NCI at proportionate share of fair value of identifiable net assets. With the assistance of a suitably qualified valuation professional, A measures the identifiable net assets of B at ₹ 10 million. A performs a review and determines that the business combination did not include any transactions that should be accounted for separately from the business combination.

Required: State whether the procedures followed by A and the resulting measurements are appropriate or not. Also calculate the bargain purchase gain in the process.

Answer: The amount of B's identifiable net assets exceeds the fair value of the consideration transferred plus the fair value of the NCI in B, resulting in an initial indication of a gain on a bargain purchase. Accordingly, A reviews the procedures it used to identify and measure the identifiable net assets acquired, to measure the fair value of both the NCI and the consideration transferred, and to identify transactions that were not part of the business combination.

Following that review, A concludes that the procedures followed and the resulting measurements were appropriate. (₹)

Identifiable net assets	1,00,00,000
Less: Consideration transferred	(50,00,000)
NCI (10 million x 30%)	(30,00,000)
Gain on bargain purchase	20,00,000

Illustration 41: Gain on bargain purchase

On 1 January 20X5 AC acquires 80 per cent of the equity interests of TC, a private entity, in exchange for cash of ₹ 150. Because the former owners of TC needed to dispose of their investments in TC by a specified date, they did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of IND AS103. The identifiable assets are measured at ₹ 250 and the liabilities assumed are measured at ₹ 50. AC engages an independent consultant, who determines that the fair value of the 20 per cent non-controlling interest in TC is ₹ 42.

The amount of TC's identifiable net assets (₹ 200, calculated as ₹ 250 – ₹ 50) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in TC. Therefore, AC reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in TC and the consideration transferred. After that review, AC decides that the procedures and resulting measures were appropriate.

Calculate the gain or loss on acquisition and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest on the basis of proportionate interest method, if alternatively applied?

Answer: Goodwill/bargain purchase gain

AC measures the gain on its purchase of the 80 per cent interest as follows:

	₹	₹
Amount of the identifiable net assets acquired (₹250 – ₹50)		200
Less: Fair value of the consideration transferred for		
AC's 80 per cent interest in TC; plus	150	
Fair value of non-controlling interest in TC	42	192
Gain on bargain purchase of 80 per cent interest		8

AC would record its acquisition of TC in its consolidated financial statements as follows:

	₹	₹
Dr Identifiable assets acquired	250	
Cr Cash		150
Cr Liabilities assumed		50
Cr Gain on the bargain purchase		8
Cr Equity – non-controlling interest in TC		42

If the acquirer chose to measure the non-controlling interest in TC on the basis of its proportionate interest in the identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be ₹40 (₹200 x 0.20). The gain on the bargain purchase then would be ₹10 (₹200 – (₹150 + ₹40)).

Illustration 42: Business combination under Common control

Company X, the ultimate parent of a large number of subsidiaries, reorganises the retail segment of its business to consolidate all of its retail businesses in a single entity. Under the reorganisation, Company Z (a subsidiary and the biggest retail company in the group) acquires Company X's shareholdings in its one operating subsidiary, Company Y by issuing its own shares to Company X. After the transaction, Company X will directly control the operating and financial policies of Companies Y. Is the transaction meets the definition of a common control combination and is outside the scope of Ind AS 103

Answer: In this situation, Company Z pays consideration to Company X to obtain control of Company Y. The transaction meets the definition of a business combination. Prior to the reorganisation, each of the parties are controlled by Company X. After the reorganisation, although Company Y are now owned by Company Z, all two companies are still ultimately owned and controlled by Company A. From the perspective of Company X, there has been no change as a result of the reorganisation. This transaction therefore meets the definition of a common control combination and is outside the scope of Ind AS 103.

Illustration 43: Business combination under Common control

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. Shareholders B, C and D have entered into a shareholders' agreement in terms of governance of ABC Ltd. and XYZ Ltd. due to which they exercise joint control.

Whether ABC Ltd. and XYZ Ltd. are under common control?

Answer: Appendix C to Ind AS 103 defines common control business combination as a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

As per paragraphs 6 and 7 of Appendix C to Ind AS 103, an entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one having entities under common control. Also, a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

In the instant case, both ABC Ltd. and XYZ Ltd. are jointly controlled by group of individuals (B, C and D) as a result of contractual arrangement. Therefore, in the current scenario, ABC Ltd. and XYZ Ltd. are considered to be under common control.

Illustration 44: Business combination under Common control

ABC Ltd. and XYZ Ltd. are owned by four shareholders B, C, D and E, each of whom holds 25% of the shares in each company. However, there are no agreements between any of the shareholders that they will exercise their voting power jointly.

Whether ABC Ltd. and XYZ Ltd. are under common control?

Answer: Appendix C to Ind AS 103 defines 'Common control business combination' as business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

Further as per paragraphs 6 and 7 of Appendix C to Ind AS 103, an entity can be controlled by an individual, or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of Ind AS. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a control. Also a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

In the present case, there is no contractual arrangement between the shareholders who exercise control collectively over either company. Thus, ABC Ltd. and XYZ Ltd. are not considered to be under common control even if there is an established pattern of voting together.

Illustration 45: Business combination under Common control

ABC Ltd. had a subsidiary, namely, X Ltd. which was acquired on 1st April, 2XX0. ABC Ltd. acquires all of the shares of Y Ltd. on 1st April, 2X17. ABC Ltd. transfers the shares in Y Ltd. to X Ltd. on 2nd April, 2X17. How should the above transfer of Y Ltd. into X Ltd. be accounted for in the consolidated financial statements of X Ltd.?

Answer: Appendix C to Ind AS 103 defines common control business combination as business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

As per paragraph 7 of Appendix C to Ind AS 103, a group of individuals are regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities, and that ultimate collective power is not transitory.

The term 'transitory' has been included as part of Appendix C to Ind AS 103.

The word 'transitory' has been included in the common control definition to ensure that acquisition accounting applies to those transactions that look as though they are combinations involving entities under common control, but which in fact represent genuine substantive business combinations with unrelated parties.

Based on above, if the intermediate step had been omitted and instead X Ltd. had been the ABC group's vehicle for the acquisition of Y Ltd. - i.e. going straight to the 'after' position - then X Ltd. would have been identified as the acquirer.

Considering X Ltd. and Y Ltd. are under common control (with common parent), it might seem that acquisition accounting is not required because of the specific requirement for common control business combination. However, X Ltd. should be identified as the acquirer and should account for its combination with Y Ltd. using acquisition accounting. This is because X Ltd. would have applied acquisition accounting for Y Ltd. if X Ltd. had acquired Y Ltd directly rather than through ABC Ltd. Acquisition accounting cannot be avoided in the financial statements of X Ltd. simply by placing X Ltd. and Y Ltd. under the common control of P shortly before the transaction

Illustration 46

How will the financial statement of the prior periods be restated under common control in the following scenarios:

a) Common Control period extends beyond the start of comparative period

XYZ Ltd acquired PQR Ltd in a common control transaction on 1 October 20X9. The year-end of XYZ Ltd is 31 March. Both XYZ Ltd and PQR Ltd have been controlled by shareholders since their incorporation.

b) Common Control period started in the comparative period

ABC Ltd acquired DEF Ltd in a common control transaction on 1 October 20X9. The year end of ABC Ltd is 31 March. Both ABC Ltd and DEF Ltd are controlled by shareholder A. A made investment in ABC Ltd in 20X0 and made investment in DEF Ltd on 1 October 20X8.

Answer: Paragraph 9(iii) of Appendix C to Ind AS 103 states that the financial information in the financial statements in respect of prior periods should be restated as if the business combination had occurred from the beginning of the preceding period in the financial statements, irrespective of the actual date of the combination. However, if business combination had occurred after that date, the prior period information shall be restated only from that date.

a) In accordance with Paragraph 9(iii) above, the entity will be required to restate its financial statements as if the business combination had occurred from the beginning of the preceding period in the financial statements, accordingly in the present case XYZ Ltd will have to restate its comparatives for the financial year 20X8-20X9 as if the acquisition had occurred before 1 April 20X8. Additionally, the results of current year of PQR Ltd will be required to include XYZ's financial statements for the period from 1 April 20X9 to 30 September 20X9.

b) In accordance with paragraph 9(iii) above, ABC Ltd will have to restate its comparatives for the financial year ended 20X8-20X9 as if the acquisition had occurred on 1 October 20X8, but not earlier. Additionally, the results of current year of DEF Ltd will be required to include the financial statements of ABC Ltd for the period from 1 April 20X9 to 1 October 20X9.

Illustration 47

Entity A owns 100% equity shares of entity B since 01.04.20X1. Entity A arranges loan funding from a financial institution in a new wholly-owned subsidiary called “Entity C”. The loan is used by Entity C to acquire 100% shareholding in entity B, for cash consideration of ₹ 2,00,000. Entity A applies Ind AS 103 to account for common control transactions and Entity C will adopt the same policy. Fair Value of Net identifiable Assets is ₹ 1,50,000 and Carrying Value of Net Identifiable Assets is ₹ 1,00,000.

How will Entity C apply acquisition accounting in its consolidated financial statements?

Answer: As per para 2 of appendix C of Ind AS 103, Common control business combination means a business combination involving entities or businesses in which all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.

In the above scenario, the Entity A controls Entity B before and after the acquisition. After acquisition, entity A controls entity B through entity C.

As per para 8 of appendix C of Ind AS 103, Business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method.

As per para 9(i) of appendix C of Ind AS 103, the pooling of interest method is considered to involve the assets and liabilities of the combining entities are reflected at their carrying amounts.

Based on the above analysis, Entity C cannot be the acquirer. Entity A has created Entity C and is the seller, so Entity C has effectively been formed and issued shares to effect the business combination. Entity C is not a business and the transaction between entity B and Entity C is not a business combination. It is a reorganisation of entity B. As a result, entity B’s assets and liabilities are included in Entity C consolidated financial statements at their pre-combination carrying amounts without a fair value uplift.

Illustration 48

Entity A and entity B provide construction services in India. Entity A is owned by a group of individuals, none of whom has control and does not have a collective control agreement. Entity B is owned by a single individual, Mr. Ram. The owners of entities A and B have decided to combine their businesses. The consideration will be settled in shares of entity B. Entity B issues new shares, amounting to 40% of its issued share capital, to its controlling shareholder, Mr. Ram. Mr. Ram then transfers the shares to the owners of entity A in exchange for their interest in entity A. At this point Mr. Ram controls both entities A and B, owning 100% of entity A and 71.42% of entity B. Mr. Ram had a controlling interest in both entity A and entity B before and after the contribution. Is the combination of entities A and B a combination of entities under common control?

Answer: No. This is not a business combination of entities under common control. Mr. Ram's control of both entities before the business combination was transitory. The substance of the transaction is that entity B has obtained control of entity A. Entity B accounts for this transaction as a business combination under Ind AS 103 using acquisition accounting.

Illustration 49: Identification of Business Combination

Which of the following scenario represents a Business Combination?

a) Case A: On 1 January 2012, ABC Ltd. owns a majority share of its investee's voting equity interests. The other investors in the investee hold contractual rights (for example, board membership rights accompanied by veto rights on operating matters, or other substantive participation rights) which preclude ABC Ltd. from exercising control over the investor. The contractual rights of other investors were for 5 years which lapsed on 31 December 2016 as per the terms of the contract.

b) Case B: PQR Ltd. owns an equity investment in an investee that gives it significant influence but not control. During the year, the investee repurchased its own shares from other parties and the same were extinguished which resulted in an increase in the PQR Ltd.'s proportional interest in the investee (to 60% of the voting rights), which results in PQR Ltd. acquiring control of the investee.

Answer:

a) In Case A, on 1 January 2017, it represents a change in the rights of other shareholders (elimination or expiration of the contractual rights precluding control) which result in ABC Ltd. obtaining control of the investee and qualifying as a business combination.

b) In Case B, the repurchase by investee of its own shares from other parties results in PQR Ltd. obtaining control of the investee (presuming no other indicator impacting control). This transaction qualifies as a business combination and the acquisition method would be applied by PQR Ltd.

It has been presumed that in both the cases above, the activities of the investee meet the definition of business.

PRACTICE QUESTIONS

Q1: An entity acquires an equipment and a patent in exchange for INR 1,000 crores cash and land. The fair value of the land is INR 400 crores and its carrying value is INR 100 crores. The fair values of the equipment and patent are estimated to be INR 500 crores and INR 1,000 crores, respectively. The equipment and patent relate to a product that has just recently been commercialised. The market for this product is still developing. Assume the entity incurred no transaction costs. For ease of convenience, the tax consequences on the gain have been ignored. How should the transaction be accounted for? **[ICAI SM]**

Ans: As per paragraph 2(b) of Ind AS 103, the standard does not apply to "the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill".

In the given case, the acquisition of equipment and patent does not represent acquisition of a business.

The cost of the asset acquisition is determined based on the fair value of the assets given, unless the fair value of the assets received is more reliably determinable. In the given case, the fair value measurement of the land appears more reliable than the fair value estimate of the equipment and patent. Thus, the entity should record the acquisition of the equipment and patent as INR 1,400 crores (the total fair value of the consideration transferred).

Thus, the fair value of the consideration given, i.e., INR 1,400 crores is allocated to the individual assets acquired based on their relative estimated fair values. The entity should records a gain of INR 300 crores for the difference between the fair value and carrying value of the land.

The equipment is recorded at its relative fair value ((INR 500 / INR 1,500) × INR1,400 = INR 467 crores).

The patent is recorded at its relative fair value ((INR 1,000 / INR 1,500) × INR1,400 = INR 933 Crores).

Q2: Entity A acquires 80% of the share capital of Entity B, which holds a single asset, or a group of assets not constituting a business. The remaining 20% of the share capital is held by Entity M, an unrelated third party. The fair value of the asset is ₹ 20,000. Entity A controls Entity B, as defined in Ind AS 110 Consolidated Financial Statements. Cash paid for the acquisition is ₹ 16,000 and fair value of non-controlling interest is ₹ 4,000. How does an acquirer account for the acquisition of a controlling interest in another entity that is not a business?

[Other Sources]

Ans: Under Ind AS 110, an entity must consolidate all investees that it controls, not just those that are businesses, and recognise any non-controlling interest in non-wholly owned subsidiaries.

When the acquisition of an entity is not a business combination, the requirements of acquisition accounting of Ind AS 103 relating to the allocation of the consideration transferred to the identifiable assets and liabilities and the recognition of goodwill are not applicable.

Paragraph 2(b) of Ind AS 103 states that upon the acquisition of an asset or a group of assets that does not constitute a business, the acquirer shall identify and recognise the individual identifiable assets acquired and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.

Ind AS 16, Property, Plant and Equipment and Ind AS 38, Intangible Assets state that "Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction. Therefore, when an asset is acquired, its cost is the amount of consideration paid, plus the amount of non-controlling interest (NCI) recorded related to that asset- as this represents a 'claim' relating to that asset.

With respect to case above, the following entries would be recorded:

Asset	Dr	20,000
NCI	Cr	4,000
Cash	Cr	16,000

Q3: Company A and Company B are in power business. Company A holds 25% of equity shares of Company B. On November 1, Company A obtains control of Company B when it acquires a further 65% of Company B's shares, thereby resulting in a total holding of 90%. The acquisition had the following features:

- Consideration: Company A transfers cash of ₹ 59,00,000 and issues 1,00,000 shares on November 1. The market price of Company A's shares on the date of issue is ₹ 10 per share. The equity shares issued as per this transaction will comprise 5% of the post-acquisition equity capital of Company A.
- Contingent consideration: Company A agrees to pay additional consideration of ₹ 7,00,000 if the cumulative profits of Company B exceed ₹ 70,00,000 over the next two years. At the acquisition date, it is not considered probable that the extra consideration will be paid. The fair value of the contingent consideration is determined to be ₹ 3,00,000 at the acquisition date.
- Transaction costs: Company A pays acquisition-related costs of ₹ 1,00,000.
- Non-controlling interests (NCI): The fair value of the NCI is determined to be ₹ 7,50,000 at the acquisition date based on market prices. Company A elects to measure non-controlling interest at fair value for this transaction.
- Previously held non-controlling equity interest: Company A has owned 25% of the shares in Company B for several years. At November 1, the investment is included in Company A's consolidated statement of financial position at ₹ 6,00,000, accounted for using the equity method; the fair value is ₹ 20,00,000.

The fair value of Company B’s net identifiable assets at November 1 is ₹ 60,00,000, determined in accordance with Ind AS 103.

Required: Determine the accounting under acquisition method for the business combination by Company A. **[ICAI SM]**

Ans: Let us evaluate each of the steps discussed in the above analysis:

Identify the acquirer

In this case, Company A has paid cash consideration to shareholders of Company B. Further, the shares issued to Company B pursuant to the acquisition do not transfer control of Company A to erstwhile shareholders of Company B. Therefore, Company A is the acquirer and Company B is the acquirer.

Determine acquisition date

As the control over the business of Company B is transferred to Company A on November 1, that date is considered as the acquisition date.

Determine the purchase consideration

The purchase consideration in this case will comprise the following:

Cash consideration	₹ 59,00,000
Equity shares issued (1,00,000 x 10 i.e., at fair value)	₹ 10,00,000
Contingent consideration (at fair value)	₹ 3,00,000
Fair value of previously held interest	₹ 20,00,000
As such, the total purchase consideration is	₹ 92,00,000.

Acquisition cost incurred by and on behalf of the Company A for acquisition of Company B should be recognised in the Statement of profit and loss. As such, an amount of ₹ 1,00,000 should be recognised in Statement of profit and loss.

Determine fair value of identifiable assets and liabilities

The fair value of identifiable net assets is determined at ₹ 60,00,000.

Measure NCI

The management has decided to recognise the NCI at its fair value. As such, the NCI will be recognised at ₹ 7,50,000.

Re-measure previously held interests in case business combination is achieved in stages

In this case, the control has been acquired in stages i.e., before acquisition to control, the Company A exercised significant influence over Company B. As such, the previously held interest should be measured at fair value and the difference between the fair value and the carrying amount as at the acquisition date should be recognised in Statement of Profit and Loss. As such, an amount of ₹ 14,00,000 (i.e., 20,00,000 less 6,00,000) will be recognised in Statement of profit and loss.

Determination of goodwill or gain on bargain purchase

Goodwill should be calculated as follows:	**(₹)**
Total consideration	92,00,000
Recognised amount of any non-controlling interest	7,50,000
Less: fair value of Lila-Domestic's net identifiable assets	(60,00,000)
Goodwill	39,50,000

Q4: How should contingent consideration payable in relation to a business combination be accounted for on initial recognition and at the subsequent measurement as per Ind AS in the following cases:

(i) On 1 April 2016, A Ltd. acquires 100% interest in B Ltd. As per the terms of agreement the purchase consideration is payable in the following 2 tranches:

a. an immediate issuance of 10 lakhs shares of A Ltd. having face value of INR 10 per share;

b. a further issuance of 2 lakhs shares after one year if the profit before interest and tax of B Ltd. for the first year following acquisition exceeds INR 1 crore.

i. The fair value of the shares of A Ltd. on the date of acquisition is INR 20 per share. Further, the management has estimated that on the date of acquisition, the fair value of contingent consideration is ₹25 lakhs.

ii. During the year ended 31 March 2017, the profit before interest and tax of B Ltd. exceeded ₹1 crore. As on 31 March 2017, the fair value of shares of A Ltd. is ₹25 per share.

(ii) Continuing with the fact pattern in (a) above except for:

c. The number of shares to be issued after one year is not fixed.

d. Rather, A Ltd. agreed to issue variable number of shares having a fair value equal to ₹40 lakhs after one year, if the profit before interest and tax for the first year following acquisition exceeds ₹1 crore. A Ltd. issued shares with ₹40 lakhs after a year. **[RTP May 2019]**

Ans: Paragraph 37 of Ind AS 103, inter alia, provides that the consideration transferred in a business combination should be measured at fair value, which should be calculated as the sum of

(a) the acquisition-date fair values of the assets transferred by the acquirer,

(b) the liabilities incurred by the acquirer to former owners of the acquiree and

(c) the equity interests issued by the acquirer.

Further, paragraph 39 of Ind AS 103 provides that the consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

With respect to contingent consideration, obligations of an acquirer under contingent consideration arrangements are classified as equity or a liability in accordance with Ind AS 32 or other applicable Ind AS, i.e., for the rare case of non-financial contingent consideration. Paragraph 40 provides that the acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of Ind AS 32, Financial Instruments: Presentation. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 of Ind AS 103 provides guidance on the subsequent accounting for contingent consideration.

(i) In the given case the amount of purchase consideration to be recognized on initial recognition shall be as follows:

Fair value of shares issued (10,00,000 x ₹20)	₹2,00,00,000
Fair value of contingent consideration	₹25,00,000
Total purchase consideration	₹2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

In general, an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Ind AS 32 describes an equity instrument as one that meets both of the following conditions:

(a) There is no contractual obligation to deliver cash or another financial asset to another party, or to exchange financial assets or financial liabilities with another party under potentially unfavorable conditions (for the issuer of the instrument).

(b) If the instrument will or may be settled in the issuer's own equity instruments, then it is:

(i) a non-derivative that comprises an obligation for the issuer to deliver a fixed number of its own equity instruments; or

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or other financial assets for a fixed number of its own equity instruments.

In the given case, given that the acquirer has an obligation to issue fixed number of shares on fulfilment of the contingency, the contingent consideration will be classified as equity as per the requirements of Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration classified as equity should not be re-measured and its subsequent settlement should be accounted for within equity.

Here, the obligation to pay contingent consideration amounting to ₹25,00,000 is recognized as a part of equity and therefore not re-measured subsequently or on issuance of shares.

(ii) The amount of purchase consideration to be recognized on initial recognition is shall be as follows:

Fair value shares issued (10,00,000 x ₹20)	₹2,00,00,000
Fair value of contingent consideration	₹25,00,000
Total purchase consideration	₹2,25,00,000

Subsequent measurement of contingent consideration payable for business combination

The contingent consideration will be classified as liability as per Ind AS 32.

As per paragraph 58 of Ind AS 103, contingent consideration not classified as equity should be measured at fair value at each reporting date and changes in fair value should be recognized in profit or loss.

As at 31 March 2017, (being the date of settlement of contingent consideration), the liability would be measured at its fair value and the resulting loss of ₹15,00,000 (₹40,00,000 - ₹25,00,000) should be recognized in the profit or loss for the period. A Ltd. would recognize issuance of 160,000 (₹40,00,000/25) shares at a premium of ₹15 per share.

Q5: ABC Ltd. acquires PQR Ltd. in September 2016 for cash. Additionally, ABC Ltd. agrees to pay the selling shareholder an amount equivalent to 10% of profits in excess of INR 10 crores generated over the next two years in cash in lumpsum at the end of the three years. ABC Ltd. determines the fair value of the contingent consideration liability to be INR 1 crores at the date of acquisition.

A year after the acquisition, PQR Ltd. has performed better than initially projected by ABC Ltd. and a higher payment is now expected to be made at the end of year two. The fair value of this financial liability is INR 2.5 crores at the end of the first year.

Whether there should be any adjustment in the acquisition accounting? If yes, by what amount? **[Other Sources]**

Ans: Paragraph 58 of Ind AS 103, inter alia, provides that the acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.

(b) Other contingent consideration that:

(i) is within the scope of Ind AS 109 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss in accordance with Ind AS 109.

(ii) is not within the scope of Ind AS 109 shall be measured at fair value at each reporting date and changes in fair value shall be recognised in profit or loss.

In accordance with the above, where contingent consideration is not classified as equity, the changes in its fair value that are not measurement period adjustment should be remeasured to fair value at each reporting date until the contingency is settled. Such changes in fair value are required to recognised in profit or loss (in accordance with Ind AS 109 where such contingent consideration is within the scope of the standard).

Thus, ABC Ltd. should re-measure contingent consideration at the end of the year i.e. 31 March 2017 as follows:

Profit and loss A/c	Dr	1,50,00,000
Liability for contingent consideration	Cr	1,50,00,000

Similarly, the adjustment to the financial liability to reflect the final settlement amount (final fair value) is required to be recognised in profit or loss if the amount differs from the fair value estimate at the end of the first year.

Q6: Green Ltd acquired Pollution Ltd. as a part of the arrangement Green Ltd had to replace the Pollution Ltd.'s existing equity-settled award. The original awards specify a vesting period of five years. At the acquisition date, Pollution Ltd employees have already rendered two years of service.

As required, Green Ltd replaced the original awards with its own share-based payment awards (replacement award). Under the replacement awards, the vesting period is reduced to 2 year (from the acquisition date).

The value (market-based measure) of the awards at the acquisition date are as follows:

- original awards: INR 500
- replacement awards: INR 600.

As of the acquisition date, all awards are expected to vest **[ICAI SM]**

Solution:

Pre-combination period: The value of the replacement awards will have to be allocated between the pre-combination and post combination period. As of the acquisition date, the fair value of the original award (INR 500) will be multiplied by the service rendered upto acquisition date (2 years) multiplied by greater of original vesting period (5 years) or new vesting period (4 years). Accordingly, 500 x 2/5= 200 will be considered as pre-combination service and will be included in the purchase consideration.

Post- Combination period: The fair value of the award on the acquisition date is 600 which means the difference between the replacement award which is 600 and the amount allocated to pre-combination period (200) is 400 which will be now recorded over the remaining vesting period which is 2 years as an employee compensation cost.

Q7: P a real estate company acquires Q another construction company which has an existing equity settled share based payment scheme. The awards vest after 5 years of employee service. At the acquisition date, Company Q's employees have rendered 2 years of service. None of the awards are vested at the acquisition date. P did not replace the existing share-based payment scheme but reduced the remaining vesting period from 3 years to 2 year. Company P determines that the market-based measure of the award at the acquisition date is INR 500 (based on measurement principles and conditions at the acquisition date as per Ind AS 102). **[ICAI SM]**

Ans: The market based measure or the fair value of the award on the acquisition date of 500 is allocated NCI and post combination employee compensation expense. The portion allocable to pre-combination period is 500 x 2/5 = 200 which will be included in pre-combination period and is allocated to NCI on the acquisition date. The amount is computed based on original vesting period.

The remaining expense which is 500-200= 300 is accounted over the remaining vesting period of 2 years as an compensation expenses.

Q8: Calculation of goodwill

P acquired Q in two stages.

- In 20X1, P acquired a 30% equity interest for cash consideration of ₹ 32,000 when the fair value of Q's identifiable net assets was ₹ 100,000.
- In 20X5, P acquired a further 50% equity interest for cash consideration of ₹ 75,000. On the acquisition date, the fair value of Q's identifiable net assets was ₹ 120,000. The fair value of P's original 30% holding was ₹ 40,000 and the fair value of the 20% non-controlling interest is assessed as ₹, 28,000. **[ICAI SM]**

Ans: Goodwill is calculated, on the alternative bases that P records non-controlling interests (NCI) at their share of net assets, or at fair value, as follows:

	NCI @ % of net assets	**NCI @fair value**
Fair value of consideration	75,000	75,000
Non-controlling interests [1,20,000 x 20%]	24,000	28,000
Previously-held interest	40,000	40,000
	139,000	143,000
Fair value of identifiable net assets	120,000	120,000
Goodwill	19,000	23,000

Q9: A Ltd. agreed to absorb B Ltd. on 31st March 1999, whose balance sheet stood as follows:

Liabilities	**₹**	**Assets**	**₹**
Share Capital		Fixed Assets	7,00,000
80,000 shares of ₹ 10 each fully paid		*Current Assets* and *Loans*	
Reserves & Surplus	8,00,000	*& Advances*	
General Reserve		Stock in trade	1,00,000
Current Liabilities & Provisions	1,00,000	Sundry Debtors	2,00,000
Sundry Creditors			
	1,00,000		

	10,00,000		10,00,000

The consideration was agreed to be paid as follows:

1. A payment in cash of ₹ 5 per share in B Ltd. and

2. The issue of shares of ₹ 10 each in A Ltd., on the basis of 2 Equity Shares (valued at ₹ 15) and one 10% cum. Preference share (valued at ₹ 10) for every five shares held in B Ltd.

3. The whole of the share capital consists of shareholdings in exact multiple of five except the following holding.

Chopra	116
Karki	76
Amar Singh	72
Malhotra	28
Other individuals (Eight members holding one share each)	8
	300

4. It was agreed that A Ltd. will pay in cash for fractional shares equivalent at agreed value of shares in B Ltd. i.e. ₹ 65 for five shares of ₹ 50 paid.

Prepare a statement showing the purchase consideration receivable in share and cash.

[Other Sources]

Ans: a) Schedule of Fraction

	Holding ofShares (A)	*Exchangeable in nearest multiple of five(B)*	*Non Exchangeable (E) = (A) –(B)*
Chopra	116	115	1
Karki	76	75	1
Amarsingh	72	70	2
Malhotra	28	25	3
Others	8	-	8
	300	285	15

b) Shares Exchangeable: Equity Shares in A Ltd.

		No.		*No.*
(i)	80,000–300 (Total A above)	79,700	2/5 there of	31,880
	300-15 (Total E Above)	285	2/5 there of	114
		79,985		31,994

c) Shares Exchangeable: Preference Shares in A Ltd.

		No.		*No.*
(ii)	80,000–300 (Total A above)	79,700	1/5 there of	15,940

	300-15 (Total E Above)	285	1/5 there of	57
		79,985		15,997

There are 15 shares in B Ltd. which are not capable of exchange into equity and preference shares of A Ltd. they will be paid in cash (150 x 65/50) = 195

d) Purchase Consideration

	₹
31,994 Equity Shares @ ₹ 15 each	4,79,910
15,997 Preference shares @ ₹ 10 each	1,59,970
Cash on 79,985 @ ₹ 5 each	3,99,925
	10,39,805
Add: Cash for 15 shares	195
	10,40,000

Q10: In March 2018, Pharma Ltd. acquires Dorman Ltd. in a business combination for a total cost of ₹ 12,000 lakhs. At that time Dorman Ltd.'s assets and liabilities are as follows:

	₹ in lakhs
Assets	
Cash	780
Receivables (net)	5,200
Plant and equipment	7,000
Deferred tax asset	360
Liabilities	
Payables	1,050
Borrowings	4,900
Employee entitlement liabilities	900
Deferred tax liability	300

The plant and equipment has a fair value of ₹ 8,000 lakhs and a tax written down value of ₹ 6,000 lakhs. The receivables are short-term trade receivables net of a doubtful debts allowance of ₹ 300 lakhs.

Bad debts are deductible for tax purposes when written off against the allowance account by Dorman Ltd. Employee benefit liabilities are deductible for tax when paid.

Dorman Ltd. owns a popular brand name that meets the recognition criteria for intangible assets under Ind AS 103 'Business Combinations'. Independent valuers have attributed a fair value of ₹ 4.300 lakhs for the brand. However, the brand does not have any cost for tax purposes and no tax deductions are available for the same.

The tax rate of 30% can be considered for all items. Assume that unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts at the acquisition date.

You are required to:

1. Calculate deferred tax assets and liabilities arising from the business combination (do not offset deferred tax assets and liabilities)

2. Calculate the goodwill that should be accounted on consolidation. **[MTP May 2019]**

Ans: Breakdown of assets and liabilities acquired as part of the business combination, including deferred taxes and goodwill.

					₹ In lakhs
	Book value	**Fair value**	**Tax base**	**Taxable (deductible) temporary difference**	**Deferred tax asset (liability) @ 30%**
Cash	780	780[1]	780 [1]	-	-
Receivables	5,200	5,200[1]	5,500[3]	(300)	90
Plant and equipment	7,000	8,000[2]	6,000[4]	2,000	(600)
Brands		4,300[2]	-[5]	4,300	(1,290)
Goodwill (Balancing figure)		2,100[9]			
Deferred tax asset	360	3,60[7]			
Total assets		**20,740**			
Payables	(1,050)	(1,050)[1]	(1,050) [1]		
Borrowings	(4,900)	(4,900)[1]	(4,900) [1]		
Employee Entitlement liabilities	(900)	(900) [1]	-[6]	(900)	270
Deferred tax liability	(300)	(1,890)[8]			
Total liabilities		**(8,740)**			
Consideration paid		**12,000**			

Notes :

(1) This amount has been derived from Dorman Ltd.'s Balance Sheet as it is stated that 'unless otherwise stated, all items have a fair value and tax base equal to their carrying amounts in Dorman Ltd.'s Balance Sheet at the acquisition date'.

(2) Stated fair value in the fact pattern (different to the carrying amount in Dorman Ltd.'s Balance Sheet at the acquisition date).

(3) Because bad debts are only deductible when written off against the allowance account by Dorman Ltd. the tax base of the receivables is their gross value, i.e., (₹ 5,200 + ₹ 300) lakhs allowance account.

(4) Tax written down value of the plant and equipment as stated in the fact pattern.

(5) As the brand name does not have a cost for tax purposes and no tax deduction is available in relation to it, its tax base is nil.

(6) As the employee entitlement liabilities are only deductible for tax purposes when paid, their tax base is nil.

(7) The aggregate deferred tax asset is ₹ 360 lakhs, comprised of ₹90 lakhs in relation to the receivables and ₹270 lakhs in relation to the employee entitlement liabilities.

(8) The aggregate deferred tax liability is ₹ 1,890 lakhs calculated as follows:

₹ In lakhs	**DTL amount in Dorman Ltd.'s Balance Sheet**	**Deferred tax impact of fair value adjustments**	**Total DTL in Pharma Ltd's consolidated financial statements**
Plant and equipment	300 ([7,000-6,000] × 30%)	300 ([1,000 × 30%)	600
Brand names	0	1,290 (4,300 × 30%)	1,290
TOTAL	300	1,590	1,890

(9) Goodwill is effectively the 'balancing item' in the equation, applying the requirements of Ind AS 103, para 32. The consideration transferred is ₹ 12,000 lakhs and the net of the acquisition date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with Ind AS 103, including the deferred tax assets and liabilities arising, is ₹ 9,900 lakhs.

Q11: On 1 April 2016, Company PQR Ltd. acquired 30% of the voting ordinary shares of Company XYZ Ltd. for INR 8,000 crores. PQR Ltd. accounts its investment in XYZ Ltd. using equity method as prescribed under Ind AS 28, Investments in Associates and Joint Ventures. At 31 March 2017, PQR Ltd. recognised its share of the net asset changes of XYZ Ltd. using equity accounting as follows:

	(Amounts in INR-crores)
Share of profit or loss	700
Share of exchange difference in OCI	100
Share of revaluation reserve of PPE in OCI	50

The carrying amount of the investment in the associate on 31 March 2017 was therefore 8,850 (8,000 + 700 + 100 + 50).

On 1 April 2017, PQR Ltd. acquired the remaining 70% of XYZ Ltd. for cash of INR 25,000 crores. The following additional information is relevant at that date

	(Amount in INR-crores)
Fair value of the 30% interest already owned	9,000
Fair value of XYZ's identifiable net assets	30,000

How should such business combination be accounted for? **[ICAI SM]**

Ans: Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Applying the above, PQR Ltd. records the following entry in its consolidated financial statements:

(Amounts in INR-crores)

	Debit	Credit
Identifiable net assets of XYZ Ltd.	30,000	
Goodwill(1)	4,000	
Foreign currency translation reserve	100	
PPE revaluation reserve	50	
Cash	25,000	
Investment in associate -XYZ Ltd.		8,850
Retained earnings(2)		50
Gain on previously held interest in XYZ recognised in Profit or loss (3)		250
(To recognise acquisition of XYZ Ltd.)		

Notes:

1. Goodwill calculated as follows: INR

Cash consideration	25,000
Fair value of previously held equity interest in XYZ Ltd.	9,000
Total consideration	34,000
Fair value of identifiable net assets acquired	(30,000)
Goodwill	4,000

2. The credit to retained earnings represents the reversal of the unrealised gain of INR 50 crores in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The gain on the previously held equity interest in XYZ Ltd. is calculated as follows: INR

Fair Value of 30% interest in XYZ Ltd. at 1 April 2017	9,000
Carrying amount of interest in XYZ Ltd. at 1 April 2017	(8,850)

	150
Unrealised gain previously recognised in OCI	100
Gain on previously held interest in XYZ Ltd. recognised in profit or loss	250

Q12: The summarized Balance Sheet of A Ltd. and its subsidiary B Ltd. as on 31-03-2001 are as follows:

	A Ltd. ₹	**B Ltd. ₹**
Shares of ₹ 10 each	1,00,00,000	20,00,000
Reserves and Surplus	1,40,00,000	60,00,000
Secured Loans	40,00,000	---
Current Liabilities	60,00,000	20,00,000
	3,40,00,000	1,00,00,000
Fixed Assets	1,20,00,000	35,00,000
Investment in B Ltd.	7,40,000	---
Sundry Debtors	70,00,000	10,00,000
Inventories	60,00,000	50,00,000
Cash and Bank	82,60,000	5,00,000
	3,40,00,000	1,00,00,000

A Ltd. holds 24% of the paid up capital of B Ltd. The balance shares in B Ltd. are held by a Foreign Collaborating Company. A memorandum of understanding has been entered into with the foreign company providing for the following:

1. The shares held by the foreign company will be sold to A Ltd. The price per share will be calculated by capitalizing the yield at 16%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were ₹ 35 lakhs, ₹ 44 lakhs and ₹ 65 lakhs.
2. The actual cost of shares to the foreign company was ₹ 32,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable be deducted from the proceeds and A Ltd. will pay it to the Government.
3. Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable within one month. It was also decided that A Ltd. would absorb B Ltd. simultaneously by writing down the Fixed Assets of B Ltd. by 5%. The Balance Sheet figures included a sum of ₹ 1,50,000 due by B Ltd. to A Ltd.

The entire arrangement was approved by all concerned for giving effect to on 01-04-2001.

You are required to show the Balance Sheet of A Ltd. as it would appear after the arrangement is put through on 01-04-2001. **[Other Sources]**

Q13: X Ltd. and Y Ltd. were in company business. They decided to form a new company named XY Ltd. The balance sheets of both the companies were as under:

Balance Sheet as at 31st December, 2002

Liabilities	**X Ltd. ₹**	**Y Ltd. ₹**	**Assets**	**X Ltd. ₹**	**Y Ltd. ₹**

Equity Shares of ₹100	20,00,000	10,00,000	Goodwill	---	1,00,000
			Building	10,00,000	6,00,000
Reserve	2,00,000	2,60,000	Machinery	4,00,000	5,00,000
Sundry Creditors	60,000	40,000	Stock	3,00,000	40,000
			Sundry Debtors	2,40,000	40,000
			Cash at Bank	2,20,000	10,000
			Cash in Hand	1,00,000	10,000
	22,60,000	**13,00,000**		**22,60,000**	**13,00,000**

The companies were allotted equity shares of ₹ 100 each in lieu of purchase consideration.

Fair value of Assets is as under

Assets	**X ltd**	**Y Ltd.**
Goodwill	2,00,000	1,50,000
Building	12,60,000	8,00,000
Machinery	3,00,000	7,00,000
Stock	3,40,000	30,000

Prepare opening balance sheet of XY Ltd if XY Ltd. issue shares to shareholders of X Ltd and Y Ltd, on the basis of the intrinsic value of its shares on the date of take over. **[Other Sources]**

Q14: X Ltd. and Y Ltd. were in company business. X ltd decide to absorb Y ltd. The balance sheets of both the companies were as under:

Balance Sheet as at 31st December, 2002

Liabilities	**X Ltd.**	**Y Ltd.**	**Assets**	**X Ltd.**	**Y Ltd.**
Equity Shares of	10,00,000	20,00,000	Goodwill	1,00,000	
₹100 each			Building	6,00,000	10,00,000
Sundry Creditors	40,000	60,000	Machinery	5,00,000	4,00,000
Reserve	2,60,000	2,00,000	Stock	40,000	3,00,000
			Sundry Debtors	40,000	2,40,000
			Cash at Bank	10,000	2,20,000
			Cash in Hand	10,000	1,00,000
	13,00,000	**22,60,000**		**13,00,000**	**22,60,000**

Fair value of Assets is as under

Assets	X Ltd.	Y ltd
Goodwill	11,50,000	2,00,000
Building	3,00,000	12,60,000
Machinery	5,00,000	3,00,000
Stock	30,000	3,40,000

X Ltd. to issue shares to shareholders of Y Ltd. on the basis of the intrinsic value of its shares on the date of take over. Prepare opening balance sheet of X Ltd after absorption.

[Other Sources]

Q15: On September 30, 20X1 Entity A issues 2.5 shares in exchange for each ordinary share of Entity B. All of Entity B's shareholders exchange their shares in Entity B. Therefore, Entity A issues 150 ordinary shares in exchange for all 60 ordinary shares of Entity B.

The fair value of each ordinary share of Entity B at September 30, 20X1 is 40. The quoted market price of Entity A's ordinary shares at that date is 16. The fair values of Entity A's identifiable assets and liabilities at September 30, 20X1 are the same as their carrying amounts, except that the fair value of Entity A's non- current assets at September 30, 20X1 is 1,500.

The statements of financial position of Entity A and Entity B immediately before the business combination are:

	Entity A	Entity B
	(legal parent, accounting acquiree)	(legal subsidiary, accounting acquirer)
Current assets	500	700
Non-current assets	1,300	3,000
Total assets	1,800	3,700
Current liabilities	300	600
Non-current liabilities	400	1,100
Total liabilities	700	1,700
Shareholders' equity		
Retained earnings	800	1,400
Issued equity		
100 ordinary shares	300	
60 ordinary shares		600
Total shareholders' equity	1,100	2,000
Total liabilities and shareholders'	1,800	3,700

equity		

Prepare consolidated balance sheet. Also calculate earnings per share from the following information:

Entity B's earnings for the annual period ended December 31, 20X0 were 600 and that the consolidated earnings for the annual period ended December 31, 20X1 were 800. There was no change in the number of ordinary shares issued by Entity B during the annual period ended December 31, 20X0 and during the period from January 1, 2006 to the date of the reverse acquisition on September 30, 20X1. **[ICAI SM]**

Ans: **Identifying the acquirer:** As a result of Entity A issuing 150 ordinary shares, Entity B's shareholders own 60 per cent of the issued shares of the combined entity (i.e., 150 of the 250 total issued shares). The remaining 40 per cent are owned by Entity A's shareholders. Thus, the transaction is determined to be a reverse acquisition in which Entity B is identified as the accounting acquirer (while Entity A is the legal acquirer).

Calculating the fair value of the consideration transferred: If the business combination had taken the form of Entity B issuing additional ordinary shares to Entity A's shareholders in exchange for their ordinary shares in Entity A, Entity B would have had to issue 40 shares for the ratio of ownership interest in the combined entity to be the same. Entity B's shareholders would then own 60 of the 100 issued shares of Entity B — 60 per cent of the combined entity. As a result, the fair value of the consideration effectively transferred by Entity B and the group's interest in Entity A is 1,600 (40 shares with a fair value per share of 40).

The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted market price of Entity A's shares provides a more reliable basis for measuring the consideration effectively transferred than the estimated fair value of the shares in Entity B, and the consideration is measured using the market price of Entity A's shares — 100 shares with a fair value per share of 16.

Measuring goodwill: Goodwill is measured as the excess of the fair value of the consideration effectively transferred (the group's interest in Entity A) over the net amount of Entity A's recognised identifiable assets and liabilities, as follows:

Consideration effectively transferred		1,600
Net recognised values of Entity A's identifiable assets and liabilities		
Current assets	500	
Non-current assets	1,500	
Current liabilities	(300)	
Non-current liabilities	(400)	(1,300)
Goodwill		300

Consolidated statement of financial position at September 30, 20X1

The consolidated statement of financial position immediately after the business combination is:

Current assets [700 + 500]	1,200
Non-current assets [3,000 + 1,500]	4,500
Goodwill	300
Total assets	**6,000**
Current liabilities [600 + 300]	900
Non-current liabilities [1,100 + 400]	1,500
Total liabilities	2,400
Shareholders' equity	
Issued equity 250 ordinary shares [600 + 1,600]	2,200
Retained earnings	1,400
Total shareholders' equity	3,600
Total liabilities and shareholders' equity	**6,000**

The amount recognised as issued equity interests in the consolidated financial statements (2,200) is determined by adding the issued equity of the legal subsidiary immediately before the business combination (600) and the fair value of the consideration effectively transferred (1,600). However, the equity structure appearing in the consolidated financial statements (i.e., the number and type of equity interests issued) must reflect the equity structure of the legal parent, including the equity interests issued by the legal parent to effect the combination.

Earnings per share

Earnings per share for the annual period ended December 31, 20X1 is calculated as follows:

Number of shares deemed to be outstanding for the period from January 1,

20X1 to the acquisition date (i.e., the number of ordinary shares issued by Entity A

(legal parent, accounting acquiree) in the reverse acquisition) 150

Number of shares outstanding from the acquisition date to December 31, 20X1 250

Weighted average number of ordinary shares outstanding [(150 × 9/12) + (250 × 3/12)]175

Earnings per share [800/175] 4.57

Restated earnings per share for the annual period ended December 31, 20X0 is 4.00 [calculated as the earnings of Entity B of 600 divided by the number of ordinary shares Entity A issued in the reverse acquisition (150)].

Q16: Enterprise Ltd. has 2 divisions Laptops and Mobiles. Division Laptops has been making constant profits while division Mobiles has been invariably suffering losses.

On 31st March, 20X2, the division-wise draft extract of the Balance Sheet was: (₹ in crores)

	Laptops	Mobiles	Total
Fixed assets cost	250	500	750
Depreciation	(225)	(400)	(625)
Net Assets (A)	25	100	125
Current assets:	200	500	700
Less: Current liabilities	(25)	(400)	(425)
(B)	175	100	275
Total (A+B)	200	200	400
Financed by:			
Loan funds	-	300	300
Capital : Equity ₹ 10 each	25	-	25
Surplus	175	(100)	75
	200	200	400

Division Mobiles along with its assets and liabilities was sold for ₹ 25 crores to Turnaround Ltd. a new company, who allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share to the members of Enterprise Ltd. in full settlement of the consideration, in proportion to their shareholding in the company. One of the members of the Enterprise ltd was holding 52% shareholding of the Company.

Assuming that there are no other transactions, you are asked to:

(i) Pass journal entries in the books of Enterprise Ltd.

(ii) Prepare the Balance Sheet of Enterprise Ltd. after the entries in (i).

(iii) Prepare the Balance Sheet of Turnaround Ltd.

Balance Sheet prepared for (ii) and (iii) above should comply with the relevant Ind AS and Schedule III of the Companies Act, 2013. Provide Notes to Accounts, for 'Other Equity' in case of (ii) and 'Share Capital' in case of (iii), only. **[ICAI SM; May 2018]**

Ans: Journal of Enterprise Ltd. **(₹ in crores)**

			Dr.	*Cr.*
(1)	Loan Funds	Dr.	300	
	Current Liabilities	Dr.	400	

	Provision for Depreciation	Dr.	400	
	To Property, Plant and Equipment			500
	To Current Assets			500
	To Capital Reserve			100
	(Being division Mobiles along with its assets and liabilities sold to Turnaround Ltd. for ₹ 25 crores)			

Notes :

1. Any other alternative set of entries, with the same net effect on various accounts, may be given by the students.

2. In the given scenario, this demerger will meet the definition of common control transaction. Accordingly, the transfer of assets and liabilities will be derecognized and recognized as per book value and the resultant loss or gain will be recorded as capital reserve in the books of demerged entity (Enterprise Ltd).

Enterprise Ltd.

Balance Sheet after reconstruction **(₹in crores)**

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		25
Current assets		
Other current assets		200 225
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		25
Other equity (Surplus)		175
Liabilities		
Current liabilities		25
Current liabilities		
		225

Notes to Accounts

		(₹ in crores)
1.	**Other Equity**	
	Surplus (175-100)	75
	Add: Capital Reserve on reconstruction	100
		175

Notes to Accounts: Consequent on transfer of Division Mobiles to newly incorporated company Turnaround Ltd., the members of the company have been allotted 1 crore equity shares of ₹ 10 each at a premium of ₹ 15 per share of Turnaround Ltd., in full settlement of the consideration in proportion to their shareholding in the company.

Balance Sheet of Turnaround Ltd. **(₹ in crores)**

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		100
Current assets		
Other current assets		500
		600
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)	1	10
Other equity	2	(110)
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		300
Current liabilities		
Current liabilities		400
		600

Notes to Accounts

		(₹ in crores)
1.	**Share Capital:**	
	Issued and Paid-up capital	
	1 crore Equity shares of ₹ 10 each fully paid up	10
	(All the above shares have been issued for consideration other than	
	cash, to the members of Enterprise Ltd. on takeover of Division Mobiles	
	from Enterprise Ltd.)	
2.	**Other Equity:**	
	Securities Premium	15
	Capital reserve [25- (600 – 700)]	(125)
		(110)

Working Note:

In the given case, since both the entities are under common control, this will be accounted as follows:

- All assets and liabilities will be recorded at book value
- Identity of reserves to be maintained.
- No goodwill will be recorded.
- Securities issued will be recorded as per the nominal value

Q17: Maxi Mini Ltd. has 2 divisions - Maxi and Mini. The draft information of assets and liabilities as at 31st October, 20X2 was as under:

	Maxi division	Mini division	Total
			(in crores)
Fixed assets:			
Cost	600	300	900
Depreciation	(500)	(100)	(600)
W.D.V. (A)	100	200	300
Net current assets:			
Current assets	400	300	700
Less: Current liabilities	(100)	(100)	(200)
(B)	300	200	500
Total (A+B)	400	400	800
Financed by :			
Loan funds (A)	–	100	100
(secured by a charge on fixed assets)			
Own funds:			
Equity capital			50
(fully paid up ₹ 10 shares)			
Reserves and surplus			650
(B)	?	?	700
Total (A+B)	**400**	**400**	**800**

It is decided to form a new company Mini Ltd. to take over the assets and liabilities of Mini division.

Accordingly, Mini Ltd. was incorporated to take over at Balance Sheet figures the assets and liabilities of that division. Mini Ltd. is to allot 5 crores equity shares of ₹ 10 each in the company to the members of Maxi Mini Ltd. in full settlement of the consideration. The members of Maxi Mini Ltd. are therefore to become members of Mini Ltd. as well without having to make any further investment.

(a) You are asked to pass journal entries in relation to the above in the books of Maxi Mini Ltd. and Mini Ltd. Also show the Balance Sheets of the 2 companies as on the morning of 1st November, 20X2, 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".

[ICAI SM; May 2018]

Ans: (a) Demerged Company: Mini Division of "Maxi Mini Ltd"

Resulting Company: "Mini Ltd."

Journal of Maxi Mini Ltd. (Demerged Company)

		(₹ in crores)	
		Dr.	***Cr.***
Current liabilities A/c	Dr.	100	
Loan fund (secured) A/c	Dr.	100	
Provision for depreciation A/c	Dr.	100	
Loss on reconstruction (Balancing figure)	Dr.	300	
To Property, Plant and Equipment A/c			300
To Current assets A/c			300
(Being the assets and liabilities of Mini division taken out of the books on transfer of the division to Mini Ltd., the consideration being allotment to the members of the company of one equity share of ₹ 10 each of that company at par for every share held in the company vide scheme of reorganisation)			

Note: Any other alternatives set of entries, with the same net effect on various accounts, may be given by the students. In the absence of additional information on fair value of the assets transferred it has been assumed that the group of shareholders control both the demerged and the resultant entity. It is expected that students should evaluate all reorganization from common control parameters and aptly highlight the assumptions in the note while solving the question.

Journal of Mini Ltd.

		(₹ in crores)	
		Dr.	***Cr.***
Property, Plant and Equipment (300-100) A/c	Dr.	200	
Current assets A/c	Dr.	300	
To Current Liabilities A/c			100
To Secured loan funds A/c			100
To Equity share capital A/c			50
To Capital reserve			250
(Being the assets and liabilities of Mini division of Maxi Mini Ltd. taken over and allotment of 5 crores equity shares of ₹ 10 each at part as fully paid up to the members of Maxi Mini Ltd.)			

Maxi Mini Ltd.

Balance Sheet as at 1st November, 20X2

₹ in crore

ASSETS	**Note No.**	**After Reconstruction**	**Before Reconstruction**
Non-current assets			
Property, Plant and Equipment	2	100	300
Current assets			
Other current assets		400 500	700 1,000
EQUITY AND LIABILITIES			
Equity			
Equity share capital (of face value of ₹ 10 each)		50	50
Other equity	1	*350*	650
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings		-	100
Current liabilities			
Current liabilities		*100*	200
		500	1,000

Notes to Accounts

		After Reconstruction	*Before Reconstruction*
1.	**Other Equity**		
	Other Equity	650	650
	Less: Loss on reconstruction	(300)	–
		350	650
2.	**Property, Plant and Equipment**	600	900
	Less: Depreciation	(500)	(600)
		100	300

Notes to Accounts: Consequent on reconstruction of the company and transfer of Mini division to newly incorporated company Mini Ltd., the members of the company have been allotted 5 crores equity shares of ₹ 10 each at part of Mini Ltd. The demerged entity and the resultant entity are common control and accordingly the transaction has been accounted at book values of the assets transferred in both the entity.

Mini Ltd.

Balance Sheet as at 1st November, 20X2

₹ in crore

ASSETS	**Note No.**	**After reconstruction**
Non-current assets		
Property, Plant and Equipment		200
Current assets		
Other current assets		300
		500
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of ₹ 10 each)		50
Other equity (capital reserve)		250
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings		100
Current liabilities		
Current liabilities		100
		500

Notes to Account

	(₹ in crores)
1. Share Capital:	50
Issued and paid up :	
5 crores Equity shares of ₹ 10 each fully paid up	
(All the above shares have been issued for consideration other than cash, to the members of Maxi Mini Ltd., on takeover of Mini division from Maxi Mini Ltd.)	

(b) Net asset value of an equity share

	Pre-demerger	Post-demerge
Maxi Mini Ltd. :	₹ 700 crores /5 crores	₹ 400 crores/5 crores
	140	= ₹ 80
Mini Ltd.:		₹ 300 crores/ 5 crores
		= ₹ 60

(c) Demerger into two companies has had no impact on "net asset value" of shareholding. Pre- demerger, it was ₹ 140 per share. After demerger, it is ₹ 80 plus ₹ 60 i.e. ₹ 140 per original share.

It is only yield valuation that is expected to change because of separate focusing on two distinct businesses whereby profitability is likely to improve on account of demerger.

Q18: The Balance Sheet of Z Ltd. as at 31st March, 2003 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:			
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, 2002 and 30th September, 2003.

On 1st April, 2003 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 authorised 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 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:

1. Show the journal entries in the books of Z Ltd.

2. Prepare Z Ltd.'s Balance Sheet immediately after the demerger and the initial Balance Sheet of Y Ltd. (Notes in both cases need not be prepared). **[Other Sources]**

Q19: AX Ltd. and BX Ltd. amalgamated on and from 1st January 20X2. A new Company ABX Ltd. was formed to take over the businesses of the existing companies.

Summarized Balance Sheet as on 31-12-20X2 **INR in '000**

ASSETS	**Note No.**	**AX Ltd**	**BX Ltd**
Non-current assets			
Property, Plant and Equipment		8,500	7,500
Financial assets			
Investments		1,050	550
Current assets			
Inventory		1,250	2,750
Trade receivable		1,800	4,000
Cash and Cash equivalent		450	400
		13,050	15,200
EQUITY AND LIABILITIES			
Equity			

Equity share capital (of face value of INR 10 each)		6,000	7,000
Other equity		3,050	2,700
Liabilities			
Non-current liabilities			
Financial liabilities			
Borrowings		3,000	4,000
Current liabilities			
Trade payable		1,000	1,500
		13,050	**15,200**

ABX Ltd. issued requisite number of shares to discharge the claims of the equity shareholders of the transferor companies.

Prepare a note showing purchase consideration and discharge thereof and draft the Balance Sheet of ABX Ltd:

a. Assuming that both the entities are under common control

b. Assuming BX ltd is a larger entity and their management will take the control of the entity.

The fair value of net assets of AX and BX limited are as follows:

Assets	**AX Ltd. (‘000)**	**BX Ltd. (‘000)**
Fixed assets	9,500	1,000
Inventory	1300	2900
Fair value of the business	11,000	1,4000

ICAI SM]

Ans:

(a) (Assumption: Common control transaction)

1. Calculation of Purchase Consideration

		AX Ltd.		*BX Ltd.*
		₹ ’000		*₹ ’000*
Assets taken over:				
Property, Plant and Equipment		85,00		75,00
Investment		10,50		5,50
Inventory		12,50		27,50
Trade receivables		18,00		40,00

Cash & Cash equivalent		4,50		4,00
Gross Assets		130,50		152,00
Less : Liabilities				
12% Debentures	30,00		40,00	
Trade payables	10,00	(40,00)	15,00	(55,00)
Net Assets taken over		90,50		97,00
Less: Other Equity:				
General Reserve	15,00		20,00	
P & L A/c	10,00		5,00	
Investment Allowance Reserve	5,00		1,00	
Export Profit Reserve	50	(30,50)	1,00	(27,00)
Purchase Consideration		60,00		70,00

Total Purchase Consideration = 130,00 (60,00 of AX Ltd. & 70,00 of BX Ltd.)

2. Discharge of Purchase Consideration

   No. of shares to be issued to AX Ltd =(Net Assets taken over of AX Ltd/ Net Assets taken over of AX Ltd. and BX Ltd.) X Purchase Consideration

   No. of shares to be issued to BX Ltd = Net Assets taken over of BX Ltd./ Net Assets taken over of AX Ltd. and BX Ltd. x Purchase Consideration

	AX Ltd.	*BX Ltd.*
	₹ '000	*₹ '000*
130,00 x $\frac{90,50}{187,50}$ = 6,27,500	62,75	
* Equity shares of ₹ 10 each		
130,00 x $\frac{97,00}{187,50}$ = 6,72,500		67,25
Equity shares of ₹ 10 each		

Balance Sheet of ABX Ltd. as on 1.1.20X2

₹ in '000

ASSETS	Note No.	Amount
Non-current assets		
Property, Plant and Equipment		16,000
Financial assets		
Investments		1,600
Current assets		
Inventory		4,000

Trade receivable		5,800
Cash and Cash equivalent		850
		28,250
EQUITY AND LIABILITIES		
Equity		
Equity share capital (of face value of	1	13,000
₹ 10 each)		
Other equity	2	5,750
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings	3	7,000
Current liabilities		
Trade payable		2,500
		28,250

Notes to Accounts

		(₹ 000)	*(₹ 000)*
1.	**Share Capital**		
	13,00,000 Equity Shares of ₹ 10 each		130,00
2.	**Other Equity**		
	General Reserve (15,00 + 20,00)	35,00	
	Profit & Loss (10,00 + 5,00)	15,00	
	Investment Allowance Reserve (5,00 + 1,00)	6,00	
		1,50	57,50
3.	Export Profit Reserve (50 + 1,00)		
	Long Term Borrowings		70,00
	12% Debentures		

(b) Assuming BX Ltd is a larger entity and their management will take the control of the entity ABX Ltd.

In this case BX Ltd. and AX Ltd. are not under common control and hence accounting prescribed under Ind AS 103 for business combination will be applied. A question arises here is who is the accounting acquirer ABX Ltd which is issuing the shares or AX Ltd. or BX Ltd. As per the accounting guidance provided in Ind AS 103, sometimes the legal acquirer may not be the accounting acquirer. In the given scenario although ABX Ltd. is issuing the shares but BX Ltd. post-merger will have control and is bigger in size which is a clear indicator that BX Ltd. will be an accounting acquirer. This can be justified by the following table:

(In '000s)

	AX Ltd.	BX Ltd.
Fair Value	11,000	14,000
Value per share	10	10
No. of shares	1,100	1,400
i.e. Total No. of shares in ABX Ltd. = 2,500 thousand shares		
Thus, % Held by each Company in Combined Entity	44%	56%

Note: It is a case of Reverse Acquisition.

Accordingly, BX Ltd. assets will be recorded at historical cost in the merged financial statements.

(1) Calculation of Purchase Consideration (All figures are in thousands)

We need to calculate the number of shares to be issued by BX Ltd. to AX Ltd. to maintain the same percentage i.e. 56%:

Thus, 700 thousand shares of BX Ltd. (given in the balance sheet) represents 56%. This means that total no. of shares would be 1,250 thousand shares ie 700 thousand shares / 56%.

This implies BX Ltd. would need to issue 550 thousand shares (1,250 less 700) to AX Ltd.

Purchase Consideration = 550 thousand shares x ₹ 20 per share (ie. 14,000 thousand / 700 thousand shares) = ₹ 11,000 thousand.

Balance Sheet of ABX Ltd. as on 1.1.20X2 ₹ in '000

ASSETS	Note No.	Amount
Non-current assets		
Goodwill (Refer Working Note)		900
Property, Plant and Equipment (9500+7500)		17,000
Financial assets		
Investment (1050+550)		1,600
Current assets		
Inventory (1300+2750)		4,050
Trade receivables (1800+4000)		5,800
Cash and Cash equivalent (450+400)		850
		30,200
EQUITY AND LIABILITIES		
Equity		

Equity share capital (of face value of ₹ 10 each)	1	12,500
Other equity	2	8,200
Liabilities		
Non-current liabilities		
Financial liabilities		
Borrowings (12% Debentures)	3	7,000
Current liabilities		
Trade payables		2,500
		30,200

Notes to Accounts

		(₹ 000)	*(₹ 000)*
1.	**Share Capital**		
	1,250,000 Equity Shares of ₹ 10 each (700,000 to BX Ltd and 550,000 as computed above to AX LTD)		1,25,00
2.	**Other Equity**		
	General reserve of BX Ltd	20,00	
	P&L of BX Ltd	5,00	
	Export Profit Reserve of BX Ltd	1,00	
	Investment Allowance Reserve of BX Ltd	1,00	
	Security Premium (550 shares x 10)	5,500	8,200
3.	**Long Term Borrowings**		
	12% Debentures		70,00

Working Note: Goodwill Computation:

Assets:	**₹ in 000s**
Property, Plant and Equipment	9,500
Investment	1,050
Inventory	1,300
Trade Receivable	1,800
Cash & Cash Equivalent	450
Total Assets	14,100
Less : Liabilities:	
Borrowings	3,000
Trade Payable	1,000
Net Assets	10,100
Purchase Consideration	11,000

Goodwill	900

Q20: The balance sheet of Professional Ltd and Dynamic Ltd as of 31 March 20X2 is given below:

		₹ In lacs
Assets	**Professional Ltd**	**Dynamic Ltd**
Non-Current Assets:		
Property plant and equipment	300	500
Investments	400	100
Current assets:		
Inventories	250	150
Financial assets	400	230
Trade receivable	450	300
Cash and cash balances	200	100
Total	**2,000**	**1,380**
Equity and Liabilities		
Equity		
Share capital- Equity shares of ₹ 100 each of Dynamic Ltd. and ₹ 10 each of Professional Ltd.	500	400
Reserve and surplus	730	180
OCI	80	45
Non-Current liabilities:		
Long term borrowings	250	200
Long term provisions	50	70
Deferred tax	40	35
Current Liabilities:		
Short term borrowings	100	150
Trade payable	250	300
Total	**2,000**	**1,380**

Other information

a. Professional acquired 70% of Dynamic Ltd on 1 April 20X2 for by issuing its own share in the ratio of 1 share of Professional Ltd for every 2 shares of Dynamic Ltd. The fair value of the shares of Professional Ltd was 40.

b. The fair value exercise resulted in the following: **(all nos in Lakh)**

  a. PPE fair value on 1 April 20X2 was 350.

  b. Professional Ltd also agreed to pay an additional payment that is higher of 35 lakh and 25% of any excess of Dynamic Ltd in the first year after acquisition over its profits in the preceding 12 months. This additional amount will be due after 2 years. Dynamic Ltd has earned 10 lakh profit in the preceding year and expects to earn another 20 Lakh.

  c. In addition to above, Professional Ltd also had agreed to pay one of the founder shareholder a payment of 20 lakh provided he stays with the Company for two year after the acquisition.

  d. Dynamic Ltd had certain equity settled share based payment award (original award) which got replaced by the new awards issued by Professional Ltd. As per the original term the vesting period was 4 years and as of the acquisition date the employees of Dynamic Ltd have already served 2 years of service. As per the replaced awards the vesting period has been reduced to one year (one year from the acquisition date). The fair value of the award on the acquisition date was as follows:

    i. Original award- INR 5

    ii. Replacement award- INR 8.

  e. Dynamic Ltd had a lawsuit pending with a customer who had made a claim of 50. Management reliably estimated the fair value of the liability to be 5.

  f. The applicable tax rate for both entities is 30%.

You are required to prepare opening consolidated balance sheet of Professional Ltd as on 1 April 20X2 **[ICAI SM; NOV 19]**

Ans: Consolidated Balance Sheet of Professional Ltd as on 1st April, 20X2(₹ in Lakhs)

	Amount
Assets	
Non-Current Assets:	
Property, plant and equipment	650
Investment	500
Current assets:	
Inventories	400
Financial assets:	

Trade receivables	750
Cash and cash equivalents	300
Others	630
Total	3,230
Equity and Liabilities	
Equity	
Share capital- Equity shares of ₹ 100 each	514
Other Equity	1,128.62
NCI	154.95
Non-Current liabilities:	
Long term borrowings	450
Long term provisions (50+70+28.93)	148.93
Deferred tax	28.5
Current Liabilities:	
Short term borrowings	250
Trade payables	550
Provision for Law suit Damages	5
Total	3,230

Notes:

- Fair value adjustment- As per Ind AS 103, the acquirer is required to record the assets and liabilities at their respective fair value. Accordingly, the PPE will be recorded at ₹ 350 lakhs.
- The value of replacement award is allocated between consideration transferred and post combination expense. The portion attributable to purchase consideration is determined based on the fair value of the replacement award for the service rendered till the date of the acquisition. Accordingly, 2.5 (5 x 2/4) is considered as a part of purchase consideration and is credited to Professional Ltd equity as this will be settled in its own equity. The balance of 2.5 will be recorded as employee expense in the books of Dynamic Ltd over the remaining life, which is 1 year in this scenario.
- There is a difference between contingent consideration and deferred consideration. In the given case 35 is the minimum payment to be paid after 2 years and accordingly will be considered as deferred consideration. The other element is if company meet certain target then they will get 25% of that or 35 whichever is higher. In the given case since the minimum what is expected to be paid the fair value of the contingent consideration has been considered as zero. The impact of time value on deferred consideration has been given @ 10%.
- The additional consideration of ₹ 20 lakhs to be paid to the founder shareholder is contingent to him/her continuing in employment and hence this will be considered as

employee compensation and will be recorded as post combination expenses in the income statement of Dynamic Ltd.

Working Notes:

1. Computation for Purchase consideration

Particulars		**Amount**
Share capital of Dynamic Ltd		4,00,00,000
Number of shares	4,00,000	
Shares to be issued 2:1	2,00,000	
Fair value ₹ per share		40
		₹ in lakhs
PC (2,00,000 x 70% x ₹ 40 per share) (A)		56.00
Deferred consideration after discounting ₹ 35 lakhs for 2 years @ 10% (B)		28.93
Replacement award Market based measure of the acquiree award (5) x ratio of the portion of the vesting period completed (2) / greater of the total vesting period (3) or the original vesting period (4) of the acquiree award ie (5 x 2 / 4) (C)		2.50
PC in lakhs (A+B+C)		87.43

2. Allocation of Purchase price

Particulars	**Book value (A)**	**Fair value (B)**	**FV adjustment (A-B)**
Property, plant and equipment	500	350	(150)
Investment	100	100	-
Inventories	150	150	-
Financial assets:			-
Trade receivables	300	300	-
Cash and cash equivalents	100	100	-
Others	230	230	
Less: Long term borrowings	(200)	(200)	-
Long term provisions	(70)	(70)	-
Deferred tax	(35)	(35)	-
Short term borrowings	(150)	(150)	-
Trade payables	(300)	(300)	-

Contingent liability	-	(5)	(5)
Net assets (X)	625	470	(155)
Deferred tax Asset on FV adjustment (155 x 30%) (Y)		46.50	155
Net assets (X+Y)		516.5	
Non-controlling interest (516.50 x 30%) rounded off		154.95	
Capital Reserve (Net assets – NCI – PC)		274.12	
Purchase consideration (PC)		87.43	

3. Computation of consolidated amounts of Consolidated financial statements

	Professional Ltd.	**Dynamic Ltd. (pre-acquisition)**	**PPA Allocation**	**Total**
Assets				
Non-Current Assets:				
Property, plant and equipment	300	500	(150)	650
Investment	400	100		500
Current assets:				
Inventories	250	150		400
Financial assets:				
Trade receivables	450	300		750
Cash and cash equivalents	200	100		300
Others	400	230		630
Total	2,000	1,380		3230
Equity and Liabilities				
Equity				
Share capital-Equity shares of ₹ 100 each Shares allotted to Dynamic Ltd. (2,00,000 x 70% x ₹ 10 per share)	500		14	514
Other Equity	810		318.62	1128.62

Replacement award			2.5	2.5
Security Premium (2,00,000 shares x 70% x ₹ 30)			42	42
Capital Reserve			274.12	274.12
Non-controlling interest	0		154.95	154.95
Non-Current liabilities:				
Financial liabilities Long term borrowings	250	200		450
Long term provisions	50	70	28.93	148.93
Deferred tax	40	35	(46.5)	28.5
Current Liabilities:				
Financial liabilities Short term borrowings	100	150		250
Trade payable	250	300	0	550
Liability for lawsuit damages			5	5
Total	2,000	755	475	3230

Q21: H Ltd. acquired equity shares of S Ltd., a listed company, in two tranches as mentioned in the below table:

Date	Equity stake purchased	Remarks
1st November, 2016	15%	The shares were purchased based on the quoted price on the stock exchange on the relevant dates.
1st January, 2017	45%	

Both the above-mentioned companies have INR as their functional currency. Consequently, H Ltd. acquired control over S Ltd. on 1st January, 2017. Following is the Balance Sheet of S Ltd. as on that date:

Particulars	Carrying value (₹ in crore)	Fair value (₹ in crore)
ASSETS:		
Non-current assets		
(a) Property, plant and equipment	40.0	90.0
(b) Intangible assets	20.0	30.0
(c) Financial assets	100.0	350.0

- Investments		
Current assets		
(a) Inventories	20.0	20.0
(b) Financial assets		
- Trade receivables	20.0	20.0
- Cash held in functional currency	4.0	4.5
(c) Other current assets		
Non-current asset held for sale	4.0	4.5
TOTAL ASSETS	208	
EQUITY AND LIABILITIES:		
Equity		
(a) Share capital (face value ₹100)	12.0	50.4
(b) Other equity	141.0	Not applicable
Non-current liabilities		
(a) Financial liabilities		
- Borrowings	20.0	20.0
Current liabilities		
(a) Financial liabilities		
- Trade payables	28.0	28.0
(b) Provision for warranties	3.0	3.0
(c) Current tax liabilities	4.0	4.0
TOTAL EQUITY AND LIABILITIES	208.0	

Other information:

Property, plant and equipment in the above Balance Sheet include leasehold motor vehicles having carrying value of ₹ 1 crore and fair value of ₹ 1.2 crore. The date of inception of the lease was 1st April, 2010. On the inception of the lease, S Ltd. had correctly classified the lease as a finance lease. However, if facts and circumstances as on 1st April, 2017 are considered, the lease would be classified as an operating lease.

Following is the statement of contingent liabilities of S Ltd. as on 1st January, 2017:

Particulars	Fair value (₹ In crore)	Remarks
Law suit filed by a customer for a claim of ₹ 2 crore	0.5	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim. Any amount which would be paid in respect of law suit will be tax deductible.

Income tax demand of ₹ 7 crore raised by tax authorities; S Ltd. has challenged the demand in the court.	2.0	It is not probable that an outflow of resources embodying economic benefits will be required to settle the claim.

In relation to the above-mentioned contingent liabilities, S Ltd. has given an indemnification undertaking to H Ltd. up to a maximum of ₹ 1 crore.

₹ 1 crore represents the acquisition date fair value of the indemnification undertaking.

Any amount which would be received in respect of the above undertaking shall not be taxable.

The tax bases of the assets and liabilities of S Ltd. is equal to their respective carrying values being recognised in its Balance Sheet.

Carrying value of non-current asset held for sale of ₹ 4 crore represents its fair value less cost to sell in accordance with the relevant Ind AS.

In consideration of the additional stake purchased by H Ltd. on 1st January, 2017, it has issued to the selling shareholders of S Ltd. 1 equity share of H Ltd. for every 2 shares held in S Ltd. Fair value of equity shares of H Ltd. as on 1st January, 2017 is ₹ 10,000 per share.

On 1st January, 2017, H Ltd. has paid ₹ 50 crore in cash to the selling shareholders of S Ltd. Additionally, on 31st March, 2019, H Ltd. will pay ₹ 30 crore to the selling shareholders of S Ltd. if return on equity of S Ltd. for the year ended 31st March, 2019 is more than 25% per annum. H Ltd. has estimated the fair value of this obligation as on 1st January, 2017 and 31st March, 2017 as ₹ 22 crore and ₹ 23 crore respectively. The change in fair value of the obligation is attributable to the change in facts and circumstances after the acquisition date.

Quoted price of equity shares of S Ltd. as on various dates is as follows:

As on November, 2016	₹ 350 per share
As on 1st January, 2017	₹ 395 per share
As on 31st March, 2017	₹ 420 per share

On 31st May, 2017, H Ltd. learned that certain customer relationships existing as on 1st January, 2017, which met the recognition criteria of an intangible asset as on that date, were not considered during the accounting of business combination for the year ended 31st March, 2017. The fair value of such customer relationships as on 1st January, 2017 was ₹ 3.5 crore (assume that there are no temporary differences associated with customer relations; consequently, there is no impact of income taxes on customer relations).

On 31st May, 2017 itself, H Ltd. further learned that due to additional customer relationships being developed during the period 1st January, 2017 to 31st March, 2017, the fair value of such customer relationships has increased to ₹ 4 crore as on 31st March, 2017.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and that more information is not obtainable.

H Ltd. and S Ltd. are not related parties and follow Ind AS for financial reporting. Income tax rate applicable is 30%.

You are required to provide your detailed responses to the following, along with reasoning and computation notes:

a. What should be the goodwill or bargain purchase gain to be recognised by H Ltd. in its financial statements for the year ended 31st March, 2017. For this purpose, measure non- controlling interest using proportionate share of the fair value of the identifiable net assets of S Ltd.

b. Will the amount of non-controlling interest, goodwill, or bargain purchase gain so recognised in (a) above change subsequent to 31st March, 2017?

If yes, provide relevant journal entries.

c. What should be the accounting treatment of the contingent consideration as on 31st March, 2017? **[MTP May 2019]**

Ans:

(a) As an only exception to the principle of classification or designation of assets as they exist at the acquisition date is that for lease contract and insurance contracts classification which will be based on the basis of the conditions existing at inception and not on acquisition date.

Therefore, H Ltd. would be required to retain the original lease classification of the lease arrangements and thereby recognise the lease arrangements as finance lease.

(b) The requirements in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets', do not apply in determining which contingent liabilities to recognise as of the acquisition date as per Ind AS 103 'Business Combination'. Instead, the acquirer shall recognise as of the acquisition date a contingent liability assumed in a business combination if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to Ind AS 37, the acquirer recognises a contingent liability assumed in a business combination at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation. Hence H Ltd. will recognize contingent liability of ₹ 2.5 cr.

Since S Ltd. has indemnified for ₹ 1 cr., H Ltd. shall recognise an indemnification asset at the same time for ₹ 1 cr.

As per the information given in the question, this indemnified asset is not taxable. Hence, its tax base will be equal to its carrying amount. No deferred tax will arise on it.

(c) As per Ind AS 103, non-current assets held for sale should be measured at fair value less cost to sell in accordance with Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'. Therefore, its carrying value as per balance sheet has been considered in the calculation of net assets.

(d) Any equity interest in S Ltd. held by H Ltd. immediately before obtaining control over S Ltd. is adjusted to acquisition-date fair value. Any resulting gain or loss is recognised in the profit or loss of H Ltd.

Calculation of purchase consideration as per Ind AS 103 ₹ in lakh

Investment in S Ltd.			
On 1st Nov. 2016	15%	[(12/100) x 395 x 15%]	7.11
On 1st Jan. 2017	45%		
Own equity given		10,000 x 12% x 45% x 1/2	270
Cash			50
Contingent consideration			22
			349.11

(e) Calculation of defer tax on assets and liabilities acquired as part of the business combination, including current tax and goodwill.

Item	₹ in crore				
	Book value	Fair value	Tax base	Taxable (deductible) temporary difference	Deferred tax assets (liability) @ 30%
Property, plant and equipment	40	90	40	50	(15)
Intangible assets	20	30	20	10	(3)
Investments	100	350	100	250	(75)
Inventories	20	20	20	-	-
Trade receivables	20	20	20	-	-
Cash held in functional currency	4	4	4	-	-
Non-current asset held for sale	4	4	4	-	-
Indemnified asset	-	1	1	-	-
Borrowings	20	20	20	-	-
Trade payables	28	28	28	-	-
Provision for warranties	3	3	3	-	-
Current tax liabilities	4	4	4	-	-

Contingent liability		0.5	-	(0.5)	0.15
Deferred tax Liability					(92.85)

(f) Calculation of identifiable net assets acquired

	₹ in crore	₹ in crore
Property, plant and equipment	90	
Intangible assets	30	
Investments	350	
Inventories	20	
Trade receivables	20	
Cash held in functional currency	4	
Non-current asset held for sale	4	
Indemnified asset	1	
Total asset		519
Less: Borrowings	20	
Trade payables	28	
Provision for warranties	3	
Current tax liabilities	4	
Contingent liability (2 + 0.5)	2.50	
Deferred tax liability (W.N.2)	92.85	(150.35)
Net identifiable assets		368.65

1) Calculation of NCI by proportionate share of net assets

Net identifiable assets of S Ltd. on 1.1.2017 (Refer W.N.3) = 372.85 crore NCI on 1.1.2017 = 368.65 crore x 40% = 147.46 crore

Calculation of Goodwill as per Ind AS 103

Goodwill on 1.1.2017 = Purchase consideration + NCI – Net assets = 349.11 + 147.46 – 368.65 = 127.92 crore

2) As per para 45 of Ind AS 103 'Business Combination', if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete.

During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date.

During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date.

The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

Further, as per para 46 of Ind AS 103, the measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the fo llowing as of the acquisition date in accordance with the requirements of this Ind AS:

a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;

b) …..

c) ……; and

d) the resulting goodwill or gain on a bargain purchase.

Para 48 states that the acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill.

Para 49 states that during the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date.

Para 50 states that after the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with Ind AS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

On 31st December, 2017, H Ltd. has established that it has obtained all the information necessary for the accounting of the business combination and the more information is not obtainable. Therefore, the measurement period for acquisition of S Ltd. ends on 31 st December, 2017.

On 31st May, 2017 (ie within the measurement period), H Ltd. learned that certain customer relationships existing as on 1st January, 2017 which met the recognition criteria of an intangible asset as on that date were not considered during the accounting of business combination for the year ended 31st March, 2017. Therefore, H Ltd. shall account for the acquisition date fair value of customer relations existing on

1st January, 2017 as an identifiable intangible asset. The corresponding adjustment shall be made in the amount of goodwill.

Accordingly, the amount of goodwill will be changed due to identification of new asset from retrospective date for changes in fair value of assets and liabilities earlier recognised on provisional amount (subject to meeting the condition above for measurement period). NCI changes would impact the consolidated retained earnings (parent's share). Also NCI will be increased or decreased based on the profit during the post-acquisition period.

Journal entry

Customer relationship	Dr.	3.5 crore	
To NCI			1.4 crore
To Goodwill			2.1 crore

However, the increase in the value of customer relations after the acquisition date shall not be accounted by H Ltd., as the customer relations developed after 1st January, 2017 represents internally generated intangible assets which are not eligible for recognition on the balance sheet.

3) Since the contingent considerations payable by H Ltd is not classified as equity and is within the scope of Ind AS 109 'Financial Instruments', the changes in the fair value shall be recognised in profit or loss. Change in Fair value of contingent consideration (23 -22) ₹ 1 crore will be recognized in the Statement of Profit and Loss.

ASSIGNMENT QUESTIONS

Q22: Smart Technologies Inc. is a Company incorporated in India in 1998 having business in the field of development and installation of softwares, trading of computer peripherals and other IT related equipment and provision of cloud computing services along with other services incidental thereto. It is one of the leading brands in India.

After witnessing immense popularity and support in its niche market, Smart Technologies further grew by bringing its subsidiaries namely:

Company Name	Principle Activity
Cloudustries India Private Limited	Provision of cloud computing services.
MicroFly India Private Limited	Trading of computer peripherals like mouse, keyboard, printer etc.

Smart Technologies started preparing its financial statements based on Ind AS from 1st April, 2015 on voluntary basis. The Microfly India Pvt. Ltd. is planning to merge the business of Cloudstries India Pvt. Ltd. with its own for which it presented before the members in the meeting the below extract of latest audited Balance Sheet of Cloudustries (prepared on the basis of Ind AS) for the year ended 31st March, 2017:

Balance Sheet as at March 31, 2017 (₹ in Crores)

	Assets		
	Non-current assets		
	Property, plant and Equipment	15.00	
			15.00
	Current Assets		
	Financial assets		
	Trade Receivables	10.00	
	Cash and cash equivalents	10.00	
	Other current assets	8.00	
			28.00
	Total		43.00
	Equity and Liabilities		
	Equity		
	Equity Share Capital	45.00	
	Other Equity		
	Reserves and Surplus (Accumulated Losses)*	(24.80)	20.20
	Liabilities		
	Non-current Liabilities		
	Financial liabilities		
	Borrowings	2.80	
	Current Liabilities	20.00	
			22.80
	Total		43.00

*The Tax Loss carried forward of the company is ₹ 27.20 crores

On September 5, 2017, the merger got approved by the Directors. The purchase consideration payable by MicroFly to Cloudustries was fixed at ₹ 18.00 crores payable in cash and that MicroFly take over all the assets and liabilities of Cloudustries.

Present the statement showing the calculation of assets/liabilities taken over as per Ind AS. Also mention the accounting of difference between consideration and assets/liabilities taken over. **[RTP Nov 2018]**

Ans: Before the merger, Cloudustries and MicroFly are the subsidiary of Smart Technologies Inc. As the control is not transitory, the proposed merger will fall under the category of Business combination of entities under common control, it will be accounted as per Appendix C of Ind AS 103 "Business Combination" and Pooling of Interest Method would be applied.

Statement showing the calculation of assets/liabilities taken over and treatment of difference between consideration and assets/liabilities taken over:

(a)	Net asset taken over:	(₹ in crore)
	Assets taken over:	
	Property, Plant and Equipment	15.00
	Cash and cash equivalents	10.00
	Other current assets	8.00
	Trade Receivables	10.00
	Total - A	43.00
	Less: Liabilities taken over:	
	Borrowings	2.80
	Current Liabilities	20.00
	Total - B	22.80
	Net Asset taken over (A-B)	20.20
(b)	Treatment of difference between consideration and assets/liabilities taken over:	(₹ in crore)
	Net Asset taken over - A	20.20
	Less: Purchase Consideration - B	18.00
	Difference (A – B)	1.80

The difference between consideration and assets/liabilities taken over of ₹ 1.80 crore shall be transferred to capital reserve.

Q23: On 1 April 20X1, Alpha Ltd. acquires 80 percent of the equity interest of Beta Pvt. Ltd. in exchange for cash of ₹ 300. Due to legal compulsion, Beta Pvt. Ltd. had to dispose of their investments by a specified date. Therefore, they did not have sufficient time to market Beta Pvt. Ltd. to multiple potential buyers. The management of Alpha Ltd. initially measures the separately recognizable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirement of Ind AS 103. The identifiable assets are measured at ₹ 500 and the liabilities assumed are measured at ₹ 100. Alpha Ltd. engages on independent consultant, who determined that the fair value of 20 per cent non-controlling interest in Beta Pvt. Ltd. is ₹ 84.

Alpha Ltd. reviewed the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non controlling interest in Beta Pvt. Ltd. and the consideration transferred. After the review, it decided that the procedures and resulting measures were appropriate.

Calculate the gain or loss on acquisition of Beta Pvt. Ltd. and also show the journal entries for accounting of its acquisition. Also calculate the value of the non-controlling interest in Beta Pvt. Ltd. on the basis of proportionate interest method, if alternatively applied **[RTP May 2018]**

Ans: The amount of Beta Pvt. Ltd. identifiable net assets [₹ 400, calculated as ₹ 500 - ₹ 100) exceeds the fair value of the consideration transferred plus the fair value of the non controlling interest in Beta Pvt. Ltd. [₹ 384 calculated as 300 + 84]. Alpha Ltd. measures the gain on its purchase of the 80 per cent interest as follows:

		₹ in lakh
Amount of the identifiable net assets acquired (₹ 500 - ₹ 100)		400
Less: Fair value of the consideration transferred for Alpha Ltd. 80 per cent interest in Beta Pvt. Ltd.	300	
Add: Fair value of non controlling interest in Beta Pvt. Ltd.	84	(384)
Gain on bargain purchase of 80 per cent interest		16

Journal Entry

		₹ in lakhs
Identifiable assets acquired Dr.	500	
To Cash		300
To Liabilities assumed		100
To OCI/Equity-Gain on the bargain purchase		16
To Equity-non controlling interest in Beta Pvt Ltd.		84

If the acquirer chose to measure the non controlling interest in Beta Pvt. Ltd. on the basis of its proportionate interest in the identifiable net assets of the acquire, the recognized amount of the non controlling interest would be ₹ 80 (₹ 400 x 0.20). The gain on the bargain purchase then would be ₹ 20 (₹ 400- (₹ 300 + ₹ 80)

Q24: On December 31, 2009, the Balance Sheets of the Dor and Dee Companies, prior to any business combination transaction, are as follows:

Balance Sheets As At December 31, 2009

	Dor Company	**Dee Company**
Cash	₹ 1,200,000	₹ 600,000
Accounts Receivable	2,400,000	800,000

Inventories	3,800,000	1,200,000
Plant And Equipment (Net)	4,600,000	2,400,000
Total Assets	₹12,000,000	₹5,000,000
Liabilities	₹ 1,500,000	₹ 700,000
Equity Share Capital (₹ 10)	6,000,000	2,500,000
Retained Earnings	4,500,000	1,800,000
Total Equities	₹12,000,000	₹5,000,000

On December 31, 2009, the Dor Company issues 204,000 shares of its Equity shares to the Dee Company in return for 100 percent of its net assets. On this date the shares of the Dor Company are trading at ₹25 per share. All of the identifiable assets and liabilities of the Dee Company have fair values that are equal to their carrying values except for the Plant And Equipment which has a fair value of ₹2,700,000 and a remaining useful life of ten years.

[Other Sources]

Ans: **Identification Of An Acquirer:** Since the Dor Company issued fewer shares (204,000) to the Dee Company than it had outstanding prior to the business combination (6,00,000), the shareholders of the Dor Company would be the majority shareholders in the combined company and the Dor Company would be identified as the acquirer.

Determination Of Purchase Price: With a market value of ₹25 per share, the 204,000 shares issued to effect the business combination would have a total market value in the amount of ₹5,100,000. This would be the purchase price of the Dee Company.

Investment Analysis: The required investment analysis schedule for this example would be as follows:

Carrying Value Of Dee's Net Identifiable Assets (₹5,000,000 - ₹700,000)	₹4,300,000
Fair Value Increase On Plant (₹2,700,000 - ₹2,400,000)	300,000
Fair Value Of Dee's Net Identifiable Assets	₹4,600,000

Given the purchase price and the fair values, the Goodwill that will be recognized from this business combination can be calculated in the following manner:

Investment Cost (Consideration Transferred)[(204,000)(₹25)]	₹5,100,000
Fair Value Of Dee's Net Identifiable Assets	(4,600,000)
Goodwill To Be Recognized	₹ 500,000

Journal Entry: Using the preceding investment analysis, we are now in a position to record the business combination. It would be recorded on the books of the Dor Company as a simple acquisition of assets and liabilities. Except for Dee's Plant And Equipment and the Goodwill to be recorded as a result of the business combination, the carrying values from the books of the Dee Company would be used. The entry is as follows:

Cash	₹ 600,000	
Accounts Receivable	800,000	
Inventories	1,200,000	
Plant And Equipment (Fair Value)	2,700,000	
Goodwill (Arising From The Acquisition)	500,000	
Liabilities		700,000
Equity Share capital (Dor)		2,040,000
Securities premium		3,060,000

Combined Balance Sheet

The resulting December 31, 2009 Balance Sheet for the Dor Company, which now includes all of the assets and liabilities of the Dee Company, would be as follows:

Dor Company

Balance Sheet As At December 31, 2009

Cash (₹1,200,000 + ₹600,000)	1,800,000
Accounts Receivable (₹2,400,000 + ₹800,000)	3,200,000
Inventories (₹3,800,000 + ₹1,200,000)	5,000,000
Plant And Equipment (₹4,600,000 + ₹2,700,000)	7,300,000
Goodwill	500,000
Total Assets	**17,800,000**
Liabilities (₹1,500,000 + ₹700,000)	2,200,000
Common Stock - No Par (₹6,000,000 + ₹2,040,000)	8,040,000
Retained Earnings (4,500,000+3,060,000)	7,560,000
Total Equities	**17,800,000**

Q25: ABC Ltd. prepares consolidated financial statements upto 31st March each year. On 1st July 2017, ABC Ltd. acquired 75% of the equity shares of JKL Ltd. and gained control of JKL Ltd. the issued shares of JKL Ltd. is 1,20,00,000 equity shares. Details of the purchase consideration are as follows:

- On 1st July, 2017, ABC Ltd. issued two shares for every three shares acquired in JKL Ltd. On 1st July, 2017, the market value of an equity share in ABC Ltd. Was ₹ 6.50 and the market value of an equity share in JKL Ltd. was ₹ 6.
- On 30th June, 2018, ABC Ltd. will make a cash payment of ₹ 71,50,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 2017. On 1st July, 2017, ABC Ltd. would have to pay interest at an annual rate of 10% on borrowings.
- On 30th June, 2019, ABC Ltd. may make a cash payment of ₹ 3,00,00,000 to the former shareholders of JKL Ltd. who sold their shares to ABC Ltd. on 1st July, 2017. This payment is contingent upon the revenues of ABC Ltd. growing by 15% over the two-year period from 1st July, 2017 to 30th June, 2019. On 1st July, 2017, the fair value of this contingent consideration was ₹ 2,50,00,000. On 31st March, 2018, the fair value of the contingent consideration was ₹ 2,20,00,000.

On 1st July, 2017, the carrying values of the identifiable net assets of JKL Ltd. in the books of that company was ₹ 6,00,00,000. On 1st July, 2017, the fair values of these net assets was ₹ 7,00,00,000. The rate of deferred tax to apply to temporary differences is 20%.

During the nine months ended on 31st March, 2018, JKL Ltd. had a poorer than expected operating performance. Therefore, on 31st March, 2018 it was necessary for ABC Ltd. to recognise an impairment of the goodwill arising on acquisition of JKL Ltd., amounting to 10% of its total computed value.

Compute the impairment of goodwill in the consolidated financial statements of ABC Ltd. under both the methods permitted by Ind AS 103 for the initial computation of the non- controlling interest in JKL Ltd. at the acquisition date. **[RTP Nov 2018]**

Ans:

Computation of goodwill impairment	**NCI at fair value**	**NCI at of net**
		assets
	₹ in ‘000	₹ in ‘000
Cost of investment		
Share exchange (12,000 x 75% x 2/3 x ₹ 6.50)	39,000	39,000
Deferred consideration (7,150 / 1.10)	6,500	6,500
Contingent consideration	25,000	25,000
Non-controlling interest at date of acquisition:		
Fair value – 3000 x ₹ 6	18,000	
% of net assets – 68,000 (Refer W.N.) x 25%		17,000
Net assets on the acquisition date (Refer W.N.)	(68,000)	(68,000)

Goodwill on acquisition	20,500	19,500
Impairment @ 10%	2,050	1,950
Working Note:		
Net assets on the acquisition date		₹ ’000
Fair value at acquisition date		70,000
Deferred tax on fair value adjustments [20% x (70,000 – 60,000)]		(2,000)
		68,000

Q26: Entity X acquired 100% of entity Y in a Business combination as per Ind AS 103. There is an existing Share based plan in Entity Y with a vesting condition for 3 years in which 2 years has already lapsed at the date of such business acquisition. Entity X agrees to replace the existing award for the employee of combined entity. The details are as below –

Acquisition date Fair value of SBP	INR 300
No. of years to Vest after acquisition	1 year
Fair Value of award which replaces existing	INR 400

Calculate the Share-based payment values as per Ind AS 102? **[Other Sources]**

Ans: Pre-acquisition period = 2

Post-acquisition period =1

Total fair value at acquisition =INR 300

Value to be recorded as per Business combination under Ind AS 103

= INR 300/3 * 2 = INR 200

Value to be recorded as per Ind AS 102 = INR 300/3 *1 = INR 100

Fair value of the replacement of such award = INR 400

Difference from Acquisition date fair value = INR 400- INR 300 = INR 100

Total value to be accounted over vesting period as per Ind AS 102 = INR 100 + INR 100 = INR 200

Q27: MNC Ltd. is in process of setting up a medicine manufacturing business which is at very initial stage. For this purpose, MNC Ltd. as part of its business expansion strategy acquired on 1st April, 2019, 100% shares of Akash Ltd., a company that manufactures pharmacy products. The purchase consideration for the same was by way of a share exchange valued at ₹ 38 crore. The fair value of Akash Ltd.’s assets and liabilities were ₹ 68 crore and ₹ 50 crore respectively, but the same does not include the following:

1. A patent owned by Akash Ltd. for an established successful new drug that has a remaining life of 6 years. A consultant has estimated the value of this patent to be ₹ 8

crore. However, the outcome of clinical trails for the same are awaited. If the trails are successful, the value of the drug would fetch the estimated ₹ 12 crore.

2. Akash Ltd. has developed and patented another new drug which has been approved for clinical use. The cost of developing the drug was ₹ 13 crore. Based on early assessment of its sales success, a reputed valuer has estimated its market value at ₹ 19 crore. However, there is no active market for the patent.

3. Akash Ltd.'s manufacturing facilities have received a favourable inspection by a government department. As a result of this, the company has been granted an exclusive five-year license on 1st April, 2018 to manufacture and distribute a new vaccine. Although the license has no direct cost to the Company, its directors believe that obtaining the license is valuable asset which assures guaranteed sales and the cost to acquire the license is estimated at ₹ 7 crore of remaining period of life. It is expected to generate at least equivalent revenue.

Suggest the accounting treatment of the above transactions with reasoning under applicable Ind AS in the books of MNC Ltd. **[RTP May 2019; Exam Nov 19]**

Ans: As per para 13 of Ind AS 103 'Business Combination', the acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the 90cquire had not previously recognised as assets and liabilities in its financial statements. This may be the case when the asset is developed by the entity internally and charged the related costs to expense.

Based on the above, the company can recognise following Intangible assets while determining Goodwill / Bargain Purchase for the transaction:

(i) **Patent owned by Akash Ltd.:** The patent owned will be recognised at fair value by MNC Ltd. even though it was not recognised by Akash Ltd. in its financial statements. The patent will be amortised over the remaining useful life of the asset i.e. 6 years. Since the company is awaiting the outcome of the trials, the value of the patent should be valued at ₹ 8 crore. It cannot be estimated at ₹ 12 crore and the extra ₹ 4 crore should only be disclosed as a contingent asset and not recognised.

(ii) **Patent internally developed by Akash Ltd.:** As per para 18 of Ind AS 103 'Business Combination', the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. Since the patent developed has been approved for clinical use, it is an identifiable asset, hence the same will be measured at fair value ie ₹ 19 crore on the acquisition date.

(iii) **Grant of Licence to Akash Ltd. by the Government:** As regards to the five-year license, applying para 18 of Ind AS 103, grant asset will be recognised at fair value on the acquisition date by MNC Ltd. On acquisition date, the fair value of the license asset is ₹ 7 crore. However, since the question does not mention about the fair value of the identifiable liability with respect to grant of license for the acquirer , it is assumed that the fair value of the liability with respect to grant, for acquirer is nil. Therefore, only, the grant asset (license) would be recognised at ₹ 7 crore in the books of acquirer MNC Ltd.

Hence the revised working would be as follows:

Fair value of net assets of Akash Ltd. (68-50)	₹ 18 crore
Add: Patent (8 + 19)	₹ 27 crore
Add: License	₹ 7 crore
Less: Grant for License	(Nil)
	₹ 52 crore
Purchase Consideration	(₹ 38 crore)
Capital Reserve	₹ 14 crore

Q28: Parent A holds 100% in its subsidiary B. Parent A had acquired B, 10 years back and had decided to account for the acquisition under the purchase method using fair values of the subsidiary B in its consolidated financial statements.

During the current year, A decides to merge B with itself.

For the purpose of this proposed merger, what values of B should be used for accounting under the Ind AS? **[Exam Nov 19]**

Ans: Reference to be included to Appendix C of Ind AS 103

The acquisition of B Ltd. by A Ltd. is business combination under common control. In such a situation, pooling of interest method should be applied. However, B Ltd. is 100% subsidiary of A Ltd. and A Ltd. in its Consolidated financial statements use to give the carrying values of assets and liabilities of B Ltd. at fair value (as per acquisition under purchase method). Hence the carrying value for the purpose of pooling of interest method will be the values given in Consolidated financial statements and not in Separate financial statements.

In other words, since B Ltd. is merging with A Ltd. (i.e. parent) nothing has changed and the transaction only means that the assets, liabilities and reserves of B Ltd. which were appearing in the consolidated financial statements of Group A immediately before the merger would now be a part of the separate financial statements of A Ltd. Accordingly, it would be appropriate to recognise the carrying value of the assets, liabilities and reserves pertaining to B Ltd as appearing in the consolidated financial statements of A Ltd.

Q29: Deepak Ltd., an automobile group acquires 25% of the voting ordinary shares of Shaun Ltd., another automobile business, by paying, ₹ 4,320 crore on 01.04.2019. Deepak Ltd. accounts its investment in Shaun Ltd. using equity method as prescribed under Ind AS 28. At 31.03.2020, Deepak Ltd. recognised its share of the net asset changes of Shaun Ltd. using equity accounting as follows:

	(₹ in crore)
Share of Profit or Loss	378
Share of Exchange difference in OCI	54
Share of Revaluation Reserve of PPE in OCI	27

On 01.04.2020, Deepak Ltd. acquired remaining 75% of Shaun Ltd. for cash ₹ 13,500 crore. Fair value of the 25% interest already owned was ₹ 4,860 crore and fair value of Shaun Ltd.'s identifiable net assets was ₹ 16,200 crore as on 01.04.2020. How should such business combination be accounted for in accordance with the applicable Ind AS? **[MTP Nov 2020]**

Ans: Paragraph 42 of Ind AS 103 provides that in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognized changes in the value of its equity interest in the acquiree in other comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed of directly the previously held equity interest.

Applying the above, Deepak Ltd. records the following entry in its consolidated financial statements:

		(₹ in crore)	
		Debit	**Credit**
Identifiable net assets of Shaun Ltd.	Dr.	16,200	
Goodwill (W.N.1)	Dr.	2,160	
Foreign currency translation reserve	Dr.	54	
PPE revaluation reserve	Dr.	27	
To Cash			13,500
To Investment in associate (4,320 + 378 + 54 + 27)			4,779
To Retained earnings (W.N.2)			27
To Gain on previously held interest in Shaun Ltd. recognised in Profit or loss (W.N.3)			135
(Recognition of acquisition of Shaun Ltd.)			

Working Notes:

1. Calculation of Goodwill

	₹ in crore
Cash consideration	13,500
Add: Fair value of previously held equity interest in Shaun Ltd.	4,860
Total consideration	18,360
Less: Fair value of identifiable net assets acquired	(16,200)
Goodwill	2,160

2. The credit to retained earnings represents the reversal of the unrealized gain of ₹ 27 crore in Other Comprehensive Income related to the revaluation of property, plant and equipment. In accordance with Ind AS 16, this amount is not reclassified to profit or loss.

3. The gain on the previously held equity interest in Shaun Ltd. is calculated as follows:

	₹ in crore
Fair Value of 30% interest in Shaun Ltd. at 1st April, 2020	4,860
Carrying amount of interest in Shaun Ltd. at 1st April, 2020	(4,779)
	81
Unrealised gain previously recognised in OCI	54
Gain on previously held interest in Shaun Ltd. recognised in profit or loss	135

Q30: On 1st April, 2018, KK Ltd. has acquired 80% of the equity interest in CK Ltd., a private entity in exchange for cash of ₹150 crore. Because the former owners of CK Ltd. needed to dispose of their investment in CK Ltd. by a specified date, they did not have sufficient time to identify other potential buyers. Additional information with respect to the said acquisition are as follows:

- The identifiable assets are measured at ₹ 250 crore and the liabilities assumed at ₹ 50 crore.
- The Company has also engaged an independent consultant, who has determined that the fair value of the 20% of Non-controlling Interest in CK Ltd. is ₹ 42 crore.

(i) The Company has requested you to suggest the accounting treatment of the above acquisition made as per Ind AS.

(ii) Whether the Company has any other option other than the fair valuation of the non-controlling interest?

(iii) If yes, what will be the impact of the same under the Ind AS 103?

(iv) Further the Company has also requested you to explain the differences in the accounting under corresponding IFRS for the aforementioned transaction. **[GFRS]**

Ans: (i) Since the former owners of CK Ltd. needed to dispose of their investment in CK Ltd. by a specified date and also they did not have sufficient time to identify other potential buyers, there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase.

Therefore, the gain on bargain purchase calculated at ₹ 8 crore, will be recognised in other comprehensive income on the acquisition date and accumulated the same in equity as capital reserve as follows:

Journal Entry

		₹ in crore	₹ in crore
Identifiable assets acquired	Dr.	250	
To Bank			150
To Liabilities assumed			50

To NCI (at fair value)			42
To Capital Reserve (Bargain purchase recognized in OCI) (Balancing figure)			8

(ii) Yes, KK Ltd. has the option to value non-controlling interest by proportionate share method at the acquisition date.

(iii) If KK Ltd. chose to measure the non-controlling interest in CK Ltd. on the basis of its proportionate share of identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be ₹ 40 crore (₹ 200 crore x 20%). The gain on the bargain purchase then would be ₹ 10 crore [₹ 200 crore – (₹ 150 crore + ₹ 40 crore)].

(iv) As per IFRS 3, bargain purchase gain arising on business combination is to be recognised in profit or loss as income.

However, Ind AS 103 'Business Combination' requires the bargain purchase gain to be recognised in other comprehensive income and accumulated in equity as capital reserve if there exists clear evidence of the underlying reasons for classifying the business combination as a bargain purchase. If there is no clear evidence for the underlying reason for classification of the business combination as a bargain purchase, then it shall be recognised directly in equity as capital reserve.

Q31: Makers Ltd. acquired 65% of shares on 1st June, 2018 in D Limited which is engaged in production of components of machinery. D Limited has 1,00,000 equity shares of ₹ 10 each. The quoted market price of shares of D Limited was ₹12 on the date of acquisition. The fair value of D Limited's identifiable net assets as on 1st June, 2018 was ₹ 80,00,000.

Makers Limited wired ₹50,00,000 in cash and issued 50,000 equity shares as purchase consideration on the date of acquisition. The quoted market price of Makers Limited on the date of issue is ₹ 25 per share.

Makers Limited also agrees to pay additional consideration of ₹ 15,00,000, if the cumulative profit earned by D Limited exceeds ₹ 1 crore over the next three years. On the date of acquisition, D Limited assessed and determined that it is considered probable that the extra consideration will be paid. The fair value of this consideration on the date of acquisition is ₹ 9,80,000. D Limited incurred ₹ 1,50,000 in relation to the acquisition. It measures Non-controlling interest at fair value.

How will the acquisition of D Ltd. be accounted by Makers Limited, under Ind AS 103? Prepare detailed workings and pass the necessary journal entries.

[GFRS; RTP May 2021]

Ans: Computation of Goodwill / Capital reserve on consolidation as per Ind AS 103

Particulars	**INR**
Cost of investment:	
Share exchange (50,000 x 25)	12,50,000
Cash consideration	50,00,000
Contingent consideration	9,80,000
Consideration transferred at date of acquisition [A]	72,30,000
Fair value of non-controlling interest at date of acquisition (1,00,000 x 35% x 12) [B]	4,20,000
Total [C] = [A] + [B]	76,50,000
Net assets acquired at date of acquisition [D]	(80,00,000)
Capital Reserve [D] – [C]	3,50,000

In a business combination, acquisition-related costs (including stamp duty) are expensed in the period in which such costs are incurred and are not included as part of the consideration transferred. Therefore, ₹ 1,50,000 incurred by D Ltd. in relation to acquisition, will be ignored by Makers Ltd.

Journal entry at the date of acquisition by Makers Limited as per Ind AS 103:

		₹	₹
Identifiable net assets	Dr.	80,00,000	
To Equity share capital (50,000 x 10)			5,00,000
To Securities Premium (50,000 x 15)			7,50,000
To Cash			50,00,000
To Provision for contingent consideration to D Ltd.			9,80,000
To Non-controlling Interest			4,20,000
To Capital Reserve			3,50,000

Note: Since ₹ 1,50,000 is incurred by D Ltd., no entry is passed for it in the books of Makers Ltd.

NOTES

CHAPTER 30
EARNINGS PER SHARE (IND AS 33)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: An entity has following preference shares in issue at the end of 20X4:

- **5% redeemable, non-cumulative preference shares:** These shares are classified as liabilities. During the year, a dividend was paid on the 5% preference shares – ₹ 100,000.
- **Increasing-rate, cumulative, non-redeemable preference shares issued at a discount in 20X0, with a cumulative dividend rate from 20X5 of 10%:** The shares were issued at a discount to compensate the holders, because dividend payments will not commence until 20X5. The accrual for the discount in the current year, calculated using the effective interest method amounted to, say, ₹ 18,000. These shares are classified as equity – ₹ 200,000.
- **8% non-redeemable, non-cumulative preference shares:** At the beginning of the year, the entity had ₹ 100,000 8% preference shares outstanding but, at 30 June 20X4, it repurchased ₹ 50,000 of these at a discount of ₹ 1,000 – ₹ 50,000.
- **7% cumulative, convertible preference shares (converted in the year):** These shares were classified as equity, until their conversion into ordinary shares at the beginning of the year. No dividend was accrued in respect of the year, although the previous year's dividend was paid immediately prior to conversion. To induce conversion, the terms of conversion of the 7% convertible preference shares were also amended, and the revised terms entitled the preference shareholders to an additional 100 ordinary shares on conversion with a fair value of ₹ 300 – Nil.

The profit attributable to ordinary equity holders for the year 20X4 is ₹ 150,000.

Determine the adjustments for the purpose of calculating EPS.

Note: It may be noted that as per Sections 53 and 55 of the Companies Act, 2013, a company cannot issue shares at discount or any irredeemable preference shares. However, the above illustration has been given only to explain the concept given in Ind AS.

Ans: Adjustments for the purpose of calculating EPS are made as follows:

Particulars	Amount (₹)	Amount (₹)
Profit for the year attributable to the ordinary equity holders		150,000
Amortisation of discount on issue of increasing-rate preference shares (Refer Note 1)	(18,000)	
Discount on repurchase of 8% preference shares (Refer Note 2)	1,000	(17,000)
Profit attributable to ordinary equity holders for basic EPS (Refer Note 3-5)		1,33,000

Notes:

1. The original discount on issue of the increasing-rate preference shares is treated as amortised to retained earnings, and treated as preference dividends for EPS purposes and adjusted against profit attributable to the ordinary equity holders. There is no adjustment in respect of dividend, because these do not commence until 20X5. Instead, the finance cost is represented by the amortisation of the discount in the dividend-free period. In future years, the accrual for the dividend of ₹ 20,000 will be deducted from profits.

2. The discount on repurchase of the 8% preference shares has been credited to equity so should be added to profit.

3. The dividend on the 5% preference shares has been charged to the income statement, because the preference shares are treated as liabilities, so no adjustment is required for it from the profit.

4. No accrual for the dividend on the 8% preference shares is required, because they are non-cumulative. If a dividend had been declared for the year, it would have been deducted from profit for the purpose of calculating basic EPS, because the shares are treated as equity and the dividend would have been charged to equity in the financial statements.

5. The 7% preference shares were converted at the beginning of the year, so there is no adjustment in respect of the 7% preference shares, because no dividend accrued in respect of the year. The payment of the previous year's cumulative dividend is ignored for EPS purposes, because it will have been adjusted for in the prior year. Similarly, the excess of the fair value of additional ordinary shares issued on conversion of the convertible preference shares over the fair value of the ordinary shares to which the shareholders would have been entitled under the original conversion terms would already have been deducted from profit attributable to the ordinary shareholders, and no further adjustment is required.

Q2: ABC Company issues 9% preference shares of FV of ₹ 10 each on 1.4.20X1. Total value of the issue is ₹ 10,00,000. The shares are issued at a discount of ₹ 0.50 each, for a period of 5 years and would be redeemed at the end of 5th year. The shares are to be redeemed at ₹ 11 each.

At the end of the year 3, i.e. on 31.3.20X4, company finds that it has earned good returns than expected over last three years and can make the redemption of preference shares early. To compensate the shareholders for two years of dividend which they need to forego, company decided to redeem the shares at ₹ 12 each instead of original agreement of ₹ 11. Comment on the earnings for the year 20X3-20X4.

Ignore the EIR impact in the solution and answer on the basis of Ind AS 33 only.

Ans: In the given situation, ₹ 1 per share is the excess payment made by the company amounting to ₹ 1,00,000 in all. The amount of ₹ 1,00,000 will be deducted from the earnings of the year 20X3-20X4 while calculating the basic EPS of year 20X3-20X4.

Q3: Following is the data for company XYZ in respect of number of equity shares during the financial year 20X1-20X2. Find out the number of shares for the purpose of calculation of basic EPS as per Ind AS 33

S. No.	Date	Particulars	No of shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	100,000
2	15-Jun-20X1	Issue of equity shares	75,000
3	8-Nov-20X1	Conversion of convertible pref shares in Equity	50,000
4	22-Feb-20X2	Buy back of shares	(20,000)
5	31-Mar-20X2	Closing balance of outstanding equity shares	205,000

Ans: The closing balance of the outstanding shares is 2,05,000 by a normal addition and subtraction. But as per weighted average concept, one need to find out for how many days each type of shares was actually held during the year.

The shares which were there on 1st April 20X1, were held for the whole year. Therefore, weighted average number of such shares will be given by the formula:

No of shares x no of days the shares were held during the year / 365

= 1,00,000 x 365 / 365 = 1,00,000

But the shares which were issued on 15th June 20X1, were held for only 290 days. Therefore, the weighted average number of shares will be 75,000 x 290 / 365 = 59,589.

Following the above formula, the weighted average number of shares for calculation of EPS for the year 20X1-20X2 will be as follows:

2	Date	Particulars	No ofshares	No of days shares were outstanding	Weighted average noof shares
1	1-Apr-20X1	Opening balance of outstanding equity shares	1,00,000	365	1,00,000
2	15-Jun-20X1	Issue of equity shares	75,000	290	59,589
3	8-Nov-20X1	Conversion of convertible preference shares in Equity	50,000	144	19,726
4	22-Feb-20X2	Buy back of shares	(20,000)	(38)*	(2,082)
5	31-Mar-20X2	Closing balance ofoutstanding equity shares	2,05,000		1,77,233

* These shares had already been considered in the shares issued. The same has been deducted assuming that the bought back shares have been extinguished immediately.

Q4: An entity issues 100,000 ordinary shares of Re 1 each for a consideration of ₹ 2.50 per share. Cash of ₹ 1.75 per share was received by the balance sheet date. The partly paid shares are entitled to participate in dividends for the period in proportion to the amount paid. Calculate number of shares for calculation of Basic EPS.

Ans: The number of ordinary share equivalents that would be included in the basic EPS calculation on a weighted basis is as follows: (100,000 × ₹ 1.75) / ₹ 2.50 = 70,000 shares.

Q5: On 31 March, 20X2, the issued share capital of a company consisted of ₹ 100,000,000 in ordinary shares of ₹ 25 each and ₹ 500,000 in 10% cumulative preference shares of Re 1 each. On 1 October, 20X2, the company issued 1,000,000 ordinary shares fully paid by way of capitalization of reserves in the proportion 1:4 for the year ended 31 March, 20X3.

Profit for 20X1-20X2 and 20X2-20X3 is ₹ 450,000 and ₹ 550,000 respectively.

Calculate the basic EPS for 20X1-20X2 and 20X2-20X3.

Ans:

	20X2-20X3	**20X1-20X2**
Calculation of earnings	₹'000	₹'000
Profit for the year	550	450
Less: Preference shares dividend	(50)	(50)
Earnings (A)	500	400
Number of ordinary shares	in '000	in '000
Shares in issue for full year	4,000	4,000
Capitalization issue at 1 October 20X2	1,000	1,000
Number of shares (B)	5,000	5,000
Earnings per ordinary share (A/B)	10 Paise	8 Paise*

*The comparative EPS for 20X1-20X2 can alternatively be calculated by adjusting the previously disclosed EPS in 20X1-20X2 (in this example, 10 Paise) by the following factor:

Number of shares before the bonus issue/ Number of shares after the bonus issue

*Adjusted EPS for 20X1-20X2 10 Paise x (4,000/ 5,000) = 8 Paise

Q6: X Ltd.

1 January	1,000,000 shares in issue
28 February	Issued 200,000 shares at fair value
31 August	Bonus issue 1 share for 3 shares held
30 November	Issued 250,000 shares at fair value

Calculate the number of shares which would be used in the basic EPS calculation. Consider reporting date as December end.

Ans:

Period	Calculations	Weighted average number of shares
1 January - 28 February	1,000,000 × 2 / 12 × 4 / 3	222,222
1 March - 31 August	1,200,000 × 6 / 12 × 4 / 3	800,000
1 September - 30 November	1,600,000 × 3 / 12	400,000
1 December - 31 December	1,850,000 × 1 / 12	154,167
		1,576,389

Q7: Entity A has in issue 25,000 4% debentures with a nominal value of Re 1. The debentures are convertible to ordinary shares at a rate of 1:1 at any time until 20X9. The entity's management receives a bonus based on 1% of profit before tax.

Entity A's results for 20X2 showed a profit before tax of ₹ 80,000 and a profit after tax of ₹ 64,000 (for simplicity, a tax rate of 20% is assumed in this example).

Calculate Earnings for the purpose of diluted EPS.

Ans: For the purpose of calculating diluted EPS, the earnings should be adjusted for the reduction in the interest charge that would occur if the debentures were converted, and for the increase in the management bonus payment that would arise from the increased profit.

	Amount (₹)
Profit after tax	64,000
Add: Reduction in interest cost (25,000 × 4%) (Refer Note)	1,000
Less: Tax expense (1,000 × 20%)	(200)
Less: Increase in management bonus (1,000 × 1%)	(10)
Add: Tax benefit (10 × 20%)	2
Earnings for the purpose of diluted EPS	64,792

Note: For simplicity, this illustration does not classify the components of the convertible debenture as liabilities and equity, as required by Ind AS 32.

Q8: ABC Ltd. has 1,000,000 ₹ 1 ordinary shares and 1,000 ₹ 100 10% convertible bonds (issued at par), each convertible into 20 ordinary shares on demand, all of which have been in issue for the whole of the reporting period.

ABC Ltd.'s share price is ₹ 4.50 per share and earnings for the period are ₹ 500,000. The tax rate applicable to the entity is 21%.

Calculate earnings per incremental share for the convertible bonds.

Ans: Basic EPS is ₹ 0.50 per share (ie 500,000/1,000,000)

The earnings per incremental share for the convertible bonds is calculated as follows:

Earnings effect = No. of bonds x nominal value x interest cost - tax deduction @ 21%

= 1,000 x 100 x 10% x (1- 0.21)

= ₹ 7,900.

Incremental shares calculation

Assume all bonds are converted to shares, even though this converts ₹ 100 worth of bonds into 20 shares worth only ₹ 90 and is therefore not economically rational. This gives 1000 x 20 = 20,000 additional shares.

Earnings per incremental share = ₹ 7,900 / 20,000 = ₹ 0.395

Diluted EPS = (₹ 500,000 + ₹ 7,900) / (1,000,000 + 20,000) = ₹ 0.498 per share.

Q9: At 30 June 20X1, the issued share capital of an entity consisted of 1,500,000 ordinary shares of ₹ 1 each. On 1 October 20X1, the entity issued ₹ 1,250,000 of 8% convertible loan stock for cash at par. Each ₹ 100 nominal of the loan stock may be converted, at any time during the years ended 20X6 to 20X9, into the number of ordinary shares set out below:

30 June 20X6: 135 ordinary shares;

30 June 20X7: 130 ordinary shares;

30 June 20X8: 125 ordinary shares; and

30 June 20X9: 120 ordinary shares.

If the loan stocks are not converted by 20X9, they would be redeemed at par. There are two different ways of assessing these instruments under Ind AS 32: the conversion option, to convert to a number of shares which varies only with time, could be viewed as either an option to convert to a variable or a fixed number of shares and recognised as either a liability or equity respectively.

This illustration assumes that the written equity conversion option is accounted for as a derivative liability and marked to market through profit or loss. The change in the options' fair value reported in 20X2 and 20X3 amounted to losses of ₹ 2,500 and ₹ 2,650 respectively. It is assumed that there are no tax consequences arising from these losses.

The profit before interest, fair value movements and taxation for the year ended 30 June 20X2 and 20X3 amounted to ₹ 825,000 and ₹ 895,000 respectively and relate wholly to continuing operations. The rate of tax for both periods is 33%.

Calculate Basic and Diluted EPS.

Ans: Calculation of Basic EPS

		20X3	20X2
	Trading results	₹	₹
A.	Profit before interest, fair value movements and tax	895,000	825,000
B.	Interest on 8% convertible loan stock		
	(20X2: 9/12 × ₹100,000)	(100,000)	(75,000)
C.	Change in fair value of embedded option	(2,650)	(2,500)
	Profit before tax	792,350	747,500
	Taxation @ 33% on (A-B)	(262,350)	(247,500)
	Profit after tax	530,000	500,000
	Calculation of basic EPS		
	Number of equity shares outstanding	1,500,000	1,500,000
	Earnings	₹ 530,000	₹ 500,000
	Basic EPS	35 paise	33 paise

Calculation of diluted EPS

Test whether convertibles are dilutive:

The saving in after-tax earnings, resulting from the conversion of ₹ 100 nominal of loan stock, amounts to ₹ 100 × 8% × 67% + ₹ 2,650/12,500 = ₹ 5.36 + ₹ 0.21 = ₹ 5.57.

There will then be 135 extra shares in issue.

Therefore, the incremental EPS is 4 paise (ie. ₹ 5.57/135). As this incremental EPS is less than the basic EPS at the continuing level, it will have the effect of reducing the basic EPS of 35 paise. Hence the convertibles are dilutive.

Adjusted earnings	20X3	20X2
	₹	₹

Profit for basic EPS	530,000	500,000
Add: Interest and other charges on earnings saved		
as a result of the conversion	102,650	77,500
(100,000 + 2,650) (75000+ 2500)		
Less: Tax relief thereon	(33,875)	(25,575)
Adjusted earnings for equity	598,775	551,925

Adjusted number of shares

From the conversion terms, it is clear that the maximum number of shares issuable on conversion of ₹ 1,250,000 loan stock after the end of the financial year would be at the rate of 135 shares per ₹ 100 nominal (that is, 1,687,500 shares).

	20X3	**20X2**
Number of equity shares for basic EPS	1,500,000	1,500,000
Maximum conversion at date of issue 1,687,500 × 9/12	–	1,265,625
Maximum conversion after balance sheet date	1,687,500	–
Adjusted capital	3,187,500	2,765,625
Adjusted earnings for equity	₹ 598,775	₹ 551,925
Diluted EPS (approx.)	19 paise	20 paise

Q10: At 31 December 20X7 and 20X8, the issued share capital of an entity consisted of 4,000,000 ordinary shares of ₹ 25 each. The entity has granted options that give holders the right to subscribe for ordinary shares between 20Y6 and 20Y9 at ₹ 70 per share. Options outstanding at 31 December 20X7 and 20X8 were 630,000. There were no grants, exercises or lapses of options during the year. The profit after tax, attributable to ordinary equity holders for the years ended 31 December 20X7 and 20X8, amounted to ₹ 500,000 and ₹ 600,000 respectively (wholly relating to continuing operations).

Average market price of share:

Year ended 31 December 20X7 = ₹ 120

Year ended 31 December 20X8 = ₹ 160

Calculate basic and diluted EPS.

Ans: Calculation of basic EPS

	20X8	**20X7**
Profit after tax	₹ 600,000	₹ 500,000
Number of shares	4,000,000	4,000,000
Basic EPS (approx.)	15 paise	13 paise.
Calculation of diluted EPS		
Adjusted number of shares		
Number of shares under option:		
Issued at full market price:		
(630,000 × 70) ÷ 160	275,625	
(630,000 × 70) ÷ 120		367,500
Issued at nil consideration — dilutive	354,375	262,500
Total number of shares under option	630,000	630,000

Number of equity shares for basic EPS	4,000,000	4,000,000
Number of dilutive shares under option	354,375	262,500
Adjusted number of shares (A)	4,354,375	4,262,500
Profit after tax (B)	₹ 600,000	₹ 500,000
Diluted EPS (B/A)	14 paise	12 paise
Percentage dilution	7.00%	6.40%

Note: If options had been granted or exercised during the period, the number of 'nil consideration' shares in respect of these options would be included in the diluted EPS calculation on a weighted average basis for the period prior to exercise.

Q11: Ordinary shares outstanding during 2001 10,00,000

An agreement related to a recent business combination provides for the issue of additional ordinary shares based on the following conditions:

- 5,000 additional ordinary shares for each new retail site opened during 2001
- 1,000 additional ordinary shares for each ₹ 1,000 of consolidated profit in excess of ₹ 20,00,000 for the year ended 31 December 2001

Retail sites opened during the year:

- one on 1 May 2001
- one on 1 September 2001

Consolidated year-to-date profit attributable to ordinary equity holders of the parent entity:

- ₹ 11,00,000 as of 31 March 2001
- ₹ 23,00,000 as of 30 June 2001
- ₹ 19,00,000 as of 30 September 2001 (including a ₹ 4,50,000 loss from a discontinued operation)
- ₹ 29,00,000 as of 31 December 2001

Calculate basic and diluted EPS

Ans: **Basic earnings per share**

	Full year
Numerator (₹)	29,00,000
Denominator:	
Ordinary shares outstanding	10,00,000
Retail site contingency (5,000 shares × 8/12) + (5,000 shares × 4/12)	5,000
Earnings contingency	-
Total shares	10,05,000
Basic earnings per share (Rs)	2.89

Note: The earnings contingency has no effect on basic earnings per share because it is not certain that the condition is satisfied until the end of the contingency period. The effect is negligible for the fourth-quarter and full-year calculations because it is not certain that the condition is met until the last day of the period.

Diluted earnings per share

	Full year
Numerator (₹)	29,00,000
Denominator:	
Ordinary shares	
Outstanding	10,00,000
Retail site contingency	10,000
Earnings contingency	9,00,000*
Total shares	19,10,000
Diluted earnings	
per share (₹)	1.52

* [(₹ 29,00,000 — ₹ 20,00,000) ÷ 1,000] × 1,000 shares = 9,00,000 shares.

Q12: An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three-year term, and are issued at par with a face value of ₹ 1,000 per bond, giving total proceeds of ₹ 20,00,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one ordinary share is ₹ 3. Income tax is ignored.

Profit attributable to ordinary equity holders of the parent entity Year 1	₹ 10,00,000
Ordinary shares outstanding	₹ 12,00,000
Convertible bonds outstanding	2,000

Calculate basic and diluted EPS when

Ans: Allocation of proceeds of the bond issue:

Liability component	₹ 18,48,122*
Equity component	₹ 1,51,878
	₹ 20,00,000

The liability and equity components would be determined in accordance with IND AS 32 Financial Instruments: Presentation. These amounts are recognised as the initial carrying amounts of the liability and equity components.

*This represents the present value of the principal and interest discounted at 9% ₹ 20,00,000 payable at the end of three years; ₹ 1,20,000 payable annually in arrears for three years.

Basic earnings per share Year 1:

₹ 10,00,000 / 1,200,000 = ₹ 0.83 per ordinary share

Diluted earnings per share Year 1:

It is presumed that the issuer will settle the contract by the issue of ordinary shares. The dilutive effect is therefore calculated as under.

[₹ 1,000,000 + Rs166,331[2]] / [1,200,000 + 500,000[3]] = ₹ 0.69 per ordinary share

[2] Profit is adjusted for the accretion of ₹ 166,331 (₹ 1,848,122 × 9%) of the liability because of the passage of time.

[3] 500,000 ordinary shares = 250 ordinary shares × 2,000 convertible bonds

Q13: An entity has two classes of shares in issue:

- 5,000 non-convertible preference shares
- 10,000 ordinary shares

The preference shares are entitled to a fixed dividend of ₹ 5 per share before any dividends are paid on the ordinary shares. Ordinary dividends are then paid in which the preference shareholders do not participate. Each preference share then participates in any additional ordinary dividend above ₹ 2 at a rate of 50% of any additional dividend payable on an ordinary share.

The entity's profit for the year is ₹ 100,000, and dividends of ₹ 2 per share are declared on the ordinary shares.

Compute the allocation of earnings for the purpose of calculation of Basic EPS when an entity has ordinary shares & participating equity instruments that are not convertible into ordinary shares.

Ans: The calculation of basic EPS is as follows:

₹	₹	
Profit		100,000
Less Dividends payable for the period:		
Preference (5,000 × ₹ 5)	25,000	
Ordinary (10,000 × ₹ 2)	20,000	(45,000)
Undistributed earnings		55,000
Allocation of undistributed earnings:		

Allocation per ordinary share = A

Allocation per preference share = B where B = 50% of A

(A × 10,000) + (50% × A × 5,000) = ₹ 55,000

A = 55,000 / (10,000 + 2,500) = ₹ 4.4

B = 50% of A

B = ₹ 2.2

Dividend per share are:	Preference	Ordinary
	shares	shares
	₹ per share	₹ per share
Distributed earnings	5.00	2.00
Undistributed earnings	2.20	4.40
Totals	7.20	6.40

Proof: (5,000 × ₹ 7.2) + (10,000 × ₹ 6.4) = ₹100,000

Q14:

1 January	Shares in issue	1,000,000
	5% Convertible bonds	₹ 100,000
	(terms of conversion 120 ordinary shares for ₹ 100)	
31 March	Holders of ₹ 25,000 bonds converted to ordinary shares.	

Profit for the year ended 31 December ₹ 200,000

Tax rate 30%.

Calculate basic and diluted EPS. Ignore the need to split the convertible bonds into liability and equity elements.

Ans:

	Number of shares	Profit ₹
Profit		200,000
Outstanding shares	1,000,000	
New shares on conversion (weighted average)		
9/12 × ₹ 25,000 / 100 × 120	22,500	-
Figures for basic EPS	1,022,500	200,000
Basic EPS is (₹ 200,000 / 1,022,500) = 0.196 per share		
Dilution adjustments		
Unconverted shares ₹ 75,000 / 100 × 120	90,000	
Interest: ₹ 75,000 × 5% × 0.7		2,625
Converted shares pre conversion adjustment		
3/12 × ₹ 25,000 / 100 × 120	7,500	
Interest: [3/12 × ₹ 25,000 × 5% × 0.7]		219
	1,120,000	202,844

Diluted EPS is (₹ 202,844 / 1,120,000) = 0.181

Q15: Calculate Subsidiary's and Group's Basic EPS and Diluted EPS, when:

Parent	
Profit attributable to ordinary equity holders of	₹ 12,000 (excluding any earnings of, or

the parent entity	dividends paid by, the subsidiary)
Ordinary shares outstanding	10,000
Instruments of subsidiary owned by the parent	800 ordinary shares
30 warrants exercisable to purchase ordinary shares of subsidiary	
300 convertible preference shares	
Subsidiary:	
Profit	₹ 5,400
Ordinary shares outstanding	1,000
Warrants	150, exercisable to purchase ordinary shares of the subsidiary
Exercise price	₹ 10
Average market price of one ordinary share	₹ 20
Convertible preference shares	400, each convertible into one ordinary share
Dividends on preference shares	Re 1 per share
No inter-company eliminations or adjustments were necessary except for dividends.	
Ignore income taxes. Also, ignore classification of the components of convertible financial instruments as liabilities and equity or the classification of related interest and dividends as expenses and equity as required by Ind AS 32.	

Ans: Subsidiary’s earnings per share

Basic EPS	₹ 5.00 calculated:	₹ 5,400 (a) – ₹400 (b)
		1,000 (c)
Diluted EPS	₹ 3.66 calculated:	₹ 5,400 (d)
		(1,000 + 75 (e) + 400(f))

Notes:

(a) Subsidiary's profit attributable to ordinary equity holders.

(b) Dividends paid by subsidiary on convertible preference shares.

(c) Subsidiary's ordinary shares outstanding.

(d) Subsidiary's profit attributable to ordinary equity holders (₹ 5,000) increased by ₹ 400 preference dividends for the purpose of calculating diluted earnings per share.

(e) Incremental shares from warrants, calculated: [(₹ 20 – ₹ 10) ÷ ₹ 20] × 150.

(f) Subsidiary's ordinary shares assumed outstanding from conversion of convertible preference shares, calculated: 400 convertible preference shares × conversion factor of 1.

Consolidated earnings per share

Consolidated earnings per share		
Basic EPS	₹ 1.63 calculated:	₹ 12,000(a) + ₹ 4,300(b)
		10,000(c)
Diluted EPS	₹ 1.61 calculated:	₹ 12,000 + ₹ 2,928(d) + ₹ 55(e) + ₹ 1,098(f)
		10,000

Notes:

(a) Parent's profit attributable to ordinary equity holders of the parent entity.

(b) Portion of subsidiary's profit to be included in consolidated basic earnings per share, calculated: (800 × ₹ 5.00) + (300 × Re 1.00).

(c) Parent's ordinary shares outstanding.

(d) Parent's proportionate interest in subsidiary's earnings attributable to ordinary shares, calculated: (800 ÷ 1,000) × (1,000 shares × ₹ 3.66 per share).

(e) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: (30 ÷ 150) × (75 incremental shares × ₹ 3.66 per share).

(f) Parent's proportionate interest in subsidiary's earnings attributable to convertible preference shares, calculated: (300 ÷ 400) × (400 shares from conversion × ₹ 3.66 per share).

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q16: Assume the following facts for Company XY:

Income from continuing operations:	INR 30,00,000
Loss from discontinued operations:	(INR 36,00,000)
Net loss:	(INR 6,00,000)
Weighted average Number of shares outstanding	10,00,000
Incremental common shares outstanding relating to stock options	2,00,000

a) You are required to calculate the basic and diluted EPS for Company XY from the above information.

b) Assume, if in above case, Loss from continued operations is ₹ 10,00,000 and income from discontinued operations is ₹ 36,00,000 calculate the diluted EPS.

Ans:

(a) **Step 1:**

Basic EPS= Profit for the year / Weighted average Number of shares outstanding

Basic EPS (Continued Operations) = Profit from continued operations / Weighted average Number of shares outstanding

= ₹ 30,00,000 / 10,00,000 = ₹ 3.00

Basic Loss per share (Discontinued operations) = Loss from discontinued operations / Weighted average Number of shares outstanding

= ₹ (36,00,000) / 10,00,000 = (₹ 3.60)

Overall Basic Loss per share = (₹ 6,00,000) / 10,00,000 = ₹ (0.60) (i)

Step 2: Calculation of Diluted EPS

Diluted EPS =Profit for the year / Adjusted Weighted average Number of shares outstanding

EPS (Continued Operations) = Profit from continued operations / Adjusted Weighted average Number of shares outstanding

= ₹ 30,00,000 / 12,00,000 = ₹ 2.50

Loss per share (Discontinued operations) = Loss from discontinued operations / Adjusted weighted average number of shares outstanding

= ₹ (36,00,000) / 12,00,000 = (₹ 3.00)

Overall Diluted Loss per share = ₹ 6,00,000 / 12,00,000 = ₹ (0.50) (ii)

The income from continuing operations is the control number, there is a dilution in basic EPS for income from continuing operations (reduction of EPS from ₹ 3.00 to ₹ 2.50). Therefore, even though there is an anti-dilution [Loss per share reduced from ₹ 0.60 (i) to ₹ 0.50 (ii) above], diluted loss per share of ₹ 0.50 is reported.

(b) In case of loss from continuing operations, the potential shares are excluded since including those shares would result into anti-dilution effect on the control number (loss from continuing operations). Therefore, the diluted EPS will be calculated as under:

Diluted EPS = Profit for the year / Adjusted weighted average number of shares outstanding Overall Profit = Loss from continuing operations + Gain from discontinued operations

= ₹ (10,00,000) + ₹ 36,00,000

= ₹ 26,00,000

Weighted average number of shares outstanding = 10,00,000 Diluted EPS = ₹ 2.60

The dilutive effect of the potential common shares on EPS for income from discontinued operations and net income would not be reported because of the loss from continuing operations.

QUESTIONS FROM OTHER SOURCES

Q17: ABC Company has issued contingently issuable shares on 1st January 20X1. The condition to be satisfied is the average turnover of the company for last three quarters must exceed ₹ 100 million. If the condition is satisfied the company will issue the shares within a period of 6 months. The conditions will be effective from the quarter ending 31st March 20X1. Company achieves the said target on ending 31st December 20X1.

Explain what will be the status of shares while calculating diluted EPS?

Ans: In the above case, company will calculate its average turnover for last 3 quarter, every quarter starting from 31st March 20X1.

Average of 3 quarters ending 31st March 20X1 – Not achieved – Therefore shares will not be included in Basic as well as Diluted for the year 20X0-20X1

Average of 3 quarters ending 30th June 20X1, September 20X1 – Target not achieved therefore shares will not be considered for calculation of Basic as well as Diluted.

Average of 3 quarters ending on 31st of December 20X2 – Targeted turnover is achieved. Thus the contingent condition which was needed to be satisfied for, is satisfied. Therefore, the shares will be considered for calculation of Basic and diluted EPS for the 20X1-20X2. The date that would be considered for calculation of weighted average number of shares will be 31st December 20X1. The shares can be issued at any time during 6 months period. Therefore, shares can be issued at any moment of time from the 1st January 20X2 to 30th June 20X2. In this case, for calculation of weighted average number of shares for years 20X1-20X2, the period that will be considered would be 1st January 20X2 to 31st March 20X2. For 20X2-20X3 the period will start from 1st April 20X2. After 30th June 20X2, all the share will become ordinary shares (those actually issued) and there will not be any shares for diluted as the date of agreement is over, contingent condition is met.

Q18: On 1st July 20X1, PQR company enters into a contract with its strategic partner ABC co. that 10000 shares of PQR would be issued to ABC Co, when PQR will achieve the net profit before tax of ₹1crore and will continue to retain the same profit for minimum of another 1 year. What will be the status of 10,000 shares in calculation of Basic and diluted EPS for various financial years, assuming that company achieves the profit of ₹ 90 lacs, ₹ 1.2 crores and ₹ 1.35 crores in the year 20X1-20X2, 20X2-20X3 and 20X3-20X4 respectively.

Ans: Here there is a basic requirement of achievement of profit of ₹ 1 crore plus, there is a requirement of continuation of a profit more than ₹1 crore for 1 more year. Thus as mentioned in above condition, attainment of a condition and continuation of condition is discussed in abovementioned case.

Year 20X1-20X2 – The company has not achieved the target, therefore the number of shares will not be part of Basic as well as diluted EPS for the years 20X1-20X2

Year 20X2-20X3 – The company has achieved the targeted profit of ₹1crore profit before tax. However, the condition is that it should be continued for 1 more year. Therefore 10,000 shares cannot be considered for basic EPS, as all the conditions needed are not satisfied. But as one of the condition of attainment of basic profit is achieved, it will be considered for calculation of Diluted EPS for the year 20X2-20X3, if the effect is dilutive. Here it will be assumed that the company will get the profit of ₹1 crore and more next year as well.

Year 20X3-20X4- Company has attained the required profit and also maintained the profit for one more year. Therefore, all the contingent conditions are satisfied. Therefore, the shares will be part of Basic as well as Diluted EPS for year 20X3-20X4.

Year 20X4-20X5 – Assuming that the shares will be actually issued to ABC Co, in 20X4-20X5, the shares will be part of Basic EPS as well as the diluted.

The above provisions are given in the following table

Year	Basic	Dilutes
20X1-20X2	Not Included	Not Included
20X2-20X3	Not Included	Included
20X3-20X4	Included	Included

Q19: ABC Company appoints CA X as CFO of the company on 1st July 20X1. The company enters into an agreement with CA X that the company would issue 1000 shares to her, if she can achieve the 20% rise in the market value of the share by end of 1 year of her appointment. The current market value of the share is ₹ 500 per share.

What will be the status of the shares for calculation of EPS, for the year 20X1-20X2 and 20X2-20X3 assuming the prices of the shares are as follow:

On 31st March 20X2 – ₹ 620

On 30th June 20X2 – ₹ 610

What if, the expected market value of the shares is not achieved either on 31st March or 30th June?

Ans: **Year 20X1-20X2 :**For the year 20X1-20X2 – on 31st March 20X2, the period for contingency is not yet over. The condition needs to be satisfied after 1 year after appointment of CFO. Therefore, end of contingency period will be 30th June 20X2. But as on the end of reporting date i.e. 31st March 20X2, the contingent condition, i.e. increase in the market value of the share by 20% (from ₹ 500 to more than ₹ 600) is already achieved. Therefore, these shares will be treated as outstanding while calculation of diluted EPS because the provisions say if the effect is dilutive, the calculation of diluted earnings per share is based on the number of ordinary shares that would be issued if the market price at the end of the reporting period were the market price at the end of the contingency period. The market price at the end of contingent period need to be more than ₹600. However, that price is already achieved and accordingly the provisions will apply.

However, shall company include the shares in calculation of BASIC EPS as well?

No., since the market price may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares until the end of the contingency period because not all necessary conditions have been satisfied. One cannot predict the situation on 30th June 20X2. The share prices may go up or may come down also. Therefore, all the conditions cannot be termed as satisfied and therefore the shares will not be included in Basic EPS.

Year 20X2-20X3

On 30th June 20X2, the prices of the shares are ₹ 610 which are already exceeding the contingent condition. Therefore, all the conditions are satisfied as per the contract. Time as well as price of the shares. Therefore, now the shares will be eligible for calculation of Basic as well Diluted EPS. When the shares will be actually issued they will be very much part of ordinary shares, and will form of Basic EPS only and not the diluted EPS.

If the expected market value of the shares is not achieved either on 31st March or 30th June.: If the expected market value is not achieved, i.e. if the market value is less than ₹ 600, then the conditions for issues of shares are not satisfied and therefore the shares will neither be part of basic nor of diluted EPS for the years 20X1-20X2 as well as year 20X2-20X3.

QUESTIONS FROM RTP/MTP/EXAMS

Q20: P Ltd. is a subsidiary company of ABC Ltd. It preparing both Separate financial statement (SFS) and consolidated financial statements (CFS) for the year ending on 31st March, 20XI. It has net profit after tax of ₹ 20,00,000 as per SFS & ₹ 16,00,000 as per CFS. Share capital of P Ltd. is 2,00,000 shares of ₹ 10 each. ABC Ltd. has acquired 80% shares of P Ltd. Accountant of P Ltd. had calculated following Basic EPS for its SFS:

Calculation of Basic EPS in its SFS	
Net Profit after tax	₹ 16,00,000
Number of equity shares attributable to Parent company ABC Ltd. (2,00,000 x 80%)	1,60,000 shares
Basic EPS	₹ 10 per share

Examine the correctness of the above presentation of Basic EPS. **[RTP May 2018]**

Ans: As per paragraph 4 of Ind AS 33 "Earnings per Share", when an entity presents both consolidated financial statements and separate financial statements prepared in accordance with Ind AS 110, Consolidated Financial Statements, and Ind AS 27, Separate Financial Statements, respectively, the disclosures required by this Standard shall be presented both in the consolidated financial statements and separate financial statements. In consolidated financial statements such disclosures shall be based on consolidated information and in separate financial statements such disclosures shall be based on information given in separate financial statements. An entity shall not present in consolidated financial statements, earnings per share based on the information given in separate financial statements and shall not present in separate financial statements, earnings per share based on the information given in consolidated financial statements.

Also paragraph 9 of the standard states that an entity shall calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity and, if presented, profit or loss from continuing operations attributable to those equity holders.

Further, paragraph A1 of Appendix A of Ind AS 33 states that for the purpose of calculating earnings per share based on the consolidated financial statements, profit or loss attributable to the parent entity refers to profit or loss of the consolidated entity after adjusting for non-controlling interests.

Therefore. the requirements of paragraph 9 of Ind AS 33 have been provided in the context of calculating EPS in the consolidated financial statements of an entity.

The accountants of P Ltd. had followed this for calculation of Basic EPS in its SFS. As per ITFG Bulletin 11, for SFS analogy may be drawn from paragraph 9 of Ind AS 33 that in case of separate financial statements, the parent entity mentioned in paragraph 9 will imply the legal entity of which separate financial statements are being prepared and accordingly, when an entity presents EPS in its separate financial statements, then the same shall be calculated based on the profit or loss attributable to its equity shareholders.

Hence, the presentation of Basic EPS by the Accountant of P Ltd. on the basis of consolidated financial statements in its separate financial statements is not correct. The correct presentation of Basic EPS would be as follows:

Calculation of Basic EPS of P Ltd. in SFS	
Net Profit after tax	₹ 20,00,000
No. of share issued	2,00,000 shares
Basic EPS	₹ 10 per share

Q21: CAB Limited is in the process of preparation of the consolidated financial statements of the group for the year ending 31st March, 20X3 and the extract of the same is as follows:

Particulars	**Attributable to CAB Limited**	**Non-controlling interest**	**Total (₹ in '000)**
Profit for the year	39,000	3,000	42,000
Other Comprehensive Income	5,000	Nil	5,000
Total Comprehensive Income	44,000	3,000	47,000

The long-term finance of the company comprises of the following:

a. 20,00,00,000 equity shares at the beginning of the year and the company has issued 5,00,00,000 shares on 1st July, 20X2 at full market value.

b. 8,00,00,000 irredeemable preference shares. These shares were in issue for the whole of the year ended 31st March, 20X3. The dividend on these preference shares is discretionary.

c. ₹ 18 crores of 6% convertible debentures issued on 1st April, 20X1 and repayable on 31st March, 20X5 at par. Interest is payable annually. As an alternative to repayment at par, the holder on maturity can elect to exchange their convertible debentures for 10 crores ordinary shares in the company. On 1st April, 20X1, the prevailing market interest rate for four-year convertible debentures which had no right of conversion was 8%. Using an annual discount rate of 8%, the present value of ₹ 1 payable in four years is 0.74 and the cumulative present value of ₹ 1 payable at the end of years one to four is 3.31.

In the year ended 31st March, 20X3, CAB Limited declared an ordinary dividend of 0.10 paise per share and a dividend of 0.05 paise per share on the irredeemable preference shares.

Compute the following:

a. The finance cost of convertible debentures and its closing balance as on 31st March, 20X3 to be presented in the consolidated financial statements.

b. The basic and diluted earnings per share for the year ended 31 st March, 20X3. Assume that income tax is applicable to CAB Limited and its subsidiaries at 25%.

[RTP May 2020]

Ans: Calculation of the liability and equity components on 6% Convertible debentures:

Present value of principal payable at the end of 4th year (₹ 1,80,000 thousand x 0.74) = ₹ 1,33,200 thousand

Present value of interest payable annually for 4 years (₹ 1,80,000 thousand x 6% x 3.31) = ₹ 35,748 thousand

Total liability component = ₹ 1,68,948 thousand

Therefore, equity component = ₹ 1,80,000 thousand – ₹ 1,68,948 thousand

= ₹ 11,052 thousand

Calculation of finance cost and closing balance of 6% convertible debentures

Year	Opening balance ₹ in '000	Finance cost @ 8% ₹ in '000	Interest paid @ 6% ₹ in '000	Closing balance ₹ in '000
	a	b = a x 8%	c	d = a + b - c
31.3.20X2	1,68,948	13,515.84	10,800	1,71,663.84
31.3.20X3	1,71,663.84	13,733.11	10,800	1,74,596.95

Finance cost of convertible debentures for the year ended 31.3. 20X3 is ₹ 13,733.11 thousand and closing balance as on 31.3. 20X3 is ₹ 1,74,596.95 thousand.

Calculation of Basic EPS **₹ in '000**

Profit for the year	39,000
Less: Dividend on preference shares (80,000 thousand x ₹ 0.05)	(4,000)
Profit attributable to equity shareholders	35,000

Weighted average number of shares = 20,00,00,000 + {5,00,00,000 x (9/12)}

= 23,75,00,000 shares or 2,37,500 thousand shares

Basic EPS = ₹ 35,000 thousand / 2,37,500 thousand shares = ₹ 0.147

Calculation of Diluted EPS ₹ in '000

Profit for the year		39,000
Less: Dividend on preference shares (80,000 x 0.05)		(4,000)
		35,000
Add: Finance cost (as given in the above table)	13,733.11	
Less: Tax @ 25%	(3,433.28)	10,299.83
		45,299.83

Weighted average number of shares

= 20,00,00,000 + {5,00,00,000 x (9/12)} + 10,00,00,000

= 33,75,00,000 shares or 3,37,500 thousand shares

Diluted EPS = ₹ 45,299.83 thousand / 3,37,500 thousand shares

= ₹ 0.134 to be continue 27

Q22 The following information is available relating to Space India Limited for the Financial Year 2019-2020.

Net profit attributable to equity shareholders	₹ 90,000
Number of equity shares outstanding	16,000
Average fair value of one equity share during the year	₹ 90

Potential Ordinary Shares:

Options	900 options with exercise price of ₹ 75
Convertible Preference Shares	7,500 shares entitled to a cumulative dividend of ₹ 9 per share. Each preference share is convertible into 2 equity shares.
Applicable corporate dividend tax	8%
10% Convertible Debentures of ₹ 100 each	₹ 10,00,000 and each debenture is convertible into 4 equity shares
Tax rate	25%

You are required to compute Basic and Diluted EPS of the company for the Financial Year 2019-2020.

Exam Paper November 2020 (8 Marks)

Ans. (i) Basic Earnings per share

	Year ended 31.3.2020
Net profit attributable to equity shareholders (A)	₹ 90,000
Number of equity shares outstanding (B)	16,000
Earnings per share (A/B)	₹ 5.625

(ii) Diluted earnings per share

Options are most dilutive as their earnings per incremental share is nil. Hence, for the purpose of computation of diluted earnings per share, options will be considered first. 10% convertible debentures being second most dilutive will be considered next and thereafter convertible preference shares will be considered (as per W.N.).

	Net profit attributable to equity shareholders ₹	No. of equity shares	Net Profit attributable per share ₹	
Net profit attributable to	90,000	16,000	5.625	

equity shareholders				
Options		150		
	90,000	16,150	5.572	Dilutive
10% Convertible debentures	75,000	40,000		
1,65,000		56,150	2.939	Dilutive
Convertible Preference Shares	72,900	15,000		
	2,37,900	71,150	3.344	Anti-Dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (₹ 2.939 to ₹ 3.344), the convertible preference shares are anti- dilutive and are ignored in the calculation of diluted earnings per share for the year ended 31 March 2020. Therefore, diluted earnings per share for the year ended 31 March 2020 is ₹ 2.939.

Working Note:

Calculation of incremental earnings per share and allocation of rank

	Increase in earnings (1)	**Increase in number of equity shares (2)**	**Earnings per incremental share (3) = (1) ÷ (2)**	**Rank**
	₹		₹	
Options				
Increase in earnings	Nil			
No. of incremental shares issued for no consideration [900 x (90-75)/90]		150	Nil	1
Convertible Preference Shares				
Increase in net profit attributable to equity shareholders as adjusted by attributable dividend tax [(₹ 9 x 7,500) + 8% (₹ 9 x 7,500)]	72,900			
No. of incremental shares (2 x 7,500)		15,000	4.86	3

10% Convertible Debentures			
Increase in net profit [(₹ 10,00,000 x 10% x (1 – 0.25)]	75,000		
No. of incremental shares (10,000 x 4)	40,000	1.875	2

Note: Grossing up of preference share dividend has been ignored here. At present dividend distribution tax has been abolished. However, the question has been solved on the basis of the information given in the question.

NOTES

CHAPTER 31

FIRST-TIME ADOPTION OF IND AS (IND AS 101)

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: X Ltd. is required to adopt Ind AS from April 1, 20X1, with comparatives for one year, i.e., for 20X0-20X1. What will be its date of transition?

Ans: The date of transition for X Ltd. will be April 1, 20X0 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to adopt an Ind AS from April 1, 20X1 (i.e. year 20X1-20X2), and it will give comparatives as per Ind AS for 20X0-20X1. Accordingly, the beginning of the comparative period will be April 1, 20X0 which will be considered as date of transition.

Previous GAAP

Q2: Company B is a foreign subsidiary of Company A and has adopted IFRS as issued by IASB as its primary GAAP for its local financial reporting purposes. Company B prepares its financial statements as per Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 for the purpose of consolidation with Company A. On transition of Company A to Ind-AS, what would be the previous GAAP of the foreign subsidiary Company B for its financial statements prepared for consolidation with Company A?

Ans: Ind AS 101 defines previous GAAP as the basis of accounting that a first-time adopter used for its statutory reporting requirements in India (emphasis added) immediately before adopting Ind AS. For instance, companies preparing their financial statements in accordance with the Accounting Standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts) Rules, 2014 shall consider those financial statements as previous GAAP financial statements.

Accordingly, the previous GAAP of the foreign subsidiary for the purpose of consolidation under Ind-AS with the parent company would be accounting standards specified under Section 133 of the Companies Act, 2013 read with Rule 7 of the Companies (Accounts)

Rules, 2014 and not the IFRS as issued by the IASB since the first time adoption has to be considered in the context of India only.

First Ind AS financial statements

Q3: E Ltd. is required to first time adopt Indian Accounting Standards (Ind AS) from April 1, 2016. The management of E Ltd. has prepared its financial statements in accordance with Ind AS and an explicit and unreserved statement of compliance with Ind AS has been given. However, the there is a disagreement on application of one Ind AS. Can such financial statements of E Ltd. be treated as first Ind AS financial statements?

Ans: Ind AS 101 defines first Ind AS financial statements as "The first annual financial statements in which an entity adopts Indian Accounting Standards (Ind AS), by an explicit and unreserved statement of compliance with Ind AS." In accordance with the above definition, if an explicit and unreserved statement of compliance with Ind AS has been given in the financial statements, even if the auditor's report contains a qualification because of disagreement on application of Indian Accounting Standard(s), it would be considered that E Ltd. has done the first time adoption of Ind AS. In such a case, exemptions given under Ind AS 101 cannot be availed again. If, however, the unreserved statement of compliance with Ind AS is not given in the financial statements, such financial statements would not be considered to be first Ind AS financial statements.

Date of Transition

Q4: X Ltd. is required to adopt Ind AS from April 1, 20X1, with comparatives for one year, i.e., for20X0-20X1. What will be its date of transition?

Ans: The date of transition for X Ltd. will be April 1, 20X0 being the beginning of the earliest comparative period presented. To explain it further, X Ltd. is required to adopt an Ind AS from April 1, 20X1,and it will give comparatives as per Ind AS for 20X0-20X1. Accordingly, the beginning of the comparative period will be April 1, 20X0 which will be considered as date of transition.

Non-controlling interests

Q5: Ind AS requires allocation of losses to the non-controlling interest, which may ultimately lead to a debit balance in non-controlling interests, even if there is no contract with the non-controlling interest holders to contribute assets to the Company to fund the losses. Whether this adjustment is required or permitted to be made retrospectively?

Ans: In case an entity elects not to restate past business combinations, Ind AS 101 requires the measurement of non-controlling interests (NCI) to follow from the measurement of other assets and liabilities on transition to Ind AS. However, Ind AS 101 contains a mandatory exception that prohibits retrospective allocation of accumulated profits between the owners of the parent and the NCI. In case an entity elects not to restate past business combinations, the previous GAAP carrying value of NCI is not changed other than for adjustments made(remeasurement of the assets and liabilities subsequent to the business combination) as part of the transition to Ind AS. As such, the carrying value of NCI in the opening Ind AS balance sheet cannot have a deficit balance on account of recognition of the losses attributable tithe minority interest, which was not recognised under the previous GAAP as part of NCI in the absence of contract to contribute assets to fund such a deficit. However, the NCI could have a deficit balance due to remeasurement of the assets and liabilities subsequent to the business combination as part of the transition to Ind AS. In case an entity restates past business combination, Ind AS 101 requires that the balance in NCI as at the date of transition shall be determined retrospectively in accordance with Ind AS, taking into account the impact of other elections made as part of the adoption of Ind AS. As such, the NCI could have a deficit balance on account of losses attributable to the NCI, even if there is no obligation on the holders of NCI to contribute assets to fund such a deficit.

Business combination

Q6: A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

Ans: In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values, as at the date of transition, of investments in subsidiaries, associates and joint ventures as its deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of such investments are not adjusted. Accordingly, any adjustments in relation to recognition of contingent consideration on first time adoption shall be made in the statement of profit and loss.

Business combination

Q7: A Ltd. had made certain investments in B Ltd's convertible debt instruments. The conversion rights are substantive rights and would provide A Ltd. with a controlling stake over B Ltd. A Ltd. has evaluated that B Ltd. would be treated as its subsidiary under Ind AS and, hence, would require consolidation in its Ind AS consolidated financial statements. B Ltd. was not considered as a subsidiary, associate or a joint venture under previous GAAP. How should B Ltd. be consolidated on transition to Ind AS assuming that A Ltd. has opted to avail the exemption from retrospective restatement of past business combinations?

Ans: Ind AS 101 prescribes an optional exemption from retrospective restatement in relation to past business combinations. Ind AS 101 prescribes that when the past business combinations are not restated and a parent entity had not consolidated an entity as a subsidiary in accordance with its previous GAAP (either because it was not regarded as a subsidiary or no consolidated financial statements were required under previous GAAP), then the subsidiary's assets and liabilities would be included in the parent's opening consolidated financial statements at such values as would appear in the subsidiary's separate financial statements if the subsidiary were to adopt the Ind AS as at the parent's date of transition. For this purpose, the subsidiary's separate financial statements would be prepared as if it was a first-time adopter of Ind AS i.e. after availing relevant first-time adoption mandatory exceptions and voluntary exemptions. In other words, the parent will adjust the carrying amount of the subsidiary's assets and liabilities to the amounts that Ind AS would require in the subsidiary's balance sheet.

The deemed cost of goodwill equals the difference at the date of transition between:

(a) the parent's interest in those adjusted carrying amount; and

(b) the cost in the parent's separate financial statements of its investment in the subsidiary.

The measurement of non-controlling interest and deferred tax follows from the measurement of other assets and liabilities.

It may be noted here that the above exemption is available only under those circumstances where the parent, in accordance with the previous GAAP, has not presented consolidated financial statements for the previous year; or where the consolidated financial statements were prepared in accordance with the previous GAAP but the entity was not treated as a subsidiary, associate or joint venture under the previous GAAP. As such, if the consolidated financial statements were required to be prepared and there is a change in classification of the entity from subsidiary to associate or vice versa in accordance with Ind AS, then the above exemption does not apply.

Business combination

Q8: A Ltd. has a subsidiary B Ltd. On first time adoption of Ind AS by B Ltd., it availed the optional exemption of not restating its past business combinations. However, A Ltd. in its consolidated financial statements has decided to restate all its past business combinations. Whether the amounts recorded by subsidiary need to be adjusted while preparing the consolidated financial statements of A Ltd. considering that A Ltd. does not avail the business combination exemption? Will the answer be different if the A Ltd. adopts Ind AS after the B Ltd?

Ans: As per Ind AS 101: "A first-time adopter may elect not to apply Ind AS 103 retrospectively to past business combinations (business combinations that occurred before the date of transition to Ind AS). However, if a first-time adopter restates any business combination to comply with Ind AS 103, it shall restate all later business combinations and shall also apply Ind AS 110 from that same date.

For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 20X0, it shall restate all business combinations that occurred between 30 June 20X0 and the date of transition to Ind AS, and it shall also apply Ind AS 110 from 30 June 20X0." Based on the above, if A Ltd. restates past business combinations, it would have to be applied to all business combinations of the group including those by subsidiary B Ltd. for the purpose of Consolidated Financial Statements. Ind AS 101 states, "However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary." Thus, in case where the parent adopts Ind AS later than the subsidiary then it does not change the amounts already recognised by the subsidiary.

Business combination

Q9: Company A intends to restate its past business combinations with effect from 30 June 2010(being a date prior to the transition date). If business combinations are restated, whether certain other exemptions, such as the deemed cost exemption for property, plant and equipment (PPE), can be adopted?

Ans: Ind-AS 101 prescribes that an entity may elect to use one or more of the exemptions of the Standard. As such, an entity may choose to adopt a combination of optional exemptions in relation to the underlying account balances.

When the past business combinations after a particular date (30 June 2010 in the given case)are restated, it requires retrospective adjustments to the carrying amounts of acquiree's assets and liabilities on account of initial acquisition accounting of the acquiree's net assets, the effects of subsequent measurement of those net assets (including amortisation of non-current assets that were recognised at its fair value), goodwill on consolidation and the consolidation adjustments. Therefore, the goodwill and equity (including non-controlling interest (NCI)) cannot be computed by considering the deemed cost exemption for PPE.

However, the entity may adopt the deemed cost exemption for its property, plant and equipment other than those acquired through business combinations.

Deemed cost for PPE and intangible assets

Q10: X Ltd. is the holding company of Y Ltd. X Ltd. is required to adopt Ind AS from April 1, 2016. X Ltd. wants to avail the optional exemption of using the previous GAAP carrying values in respect of its property, plant and equipment whereas Y Ltd. wants to use fair value of its property, plant and equipment as its deemed cost on the date of transition. Examine whether X Ltd. can do so for its consolidated financial statements. Also, examine whether different entities in a group can use different basis for arriving at deemed cost for property, plant and equipment in their respective standalone financial statements

Ans: Where there is no change in its functional currency on the date of transition to Ind AS, a first time adopter to Ind AS may elect to continue with the carrying value of all of its property, plant and equipment as at the date of transition measured as per the previous GAAP and use that as its deemed cost at the date of transition after making necessary adjustments. If a first time adopter chooses this option then the option of applying this on selective basis to some of the items of property, plant and equipment and using fair value for others is not available. Nothing prevents different entities within a group to choose different basis for arriving at deemed cost for the standalone financial statements. However, in Consolidated Financial Statements, the entire group should be treated as one reporting entity. Accordingly, it will not be permissible to use different basis for arriving at the deemed cost of property, plant and equipment on the date of transition by different entities of the group for the purpose of preparing Consolidated Financial Statements.

Deemed cost for PPE and intangible assets

Q11: For the purpose of deemed cost on the date of transition, an entity has the option of using the carrying value as the deemed cost. In this context, suggest which carrying value is to be considered as deemed cost: original cost or net book value? Also examine whether this would have any impact on future depreciation charge?

Ans: For the purpose of deemed cost on the date of transition, if an entity uses the carrying value as the deemed cost, then it should consider the net book value on the date of transition as the deemed cost and not the original cost because carrying value here means net book value. The future depreciation charge will be based on the net book value and the remaining useful life on the date of transition. Further, as per the requirements of Ind AS 16, the depreciation method, residual value and useful life need to be reviewed atleast annually. As a result of this, the depreciation charge may or may not be the same as the depreciation charge under the previous GAAP.

Deemed cost for PPE and intangible assets

Q12: Is it possible for an entity to allocate cost as per the previous GAAP to a component based on its fair value on the date of transition even when it does not have the component-wise historical cost?

Ans: Yes, an entity can allocate cost to a component based on its fair value on the date of transition. This is permissible even when the entity does not have component-wise historical cost.

Deemed cost for PPE and intangible assets

Q13: Revaluation under previous GAAP can be considered as deemed cost if the revaluation was, at the date of the revaluation, broadly comparable to fair value or cost or depreciated cost of assets in accordance with Ind AS, adjusted to reflect, e.g., changes in a general or specific price index. What is the acceptable time gap of such revaluation from the date of transition? Can adjustments be made to take effects of events subsequent to revaluation?

Ans: There are no specific guidelines in Ind AS 101 to indicate the acceptable time gap of such revaluation from the date of transition. The management of an entity needs to exercise judgement in this regard. However, generally, a period of 2–3 years may be treated as an acceptable time gap of such revaluation from the date of transition. In any case, adjustments should be made to reflect the effect of material events subsequent to revaluation.

Deemed cost for PPE and intangible assets

Q14: X Ltd. was using cost model for its property, plant and equipment till March 31, 2016 under previous GAAP. The Ind AS become applicable to the company for financial year beginning April 1, 2016. On April 1, 2015, i.e., the date of its transition to Ind AS, it used fair value as the deemed cost in respect of its property, plant and equipment. X Ltd. wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements. Whether use of fair values as deemed cost on the date of transition and use of revaluation model in the first annual Ind AS financial statements would amount to a change in accounting policy?

Ans: In the instant case, X Ltd. is using revaluation model for property, plant and equipment for the first annual Ind AS financial statements and using fair value of property, plant and equipment on the date of the transition, as deemed cost. Since the entity is using fair value at the transition date as well as in the first Ind AS financial statements, there is no change in accounting policy and mere use of the term ‘deemed cost’ would not mean that there is a change in accounting policy.

Long- term foreign currency monetary

Q15: Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. On the date of transition, there is a long- term foreign currency monetary liability of ₹ 60 crores

(US $ 10 million converted at an exchange rate of US $ 1 = ₹ 21 60). The accumulated exchange difference on the date of transition is nil since Y Ltd. was following AS 11 notified under the Companies (Accounting Standards) Rules, 2006 and has not exercised the option provided in paragraph 46/46A of AS 11. The Company wants to avail the option under paragraph 46A of AS

11 prospectively or retrospectively on the date of transition to Ind AS. How should it account for the translation differences in respect of this item under Ind AS 101?

Ans: Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP.

If the Company wants to avail the option prospectively: The Company cannot avail the exemption given in Ind AS 101 and cannot exercise option under paragraph 46/46A of AS 11, prospectively, on the date of transition to Ind AS in respect of Long term foreign currency monetary liability existing on the date of transition as the company has not availed the option under paragraph 46/46A earlier. Therefore, the Company need to recognise the exchange differences in accordance with the requirements of Ind AS 21, The Effects of Changes in Foreign Exchange Rates which requires all foreign exchange differences to be recognised in profit or loss, except such foreign exchange differences which are accounted for as an adjustment to borrowing costs in accordance with Ind AS 23.

If the Company wants to avail the option retrospectively: The Company cannot avail the exemption given in Ind AS 101 and cannot exercise the option under paragraph 46/46A of AS 11 retrospectively on the date of transition to Ind AS in respect of long term foreign currency monetary liability that existed on the date of transition since the option is available only if it is in continuation of the accounting policy followed in accordance with the previous GAAP. Y Ltd. has not been using the option provided in Para 46/ 46A of AS 11, hence, it will not be permitted to use the option given in Ind AS 101 retrospectively.

Long- term foreign currency monetary

Q16: Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 2015. On April 1, 2010, it obtained a 7 year US$ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition, the company wants to continue the same accounting policy with regard to amortising of exchange differences. Whether the Company is permitted to do so?

Ans: Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. In view of the above, the Company can continue to follow the existing accounting policy of amortising the exchange differences in respect of this loan over the balance period of such long term liability.

Long- term foreign currency monetary

Q17: Y Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 2015. On April 1,2010, it obtained a 7 year US $ 1,00,000 loan. It has been exercising the option provided in Paragraph 46/46A of AS 11 and has been amortising the exchange differences in respect of this loan over the balance period of such loan. On the date of transition to Ind AS, Y Ltd. wants to discontinue the accounting policy as per the previous GAAP and follow the requirements of Ind AS 21, The

Effects of Changes in Foreign Exchange Rates with respect to recognition of foreign exchange differences. Whether the Company is permitted to do so?

Ans: Ind AS 101 provides that a first-time adopter may continue the policy adopted for accounting for exchange differences arising from translation of long-term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Ind AS 101gives an option to continue the existing accounting policy. Hence, Y Ltd. may opt for discontinuation of accounting policy as per previous GAAP and follow the requirements of Ind AS 21. The cumulative amount lying in the FCMITDA should be derecognised by an adjustment against retained earnings on the date of transition.

Long- term foreign currency monetary

Q18: A company has chosen to elect the deemed cost exemption in accordance with Ind AS 101.However, it does not wish to continue with its existing policy of capitalising exchange fluctuation on long term foreign currency monetary items to fixed assets i.e. it does not want to elect the exemption available as per Ind AS 101. In such a case, how would the company be required to adjust the foreign exchange fluctuation already capitalised to the cost of property, plant and equipment under previous GAAP?

Ans: Ind AS 101 permits to continue with the carrying value for all of its property, plant and equipment as per the previous GAAP and use that as deemed cost for the purposes of first time adoption of Ind AS. Accordingly, the carrying value of property, plant and equipment as per previous GAAP as at the date of transition need not be adjusted for the exchange fluctuations capitalized to property, plant and equipment. Separately, it allows a company to continue with its existing policy for accounting for exchange differences arising from translation of long term foreign currency monetary items recognised in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. Accordingly, given that Ind AS 101 provides these two choices independent of each other, it may be possible for an entity to choose the deemed cost exemption for all of its property, plant and equipment and not elect the exemption of continuing the previous GAAP policy of capitalising exchange fluctuation to property, plant and equipment. In such a case, in the given case, a harmonious interpretation of the two exemptions would require the company to recognise the property, plant and equipment at the transition date at the previous GAAP carrying value (without any adjustment for the exchanges differences capitalized under previous GAAP) but for the purposes of the first (and all subsequent) Ind AS financial statements, foreign exchange fluctuation on all long term foreign currency borrowings would be recognised in the statement of profit and loss.

Investment in subsidiaries, joint ventures and associates

Q19: A Ltd. acquired B Ltd. in a business combination transaction. A Ltd. agreed to pay certain contingent consideration (liability classified) to B Ltd. As part of its investment in its separate financial statements, A Ltd. did not recognise the said contingent consideration (since it was not considered probable) A Ltd. considered the previous GAAP carrying amounts of investment as its deemed cost on first-time adoption. In that case, does the carrying amount of investment required to be adjusted for this transaction?

Ans: In accordance with Ind AS 101, an entity has an option to treat the previous GAAP carrying values, as at the date of transition, of investments in subsidiaries, associates and joint ventures as its deemed cost on transition to Ind AS. If such an exemption is adopted, then the carrying values of such investments are not adjusted. Accordingly, any adjustments in relation to recognition of contingent consideration on first time adoption shall be made in the statement of profit and loss.

Shares Based Payment

Q20: X Ltd. is a first time adopter of Ind AS. The date of transition is April 1, 20X1. It has given 200 stock options to its employees. Out of these, 75 options have vested on November 30, 20X0 and the remaining 125 will vest on November 30, 20X1. What are the options available to X Ltd. at the date of transition?

Ans: Ind AS 101 provides that a first-time adopter is encouraged, but not required, to apply Ind AS 102 on 'Share-based Payment' to equity instruments that vested before the date of transition to Ind-AS. However, if a first time adopter elects to apply Ind AS 102 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.

Having regard to the above, X Ltd. has the following options:

- For 75 options that vested before the date of transition:

  (a) To apply Ind AS 102 and account for the same accordingly, provided it has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in Ind AS 102.

  (b) Not to apply Ind AS 102.

  However, for all grants of equity instruments to which Ind AS 102 has not been applied, i.e., equity instruments vested but not settled before date of transition to Ind AS, X Ltd. would still need to disclose the information.

- For 125 options that will vest after the date of transition: X Ltd. will need to account for the same as per Ind AS 102.

Compound financial instruments

Q21: On April 1, 20X1, Sigma Ltd. issued 30,000 6% convertible debentures of face value of ₹ 100 per debenture at par. The debentures are redeemable at a premium of 10% on 31 March 20X5 or these may be converted into ordinary shares at the option of the holder. The interest rate for equivalent debentures without conversion rights would have been 10%. The date of transition to Ind AS is 1 April 20X3. Suggest how should Sigma Ltd. account for this compound financial instrument on the date of transition. The present value of ₹ 1 receivable at the end of each year based on discount rates of 6% and 10% can be taken as:

End of year	*6%*	*10%*
1	*0.94*	*0.91*
2	*0.89*	*0.83*

3	*0.84*	*0.75*
4	*0.79*	*0.68*

Ans: The carrying amount of the debenture on the date of transition under previous GAAP, assuming that all interest accrued other than premium on redemption have been paid, will be ₹ 31,20,000 [(30,000 x 100) + (30,000 x 100 x 10/100 x 2/5)]. The premium payable on redemption is being recognised as borrowing costs as per para 4(b) of AS 16 ie under previous GAAP on straight-line basis.

As per para D18 of Ind AS 101, Ind AS 32, Financial Instruments: Presentation, requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of Ind AS 32 would involve separating two portions of equity. The first portion is recognised in retained earnings and represents the cumulative interest accreted on the liability

component. The other portion represents the original equity component. However, in accordance with this Ind AS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to Ind AS.

In the present case, since the liability is outstanding on the date of transition, Sigma Ltd. will need to split the convertible debentures into debt and equity portion on the date of transition. Accordingly, we will first measure the liability component by discounting the contractually determined stream of future cash flows (interest and principal) to present value by using the discount rate of 10% p.a. (being the market interest rate for similar debentures with no conversion option).

	(₹)
Interest payments p.a. on each debenture	6
Present Value (PV) of interest payment for years 1 to 4 (6 × 3.17) (Note 1)	19.02
PV of principal repayment (including premium) 110 × 0.68 (Note 2)	74.80
Total liability component per debenture	93.82
Equity component per debenture (Balancing figure)	6.18
Face value of debentures	100.00
Total equity component for 30,000 debentures	1,85,400
Total debt amount (30,000 x 93.82)	28,14,600

Thus, on the date of initial recognition, the amount of ₹ 30,00,000 being the amount of debentures will be split as under:

Debt	₹ 28,14,600
Equity	₹ 1,85,400

However, on the date of transition, unwinding of ₹ 28,14,600 will be done for two years as follows:

Year	Opening balance	Finance cost @ 10%	Interest paid	Closing balance
1	28,14,600	2,81,460	1,80,000	29,16,060
2	29,16,060	2,91,606	1,80,000	30,27,666

Therefore, on transition date, Sigma Ltd. shall –

- recognise the carrying amount of convertible debentures at ₹ 30,27,666;
- recognise equity component of compound financial instrument of ₹ 1,85,400;
- debit ₹ 93,066 to retained earnings being the difference between the previous GAAP amount of ₹ 31,20,000 and ₹ 30,27,666 and the equity component of compound financial instrument of ₹ 1,85,400; and
- derecognise the debenture liability in previous GAAP of ₹ 31,20,000.

Notes:

3.17 is present value of annuity factor of ₹ 1 at a discount rate of 10% for 4 years.

On maturity, ₹ 110 will be paid (₹ 100 as principal payment + ₹ 10 as premium)

Q22: H Ltd. has the following assets and liabilities as at March 31, 2016, prepared in accordance with previous GAAP:

Particulars	**Notes**	**Amount (₹)**
Fixed assets	1	1,34,50,000
Investments in S. Ltd.	2	48,00,000
Debtors		2,00,000
Advances for purchase of inventory		50,00,000
Inventory		8,00,000
Cash		49,000
Total assets		2,42,99,000
VAT deferral loan	3	60,00,000
Creditors		30,00,000
Short term borrowing		8,00,000
Provisions		12,00,000
Total liabilities		1,10,00,000
Share capital		1,30,00,000
Reserves:		2,99,000
Cumulative translation difference	4	1,00,000
ESOP reserve	4	20,000

Retained earnings		1,79,000
Total equity		1,32,99,000
Total equity and liabilities		2,42,99,000

The following GAAP differences were identified by the Company on first-time adoption of Ind AS with effect from April 1, 2016:

1. In relation to tangible fixed assets (property, plant and equipment), the following adjustments were identified:

   ♦ Fixed assets comprise land held for capital appreciation purposes costing ₹ 4,50,000 and was classified as investment property as per Ind AS 40.

   ♦ Exchange differences of ₹ 1,00,000 were capitalised to depreciable fixed assets on which accumulated depreciation of ₹ 40,000 was recognised.

   ♦ There were no asset retirement obligations.

   ♦ The management intends to adopt deemed cost exemption for using the previous GAAP carrying values as deemed cost as at the date of transition for PPE and investment property.

2. The Company had made an investment in S Ltd. (subsidiary of H Ltd.) for ₹ 48,00,000 that carried a fair value of ₹ 68,00,000 as at the transition date. The Company intends to recognise the investment at its fair value as at the date of transition.

3. Financial instruments:

   ♦ VAT deferral loan ₹ 60,00,000 :

   The VAT deferral loan of ₹ 60,00,000 was obtained on March 31, 2016, for setting up a business in a backward region with a condition to create certain defined targets for employment of local population of that region. The loan does not carry any interest and is repayable in full at the end of 5 years. In accordance with Ind AS 109, the discount factor on the loan is to be taken as 10%, being the incremental borrowing rate. Accordingly, the fair value of the loan as at March 31, 2016, is ₹ 37,25,528. The entity chooses to exercise the option given in paragraph B11 of Ind AS 101, i.e., the entity chooses to apply the requirements of Ind AS 109, Financial Instruments and Ind AS 20, Accounting for Government Grants and Disclosure of Government Assistance, retrospectively as required information had been obtained at the time of initially accounting for VAT deferral loan

4. The retained earnings of the Company contained the following:

   ♦ ESOP reserve of ₹ 20,000:

   The Company had granted 1,000 options to employees out of which 800 have already vested. The Company followed an intrinsic value method for recognition of ESOP charge and recognised ₹ 12,000 towards the vested options and ₹ 8,000 over a period of time as ESOP charge and a corresponding reserve. If fair value method had been followed in accordance with Ind AS 102, the corresponding charge would have been ₹ 15,000 and ₹ 9,000 for the vested and unvested shares respectively. The Company intends to avail the Ind AS 101 exemption for share-based payments for not restating the ESOP charge as per previous GAAP for vested options.

♦ Cumulative translation difference :

₹ 1,00,000 The Company had a non-integral foreign branch in accordance with AS 11 and had recognised a balance of ₹ 1,00,000 as part of reserves. On first-time adoption of Ind AS, the Company intends to avail Ind AS 101 exemption of resetting the cumulative translation difference to zero.

Ans: Adjustments for opening balance sheet as per Ind AS 101

1. Fixed assets: As the land held for capital appreciation purposes qualifies as investment property, such investment property should be reclassified from property, plant and equipment (PPE) to investment property and presented separately; As the Company has adopted the previous GAAP carrying values as deemed cost, all items of PPE and investment property should be carried at its previous GAAP carrying values. As such, the past capitalised exchange differences require no adjustment in this case.

2. Investment in subsidiary: On first time adoption of Ind AS, a parent company has an option to carry its investment in subsidiary at fair value as at the date of transition in its separate financial statements. As such, the Company can recognise such investment at a value of ₹ 68,00,000.

3. Financial instruments: As the VAT deferral loan is a financial liability under Ind AS 109, that liability should be recognised at its present value discounted at an appropriate discounting factor. Consequently, the VAT deferral loan should be recognised at ₹ 37,25,528and the remaining ₹ 22,74,472 would be recognised as deferred government grant.

4. ESOPs: Ind AS 101 provides an exemption of not restating the accounting as per the previous GAAP in accordance with Ind AS 102 for all options that have vested by the transition date. Accordingly, out of 1000 ESOPs granted, the first-time adoption exemption is available on 800 options that have already vested. As such, its accounting need not be restated. However, the 200 options that are not vested as at the transition date, need to be restated in accordance with Ind AS 102. As such, the additional impact of ₹ 1,000 (i.e., 9,000 less 8,000) would be recognised in the opening Ind AS balance sheet.

5. Cumulative translation difference : As per paragraph D 12 of Ind AS 101, the first-time adopter can avail an exemption regarding requirements of Ind AS 21 in context of cumulative translation differences. If a first-time adopter uses this exemption the cumulative translation differences for all foreign operation are deemed to be zero as at the transition date. In that case, the balance is transferred to retained earnings. As such, the balance of ₹ 1,00,000should be transferred to retained earnings

6. Retained earnings should be increased by ₹ 20,99,000 on account of the following:

	₹
Increase in fair value of investment in subsidiary (note 2)	20,00,000
Additional ESOP charge on unvested options (note 4)	(1,000)
Transfer of cumulative translation difference balance to retained earnings (note 5)	1,00,000

After the above adjustments, the carrying values of assets and liabilities for the purpose of opening Ind AS balance sheet of Company H should be as under:

Particulars	Notes	Previous	Adjustments	Ind AS GAAP
Non-Current Assets				
Fixed assets	1	1,34,50,000	(4,50,000)	1,30,00,000
Investment property	1	0	4,50,000	4,50,000
Investment in S Ltd.	2	48,00,000	20,00,000	68,00,000
Advances for purchase of inventory		50,00,000		50,00,000
Current Assets				
Debtors		2,00,000		2,00,000
Inventory		8,00,000		8,00,000
Cash		49,000		49,000
Total assets		**2,42,99,000**	**20,00,000**	**2,62,99,000**
Non-current Liabilities				
Sales tax deferral loan	3	60,00,000	(22,74,472)	37,25,528
Deferred government grant	3	0	22,74,472	22,74,472
Current Liabilities				
Creditors		30,00,000		30,00,000
Short term borrowing		8,00,000		8,00,000
Provisions		12,00,000		12,00,000
Total liabilities		1,10,00,000		1,10,00,000
Share capital		1,30,00,000		1,30,00,000
Reserves:				
Cumulative translation difference	5	1,00,000	(1,00,000)	0

ESOP reserve	4	20,000	1,000	21,000
Other reserves	6	1,79,000	20,99,000	22,78,000
Total equity		1,32,99,000	20,00,000	1,52,99,000
Total equity and liabilities		**2,42,99,000**	**20,00,000**	**2,62,99,000**

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q23: ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters‟ contribution have been recognised in capital reserve and treated as part of shareholders‟ funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters‟ contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS.

Ans: Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity.

Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 "First Time Adoption of Ind AS‟. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter‟s contribution directly to shareholders‟ funds.

Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that except in certain cases, an entity shall in its opening Ind AS Balance Sheet:

a) recognise all assets and liabilities whose recognition is required by Ind AS;

b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

d) apply Ind AS in measuring all recognised assets and liabilities.

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under „Other Equity‟ at the date of transition to Ind AS.

QUESTIONS FROM RTP/MTP/EXAMS/GFRS

Q24: ABC Ltd is a government company and is a first-time adopter of Ind AS. As per the previous GAAP, the contributions received by ABC Ltd. from the government (which holds 100% shareholding in ABC Ltd.) which is in the nature of promoters' contribution have been recognised in capital reserve and treated as part of shareholders' funds in accordance with the provisions of AS 12, Accounting for Government Grants.

State whether the accounting treatment of the grants in the nature of promoters' contribution as per AS 12 is also permitted under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance. If not, then what will be the accounting treatment of such grants recognised in capital reserve as per previous GAAP on the date of transition to Ind AS. **[RTP May 2018]**

Ans; Paragraph 2 of Ind AS 20, "Accounting for Government Grants and Disclosure of Government Assistance" inter alia states that the Standard does not deal with government participation in the ownership of the entity.

Since ABC Ltd. is a Government company, it implies that government has 100% shareholding in the entity. Accordingly, the entity needs to determine whether the payment is provided as a shareholder contribution or as a government. Equity contributions will be recorded in equity while grants will be shown in the Statement of Profit and Loss.

Where it is concluded that the contributions are in the nature of government grant, the entity shall apply the principles of Ind AS 20 retrospectively as specified in Ind AS 101 'First Time Adoption of Ind AS'. Ind AS 20 requires all grants to be recognised as income on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate. Unlike AS 12, Ind AS 20 requires the grant to be classified as either a capital or an income grant and does not permit recognition of government grants in the nature of promoter's contribution directly to shareholders' funds.

Where it is concluded that the contributions are in the nature of shareholder contributions and are recognised in capital reserve under previous GAAP, the provisions of paragraph 10 of Ind AS 101 would be applied which states that, which states that except in certain cases, an entity shall in its opening Ind AS Balance Sheet:

(a) recognise all assets and liabilities whose recognition is required by Ind AS;

(b) not recognise items as assets or liabilities if Ind AS do not permit such recognition;

(c) reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity in accordance with Ind AS; and

(d) apply Ind AS in measuring all recognised assets and liabilities."

Accordingly, as per the above requirements of paragraph 10(c) in the given case, contributions recognised in the Capital Reserve should be transferred to appropriate category under 'Other Equity' at the date of transition to Ind AS.

Q25: XYZ Pvt. Ltd. is a company registered under the Companies Act, 2013 following Accounting Standards notified under Companies (Accounting Standards) Rules, 2006. The Company has decided to voluntary adopt Ind AS w.e.f 1st April, 2018 with a transition date of 1st April, 2017.

The Company has one Wholly Owned Subsidiary and one Joint Venture which are into manufacturing of automobile spare parts.

The -consolidated financial statements of the Company under Indian GAAP are as under:

Consolidated Financial Statements (₹ in Lakhs)

Particulars	**31.03.2018**	**31.03.2017**
Shareholder's Funds Share		
Capital	7,953	7,953
Reserves & Surplus	16,547	16,597
Non-Current Liabilities		
Long Term Borrowings	1,000	1,000
Long Term Provisions	1,101	691
Other Long-Term Liabilities	5,202	5,904
Current Liabilities		
Trade Payables	9,905	8,455
Short Term Provisions	500	475
Total	**42,208**	**41,075**
Non-Current Assets		
Property Plant & Equipment	21,488	22,288
Goodwill on Consolidation of subsidiary and JV	1,507	1,507
Investment Property	5,245	5,245
Long Term Loans & Advances	6,350	6,350
Current Assets		
Trade Receivables	4,801	1,818
Investments ·	1,263	3,763
Other Current Assets	1,554	104
Total	**42,208**	**41,075**

Additional Information:

The Company has entered into a joint arrangement by acquiring 50% of the equity shares of ABC Pvt. Ltd. Presently, the same has been accounted as per the proportionate consolidated method. The proportionate share of assets and liabilities of ABC Pvt. Ltd. included in the consolidated financial statement of XYZ Pvt. Ltd. is as under

Particulars	₹ in Lakhs
Property, Plant & Equipment	1,200
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Trade Payables	75
Short Term Provisions	35

The Investment is in the nature of Joint Venture as per Ind AS 111.

The Company has approached you to advice and suggest the accounting adjustments which are required to be made in the opening Balance Sheet as on 1st April, 2017. **[RTP May 2019]**

Ans: As per paras D31AA and D31AB of Ind AS 101, when changing from proportionate consolidation to the equity method, an entity shall recognise its investment in the joint venture at transition date to Ind AS.

That initial investment shall be measured as the aggregate of the carrying amounts of the assets and liabilities that the entity had previously proportionately consolidated, including any goodwill arising from acquisition. If the goodwill previously belonged to a larger cash-generating unit, or to a group of cash-generating units, the entity shall allocate goodwill to the joint venture on the basis of the relative carrying amounts of the joint venture and the cash-generating unit or group of cash-generating units to which it belonged. The balance of the investment in joint venture at the date of transition to Ind AS, determined in accordance with paragraph D31AA above is regarded as the deemed cost of the investment at initial recognition.

Accordingly, the deemed cost of the investment will be

Property, Plant & Equipment	1,200
Goodwill (Refer Note below)	119
Long Term Loans & Advances	405
Trade Receivables	280
Other Current Assets	50
Total Assets	2054
Less: Trade Payables	75
Short Term Provisions	35
Deemed cost of the investment in JV	1944

Calculation of proportionate goodwill share of Joint Venture ie ABC Pvt. Ltd.

Property, Plant & Equipment	22,288
Goodwill	1,507
Long Term Loans & Advances	6,350
Trade Receivables	1,818

Other Current Assets	104
Total Assets	32,067
Less: Trade Payables	8,455
Short Term Provisions	475
	23,137

Proportionate Goodwill of Joint Venture

= [(Goodwill on consolidation of subsidiary and JV/Total relative net asset) x Net asset of JV]

= (1507 / 23,137) x 1825 = 119 (approx.)

Accordingly, the proportional share of assets and liabilities of Joint Venture will be removed from the respective values assets and liabilities appearing in the balance sheet on 31.3.2017 and Investment in JV will appear under non-current asset in the transition date balance sheet as on 1.4.2017.

Adjustments made in I GAAP balance sheet to arrive at Transition date Ind AS Balance Sheet

Particulars	**31.3.2017**	**Ind AS Adjustment**	**Transition date Balance Sheet as per Ind AS**
Non-Current Assets	22,288	(1,200)	21,088
Property Plant & Equipment			
Intangible assets - Goodwill			
on Consolidation	1,507	(119)	1,388
Investment Property	5,245	-	5,245
Long Term Loans & Advances	6,350	(405)	5,945
Non- current investment in JV	-	1,944	1,944
Current Assets	-		
Trade Receivables	1,818	(280)	1,538
Investments	3,763	-	3,763
Other Current Assets	104	(50)	54
Total	41,075	(110)	40,965
Shareholder's Funds			
Share Capital	7,953	-	7,953
Reserves & Surplus	16,597	-	16,597
Non-Current Liabilities			

Long Term Borrowings	1,000		1,000
Long Term Provisions	691		691
Other Long-Term Liabilities	5,904		5,904
Current Liabilities			
Trade Payables	8,455	(75)	8,380
Short Term Provisions	475	(35)	440
Total	41,075	(110)	40,965

Q26: Shaurya Limited is the company having its registered and corporate office at New Delhi. 60% of the Shaurya Limited's shares are held by the Government of India and rest by other investors.

This is the first time that Shaurya limited would be applying Ind AS for the preparation of its financials for the current financial year 2019-2020. Following balance sheet is prepared as per earlier GAAP as at the beginning of the preceding period along with the additional information:

Balance Sheet as at 31 March 2018

(All figures are in '000, unless otherwise specified)

Particulars	Amount
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	10,00,000
(b) Reserves & Surplus	25,00,000
(2) Non-Current Liabilities	
(a) Long Term Borrowings	4,50,000
(b) Long Term Provisions	3,50,000
(c) Deferred tax liabilities	3,50,000
(3) Current Liabilities	
(a) Trade Payables	22,00,000
(b) Other Current Liabilities	4,50,000
(c) Short Term Provisions	12,00,000
TOTAL	85,00,000
ASSETS	
(1) Non-Current Assets	
(a) Property, Plant & Equipment (net)	20,00,000
(b) Intangible assets	2,00,000
(c) Goodwill	1,00,000

(d) Non-current Investments	5,00,000
(e) Long Term Loans and Advances	1,50,000
(f) Other Non-Current Assets	2,00,000
(2) Current Assets	
(a) Current Investments	18,00,000
(b) Inventories	12,50,000
(c) Trade Receivables	9,00,000
(d) Cash and Bank Balances	10,00,000
(e) Other Current Assets	4,00,000
TOTAL	85,00,000

Additional Information (All figures are in ’000) :

1) Other current liabilities include ₹ 3,90,000 liabilities to be paid in cash such as expense payable, salary payable etc. and ₹ 60,000 are statutory government dues.

2) Long term loans and advances include ₹ 40,000 loan and the remaining amount consists Advance to staff of ₹ 1,10,000.

3) Other non-current assets of ₹ 2,00,000 consists Capital advances to suppliers.

4) Other current assets include ₹ 3,50,000 current assets receivable in cash and Prepaid expenses of ₹ 50,000.

5) Short term provisions include Dividend payable of ₹ 2,00,000. The dividend payable had been as a result of board meeting wherein the declaration of dividend for financial year 2017 -2018 was made. However, it is subject to approval of shareholders in the annual general meeting.

Chief financial officer of Shaurya Limited has also presented the following information against corresponding relevant items in the balance sheet:

a) Property, Plant & Equipment consists a class of assets as office buildings whose carrying amount is ₹ 10,00,000. However, the fair value of said office building as on the date of transition is estimated to be ₹ 15,00,000. Company wants to follow revaluation model as its accounting policy in respect of its property, plant and equipment for the first annual Ind AS financial statements.

b) The fair value of Intangible assets as on the date of transition is estimated to be ₹ 2,50,000. However, the management is reluctant to incorporate the fair value changes in books of account .

c) Shaurya Ltd. had acquired 80% shares in a company, Excel private limited few years ago thereby acquiring the control upon it at that time. Shaurya Ltd. recognised goodwill as per erstwhile accounting standards by accounting the excess of consideration paid over the net assets acquired at the date of acquisition. Fair value exercise was not done at the time of acquisition.

d) Trade receivables include an amount of ₹ 20,000 as provision for doubtful debts measured in accordance with previous GAAP. Now as per latest estimates, the provision needs to be revised to ₹ 25,000.

e) Company had given a loan of ₹1,00,000 to an entity for the term of 10 years six years ago. Transaction costs were incurred separately for this loan. The loan carries an interest rate of 7%. The principal amount is to be repaid in equal installments over the period of ten years at the year end. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 50,000 as against the carrying amount of loan which at present amounts to ₹ 40,000. However, Ind AS 109 mandates to charge the interest expense as per effective interest method after the adjustment of transaction costs. Management says it is tedious task in the given case to apply the effective interest rate changes with retrospective effect and hence is reluctant to apply the same retrospectively in its first time adoption.

f) In the long term borrowings, ₹ 4,50,000 of component is due towards the State Government. Interest is payable on the government loan at 4%, however the prevailing rate in the market at present is 8%. The fair market value of loan stands at ₹ 4,20,000 as on the relevant date.

g) Under Previous GAAP, the mutual funds were measured at cost or market value, whichever is lower. Under Ind AS, the Company has designated these investments at fair value through profit or loss. The value of mutual funds as per previous GAAP is ₹ 2,00,000 as included in 'current investment'. However, the fair value of mutual funds as on the date of transition is ₹ 2,30,000.

h) Ignore separate calculation of deferred tax on above adjustments. Assume the net deferred tax income to be ₹ 50,000 on account of Ind AS transition adjustments.

Requirements:

- Prepare transition date balance sheet of Shaurya Limited as per Indian Accounting Standards
- Show necessary explanation for each of the items presented by chief financial officer in the form of notes, which may or may not require the adjustment as on the date of transition. **[MTP Nov 2020]**

Ans: Transition date (opening) IND-AS BALANCE SHEET of SHAURYA LIMITED

As at 1 April 2018

(All figures are in '000, unless otherwise specified)

Particulars	**Previous GAAP**	**Transitional Ind AS adjustments**	**Opening Ind AS Balance sheet**
ASSETS			
Non-current assets			
Property, plant and equipment (Note 1)	20,00,000	5,00,000	25,00,000

Goodwill (Note 2)	1,00,000	-	1,00,000
Other Intangible assets (Note 3)	2,00,000	-	2,00,000
Financial assets:			
Investment	5,00,000	-	5,00,000
Loans (Note 4)	40,000	10,000	50,000
Other financial assets	1,10,000	-	1,10,000
Other non-current assets	2,00,000	-	2,00,000
Current assets			
Inventories	12,50,000	-	12,50,000
Financial assets			
Investment (Note 5)	18,00,000	30,000	18,30,000
Trade receivables (Note 6)	9,00,000	-	9,00,000
Cash and cash equivalents/Bank	10,00,000	-	10,00,000
Other financial assets	3,50,000	-	3,50,000
Other current assets	50,000	-	50,000
TOTAL ASSETS	**85,00,000**	**5,40,000**	**90,40,000**
EQUITY AND LIABILITIES			
Equity			
Equity share capital	10,00,000	-	10,00,000
Other equity	25,00,000	7,90,000	32,90,000
Non-current liabilities			
Financial liabilities			
Borrowings (Note-7)	4,50,000	-	4,50,000
Provisions	3,50,000	-	3,50,000
Deferred tax liabilities (Net)	3,50,000	(50,000)	3,00,000
Current liabilities			
Financial liabilities			
Trade payables	22,00,000	-	22,00,000
Other financial liabilities	3,90,000	-	3,90,000
Other current liabilities	60,000	-	60,000
Provisions (Note-8)	12,00,000	(2,00,000)	10,00,000
TOTAL EQUITY AND LIABILITIES	85,00,000	5,40,000	90,40,000

OTHER EQUITY

	Retained Earnings (₹)	Fair value reserve	Total
As at 31 March, 2018	27,90,000 (W.N.1)	5,00,000	32,90,000

Working Note 1:

Retained earnings balance:	
Balance as per Earlier GAAP	25,00,000
Transitional adjustment due to loan's fair value	10,000
Transitional adjustment due to increase in mutual fund's fair value	30,000
Transitional adjustment due to decrease in deferred tax liability	50,000
Transitional adjustment due to decrease in provisions (dividend)	2,00,000
Total	27,90,000

Disclosure forming part of financial statements:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and should not recognized as liability as at the Balance Sheet date.

Note 1: Property, plant & Equipment:

As per para D5 of Ind AS 101,an entity may elect to measure an item of property, plant and equipment at the date of transition to Ind AS at its fair value and use that fair value as its deemed cost at that date.

Note 2: Goodwill:

Ind AS 103 mandatorily requires measuring the assets and liabilities of the acquiree at its fair value as on the date of acquisition. However, a first time adopter may elect to not apply the provisions of Ind AS 103 with retrospective effect that occurred prior to the date of transition to Ind AS.

Hence company can continue to carry the goodwill in its books of account as per the previous GAAP.

Note 3: Intangible assets:

Para D7 read with D6 of Ind AS 101 states that a first-time adopter may elect to use a previous GAAP revaluation at, or before, the date of transition to Ind AS as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) Fair value; or

(b) Cost or depreciated cost in accordance with Ind AS, adjusted to reflect, for example, changes in a general or specific price index.

However, there is a requirement that Intangible assets must meet the definition and recognition criteria as per Ind AS 38.

Hence, company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.

Note 4: Loan:

Para B8C of Ind AS 101 states that if it is impracticable (as defined in Ind AS 8) for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind ASs shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability at the date of transition to Ind AS. Accordingly, ₹ 50,000 would be the gross carrying amount of loan and difference of ₹ 10,000 (₹ 50,000 – ₹ 40,000) would be adjusted to retained earnings.

Note 5: Mutual Funds:

Para 29 of Ind AS 101 states that an entity is permitted to designate a previously reco gnised financial asset as a financial asset measured at fair value through profit or loss in accordance with paragraph D19A. The entity shall disclose the fair value of financial assets so designated at the date of designation and their classification and carrying amount in the previous financial statements.

D19A states that an entity may designate a financial asset as measured at fair value through profit or loss in accordance with Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind AS.

Note 6: Trade receivables:

Para 14 of Ind AS 101 states that an entity's estimates in accordance with Ind ASs at the date of transition to Ind AS shall be consistent with estimates made for the same date in accordance with previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error.

Para 15 of Ind AS 101 further states that an entity may receive information after the date of transition to Ind ASs about estimates that it had made under previous GAAP. In accordance with paragraph 14, an entity shall treat the receipt of that information in the same way as non -adjusting events after the reporting period in accordance with Ind AS 10, Events after the Reporting Period.

The entity shall not reflect that new information in its opening Ind AS Balance Sheet (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in profit or loss (or, if appropriate, other comprehensive income) for the year ended 31 March 2019.

Note 7: Government Grant:

Para 10A of Ind AS 20 states that the benefit of a government loan at a below-market rate of interest is treated as a government grant. The loan shall be recognised and measured in accordance with Ind AS 109, Financial Instruments. The benefit of the below-market rate of interest shall be measured as the difference between the initial carrying value of the loan determined in accordance with Ind AS 109, and the proceeds received. The benefit is accounted for in accordance with this Standard.

However, Para B10 of Ind AS 101 states, a first-time adopter shall classify all government loans received as a financial liability or an equity instrument in accordance with Ind AS 32, Financial Instruments: Presentation. Except as permitted by paragraph B11, a first-time adopter shall apply the requirements in Ind AS 109, Financial Instruments, and Ind AS 20, Accounting for

Government Grants and Disclosure of Government Assistance, prospectively to government loans existing at the date of transition to Ind ASs and shall not recognise the corresponding benefit of the governme nt loan at a below-market rate of interest as a government grant. Consequently, if a first -time adopter did not, under its previous GAAP, recognise and measure a government loan at a below-market rate of interest on a basis consistent with Ind AS requirements, it shall use its previous GAAP carrying amount of the loan at the date of transition to Ind AS as the carrying amount of the loan in the opening Ind AS Balance Sheet. An entity shall apply Ind AS 109 to the measurement of such loans after the date of transition to Ind AS.

Note 8: Dividend

Dividend should be deducted from retained earnings during the year when it has been declared and approved. Accordingly, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment.

Q27: Mathur India Private Limited has to present its first financials under IND AS for the year ended March 31, 2019. The transition date is April 1, 2017.

The following adjustments were made upon transition to IND AS :

(a) The Company opted to fair value its land as on the date on transition.

The fair value of the land as on April 1, 2017 was ₹ 10 crores. The carrying amount as on April 1, 2017 under the existing GAAP was ₹ 4.5 crores.

(b) The Company has recognised a provision for proposed dividend of ₹ 60 lakhs and related dividend distribution tax of ₹ 18 lakhs during the year ended March 31, 2017. It was written back as on opening balance sheet date.

(c) The Company fair values its investments in equity shares on the date of transition. The increase on account of fair valuation of shares is ₹ 75 lakhs.

(d) The· Company has an Equity Share Capital of ₹ 80 crores and Redeemable Preference Share Capital of ₹ 25 crores.

(e) The reserves and surplus as on April 1, 2017 before transition to IND AS was ₹ 95 crores representing ₹ 40 crores of general reserve and ₹ 5 crores of capital reserve acquired out of business combination and balance is surplus in the Retained Earnings.

(f) The company identified that the preference shares were in nature of financial liabilities.

What is the balance of total equity (Equity and other equity) as on April 1, 2017 after transition to IND AS. Show reconciliation between total equity as per existing GAAP and as per IND AS to be presented in the opening balance sheet as on April 1, 2017.Ignore deferred tax impact.

[GFRS]

Ans: Computation of balance total equity as on April 1, 2017 after transition to IND AS

			₹ in Crore
Share capital- Equity share Capital			80
Other Equity			
General Reserve		40	
Capital Reserve		5	
Retained Earnings (95-5-40)	50		
Add: Increase in value of land (10-4.5)	5.5		
Add: De recognition of proposed dividend (0.6 + 0.18+	0.78		
Add: Increase in value of Investment	0.75	57.03	102.03
Balance total equity as on April 1, 2017 after transition to IND AS			182.03

Reconciliation between Total Equity as per existing GAAP and IND AS to be presented in the opening balance sheet as on 1st April, 2017

		₹ in crore
Equity share capital (80+25)		80
Redeemable Preference share capital		25
		105
Reserves and Surplus		95
Total Equity as per existing GAAP		200
Adjustment due to reclassification		
Preference share capital classified as financial liability		(25)
Adjustment due to derecognition		
Proposed Dividend not considered as liability as on 1st April 2017		0.78
Adjustment due to re-measurement		
Increase in the value of Land due to re-measurement at fair value	5.5	
Increase in the value of investment due to re-measurement at fair value	0.75	6.25
Equity as on April 1, 2017 after transition to IND AS		182.03

Q28: HIM Limited having net worth of ₹ 250 crores is required to adopt Ind AS from 1 April, 20X2 in accordance with the Companies (Indian Accounting Standard) Rules 2015.

Rahul, the senior manager, of HIM Ltd. has identified following issues which need specific attention of CFO so that opening Ind AS balance sheet as on the date of transition can be prepared:

Issue 1 : As part of Property, Plant and Equipment, Company has elected to measure land at its fair value and want to use this fair value as deemed cost on the date of transition. The carrying value of land as on the date of transition was ₹ 5,00,000. The land was acquired for a consideration of ₹ 5,00,000. However, the fair value of land as on the date of transition was ₹ 8,00,000.

Issue 2 : Under Ind AS, the Company has designated mutual funds as investments at fair value through profit or loss. The value of mutual funds as per previous GAAP was ₹ 4,00,000 (at cost). However, the fair value of mutual funds as on the date of transition was ₹ 5,00,000.

Issue 3 : Company had taken a loan from another entity. The loan carries an interest rate of 7% and it had incurred certain transaction costs while obtaining the same. It was carried at cost on its initial recognition. The principal amount is to be repaid in equa l instalments over the period of loan. Interest is also payable at each year end. The fair value of loan as on the date of transition is ₹ 1,80,000 as against the carrying amount of loan which at present equals ₹ 2,00,000.

Issue 4 : The company has declared dividend of ₹ 30,000 for last financial year. On the date of transition, the declared dividend has already been deducted by the accountant from the company's 'Reserves & Surplus' and the dividend payable has been grouped under 'Provisions'. The dividend was only declared by board of directors at that time and it was not approved in the annual general meeting of shareholders. However, subsequently when the meeting was held it was ratified by the shareholders.

Issue 5 : The company had acquired intangible assets as trademarks amounting to ₹ 2,50,000. The company assumes to have indefinite life of these assets. The fair value of the intangible assets as on the date of transition was ₹ 3,00,000. However, the company wants to carry the intangible assets at ₹ 2,50,000 only.

Issue 6 : After consideration of possible effects as per Ind AS, the deferred tax impact is computed as ₹ 25,000. This amount will further increase the portion of deferred tax liability. There is no requirement to carry out the separate calculation of deferred tax on account of Ind AS adjustments.

Management wants to know the impact of Ind AS in the financial statements of company for its general understanding.

Prepare Ind AS Impact Analysis Report (Extract) for HIM Limited for presentation to the management wherein you are required to discuss the corresponding differences between Earlier IGAAP (AS) and Ind AS against each identified issue for preparation of transition date balance sheet. Also pass journal entry for each issue.

RTP May 2021

Ans: **Preliminary Impact Assessment on Transition to Ind AS in HIM Limited's Financial Statements**

Issue 1: Fair value as deemed cost for property plant and equipment:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements

As per AS 10, Property, Plant and Equipment is recognised at cost less depreciation.	Ind AS 101 allows entity to elect to measure Property, Plant and Equipment on the transition date at its fair value or previous GAAP carrying value (book value) as deemed cost.	The company has decided to adopt fair value as deemed cost in this case. Since fair value exceeds book value, so the book value should be brought up to fair value. The resulting impact of fair valuation of land ₹ 3,00,000 should be adjusted in other equity.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Property Plant and Equipment Dr.	3,00,000	
To Revaluation Surplus (OCI- Other Equity)		3,00,000

Issue 2: Fair valuation of Financial Assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per Accounting Standard, investments are measured at lower of cost and fair value.	On transition, financial assets including investments are measured at fair values except for investments in subsidiaries, associates and JVs' which are recorded at cost.	All financial assets (other than investment in subsidiaries, associates and JVs' which are recorded at cost) are initially recognized at fair value. The subsequent measurement of such assets are based on its categorization either Fair Value through Profit & Loss (FVTPL) or Fair Value through Other Comprehensive Income (FVTOCI) or at Amortised Cost based on business model assessment and contractual cash flow characteristics. Since investment in mutual fund are designated at FVTPL, increase of ₹

		1,00,000 in mutual funds fair value would increase the value of investments with corresponding increase to Retained Earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Investment in mutual funds Dr.	1,00,000	
To Retained earnings		1,00,000

Issue 3: Borrowings - Processing fees/transaction cost:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, such expenditure is charged to Profit and loss account or capitalized as the case may be	As per Ind AS, such expenditure is amortised over the period of the loan. Ind AS 101 states that if it is impracticable for an entity to apply retrospectively the effective interest method in Ind AS 109, the fair value of the financial asset or the financial liability at the date of transition to Ind AS shall be the new gross carrying amount of that financial asset or the new amortised cost of that financial liability.	Fair value as on the date of transition is ₹ 1,80,000 as against its book value of ₹ 2,00,000. Accordingly, the difference of ₹ 20,000 is adjusted through retained earnings.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Borrowings / Loan payable Dr.	20,000	
To Retained earnings		20,000

Issue 4: Proposed dividend:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, provision for proposed divided is	As per Ind AS, liability for proposed	Since dividend should be deducted from retained earnings during the

made in the year when it has been declared and approved.	dividend is recognised in the year in which it has been declared and approved.	year when it has been declared and approved. Therefore, the provision declared for preceding year should be reversed (to rectify the wrong entry). Retained earnings would increase proportionately due to such adjustment

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Provisions Dr.	30,000	
To Retained earnings		30,000

Issue 5 : Intangible assets:

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
The useful life of an intangible asset cannot be indefinite under IGAAP principles. The Company amortised brand / trademark on a straight line basis over maximum of 10 years as per AS 26.	The useful life of an intangible asset like brand / trademark can be indefinite. Not required to be amortised and only tested for impairment. Company can avail the exemption given in Ind AS 101 as on the date of transition to use the carrying value as per previous GAAP.	Consequently, there would be no impact as on the date of transition since company intends to use the carrying amount instead of book value at the date of transition.

Issue 6: Deferred tax

Accounting Standards (Erstwhile IGAAP)	Ind AS	Impact on Company's financial statements
As per AS, deferred taxes are accounted as per income statement approach.	As per Ind AS, deferred taxes are accounted as per balance sheet approach.	On date of transition to Ind AS, deferred tax liability would be increased by ₹ 25,000.

Journal Entry on the date of transition

Particulars	Debit (₹)	Credit (₹)
Retained earnings Dr.	25,000	
To Deferred tax liability		25,000

NOTES

CHAPTER 32

FAIR VALUE MEASUREMENT (IND AS 113)

Example: Settlement vs Transfer

1. A bank holds a debt obligation with a face value of ₹ 1,00,000 and a market value of ₹ 95,000. Assume that market interest rates are consistent with the amount in the note; however, there is ₹ 5,000 discount due to market concerns about the risk of non-performance by Counterparty I.

Settlement value

Counterparty I would be required to pay the face value of the note to settle the obligation, because the bank might not be willing to discount the note by the market discount or the credit risk adjustment. Therefore, the settlement value would equal the face value of the note.

Transfer value

In order to calculate the transfer value, Counterparty I must construct a hypothetical transaction in which another counterparty (Counterparty II), with a similar credit profile, is seeking financing on terms that are substantially the same as the note. Counterparty II could choose to enter into a new note agreement with the bank or receive the existing note from Counterparty I in a transfer transaction. In this hypothetical transaction, Counterparty II should be equally willing to obtain financing through a new bank note or assumption of the existing note in return for a payment of ₹ 95,000. Therefore, the transfer value would be ₹ 95,000, and thus the fair value.

Example: Entity Specific restrictions

2. An entity is having a land which has a restriction to develop into a commercial house because of restricted business objective in which currently the entity operates. The entity wants to sell the land and there would not be any restriction for a buyer of the land to develop a commercial house, since this restriction is entity specific. Hence, it will not be considered while calculating fair value of the land.

Example: Asset / Liability specific restrictions

3. A car has been bought for private use and there is a restriction of not to use the car for any commercial purposes. Commercial vehicle is having more fair value than private vehicle. since the restriction to use the vehicle is asset specific and market participant will also consider the asset specific restrictions while calculating fair values for such asset and hence this condition will be considered while evaluating fair value of the car.

Examples: Unit of Account

4. An entity having certain securities which are quoted at market and these are recognized at fair value in the balance sheet. Quoted prices at individual level will be used in order to find fair values of these investments.

5. In order to evaluate fair values of assets to identify impairment as per Ind AS 36, which requires to measure such fair value at cash generating units, hence group of assets will be used in order to find fair values for the requirement of such standard.

Example: Principal market

6. Share of a company which is listed at BSE and NYSE has different closing prices at the year end. The price at BSE has greatest volume and activity whereas at NYSE it is less in terms of volume transacted in the period. Since BSE has got highest volume and significant level of activity comparing to other market although the closing price is higher at NYSE, the closing price at BSE would be taken.

Example: Most advantageous market

7. Diamond (a commodity) has got a domestic market where the prices are lesser comparing to the price available for export of similar diamonds. The Government has a policy to cap the export of Diamond, maximum upto 10% of total output by any such manufacturer. The normal activities of diamond are being done at domestic market only i.e. 90% and balance 10% only can be sold via export. The highest level of activities with highest volume is being done at domestic market . Hence, principal market for diamond would be domestic market. Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market. Therefore, the export market would be considered as most advantageous market. However, if principal market is available, then its prices would be used for fair valuation of assets/ liabilities

Examples: Transport Cost

8. An entity sells certain commodity which are available actively at location A and which is considered to be its principal market (being significant volume of transactions and activities takes place). However, fair value of the commodity is required to be assessed for location B which is far from location A and requires a transport cost of ₹ 100. Since the transport cost is not a transaction cost and it is not specific to any transaction but it is inherent cost which requires to be incurred while bringing such commodity from location A to location B, it will be considered while evaluating fair value from the principal market.

Examples: Highest and best use

9. An entity bought some land which is intended to be used for business purposes. However, the entity now wants to sell this piece of land at its fair value. One has to evaluate all possible use of this land before determining its fair value. The land could be used to make a commercial place, which could be more in value as compared to when it is used for business purposes. The commercial place value would be considered its highest and best use if the same is allowed in its near location and conditions.

10. Current use as Highest and Best Use: A Ltd acquires a machine in a business combination by acquiring controlling stake in B Ltd. The machine will be held and used in A's operations. The machine was originally purchased by B Ltd from an outside vendor and, before the business combination, was customized by the B Ltd for use in its operations. However, the customization of the machine was not extensive.

A Ltd determines that the asset would provide maximum value to market participants through its use in combination with other assets or with other assets and liabilities (as installed or otherwise configured for use). There is no evidence to suggest that the current use of the machine is not its highest and best use. Therefore, the highest and best use of the machine is its current use in combination with other assets or with other assets and liabilities.

11. Potential use as Highest and Best Use: A Ltd owns a property, which comprises land with an old warehouse on it. It has been determined that the land could be redeveloped into a leisure park. The land‘s market value would be higher if redeveloped than the market value under its current use. A Ltd is unclear about whether the investment property‘s fair value should be based on the market value of the property (land and warehouse) under its current use, or the land‘s potential market value if the leisure park redevelopment occurred.

12. The property‘s fair value should be based on the land‘s market value for its potential use. The highest and best use‘ is the most appropriate model for fair value. Under this approach, the property‘s existing-use value is not the only basis considered. Fair value is the highest value, determined from market evidence, by considering any other use that is physically possible, legally permissible and financially feasible.

The highest and best use valuation assumes the site‘s redevelopment. This will involve demolishing the current warehouse and constructing a leisure park in its place. Therefore, none of the market value obtained for the land should be allocated to the building. So the market value of the current building, on the property ’ s highest and best use (as a warehouse), is nil. As a result, the building’s current carrying amount should be written down to zero.

Example: Adjustment to Quoted Price when it does not reflect the fair price

13. A Ltd., a large biotech company with shares traded publicly, has developed a new drug that is in the final phase of clinical trials. B Ltd. has an equity investment in A Ltd.‘s shares. B Ltd. determines that the shares have a readily determinable fair value and accounts for the investment at fair value through profit and loss. B Ltd. assesses the fair value as of the measurement date of 31 March 2020. Consider the following:

a) On 31 March 2020, the Drug Approval authority notifies A Ltd.‘s management that the drug

b) was not approved. A Ltd.‘s shares closed at ₹ 36.00 on 31 March 2020.

c) A Ltd. issued a press release after markets closed on 31 March 2020 announcing the failed clinical trial.

d) A Ltd.‘s shares opened on next working day at ₹ 22.50.

The drug failure is a condition (or a characteristic of the asset being measured) that existed as of the measurement date. B Ltd. concludes the ₹ 36.00 closing price on the measurement date does not represent fair value of the A Ltd.‘s shares at 31 March 2020 because the price does not reflect the effect of the Authority‘s non-approval.

The subsequent transactions that take place when the market opens are relevant to the fair value measurement recorded as of the measurement date. The opening price of ₹ 22.50

indicates how market participants have incorporated the effect of the non-approval on A Ltd.'s stock price.

B Ltd. adjusts the 31 March 2020 quoted price for the new information, records the shares at ₹ 22.50 per share at 31 March 2020 and discloses the investment as a Level 2 measurement

Example: Level 2 Inputs

14. Receive-fixed, pay-variable interest rate swap based on a yield curve denominated in a foreign currency. It requires rate of swap which is of 11 years. However, normally the rates are available only for the maximum period of 10 years. The rate for 11 years can be established using extrapolation or some other techniques which is based on 10 years' available rates of swap. The fair value of 11 years so derived would be level 2 fair value.

15. An entity has an investment in another entity which has no active market. However, some similar investment is being traded in an active market. Now, the fair valuation can be done based on either the prices based on the market which is not active or similar traded investment in an active market. This would be considered as level 2 inputs

16. X and Y each enter into a contractual obligation to pay ₹ 500 in cash to D in five years. X has an AA credit rating and can borrow at 6%. Y has a BBB credit rating and can borrow at 12%. X will receive about ₹ 374 in exchange for its promise (the present value of ₹ 500 in five years at 6%). Y will receive about ₹ 284 in exchange for its promise (the present value of ₹ 500 in five years at 12%). The fair value of the liability to each entity (that is, the proceeds) incorporates that entity's credit standing.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: An asset is sold in 2 different active markets (a market in which transaction for the asset or liability takes place with sufficient frequency and volume to provide pricing information on an ongoing basis) at different prices.

An entity enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Market A:

The price that would be received is 26, transaction costs in that market are 3 and the costs to transport the asset to that market are 2 (i.e., the net amount that would be received is 21).

In Market B:

The price that would be received is 25, transaction costs in that market are 1 and the costs to transport the asset to that market are 2 (i.e., the net amount that would be received in Market B is 22).

You are required to calculate:

(i) The fair value of the asset, if market A is the principal market, and

(ii) The fair value of the asset, if none of the markets is principal market. **[Nov 2018]**

Ans: If Market A is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transport costs (24).

If neither market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transport costs (i.e., the net amount that would be received in the respective markets).

Because the entity would maximise the net amount that would be received for the asset in Market B (22), the fair value of the asset would be measured using the price in that market (25), less transport costs (2), resulting in a fair value measurement of 23.

Q2: Company J acquires land in a business combination. The land is currently developed for industrial use as a factory site. Although the land's current use is presumed to be its highest and best use unless market or other factors suggest a different use, Company J considers the fact that nearby sites have recently been developed for residential use as high-rise apartment buildings.

On the basis of that development and recent zoning and other changes to facilitate that development, Company J determines that the land currently used as a factory site could be developed as a residential site (e.g., for high-rise apartment buildings) and that market participants would take into account the potential to develop the site for residential use when pricing the land.

Ans: The highest and best use of the land is determined by comparing the following:

- The value of the land as currently developed for industrial use (i.e., an assumption that the land would be used in combination with other assets, such as the factory, or with other assets and liabilities); and
- The value of the land as a vacant site for residential use, taking into account the costs of demolishing the factory and other costs necessary to convert the land to a vacant site. The value under this use would take into account risks and uncertainties about whether the entity would be able to convert the asset to the alternative use (i.e., an assumption that the land would be used by market participants on a stand-alone basis).

The highest and best use of the land would be determined on the basis of the higher of these values. In situations involving real estate appraisal, the determination of highest and best use might take into account factors relating to the factory operations (e.g., the factory's operating cash flows) and its assets and liabilities (e.g., the factory's working capital).

Q3: ABC Ltd. acquired 5% equity shares of XYZ Ltd. for ₹ 10 crore in the year 2011-12. The company is in process of preparing the financial statements for the year 2012-13 and is assessing the fair value at subsequent measurement of the investment made in XYZ Ltd. Based on the observable input, the ABC Ltd. identified a similar nature of transaction in which PQR Ltd. acquired 20% equity shares in XYZ Ltd. for ₹ 60 crore. The price of such transaction was determined on the basis of Comparable Companies Method (CCM)- Enterprise Value (EV) / EBITDA which was 8. For the current year, the EBITDA of XYZ Ltd. is ₹ 40 crore. At the time of acquisition, the valuation was determined after considering 5% of liquidity discount and 5% of non-controlling stake discount. What will be the fair value of ABC Ltd.'s investment in XYZ Ltd. as on the balance sheet date?

Ans: Determination of Enterprise Value of XYZ Ltd.

Particulars	**₹ in crore**
EBITDA as on the measurement date	40
EV/EBITDA multiple as on the date of valuation	8
Enterprise value of XYZ Ltd.	320

Determination of subsequent measurement of XYZ Ltd.

Particulars	**₹ in crore**
Enterprise Value of XYZ Ltd.	320
ABC Ltd.'s share based on percentage of holding (5% of 320)	16
Less: Liquidity discount & Non-controlling stake discount (5%+5%=10%)	(1.6)
Fair value of ABC Ltd.'s investment in XYZ Ltd.	14.4

Q4: UK Ltd. is in the process of acquisition of shares of PT Ltd. as part of business reorganization plan. The projected free cash flow of PT Ltd. for the next 5 years are as follows:

					(₹ in crore)
Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965

The weightage average cost of capital of PT Ltd. is 11%. The total debt as on measurement date is ₹ 1,465 crore and the surplus cash & cash equivalent is ₹ 106.14 crore.

The total numbers of shares of PT Ltd. as on the measurement date is 8,52,84,223 shares. Determine value per share of PT Ltd. as per Income Approach.

Ans:

Determination of equity value of PT Ltd.				**(in crore)**	
Particulars	Year 1	Year 2	Year 3	Year 4	Year 5
Cash flows	187.1	187.6	121.8	269	278.8
Terminal Value					3,965
Discount rate	0.9009	0.8116	0.7312	0.6587	0.5935
Free Cash Flow					
available to the firm	168.56	152.26	89.06	177.19	2,518.69
Total of all years					3,105.76

Less: Debt					(1,465)
Add: Cash & Cash equivalent					106.14
Equity Value of PT Ltd.					1,746.90
No. of Shares					85,284,223
Per Share Value					204.83

Q5: You are a senior consultant of your firm and are in process of determining the valuation of KK Ltd. You have determined the valuation of the company by two approaches i.e. Market Approach and Income approach and selected the highest as the final value. However, based upon the discussion with your partner you have been requested to assign equal weights to both the approaches and determine a fair value of shares of KK Ltd. The details of the KK Ltd. are as follows:

Particulars	**₹ in crore**
Valuation as per Market Approach	5268.2
Valuation as per Income Approach	3235.2
Debt obligation as on Measurement date	1465.9
Surplus cash & cash equivalent	106.14
Fair value of surplus assets and Liabilities	312.4
Number of shares of KK Ltd.	8,52,84,223 shares

Determine the Equity value of KK Ltd. as on the measurement date on the basis of above details

Ans: Equity Valuation of KK Ltd

Particulars	**Weights**	**(₹ in crore)**
As per Market Approach	50	5268.2
As per Income Approach	50	3235.2
Enterprise Valuation based on weights (5268.2 x 50%) + (3235.2 x 50%)		4,251.7
Less: Debt obligation as on measurement date		(1465.9)
Add: Surplus cash & cash equivalent		106.14
Add: Fair value of surplus assets and liabilities		312.40
Enterprise value of KK Ltd.		3204.33
No. of shares		85,284,223
Value per share		375.72

NEW QUESTIONS IN SM (FOR MAY 21 ATTEMPT)

Q6: Investment 1 is a contractual right to receive ₹ 800 in 1 year. There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

(a) Investment 2 is a contractual right to receive ₹ 1,200 in 1 year and has a market price of ₹ 1,083.

(b) Investment 3 is a contractual right to receive ₹ 700 in 2 years and has a market price of ₹ 566.

All three assets are comparable with respect to risk (that is, dispersion of possible payoffs and credit).

You are required to measure the fair value of Asset 1 basis above information.

Ans: On the basis of the timing of the contractual payments to be received for Investment 1 relative to the timing for Investment 2 and Investment 3 (that is, one year for Investment 2 versus two years for Investment 3), Investment 2 is deemed more comparable to Investment 1. Using the contractual payment to be received for Investment 1 (₹ 800) and the 1-year market rate derived from Investment 2, the fair value of Investment 1 is calculated as under:

Investment 2 Fair Value	₹ 1,083
Contractual Cash flows in 1 year	₹ 1,200

IRR =₹ 1,083 x (1 + r) = ₹ 1,200

= (1 + r) = (₹ 1,200 / ₹ 1,083) = 1.108

r = 1.108 – 1 = 0.108 or 10.8%

Value of Investment 1= ₹ 800 / 1.108 = ₹ 722

Alternatively, in the absence of available market information for Investment 2, the one-year market rate could be derived from Investment 3 using the build-up approach. In that case, the 2-year market rate indicated by Investment 3 would be adjusted to a 1-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

Q7: Comment on the following by quoting references from appropriate Ind AS.

1. DS Limited holds some vacant land for which the use is not yet determined. the land is situated in a prominent area of the city where lot of commercial complexes are coming up and there is no legal restriction to convert the land into a commercial land.

   The company is not interested in developing the land to a commercial complex as it is not its business objective. Currently the land has been let out as a parking lot for the commercial complexes around.

   The Company has classified the above property as investment property. It has approached you, an expert in valuation, to obtain fair value of the land for the purpose of disclosure under Ind AS.

   On what basis will the land be fair valued under Ind AS?

2. DS Limited holds equity shares of a private company. In order to determine the fair value' of the shares, the company used discounted cash flow method as there were no similar shares available in the market.

   Under which level of fair value hierarchy will the above inputs be classified?

What will be your answer if the quoted price of similar companies were available and can be used for fair valuation of the shares?

Ans:

(i) (As per Ind AS 113, a fair value measurement of a non-financial asset takes into account a market participant‘s ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The highest and best use of a non-financial asset takes into account the use of the asset that is physically possible, legally permissible and financially feasible, as follows:

(a) A use that is physically possible takes into account the physical characteristics of the asset that market participants would take into account when pricing the asset (eg the location or size of a property).

(b) A use that is legally permissible takes into account any legal restrictions on the use of the asset that market participants would take into account when pricing the asset (eg the zoning regulations applicable to a property).

(c) A use that is financially feasible takes into account whether a use of the asset that is physically possible and legally permissible generates adequate income or cash flows (taking into account the costs of converting the asset to that use) to produce an investment return that market participants would require from an investment in that asset put to that use.

Highest and best use is determined from the perspective of market participants, even if the entity intends a different use. However, an entity‘s current use of a non-financial asset is presumed to be its highest and best use unless market or other factors suggest that a different use by market participants would maximise the value of the asset.

To protect its competitive position, or for other reasons, an entity may intend not to use an acquired non-financial asset actively or it may intend not to use the asset according to its highest and best use. Nevertheless, the entity shall measure the fair value of a non-financial asset assuming its highest and best use by market participants.

In the given case, the highest best possible use of the land is to develop a commercial complex. Although developing a business complex is against the business objective of the entity, it does not affect the basis of fair valuation as Ind AS 113 does not consider an entity specific restriction for measuring the fair value.

Also, its current use as a parking lot is not the highest best use as the land has the potential of being used for building a commercial complex.

Therefore, the fair value of the land is the price that would be received when sold to a market participant who is interested in developing a commercial complex.

(ii) As per Ind AS 113, unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. The unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

In the given case, DS Limited adopted discounted cash flow method, commonly used technique to value shares, to fair value the shares of the private company as there were no similar shares traded in the market. Hence, it falls under Level 3 of fair value hierarchy.

Level 2 inputs include the following:

(a) quoted prices for similar assets or liabilities in active markets.

(b) quoted prices for identical or similar assets or liabilities in markets that are not active.

(c) inputs other than quoted prices that are observable for the asset or liability.

If an entity can access quoted price in active markets for identical assets or liabilities of similar companies which can be used for fair valuation of the shares without any adjustment, at the measurement date, then it will be considered as observable input and would be considered as Level 2 inputs.

QUESTIONS FROM RTP/MTP/EXAMS

Q8: An asset is sold in two different active markets at different prices. Manor Ltd. enters into transactions in both markets and can access the price in those markets for the asset at the measurement date.

In Mumbai market, the price that would be received is ₹ 290, transaction costs in that market are ₹ 40 and the costs to transport the asset to that market are ₹ 30. Thus, the net amount that would be received is ₹ 220.

In Kolkata market the price that would be received is ₹ 280, transaction costs in that market are ₹ 20 and the costs to transport the asset to that market are ₹ 30. Thus, the net amount that would be received in Kolkata market is ₹ 230.

1. What should be the fair value of the asset if Mumbai Market is the principal market? What should be fair value if none of the markets is principle market?

2. It the net realization after expenses is more in export market, say ₹ 280, but Government allows only 15% of the production to be exported out of India. Discuss what would be fair value in such case. **[Exam Nov 2019]**

Ans: 1 **(a) If Mumbai Market is the principal market**

If Mumbai Market is the principal market for the asset (i.e., the market with the greatest volume and level of activity for the asset), the fair value of the asset would be measured using the price that would be received in that market, after taking into account transportation costs. Fair value will be

	₹
Price receivable	290
Less: Transportation cost	(30)
Fair value of the asset	260

(b) If neither of the market is the principal market

If neither of the market is the principal market for the asset, the fair value of the asset would be measured using the price in the most advantageous market. The most advantageous market is the market that maximises the amount that would be received to sell the asset, after taking into account transaction costs and transportation costs (i.e., the net amount that would be received in the respective markets).

	₹	₹
	Mumbai Market	Kolkata Market
Fair value of the asset as per the question	220	230

Since the entity would maximise the net amount that would be received for the asset in Kolkata Market i.e. ₹ 230, the fair value of the asset would be measured using the price in Kolkata Market.

Fair value in such a case would be

	₹
Price receivable	280
Less: Transportation cost	(30)
Fair value of the asset	250

2) Export prices are more than the prices in the principal market and it would give highest return comparing to the domestic market. Therefore, the export market would be considered as most advantageous market. But since the Government has capped the export, maximum up to 15% of total output, maximum sale activities are being done at domestic market only i.e. 85%. Since the highest level of activities with highest volume is being done at domestic market, principal market for asset would be domestic market. Therefore, the prices received in domestic market would be used for fair valuation of assets.

NOTES

CHAPTER 33
CORPORATE SOCIAL RESPONSIBILITY

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: ABC Ltd. is a company which is formed with charitable objects under Section 8 of the Companies Act, 2013. As a result, the management of the company believes that as all the activities of the company will be with the intent of charity, the CSR provisions are not applicable to ABC Ltd. as these activities are activities in normal course of business.

Whether the provisions of CSR are applicable to ABC Ltd. provided it fulfils the criteria of Section 135 of the Act?

Ans: Section 135 of the Companies Act is applicable to every company meeting the specified criteria. As per section 2(20) of the Companies Act, 'company' means a company incorporated under the Companies Act or under any other previous company law. This would imply that companies set up for the purposes of CSR/public welfare are also required to comply with the provisions of CSR.

Q2: ABC Ltd. is a company which has a net worth of INR 200 crores, it manufactures rubber parts for automobiles. The sales of the company are affected due to low demand of its products.

The previous year's financials state: (INR in Crores)

	March 31, 20X4 (Current year)	March 31, 20X3	March 31, 20X2	March 31, 20X1
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

Required

Does the Company have an obligation to form a CSR committee since the applicability criteria is not satisfied in the current financial year? **[May 2018]**

Ans:

(i) As per section 135 of the Companies Act 2013

Every company having either

a. net worth of ₹ 500 crore or more, or

b. turnover of ₹ 1,000 crore or more or

c. a net profit of ₹ 5 crore or more

during ***immediate preceding financial year*** shall constitute a Corporate Social Responsibility (CSR) Committee of the Board consisting of three or more directors (including at least one independent director).

(ii) A company which meets the net worth, turnover or net profits criteria in immediate preceding financial years, will need to constitute a CSR Committee and comply with provisions of sections 135 (2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee –

1) Net worth greater than or equal to INR 500 Crores: This criterion is not satisfied.

2) Sales greater than or equal to INR 1000 Crores: This criterion is not satisfied.

3) Net Profit greater than or equal to INR 5 Crores: This criterion is satisfied in financial year ended March 31, 20X3.

Hence, the Company will be required to form a CSR committee.

Q3: ABC Ltd. manufactures consumable goods like bath soap, tooth brushes, soap cases etc. As part of its CSR policy, it has decided to that for every pack of these goods sold, INR 0.80 will go towards the 'Save trees foundation' which will qualify as a CSR spend as per Schedule VII. Consequently, at the year end, the company sold 25,000 such packs and a total of INR 20,000 was recognised as CSR expenditure. However, this amount was not paid to the foundation at the end of the financial year.

Required

Will the amount of INR 20,000 qualify to be a CSR expenditure? **[Nov 2018]**

Ans: By earmarking the amount from such sale for CSR expenditure, the company cannot show it as CSR expenditure. To qualify the amount to be CSR expenditure, it has to be spent. Hence, INR 20,000 will not be automatically considered as CSR expenditure until and unless it is spending on CSR activities.

(Deleted)

~~**Q4:** How can companies with small CSR funds take up CSR activities in a project/ program mode?~~

~~**Ans:** It has been clarified that companies can combine their CSR programs with other similar companies by pooling their CSR resources.~~

~~As per Rule 4 of the CSR Rules, a company may collaborate with other companies for undertaking projects or for CSR activities in such a manner that the CSR committees of the relevant companies are in a position to report separately on such projects in accordance with the prescribed Rules.~~

Q5: Due to immense loss to Nepal in the recent earthquake, one FMCG Company undertakes various commercial activities with considerable discounts and concessions at the related affected areas of Nepal for a continuous period of 3 months after earthquake. In the Financial Statements for the year 20X1-X2, the Management has shown the expenditure incurred on such activity as expenditure incurred to discharge Corporate Social Responsibility.

Required

State whether the treatment done by the management of management is correct. Explain with reasons.

Ans: The Companies Act, 2013 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

The statutory guidelines relating to CSR also require the deployment of funds for the benefit of the local area of the Company. Since Nepal is another country the expenditure done there i.e. in Nepal shall not qualify to be accounted as CSR expenditure.

Further, it is presumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the company. Therefore, the treatment done by the Management by showing the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

(Deleted)

~~**Q6:** ABC Ltd. is a company which comes under the ambit of Section 135 and CSR Rules. The Board of ABC Ltd did not appropriate the CSR funds and as a result there was no annual report on CSR in the Board's report for financial year ended March 31, 20X1.~~

~~Required: Is this a non-compliance as per the Act?~~

~~**Ans:** It has been clarified that as per Rule 9 of the CSR Rules, the Board's Report of a company qualifying under section 135 shall include an annual report on CSR, containing particulars specified in Annexure to CSR Rules. Reporting of CSR policy of the company in the Board's Report is a mandatory requirement. If the disclosure requirements are not fulfilled, penal consequences may be attracted under section 134(8) of the Companies Act.~~

Q7: A building is used for CSR activities of the company. The same is capitalised as 'an asset' in the books and depreciation is charged on the same as per the Companies Act, 2013. The Company claims the cost of the building as 'CSR expenditure' and also the depreciation thereon.

Required: Is this the correct treatment as per the Act?

Ans: In case the expenditure incurred by the company is of such nature which may give rise to an 'Asset', it should be recognised by the company in its balance sheet, provided the control over the asset is with the Company and future economic benefits are expected to flow to the company. Where any CSR asset is recognized in its balance sheet, the same may be classified under natural head (e.g. Building, Plant & Machinery etc.) with specific sub-head of 'CSR Asset' if the expenditure satisfies the definition of 'asset'.

For example, a building used for CSR activities where the beneficial interest has not been relinquished for lifetime by a company and from which any economic benefits flow to a company, may be recognised as 'CSR Building' for the purpose of reflecting the same in the balance sheet.

If an amount spent on an asset has been shown as CSR spend, then the depreciation on such asset cannot be claimed as CSR spend again. Once cost of the asset is included for CSR spend, then the depreciation on such asset will not be included for CSR spend even if the asset is capitalized in the books of accounts and depreciation charged thereon.

Q8: ABC Ltd is a Company which is covered under the ambit of CSR rules. As part of its CSR contribution an amount of INR 15,00,000 was spent as CSR expense towards the education of girl child. The average net profit of the company for the past three years was INR 70,00,000. As the Company incurred a CSR expense in excess of what is required by the rules, it decided to utilise this expense as a carry forward to the next year and reduce next year's CSR spend by INR 1,00,000.

Required: Can the excess expenditure towards CSR be carried forward to next financial year?

Ans: As per the current law of land, carry forward of excess amount over 2% of average profits, will be allowed, if the company decides to adjust such excess against future obligation.

If the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

Q9: After the havoc caused by flood in Jammu and Kashmir, a group of companies undertakes during the period from October, 20X1 to December, 20X1 various commercial activities, with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 20X1-20X2.

Required: State whether the management's intention is correct or not and why?

Ans: Corporate Social Responsibility (CSR) Reporting is an information communiqué with respect to discharge of social responsibilities of corporate entity. Through 'CSR Report' the corporate enterprises disclose the manner in which they are discharging their social responsibilities. More specifically, it is addressed to the public or society at large, although it can be squarely used by other user groups also.

Section 135 of the Companies Act, 2013 mandated the companies fulfilling the criteria mentioned in the said section to spend certain amount of their profit on activities as specified in the Schedule VII to the Act. Companies not falling within that criteria can also spend on CSR activities voluntarily. However, besides the requirements of constitution of a CSR committee and a CSR policy, the corporate entities should also take care that expenditure incurred for CSR should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Here, it is assumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the companies. Therefore, the intention of the management to highlight the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

Q10: ABC Ltd. carries out CSR activities from rented premises in Pune. The rent paid for such premises is disclosed as CSR expenditure and subsequently ABC Ltd. also claimed deduction of the same under the Income-tax Act. Is this permissible?

Ans: Based on the Explanatory Memorandum to the Bill, CSR expenditure which is of the nature described under the section 30 to 36 of the Income-tax Act shall be allowed as a deduction.

Rent expenses can be claimed under section 30 of the Act and hence it can be claimed as a deduction.

Q11: A property is being constructed to operate CSR activities by a company. At the balance sheet date, the cost of construction is treated as revenue expenditure. Are there any additional disclosures required in the financials regarding this?

Ans: Item 5 (a) of the General Instructions for Preparation of Statement of Profit and Loss under Schedule III to the Companies Act, 2013, requires that in case of companies covered under Section 135, the amount of expenditure incurred on 'Corporate Social Responsibility Activities' shall be disclosed by way of a note to the statement of profit and loss. The note should also disclose the details with regard to the expenditure incurred in construction of a capital asset under a CSR project.

Q12: State whether any unspent amount of CSR expenditure (any shortfall in the amount that was expected to be spent as per the provisions of the Companies Act on CSR activities) at the reporting date shall be provided for? Also state in case the excess amount has been spent (ie more than what is required as per the provisions of the Companies Act on CSR activities), can it be carry forward to set-off against future CSR expenditure.

Ans: **(i) Treatment of any unspent amount of CSR expenditure**

- Section 135 (5) of the Companies Act, 2013, requires that the Board of every eligible company, "shall ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy". A proviso to this Section states that "if the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount and, unless the unspent amount relates to any ongoing project, transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year".

- Any amount remaining unspent, pursuant to any ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within a period of thirty days from the end of the financial year to a special account to be opened by the company in that behalf for that financial year in any scheduled bank to be called the Unspent Corporate Social Responsibility Account. Such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of three financial years from the date of such transfer, failing which, the company shall transfer the same to a Fund specified in Schedule VII, within a period of thirty days from the date of completion of the third financial year.

- If a company contravenes the provisions, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to twenty- five lakh rupees and every officer of such company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

(ii) Treatment of excess amount spent on CSR Activities

As per the current law of land, carry forward of excess amount over 2% of average profits, will be allowed, if the company decides to adjust such excess against future obligation.

If the company decides not to carry forward such excess spend in full or in part, the same to the extent not carried forward is to be recognized as expense.

QUESTIONS FROM RTP/MTP/EXAMS

Q13: Sun Shine Limited is a company which seems to be covered under the ambit of CSR rules. As part of its CSR contribution an amount of ₹ 40,000 p.m. was spent by way of adoption of 2 families of drought hit area.

The average net profits of immediately preceding financial year was ₹ 1,80,00,000. Please note that the company commenced its commercial activities only on the first day of the immediately preceding financial year. The Accountant of the company says that CSR provisions are not applicable to his company since it is one year old and in case if it is applicable he wants to carry forward the excess amount spent on account of CSR activities to future years.

You are required to comment with the figures, whether the contention of the Accountant is correct in context of CSR provisions?

Exam Paper January 2021 (6 Marks)

Ans: As per section 135 of the Companies Act 2013, every company having either

- net worth of ₹ 500 crore or more, or
- turnover of ₹ 1,000 crore or more or
- a net profit of ₹ 5 crore or more

during the immediately preceding financial year shall constitute a Corporate Social Responsibility (CSR) Committee.

In the given case, the average net profits of immediate preceding financial year of Sun Shine Limited is ₹ 1,80,00,000 (i.e. ₹ 1.80 crore). Hence, net profit criteria is not met.

Company is covered under the ambit of CSR rules (assuming that net worth or turnover criteria is met):

Since it is given in the question that the company seems to be covered under the ambit of CSR rules, it is assumed that either the net worth of Sun Shine Limited might have exceeded ₹ 500 crore or more, or turnover might have exceeded ₹ 1,000 crore or more during immediate preceding financial year. Accordingly, CSR provisions are applicable to Sun Shine Limited irrespective of the fact that the company is in second year of operations.

If the company meets any one of the thresholds in the immediately preceding previous year, then the contention of accountant is incorrect that CSR provisions will not be applicable to the company as it is only one year old.

The accountant wants to carry forward the excess amount spent on account o f CSR activities to future years which is ₹ 1,20,000 [₹ 40,000 x 12 - (₹ 1,80,00,000 x 2%)]. However, there is no provision to carry forward the excess CSR expenditure spent ⍰⍰in a particular year. Hence, here also the contention of the accountant is incorrect. The excess expenditure made shall be considered as voluntary made by the entity.

Q14: Royal Ltd. is a company which has a net worth of ₹ 200 crore engaged in the manufacturing of rubber products. The sales of the company are badly affected due to pandemic during the Financial year 2019-2020.

Relevant financial details of the following financial years are as follows:

(₹ in crore)

Particulars	**31 March 2020 (Current year) estimated**	**31 March 2019**	**31 March 2018**	**31 March 2017**
Net Profit	3.00	8.50	4.00	3.00
Sales (turnover)	850	950	900	800

During the pandemic period (till 31 March 2020) various commercial activities were undertaken with considerable concessions/discounts, along the related affected areas. The management intends to highlight the expenditure incurred on such activities as expenditure incurred, on activities undertaken to discharge corporate social responsibility, while publishing its financial statements for the year 2019-2020.

You are requested to advise CFO of Royal Ltd on the below points along with reasons for your advise:

(i) Whether the Company has an obligation to form a CSR committee since the applicability criteria are not satisfied in the current financial year?

(ii) The accounting of expenditure during the pandemic period is to be treated as expenditure on CSR in the financial statement according to the view of the accountant of the company. **Exam Paper November 2020 (5 Marks)**

Ans: **(i)** A company which meets the net worth, turnover or net profits criteria in immediate preceding financial year will need to constitute a CSR Committee and comply with provisions of sections 135(2) to (5) read with the CSR Rules.

As per the criteria to constitute CSR committee -

(1) Net worth should be greater than or equal to ₹ 500 Crore: This criterion is not satisfied as per the facts given in the question.

(2) Sales should be greater than or equal to ₹ 1000 Crore: This criterion is not satisfied as per the facts given in the question.

(3) Net profit should be greater than or equal to ₹ 5 Crore: as per the facts given in the question, this criterion is satisfied in financial year ended 31 March 2019 i.e. immediate preceding financial year.

Hence, the Company will be required to form a CSR committee.

(ii) The Companies Act, 2013 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

Further, it is presumed that the commercial activities performed at concessional rates are the activities done in the ordinary course of business of the company other than the activities defined in Schedule VII of the Companies Act, 2013. Therefore, the treatment done by the Management by showing the expenditure incurred on such commercial activities in its financial statements as the expenditure incurred on activities undertaken to discharge CSR, is not correct.

CHAPTER 34
ANALYSIS OF FINANCIAL STATEMENTS

COMMON MISTAKES IN FINANCIAL STATEMENTS

Balance Sheets

- In Ind AS, Assets are not presented in the Balance sheet as 'Fixed Asset', rather they are classified under various categories of non-current assets as PPE etc. if question is silent, assume fixed assets are PPE
- PPE which are not ready for intended use as on the date of Balance Sheet are disclosed as "Capital work-in-progress". It would be reclassified from PPE to Capital work-in-progress.
- Land and building held for capital appreciation or for earning rental income should be reclassified as Investment property rather than PPE.
- ROU Asset will be separately shown under PPE or Investment property as per its classification.
- Goodwill acquired in a business combination to be shown separately from other Intangible Assets.
- If deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, these shall be set off, in accordance with Ind AS 12.
- Bank deposits with more than 12m to maturity should be disclosed under OTHER FINANCIAL ASSETS under Non-Current Assets
- Capital Advances should be always shown under Other Non-Current Assets.
- Non-Current Assets classified as held for Sale should be shown as a separate line item in Balance Sheet
- Trade Receivables/ Loan Receivables shall be sub-classified as;

  Trade Receivables considered good - Secured;

  Trade Receivables considered good - Unsecured;

  Trade Receivables which have significant increase in Credit Risk

  Trade Receivables - credit impaired

  Less: Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

- There is no need to subclassify trade receivable as outstanding for more than six months and outstanding within six months.
- Bonus shares issued; Shares issued for consideration other than cash & shares bought back should be DISCLOSED in Notes to Accounts.
- Debit balance of Profit and Loss should be shown as NEGATIVE FIGURE as Retained Earnings which will be shown under Other Equity.
- Reserve for Foreseeable Loss should NOT BE INCLUDED as RESERVES. It should be recognised as provisions either as current or non-current as the case may be.

- Interest Expense accrued but not due/ Interest Accrued and Due but not paid should be included in Current Liabilities as Other Financial Liabilities
- Accrued income (if not recognised) will be shown in SOPL as other income and as other financial assets under current liability in Balance sheet.
- Proposed Dividend after the end of the year shall be DISCLOSED in Notes to Accounts and shall not be included in Current Liabilities
- Other Financial Liabilities include Unpaid Dividends, Application money received for allotment of shares to the extent refundable
- Redeemable Preference Shares are presented under Non-Current Liabilities as Financial Liabilities – Borrowing.
- Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities.
  - Govt and other Statutory Dues are not FINANCIAL LIABILITIES. They need to be disclosed under Other Current Liabilities.
  - Income Tax Payable are not FINANCIAL LIABILITIES. They need to be disclosed as Current Tax Liabilities.
  - Unearned Revenue is not a FINANCIAL LIABILITY. It should be shown under Other Current Liabilities
- Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
  - Prepaid expenses are not a FINANCIAL ASSETS. They need to be disclosed under Other Current assets.
  - Income Tax Refundable are not FINANCIAL ASSETS. They need to be disclosed Current Tax assets.
- If a company applies retrospective application of Accounting Policy as per Ind AS 8, the company shall prepare 3rd Set of Balance Sheet at the Beginning of the Previous Year.
- Non-Controlling Interest should be shown as a part of Equity in CFS

Statement of Profit and Loss

- Preference Dividend on Preference shares classified as Financial Liability will be shown as Finance Cost in SOPL
- SOPL shall include Profit & Loss for the Current Period + OCI for the Period
- Profit & Loss attributable to Owners and NCI should be presented separately.
- Foreign Currency Translation Reserve as per Ind AS 21, FV Reserve as per Ind As 109 (FVTOCI Debt) & Cash Flow Hedging Reserve as per Ind AS 109 shall be RECLASSIFIED from OCI to PL as Reclassification adjustment.
- Revaluation Reserve as per Ind AS 16, FV Reserve as per Ind As 109 (FVTOCI Equity) & Remeasurement Reserve as per Ind As 19 shall be NOT BE RECLASSIFIED to PL.
- As per Division II of Schedule III to the Companies Act, 2013, the Statement of Profit and Loss should present the Earnings per Equity Share.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1: On April 1, 20X1, Pluto Ltd. has advance a loan for ₹ 10 lakhs to one of its employees for an interest rate at 4% per annum (market rate 10%) which is repayable in 5 equal annual installments along with interest at each year end. Employee is not required to give any specific performance against this benefit.

The accountant of the company has recognised the staff loan in the balance sheet equivalent to the amount disbursed i.e. ₹ 10 lakhs. The interest income for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. ₹ 40,000 (₹ 10 lakhs x 4%).

Required:

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment along with working for the same.

[MTP May 2019]

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 32 and Ind AS 109 on Financial Instruments' and Ind AS 19 'Employee Benefits'.

Para 11 (c) (i) of Ind AS 32 'Financial Instruments : Presentation' states that:

"A financial asset is any asset that is: (c) a contractual right: (i) to receive cash or….."

Further, paragraph 5.1.1 of Ind AS 109 states that:

"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 states that:

"The fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market(s) of interest rate of similar instrument with a similar credit rating. Any additional amount lent is an expense or reduction of income unless it qualifies for recognition as some other type of asset".

Further, paragraph 5.2.1 of Ind AS 109 states that:

"After initial recognition, an entity shall measure a financial asset at:

(a) amortised cost;

(b) fair value through other comprehensive income; or

(c) fair value through profit or loss.

Further, paragraph 5.4.1 of Ind AS 109 states that:

"Interest revenue shall be calculated by using the effective interest method. This shall be calculated by applying the effective interest rate to the gross carrying amount of a financial asset"

Paragraph 8 of Ind AS 19 states that:

"Employee Benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment".

The Accountant of Pluto Ltd. has recognised the staff loan in the balance sheet at ₹ 10 lakhs being the amount disbursed and ₹ 40,000 as interest income for the period is recognised at the contracted rate in the statement of profit and loss which is not correct and not in accordance with Ind AS 19, Ind AS 32 and Ind AS 109.

Accordingly, the staff advance being a financial asset shall be initially measured at the fair value and subsequently at the amortised cost. The interest income is calculated by using the effective interest method. The difference between the amount lent and fair value is charged as Employee benefit expense in statement of profit and loss.

a) Calculation of Fair Value of the Loan

Year	Cash Inflow	Discounting Factor (10%)	Present Value
1	2,40,000	0.909	2,18,160
2	2,32,000	0.826	1,91,632
3	2,24,000	0.751	1,68,224
4	2,16,000	0.683	1,47,528
5	2,08,000	0.621	1,29,168
Total			**8,54,712**

Staff loan should be initially recorded at ₹ 8,54,712.

b) Employee Benefit Expense

Loan Amount – Fair Value of the loan = ₹ 10,00,000 – ₹ 8,54,712 = ₹ 1,45,288

₹ 1,45,288 shall be charged as Employee Benefit expense in Statement of Profit and Loss for the year ended 31.03.20X2.

Amortisation table:

Year	Opening balance of Staff Advance (a)	Interest (10%) (b)= (a x 10%)	Repayment (c)	Closing balance of Staff Advance (d) = a + b -c
1	8,54,712	85,471	2,40,000	7,00,183
2	7,00,183	70,018	2,32,000	5,38,201
3	5,38,201	53,820	2,24,000	3,68,021
4	3,68,021	36,802	2,16,000	1,88,823
5	1,88,823	19,177 (b.f.)	2,08,000	*Nil*

Balance Sheet extracts showing the presentation of staff loan as at 31st March 20X2

Ind AS compliant Division II of Sch III needs to be referred for presentation requirement in Balance Sheet on Ind AS.

Assets	
Non-Current Assets	
Financial Assets	
(i) Loan	5,38,201
Current Assets	
Financial Assets	
(i) Loans (7,00,183 - 5,38,201)	1,61,982

Q2: Pluto Ltd. has purchased a manufacturing plant for ₹ 6 lakhs on 1 April 20X1. The useful life of the plant is 10 years. On 30th September 20X3, Pluto temporarily stops using the manufacturing plant because demand has declined. However, the plant is maintained in a workable condition and it will be used in future when demand picks up.

The accountant of Pluto ltd. decided to treat the plant as held for sale until the demands picks up and accordingly measures the plant at lower of carrying amount and fair value less cost to sell.

Also, the accountant has also stopped charging the depreciation for the rest of period considering the plant as held for sale. The fair value less cost to sell on 30th September 20X3 and 31 March 20X4 was ₹ 4 lakhs and ₹ 3.5 lakhs respectively.

The accountant has performed the following working: INR

Carrying amount on initial classification as held for sale	
Purchase Price of Plant	6,00,000
Less: Accumulated dep (6,00,000/ 10 Years)* 2.5 years	(1,50,000)
	4,50,000
Fair Value less cost to sell as on 31 March 20X3	4,00,000
The value will be lower of the above two	4,00,000

Balance Sheet extracts as on 31 March 20X4

Assets	
Current Assets	
Other Current Assets	
Assets classified as held for sale	3,50,000

Required:

Analyse whether the above accounting treatment made by the accountant is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same.

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 16 'Property, Plant and Equipment' and Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations'.

Para 6 of Ind AS 105 'Non-current Assets Held for Sale and Discontinued Operations' states that:

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

Paragraph 7 of Ind AS 105 states that:

"For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be highly probable. Thus, an asset (or disposal group) cannot be classified as a non-current asset (or disposal group) held for sale, if the entity intends to sell it in a distant future".

Further, paragraph 8 of Ind AS 105 states that:

"For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn."

Paragraph 13 of Ind AS 105 states that:

"An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use."

Paragraph 55 of Ind AS 16 states that:

"Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated."

Going by the guidance given above,

The Accountant of Pluto Ltd. has treated the plant as held for sale and measured it at the fair value less cost to sell. Also, the depreciation has not been charged thereon since the date of classification as held for sale which is not correct and not in accordance with Ind AS 105 and Ind AS 16.

Accordingly, the manufacturing plant should be treated as abandoned asset rather as held for sale because its carrying amount will be principally recovered through continuous use. Pluto Ltd. shall not stop charging depreciation or treat the plant as held for sale because its carrying amount will be recovered principally through continuing use to the end of their economic life.

The working of the same for presenting in the balance sheet is given as below:

Calculation of carrying amount as on 31 March 20X4	
Purchase Price of Plant	6,00,000

Less: Accumulated depreciation (6,00,000/ 10 Years)* 3 Years	(1,80,000)
	4,20,000

Balance Sheet extracts as on 31 March 20X4

Assets	
Non-Current Assets	
Property, Plant and Equipment	4,20,000

Q3: On 5th April, 20X2, fire damaged a consignment of inventory at one of the Jupiter's Ltd.'s warehouse. This inventory had been manufactured prior to 31st March 20X2 costing ₹ 8 lakhs. The net realisable value of the inventory prior to the damage was estimated at ₹ 9.60 lakhs. Because of the damage caused to the consignment of inventory, the company was required to spend an additional amount of ₹ 2 lakhs on repairing and re-packaging of the inventory. The inventory was sold on 15th May, 20X2 for proceeds of ₹ 9 lakhs.

The accountant of Jupiter Ltd treats this event as an adjusting event and adjusted this event of causing the damage to the inventory in its financial statement and accordingly re-measures the inventories as follows:

	INR lakhs
Cost	8.00
Net realisable value (9.6 -2)	7.60
Inventories (lower of cost and net realisable value)	7.60

Required:

Analyse whether the above accounting treatment made by the accountant in regard to financial year ending on 31.0.20X2 is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 10 'Events after the Reporting Period' and Ind AS 2 'Inventories'.

Para 3 of Ind AS 10 'Events after the Reporting Period' defines "Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 10 of Ind AS 10 states that:

"An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period".

Further, paragraph 6 of Ind AS 2 defines:

"Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".

Further, paragraph 9 of Ind AS 2 states that:

"Inventories shall be measured at the lower of cost and net realisable value".

Accountant of Jupiter Ltd. has re-measured the inventories after adjusting the event in its financial statement which is not correct and nor in accordance with provision of Ind AS 2 and Ind AS 10.

Accordingly, the event causing the damage to the inventory occurred after the reporting date and as per the principles laid down under Ind AS 10 'Events After the Reporting Date' is a non-adjusting event as it does not affect conditions at the reporting date. Non-adjusting events are not recognised in the financial statements, but are disclosed where their effect is material.

Therefore, as per the provisions of Ind AS 2 and Ind AS 10, the consignment of inventories shall be recorded in the Balance Sheet at a value of ₹ 8 Lakhs calculated below:

	INR' lakhs
Cost	8.00
Net realisable value	9.60
Inventories (lower of cost and net realisable value)	8.00

Q4: On April 1, 20X1, Sun Ltd. has acquired 100% shares of Earth Ltd. for ₹ 30 lakhs. Sun Ltd. has 3 cash-generating units A, B and C with fair value of ₹ 12 lakhs, 8 lakhs and 4 lakhs respectively. The company recognizes goodwill of ₹ 6 lakhs that relates to CGU 'C' only.

During the financial year 20X2-20X3, the CFO of the company has a view that there is no requirement of any impairment testing for any CGU since their recoverable amount is comparatively higher than the carrying amount and believes there is no indicator of impairment.

Required: Analyse whether the view adopted by the CFO of Sun Ltd is in compliance of the Ind AS. If not, advise the correct treatment in accordance with relevant Ind AS

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 36: Impairment of Assets.

Para 9 of Ind AS 36 'Impairment of Assets' states that "An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

Further, paragraph 10(b) of Ind AS 36 states that:

"Irrespective of whether there is any indication of impairment, an entity shall also test goodwill acquired in a business combination for impairment annually."

Sun Ltd has not tested any CGU on account of not having any indication of impairment is partially correct i.e. in respect of CGU A and B but not for CGU C. Hence the treatment made by the Company is not in accordance with Ind AS 36.

Accordingly, impairment testing in respect of CGU A and B are not required since there are no indications of impairment. However, Sun Ltd shall test CGU C irrespective of any indication of impairment annually as the goodwill acquired on business combination is fully allocated to CGU 'C'.

Q5: Neptune Ltd. issued 15,000, 12% convertible debentures for ₹ 15 lakhs of ₹ 100 each at face value on 1st April 20X1 which will be converted into equity instruments on 31st March 20X6. Similar debentures without conversion right carry interest rate of 15%.

The CFO of the company has advised to recognise the 12% debentures in the balance sheet equivalent to the amount of face value of debentures issued i.e. ₹ 15 lakhs. The interest expense for the period is recognised at the contracted rate in the Statement of Profit and Loss by the company i.e. ₹ 1,80,000 (₹ 15 lakhs x 12%).

Required: Analyse whether the above accounting treatment advised by CFO is in compliance with the Ind AS. If not, advise the correct treatment alongwith working for the same.

Ans: The above treatment needs to be analysed from the purview of provisions given in Ind AS 32, Ind AS 107 and Ind AS 109 on 'Financial Instruments'.

The terms of a financial instrument may be structured such that it contains both equity and liability components (i.e. by substance, the instrument is neither a liability nor an equity instrument in entirety).

Para 11 of Ind AS 32 'Financial Instruments : Presentation' states that:

"A financial liability is any liability that is: (a) a contractual obligation: (i) to deliver cash or .....

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities".

Paragraph 28 of Ind AS 32 states that:

"The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15."

Further, paragraph 32 of Ind AS 32 which deals with separating the liability and equity components, states that: "The issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole."

Further, paragraph 5.1.1 of Ind AS 109 states that:

"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".

Further, paragraph 5.1.1 of Appendix B to Ind AS 109 provides the guidance to determine the fair value of liability:

The fair value of the liability component on initial recognition is the present value of the contractual stream of future cash flows discounted at the market rate of interest that would have been applied to an instrument of comparable credit quality with substantially the same cash flows, on the same terms, but without the conversion option.

Further, paragraph 4.2.1 of Ind AS 109 provides that:

The financial liability component will be subsequently measured depending on its classification either as a financial liability at FVTPL, or as a Financial liability measured at amortised cost (using the effective interest rate method).

As per the facts of the case study given in the question, the liability component is measured at amortised cost using the effective interest rate method.

The equity component will not be required to remeasured.

The CFO of the Neptune Ltd. has advised to recognise 12% debenture in the balance sheet equivalent to the amount of face value of debentures issued i.e. ₹ 15 lakhs without separating into the liability and equity component and ₹ 1,80,000 as interest expense for the period is recognised at the contracted rate in the Statement of Profit and Loss which is not correct and not in accordance with Ind AS 32, 107 and 109.

Accordingly, the 12% debentures initially need to be separated between the liability and equity component using the guidance given under Ind AS 32. The liability component shall be initially measured at the fair value and subsequently at the amortised cost. The interest expense is calculated by using the effective interest method. It may be noted that equity component will not be remeasured.

a) Calculation of Financial liability INR

Year	Cash outflow	Discounting Factor (15%)	Present Value
1	1,80,000	0.870	1,56,600
2	1,80,000	0.756	1,36,080
3	1,80,000	0.658	1,18,440
4	1,80,000	0.572	1,02,960
5	1,80,000	0.497	89,460
Total			6,03,540

b) Separating the liability and equity components

Equity component = Fair value of the instrument as whole – Financial liability

= ₹ 15,00,000 – ₹ 6,03,540 = ₹ 8,96,460

The following journal entry is required to pass on the initial recognition of the instrument:

		₹	₹
Bank Account	Dr.	15,00,000	
To Financial Liability			6,03,540
To Equity			8,96,460

c) Amortisation table INR

Year	Opening balance of liability (a)	Interest (15%) (b)=(a) x 15%	Repayment (c)	Closing balance of liability (d) = (a +b -c)
1	6,03,540	90,531	1,80,000	5,14,071
2	5,14,071	77,111	1,80,000	4,11,182
3	4,11,182	61,677	1,80,000	2,92,859
4	2,92,859	43,929	1,80,000	1,56,788
5	1,56,788	23,212 (b.f.)	1,80,000	Nil

Balance Sheet extracts showing the presentation of compounded financial instrument as at 31st March 20X2

Ind AS compliant Division II of Schedule III needs to be referred for presentation requirement in Balance Sheet on Ind AS.

INR

Equity and Liabilities	
Equity	
Other Equity	
Equity component of compound financial instrument	*8,96,460*
Liabilities	
Non-Current liabilities	
Financial Liabilities	
(i) Borrowings (5,14,071 – 1,02,889)	4,11,182
Current liabilities	
Financial Liabilities	
(i) Borrowings (5,14,071 – 4,11,182)	1,02,889

The Equity component of compound financial instrument needs to be shown as a separate column in Statement of Changes in Equity as per Ind AS compliant Schedule III.

Q6: The company had spent ₹ 45 lakhs for publicity and research expenses on one of its new consumer product, which was marketed in the accounting year 20X1-20X2, but proved to be a failure.

Required: Analyse, how you will deal with this amount in the accounts of the company for the year ended 31stMarch, 20X2 with reference to Accounting Standards:

Ans: In the given case, the company spent ₹ 45 lakhs for publicity and research of a new product which was marketed but proved to be a failure. It is clear that in future there will be no related further revenue/benefit because of the failure of the product. Thus according to IND AS 38 'Intangible Assets', the company should charge the total amount of ₹ 45 lakhs as an expense in the profit and loss account.

Q7: A company with a turnover of ₹ 250 crores and an annual advertising budget of ₹ 2 crores had taken up the marketing of a new product. It was estimated that the company would have a turnover of ₹ 25 crores from the new product. The company had debited to its Profit and Loss account the total expenditure of ₹ 2 crore incurred on extensive special initial advertisement campaign for the new product.

Required: Evaluate the correctness of the procedure adopted by the company?

Ans: According to IND AS 38 'Intangible Assets', expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset.

In the given case, advertisement expenditure of ₹ 2 crores had been taken up for the marketing of a new product which may provide future economic benefits to an enterprise by having a turnover of ₹ 25 crores. Here, no intangible asset or other asset is acquired or created that can be recognised. Therefore, the accounting treatment by the company of debiting the entire advertising expenditure of ₹ 2 crores to the Profit and Loss account of the year is correct.

Q8: Good Drugs and Pharmaceuticals Ltd. acquired a sachet filling machine on 1st April, 20X1 for ₹ 60 lakhs. The machine was expected to have a productive life of 6 years. At the end of financial year 20X1-20X2 the carrying amount was ₹ 41 lakhs. A short circuit occurred in this financial year but luckily the machine did not get badly damaged and was still in working order at the close of the financial year. The machine was expected to fetch ₹ 36 lakhs, if sold in the market. The machine by itself is not capable of generating cash flows. However, the smallest group of assets comprising of this machine also, is capable of generating cash flows of ₹ 54 crore per annum and has a carrying amount of ₹ 3.46 crore. All such machines put together could fetch a sum of ₹ 4.44 crore if disposed.

Required: Discuss the applicability of Impairment loss.

Ans: As per provisions of IND AS 36 "Impairment of Assets", impairment loss is not to be recognized for a given asset if its cash generating unit (CGU) is not impaired. In the given question, the related cash generating unit which is group of asset to which the damaged machine belongs is not impaired; and the recoverable amount is more than the carrying amount of group of assets. Hence there is no need to provide for impairment loss on the damaged sachet filling machine.

Q9: On 1st January 20X2, Sun Ltd. was notified that a customer was taking legal action against the company in respect of a financial losses incurred by the customer. Customer alleged that the financial losses were caused due to supply of faulty products on 30th September 20X1 by the Company. Sun Ltd. defended the case but considered, based on the progress of the case up to 31st March 20X2, that there was a 75% probability they would have to pay damages of ₹ 10 lakhs to the customer.

However, the accountant of Sun Ltd. has not recorded this transaction in its financial statement as the case is not yet finally settled. The case was ultimately settled against the company resulting in to payment of damages of ₹ 12 lakhs to the customer on 15th May 20X2. The financials have been authorized by the Board of Directors in its meeting held on 18th May 20X2.

Required: Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' and Ind AS 10 'Events After the Reporting Period'.

Para 10 of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' defines:

"Provision is a liability of uncertain timing or amount.

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".

Further, paragraph 14 of Ind AS 37, states:

"A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation".

Further, paragraph 36 of Ind AS 37, states:

"The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period".

Further, paragraph 3 of Ind AS 10 'Events after the Reporting Period' defines:

"Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are approved by the Board of Directors in case of a company, and, by the corresponding approving authority in case of any other entity for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and

(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

Further, paragraph 8 of Ind AS 10 states that:

"An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period."

The Accountant of Sun Ltd. has not recognised the provision and accordingly not adjusted the amounts recognised in its financial statements to reflect adjusting events after the reporting period is not correct and nor in accordance with provision of Ind AS 37 and Ind AS 10.

As per given facts, the potential payment of damages to the customer is an obligation arising out of a past event which can be reliably estimated. Therefore, following the provision of Ind AS 37 'Provisions, Contingent Liabilities and Contingent Assets' – a provision is required. The provision should be for the best estimate of the expenditure required to settle the obligation at 31 March 20X2 which comes to ₹ 7.5 lakhs (₹ 10 lakhs * 75%).

Further, following the principles of Ind AS 10 'Events After the Reporting Period' evidence of the settlement amount is an adjusting event. Therefore, the amount of provision created shall be increased to ₹ 12 lakhs and accordingly be recognised as a current liability.

Q10: Mercury Ltd. is an entity engaged in plantation and farming on a large scale diversified across India. On 1st April 20X1, the company has received a government grant for ₹ 10 lakhs subject to a condition that it will continue to engage in plantation of eucalyptus tree for a coming period of five years.

The management has a reasonable assurance that the entity will comply with condition of engaging in the plantation of eucalyptus tree for specified period of five years and accordingly it recognises proportionate grant for ₹ 2 lakhs in Statement of Profit and Loss as income following the principles laid down under Ind AS 20 Accounting for Government Grants and Disclosure of Government Assistance.

Required: Analyse whether the above accounting treatment made by the management is in compliance of the Ind AS. If not, advise the correct treatment alongwith working for the same.

Ans: As per given facts, the company is engaged in plantation and farming. Hence Ind AS 41 Agriculture shall be applicable to this company.

The above facts need to be examined in the light of the provisions given in Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' and Ind AS 41 'Agriculture'.

Para 2(d) of Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance' states:

"This Standard does not deal with government grants covered by Ind AS 41, Agriculture".

Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:

"This Standard shall be applied to account for the government grants covered by paragraphs 34 and 35 when they relate to agricultural activity".

Further, paragraph 1 (c) of Ind AS 41 'Agriculture', states:

"If a government grant related to a biological asset measured at its fair value less costs to sell is conditional, including when a government grant requires an entity not to engage in specified agricultural activity, an entity shall recognise the government grant in profit or loss when, and only when, the conditions attaching to the government grant are met".

Understanding of the given facts, The Company has recognised the proportionate grant for ₹ 2 lakhs in Statement of Profit and Loss before the conditions attaching to government grant are met which is not correct and nor in accordance with provision of Ind AS 41 'Agriculture'.

Accordingly, the accounting treatment of government grant received by the Mercury Ltd. is governed by the provision of Ind AS 41 'Agriculture' rather Ind AS 20 'Accounting for Government Grants and Disclosure of Government Assistance'.

Government grant for ₹ 10 lakhs shall be recognised in profit or loss when, and only when, the conditions attaching to the government grant are met i.e. after the expiry of specified period of five years of continuing engagement in the plantation of eucalyptus tree.

Balance Sheet extracts showing the presentation of Government Grant as on 31st March 20X2

Liabilities	INR
Non-Current liabilities	
Other Non-Current Liabilities	
Government Grants	10,00,000

Q11: Mercury Ltd. has sold goods to Mars Ltd. at a consideration of ₹ 10 lakhs, the receipt of which receivable in three equal installments of ₹ 3,33,333 over a two year period (receipts on 1st April 20X1, 31st March 20X2 and 31st March 20X3).

The company is offering a discount of 5 % (i.e. ₹ 50,000) if payment is made in full at the time of sale. The sale agreement reflects an implicit interest rate of 5.36% p.a.

The total consideration to be received from such sale is at ₹ 10 Lakhs and hence, the management has recognised the revenue from sale of goods for ₹ 10 lakhs. Further, the management is of the view that there is no difference in this aspect between Indian GAAP and Ind AS.

Required: Analyse whether the above accounting treatment made by the accountant is in compliance of the Ind AS. If not, advise the correct treatment along with working for the same.

Ans: The above treatment needs to be examined in the light of the provisions given in Ind AS 115 : Revenue from Contract with customer

In determining the transaction price, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer.

A significant financing component may exist regardless of whether the promise of financing is explicitly stated in the contract or implied by the payment terms agreed to by the parties to the contract.

The objective when adjusting the promised amount of consideration for a significant financing component is for an entity to recognise revenue at an amount that reflects the price that a customer would have paid for the promised goods or services if the customer had paid cash for those goods or services when (or as) they transfer to the customer (ie the cash selling price).

The Transaction (cash price equivalent) of the sale of goods is calculated as follows: INR

Year	Consideration (Installment)	Present value factor	Present value of consideration
Time of sale	3,33,333	-	3,33,333

End of 1st year	3,33,333	0.949	3,16,333
End of 2nd year	3,33,334	0.901	3,00,334
	10,00,000		**9,50,000**

The Company that agrees for deferring the cash inflow from sale of goods will recognise the revenue from sale of goods and finance income as follows:

Initial recognition of sale of goods		INR	INR
Cash	Dr.		3,33,333
Trade Receivable	Dr.		6,16,667
To Sale		9,50,000	
Recognition of interest expense and receipt of second installment			
Cash	Dr.		3,33,333
To Interest Income		32,999	
To Trade Receivable		3,00,334	
Recognition of interest expense and payment of final installment			
Cash	Dr.		3,33,334
To Interest Income (Balancing figure)		17,000	
To Trade Receivable		3,16,333	

Balance Sheet and Profit and Loss extracts showing the presentation for the year ended as at for the year ending 31st March 20X2 and 31st March 20X3

Ind AS compliant Division II of Schedule III needs to be referred for presentation requirement in Balance Sheet and Profit and Loss on Ind AS.

Balance Sheet (extracts) as at 31st March 20X2 and 31st March 20X3 INR

	As at Mar 31, 20X2	**As at Mar 31, 20X3**
Assets		
Current Assets		
Financial Assets		
Trade Receivable	3,16,333	XXX

Statement of Profit and Loss (extracts) for the year ended 31st March 20X2 and 31st March 20X3

	As at Mar 31, 20X2	**As at Mar 31, 20X3**
Income		
Sale of Goods	9,50,000	-
Other Income (Finance income)	32,999	17,000

QUESTION FROM ICAI RTP/MTP/EXAMS

Q12: Mr. X, is the financial controller of ABC Ltd., a listed entity which prepares consolidated financial statements in accordance with Ind AS. Mr. X has recently produced the final draft of the financial statements of ABC Ltd. for the year ended 31st March, 2018 to the managing director for approval. Mr. Y, who is not an accountant, had raised following queries from Mr. X after going through the draft financial statements:

(a) One of the notes to the financial statements gives details of purchases made by ABC Ltd. from PQR Ltd. during the period. Mr. Y own 100% of the shares in PQR Ltd. However, he feels that there is no requirement for any disclosure to be made in ABC Ltd.'s financial statements since the transaction is carried out on normal commercial terms and is totally insignificant to ABC Ltd., as it represents less than 1% of ABC Ltd.'s purchases.

(b) The notes to the financial statements say that plant and equipment is held under the 'cost model'. However, property which is owner occupied is revalued annually to fair value. Changes in fair value are sometimes reported in profit or loss but usually in 'other comprehensive income'. Also, the amount of depreciation charged on plant and equipment as a percentage of its carrying amount is much higher than for owner occupied property. Another note states that property owned by ABC Ltd. but rent out to others is depreciated annually and not fair valued. Mr. Y is of the opinion that there is no consistent treatment of PPE items in the accounts. Elucidate how all these treatments comply with the relevant Ind AS.

(c) In the year to March, 2018, ABC Ltd. spent considerable amount on designing a new product. ABC Ltd. spent the six months from April, 2017 to September, 2017 researching into the feasibility of the product. Mr. X charged these research costs to profit or loss. From October, 2017, A Ltd. was confident that the product would be commercially successful and A Ltd. is fully committed to finance its future development. A Ltd. spent remaining part of the year in developing the product, which is expected to start from selling in the next few months. These development costs have been recognised as intangible assets in the Balance Sheet. State whether the treatment done by Mr. X is correct when all these research and development costs are design costs. Justify your answer with reference to relevant Ind AS.

Provide answers to the queries raised by the managing director Mr. Y as per Ind AS.

[RTP Nov 2018]

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

(a) Related parties are generally characterised by the presence of control or influence between the two parties.

Ind AS 24 'Related Party Disclosures' identifies related parties as, inter alia, key management personnel and companies controlled by key management personnel. On this basis, PQR Ltd. is a related party of ABC Ltd.

The transaction is required to be disclosed in the financial statements of ABC Ltd. since Mr. Y is Key Management personnel of ABC Ltd. Also at the same time, it owns 100% shares of PQR Ltd. ie. he controls PQR Ltd. This implies that PQR Ltd. is a related party of ABC Ltd.

Where transactions occur with related parties, Ind AS 24 requires that details of the transactions are disclosed in a note to the financial statements. This is required even if the transactions are carried out on an arm's length basis.

Transactions with related parties are material by their nature, so the fact that the transaction may be numerically insignificant to ABC Ltd. does not affect the need for disclosure.

(b) The accounting treatment of the majority of tangible non-current assets is governed by Ind AS 16 'Property, Plant and Equipment'. Ind AS 16 states that the accounting treatment of PPE is determined on a class by class basis. For this purpose, property and plant would be regarded as separate classes. Ind AS 16 requires that PPE is measured using either the cost model or the revaluation model. This model is applied on a class by class basis and must be applied consistently within a class. Ind AS 16 states that when the revaluation model applies, surpluses are recorded in other comprehensive income, unless they are cancelling out a deficit which has previously been reported in profit or loss, in which case it is reported in profit or loss. Where the revaluation results in a deficit, then such deficits are reported in profit or loss, unless they are cancelling out a surplus which has previously been reported in other comprehensive income, in which case they are reported in other comprehensive income.

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

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

(c) As per Ind AS 38 'Intangible Assets', the treatment of expenditure on intangible items depends on how it arose. Internal expenditure on intangible items incurred during research phase cannot be recognised as an asset. Once it can be demonstrated that a development project is likely to be technically feasible, commercially viable, overall profitable and can be adequately resourced, then future expenditure on the project can be recognised as an intangible asset. The difference in the treatment of expenditure upto 30th September, 2017 and expenditure after that date is due to the recognition phase ie. research or development phase.

Q13: Following are the Financial Statements of Abraham Ltd.:

Balance Sheet

Particulars	Note No.	As at 31st March, 2019 (₹ in lakh)
EQUITY AND LIABILITIES:		
Shareholders' funds		
Share capital (shares of ₹ 10 each)		1,000
Reserves and surplus	1	2,400
Non-current liabilities		
Long term borrowings	2	5,700
Deferred tax liabilities	3	400
Current liabilities		
Trade payables		300
Short-term provisions		300
Other current liabilities	4	200
Total		**10,300**
ASSETS		
Non-current assets		
Fixed assets		5,000
Deferred tax assets	3	700
Current assets		
Inventories		1,500
Trade receivables	5	1,100
Cash and bank balances		2,000
Total		**10,300**

Statement of Profit & Loss

Particular	Note No.	Year ended 31st March, 2019 (₹ in lakh)
Revenue from operations		6,000
Expenses:		
Employee benefit expense		1,200
Operating costs		3,199
Depreciation		450
Total expenses		4,849
Profit before tax		1,151
Tax expense		201
Profit after tax		950

Notes to Accounts:

Note 1: Reserves and surplus (₹ in lakh)

Capital reserve		500
Surplus from P & L		
Opening balance	550	
Additions	950	1,500
Reserve for foreseeable loss		400
Total		2,400

Note 2: Long-term borrowings

Term loan from bank	5,700
Total	5,700

Note 3: Deferred tax

Deferred tax asset	700
Deferred tax liability	400
Total	300

Note 4: Other current liabilities

Unclaimed dividends	10
Billing in advance	150
Other current liabilities	40
Total	200

Note 5: Trade Receivables

Considered good (outstanding within 6 months)	1,065
Considered doubtful (due from past 1 year)	40
Provision for doubtful debts	(5)
Total	1,100

Additional information:

1. Share capital comprises of 100 lakh shares of ₹ 10 each.
2. Term Loan from bank for ₹ 5,700 lakh also includes interest accrued and due of ₹ 700 lakh as on the reporting date.
3. Reserve for foreseeable loss is created against a service contract due within 6 months.
4. Inventory should be valued at cost ₹ 1,500 lakh, NRV as on date is ₹ 1,200 lakh.
5. A dividend of 10 % was declared by the Board of directors of the company.

6. Accrued Interest income of ₹ 300 lakh is not booked in the books of the company.
7. Deferred taxes related to taxes on income are levied by the same governing tax laws.

Identify and report the errors and misstatements in the above extracts and prepare corrected Balance Sheet and Statement of Profit & Loss and where required the relevant notes to the accounts with explanations thereof. **[Exam Nov 2019]**

Ans: Following adjustments / rectifications are required to be done

1. Reserve for foreseeable loss for ₹ 400 lakh, due within 6 months, should be a part of provisions. Hence it needs to be regrouped. If it was also part of previous year's comparatives, a note should be added in the notes to account on the regrouping done this year.
2. Interest accrued and due of ₹ 700 lakh on term loan will be a part of current liabilities. Thus, it should be shown under the heading "Other Current Liabilities".
3. As per Ind AS 2, inventories are measured at the lower of cost and net realisable value. The amount of any write down of inventories to net realisable value is recognised as an expense in the period the write-down occurs. Hence, the inventories should be valued at ₹ 1,200 lakh and write down of ₹ 300 lakh (₹ 1,500 lakh – ₹ 1,200 lakh) will be added to the operating cost of the entity.
4. In the absence of the declaration date of dividend in the question, it is presumed that the dividend is declared after the reporting date. Hence, no adjustment for the same is made in the financial year 2018-2019. However, a note will be given separately in this regard (not forming part of item of financial statements).
5. Accrued income will be shown in the Statement of Profit and Loss as 'Other Income' and as 'Other Current Asset' in the Balance Sheet.
6. Since the deferred tax liabilities and deferred tax assets relate to taxes on income levied by the same governing taxation laws, these shall be set off, in accordance with Ind AS 12. The net DTA of ₹ 300 lakh will be shown in the balance sheet.
7. As per Division II of Schedule III to the Companies Act, 2013, the Statement of Profit and Loss should present the Earnings per Equity Share.
8. In Ind AS, Assets are not presented in the Balance sheet as 'Fixed Asset', rather they are classified under various categories of Non-current assets. Here, it is assumed as 'Property, Plant and Equipment'.
9. The presentation of the notes to 'Trade Receivables' will be modified as per the requirements of Division II of Schedule III.

Balance Sheet of Abraham Ltd.

For the year ended 31st March, 2019

	Note No.	*(₹ in lakh)*
ASSETS		

Non-current assets		
Property, plant and equipment		5,000
Deferred tax assets	1	300
Current assets		
Inventories		1,200
Financial assets		
Trade receivables	2	1,100
Cash and cash equivalents		2,000
Others financial asset (accrued interest)		300
TOTAL		9,900
EQUITY AND LIABILITIES		
Equity		
Equity share capital	3	1,000
Other equity	4	2,000
Non-current liabilities		
Financial liabilities		
Long-term borrowings	5	5,000
Current liabilities		
Financial liabilities		
Trade payables		300
Others	6	710
Short-term provisions (300 + 400)	7	700
Other current liabilities	8	190
TOTAL		9,900

Statement of Profit and Loss of Abraham Ltd.

For the year ended 31st March, 2019

	Note No.	***(₹ in lakh)***
Revenue from operations	9	6,000
Other income		300
Total income		6,300
Expenses		
Operating costs		3,199
Change in inventories cost		300
Employee benefits expense		1,200
Depreciation		450
Total expenses		5,149

Profit before tax		1,151
Tax expense		(201)
Profit for the period		950
Earnings per equity share		
Basic		9.5
Diluted		9.5
Number of equity shares (face value of ₹ 10 each)		100 lakh

Statement of Changes in Equity of Abraham Ltd.

For the year ended 31st March, 2019

Equity Share Capital *(₹ in lakh)*

Balance at the beginning of the reporting period	Changes in Equity share capital during the year	Balance at the end of the reporting period
1,000	0	1,000

Other Equity *(₹ in lakh)*

Particulars	Reserves & Surplus		Total
	Capital reserve	Retained Earnings	
Balance at the beginning of the year	500*	550	1,050
Total comprehensive income for the year		950	950
Balance at the end of the year	500	1,500	2,000

***Note:** Capital reserve given in the Note 1 of the question is assumed to be brought forward from the previous year. However, alternatively, if it may be assumed as created during the year.

1. **Deferred Tax** *(₹ in lakh)*

Deferred Tax Asset	700
Deferred Tax Liability	400
	300

2. **Trade Receivables** *(₹ in lakh)*

Trade receivables considered good		1,065
Trade receivables which have significant increase in credit risk	40	
Less: Provision for doubtful debts	(5)	35
Total		1,100

3. **Long Term Borrowings** *(₹ in lakh)*

Term Loan from Bank (5,700 - 700)	5,000

Total	5,000

4. Other Financial Liabilities *(₹ in lakh)*

Unclaimed dividends	10
Interest on term loan	700
Total	710

5. Short-term provisions *(₹ in lakh)*

Provisions	300
Foreseeable loss against a service contract	400
Total	700

6. Other Current Liabilities *(₹ in lakh)*

Billing in Advance	150
Other	40
Total	190

7. Dividends not recognised at the end of the reporting period

At year end, the directors have recommended the payment of dividend of 10% ie ₹ 1 per equity share. This proposed dividend is subject to the approval of shareholders in the ensuing annual general meeting.

Q14: Deepak started a new company Softbharti Pvt. Ltd. with Iktara Ltd. wherein investment of 55% is done by Iktara Ltd. and rest by Deepak. Voting powers are to be given as per the proportionate share of capital contribution. The new company formed was the subsidiary of Iktara Ltd. with two directors, and Deepak eventually becomes one of the directors of company. A consultant was hired and he charged ₹ 30,000 for the incorporation of company and to do other necessary statuary registrations. ₹ 30,000 is to be charged as an expense in the books after incorporation of company. The company, Softbharti Pvt. Ltd. was incorporated on 1st April 2019.

The financials of Iktara Ltd. are prepared as per Ind AS.

An accountant who was hired at the time of company's incorporation, has prepared the draft financials of Softbharti Pvt. Ltd. for the year ending 31st March, 2020 as follows:

Statement of Profit and Loss

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income	1,00,000
Total Revenue (a)	**11,00,000**
Expenses:	
Purchase of stock in trade	5,00,000
(Increase)/Decrease in stock in trade	(50,000)

Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses (b)	**7,45,000**
Profit before tax (c) = (a)-(b)	**3,55,000**
Current tax	1,06,500
Deferred tax	6,000
Total tax expense (d)	**1,12,500**
Profit for the year (e) = (c) – (d)	**2,42,500**

Balance Sheet

Particulars	**Amount (₹)**
EQUITY AND LIABILITIES	
(1) Shareholders' Funds	
(a) Share Capital	1,00,000
(b) Reserves & Surplus	2,27,500
(2) Non-Current Liabilities	
(a) Long Term Provisions	25,000
(b) Deferred tax liabilities	6,000
(3) Current Liabilities	
(a) Trade Payables	11,000
(b) Other Current Liabilities	45,000
(c) Short Term Provisions	1,06,500
TOTAL	**5,21,000**
ASSETS	
(1) Non Current Assets	
(a) Property, plant and equipment (net)	1,00,000
(b) Long-term Loans and Advances	40,000
(c) Other Non Current Assets	50,000
(2) Current Assets	
(a) Current Investment	30,000
(b) Inventories	80,000
(c) Trade Receivables	55,000
(d) Cash and Bank Balances	1,15,000
(e) Other Current Assets	51,000
TOTAL	**5,21,000**

Additional information of Softbharti Pvt Ltd.:

- Deferred tax liability of ₹ 6,000 is created due to following temporary difference: Difference in depreciation amount as per Income tax and Accounting profit
- There is only one property, plant and equipment in the company, whose closing balance as at 31st March, 2020 is as follows:

Asset description	As per Books	As per Income tax
Property, plant and equipment	₹1,00,000	₹80,000

- Pre incorporation expenses are deductible on straight line basis over the period of five years as per Income tax. However, the same are immediately expensed off in the books.
- Current tax is calculated at 30% on PBT - ₹ 3,55,000 without doing any adjustments related to Income tax. The correct current tax after doing necessary adjustments of allowances / disallowances related to Income tax comes to ₹ 1,25,700.
- After the reporting period, the directors have recommended dividend of ₹ 15,000 for the year ending 31st March, 2020 which has been deducted from reserves and surplus. Dividend payable of ₹ 15,000 has been grouped under 'other current liabilities' along with other financial liabilities.
- There are 'Government statuary dues' amounting to ₹ 15,000 which are grouped under 'other current liabilities'.
- The capital advances amounting to ₹ 50,000 are grouped under 'Other non-current assets'.
- Other current assets of ₹ 51,000 comprise Interest receivable from trade receivables.
- Current investment of ₹ 30,000 is in shares of a company which was done with the purpose of trading; current investment has been carried at cost in the financial statements. The fair value of current investment in this case is ₹ 50,000 as at 31st March, 2020.
- Actuarial gain on employee benefit measurements of ₹ 1,000 has been omitted in the financials of Softbharti private limited for the year ending 31 st March, 2020.

The financial statements for financial year 2019-2020 have not been yet approved.

You are required to ascertain that whether the financial statements of Softbharti Pvt. Ltd. are correctly presented as per the applicable financial reporting framework. If not, prepare the revised financial statements of Softbharti Pvt. Ltd. after the careful analysis of mentioned facts and information. **[RTP Nov 2020]**

Ans: If Ind AS is applicable to any company, then Ind AS shall automatically be made applicable to all the subsidiaries, holding companies, associated companies, and joint ventures of that company, irrespective of individual qualification of set of standards on such companies.

In the given case it has been mentioned that the financials of Iktara Ltd. are prepared as per Ind AS. Accordingly the results of its subsidiary Softbharti Pvt. Ltd. should also have been prepared as per Ind AS. However, the financials of Softbharti Pvt. Ltd. have been presented as per accounting standards (AS).

Hence, it is necessary to revise the financial statements of Softbharti Pvt. Ltd. as per Ind AS after the incorporation of necessary adjustments mentioned in the question.

The revised financial statements of Softbharti Pvt. Ltd. as per Ind AS and Division II to Schedule III of the Companies Act, 2013 are as follows:

STATEMENT OF PROFIT AND LOSS

for the year ended 31st March, 2020

Particulars	Amount (₹)
Revenue from operations	10,00,000
Other Income (1,00,000 + 20,000) (refer note -1)	1,20,000
Total Revenue	11,20,000
Expenses:	
Purchase of stock in trade	5,00,000
(Increase) / Decrease in stock in trade	(50,000)
Employee benefits expense	1,75,000
Depreciation	30,000
Other expenses	90,000
Total Expenses	7,45,000
Profit before tax	3,75,000
Current tax	1,25,700
Deferred tax (W.N.1)	(1,200)
Total tax expense	1,24,500
Profit for the year (A)	2,50,500
OTHER COMPREHENSIVE INCOME	
Items that will not be reclassified to Profit or Loss: Remeasurements of net defined benefit plans	1,000
Tax liabilities relating to items that will not be reclassified to Profit or Loss Remeasurements of net defined benefit plans (tax) [1000 x 30%]	(300)
Other Comprehensive Income for the period (B)	700
Total Comprehensive Income for the period (A+B)	2,51,200

BALANCE SHEET

as at 31st March, 2020

Particulars	(₹)
ASSETS	
Non-current assets	

Property, plant and equipment	1,00,000
Financial assets	
Other financial assets (Long-term loans and advances)	40,000
Deferred tax asset (1200-300)	900
Other non-current assets (capital advances) (refer note-2)	50,000
Current assets	
Inventories	80,000
Financial assets	
Investments (30,000 + 20,000) (refer note -1)	50,000
Trade receivables	55,000
Cash and cash equivalents/Bank	1,15,000
Other financial assets (Interest receivable from trade receivables)	51,000
TOTAL ASSETS	5,41,900
EQUITY AND LIABILITIES	
Equity	
Equity share capital	1,00,000
Other equity	2,51,200
Non-current liabilities	
Provision (25,000 – 1,000)	24,000
Current liabilities	
Financial liabilities	
Trade payables	11,000
Other financial liabilities (Refer note 5)	15,000
Other current liabilities (Govt. statuary dues) (Refer note 3)	15,000
Current tax liabilities	1,25,700
TOTAL EQUITY AND LIABILITIES	5,41,900

STATEMENT OF CHANGES IN EQUITY

For the year ended 31st March, 2020

A. EQUITY SHARE CAPITAL

	Balance (₹)
As at 31st March, 2019	-
Changes in equity share capital during the year	1,00,000
As at 31st March, 2020	1,00,000

B. OTHER EQUITY

	Reserves & Surplus
	Retained Earnings (₹)
As at 31st March, 2019	-
Profit for the year	2,50,500
Other comprehensive income for the year	700
Total comprehensive income for the year	2,51,200
Less: Dividend on equity shares (refer note – 4)	-
As at 31st March, 2020	2,51,200

DISCLOSURE FORMING PART OF FINANCIAL STATEMENTS:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (refer note-4)

Notes:

1. Current investment are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, ₹ 20,000 (50,000 – 30,000) increase in fair value of financial asset will be recognised in profit and loss.

2. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.

3. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities.

4. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1, Presentation of Financial Statements .

5. Other current financial liabilities:

	(₹)
Balance of other current liabilities as per financial statements	45,000
Less: Dividend declared for FY 2019 - 2020 (Note – 4)	(15,000)
Reclassification of government statuary dues payable to 'other current liabilities'	(15,000)
Closing balance	15,000

Working Note:

1. Calculation of deferred tax on temporary differences as per Ind AS 12 for financial year 2019 – 2020

Item	Carrying amount (₹)	Tax base (₹)	Difference (₹)	DTA / DTL @ 30% (₹)
Property, Plant and Equipment	1,00,000	80,000	20,000	6,000-DTL
Pre-incorporation expenses	Nil	24,000	24,000	7,200-DTA
			Net DTA	1,200-DTA

Q 15. Master Creator Private Limited (a subsidiary of listed company) is an Indian company to whom Ind AS are applicable. Following draft balance sheet is prepared by the accountant for year ending 31st March 20X2.

Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	Rs.
ASSETS	
Non-current assets	
Property, plant and equipment	85,37,500
Financial assets	
Other financial assets (Security deposits)	4,62,500
Other non-current assets (capital advances)	17,33,480
Deferred tax assets	2,54,150
Current assets	
Trade receivables	7,25,000
Inventories	5,98,050
Financial assets	
Investments	55,000
Other financial assets	2,17,370
Cash and cash equivalents	1,16,950
TOTAL ASSETS	1,27,00,000
EQUITY AND LIABILITIES	
Equity share capital	10,00,000
Non-current liabilities	
Other Equity	25,00,150
Deferred tax liability	4,74,850
Borrowings	64,00,000
Long term provisions	5,24,436
Current liabilities	
Financial liabilities	
Other financial liabilities	2,00,564

Trade payables	6,69,180
Current tax liabilities	9,30,820
TOTAL EQUITY AND LIABILITIES	1,27,00,000

Additional Information:

1. On 1st April 20X1, 8% convertible loan with a nominal value of Rs. 64,00,000 was issued by the entity. It is redeemable on 31st March 20X5 also at par. Alternatively, it may be converted into equity shares on the basis of 100 new shares for each Rs. 200 worth of loan.

   An equivalent loan without the conversion option would have carried interest at 10%. Interest of Rs. 5,12,000 has already been paid and included as a finance cost.

   Present Value (PV) rates are as follows:

Year End	@ 8%	@ 10%
1	0.93	0.91
2	0.86	0.83
3	0.79	0.75
4	0.73	0.68

2. After the reporting period, the board of directors have recommended dividend of Rs. 50,000 for the year ending 31st March, 20X1. However, the same has not been yet accounted by the company in its financials.

3. 'Other current financial liabilities' consists of the following:

Particulars	Amount (Rs.)
Wages payable	21,890
Salary payable	61,845
TDS payable	81,265
Interest accrued on trade payables	35,564

4. Property, Plant and Equipment consists following items:

Particulars	Amount (Rs.)	Remarks
Building	37,50,250	It is held for administration purposes
Land	15,48,150	It is held for capital appreciation
Vehicles	12,37,500	These are used as the conveyance for employees
Factory premises	20,01,600	The construction was started on 31st March 20X2 and consequently no depreciation has been charged on it. The construction activities will continue to happen, and it will take 2 years to complete and be available for use.

5. The composition of 'other current financial assets' is as follows:

Particulars	Amount (Rs.)
Interest accrued on bank deposits	57,720
Prepaid expenses	90,000
Royalty receivable from dealers	69,650

6. Current Investments consist of securities held for trading which are carried at fair value through profit & loss. Investments were purchased on 1st January,20X2 at Rs.55,000 and accordingly are shown at cost as at 31st March 20X2. The fair value of said investments as on 31st March 20X2 is Rs.60,000.

7. Trade payables and Trade receivables are due within 12 months.

8. There has been no changes in equity share capital during the year.

9. Entity has the intention to set off a deferred tax asset against a deferred tax liability as they relate to income taxes levied by the same taxation authority and the entity has a legally enforceable right to set off taxes.

10. Other Equity consists retained earnings only. The opening balance of retained earnings was Rs.21,25,975 as at 1st April 20X1.

11. No dividend has been actually paid by company during the year.

12. Assume that the deferred tax impact, if any on account of above adjustments is correctly calculated in financials.

Being Finance & Accounts manager, you are required to identify the errors and misstatements if any in the balance sheet of Master Creator Private Limited and prepare corrected balance sheet with details on the face of the balance sheet i.e. no need to prepare notes to accounts, after considering the additional information. Provide necessary explanations/workings for the treated items, wherever necessary.

[MTP May 2019]

Ans: Balance Sheet of Master Creator Private Limited as at 31st March, 20X2

Particulars	Working/ Note reference	(Rs.)
ASSETS Non-current assets Property, plant and equipment	1	49,87,750
Capital work-in-progress	2	20,01,600
Investment Property	3	15,48,150
Financial assets Other financial assets (Security deposits)		4,62,500

Other non-current assets (capital advances)	4	17,33,480
Current assets Inventories		5,98,050
Financial assets Investments (55,000 + 5,000)	5	60,000
Trade receivables	6	7,25,000
Cash and cash equivalents	7	1,16,950
Other financial assets	8	1,27,370
Other current assets (Prepaid expenses)	8	90,000
TOTAL ASSETS		1,24,50,850
EQUITY AND LIABILITIES		
Equity		
Equity share capital	A	10,00,000
Other equity	B	28,44,606
Non-current liabilities		
Financial liabilities		
8% Convertible loan	11	60,60,544
Long term provisions		5,24,436
Deferred tax liability	12	2,20,700
Current liabilities		
Financial liabilities		
Trade payables	13	6,69,180
Other financial liabilities	14	1,19,299
Other current liabilities (TDS payable)	15	81,265
Current tax liabilities		9,30,820
TOTAL EQUITY AND LIABILITIES		1,24,50,850

1. Statement of changes in equity For the year ended 31st March, 20X2

   A) Equity Share Capital

	Balance (Rs.)
As at 31st March, 20X1	10,00,000
Changes in equity share capital during the year	-
As at 31st March, 20X2	10,00,000

   B) Other Equity

	Retained Earnings (Rs.)	Equity component of Compound Financial Instrument (Rs.)	Total (Rs.)
As at 31st March, 20X1	21,25,975	-	21,25,975
Total comprehensive income for the year			
(25,00,150 + 5,000 - 85,504- 21,25,975)	2,93,671	-	2,93,671
Issue of compound financial instrument			
during the year	-	4,24,960	4,24,960
As at 31st March, 20X2	24,19,646	4,24,960	28,44,606

Disclosure forming part of Financial Statements:

Proposed dividend on equity shares is subject to the approval of the shareholders of the company at the annual general meeting and not recognized as liability as at the Balance Sheet date. (Note 9)

Notes/ Workings: (for adjustments/ explanations)

1. Property, plant and equipment are tangible items that: (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) are expected to be used during more than one period. Therefore, the items of PPE are Buildings (Rs. 37,50,250) and Vehicles (Rs. 12,37,500), since those assets are held for administrative purposes.
2. Property, plant and equipment which are not ready for intended use as on the date of Balance Sheet are disclosed as "Capital work-in-progress". It would be classified from PPE to Capital work-in-progress.
3. Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee as a right-of-use asset) to earn rentals or for capital appreciation or both, rather than for:
   a) use in the production or supply of goods or services or for administrative purposes; or
   b) sale in the ordinary course of business.

   Therefore, Land held for capital appreciation should be classified as Investment property rather than PPE.
4. Assets for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets.
5. Current investments here are held for the purpose of trading. Hence, it is a financial asset classified as FVTPL. Any gain in its fair value will be recognised through profit or loss. Hence, Rs. 5,000 (60,000 – 55,000) increase in fair value of financial asset will be recognised in profit and loss.

6. A contractual right to receive cash or another financial asset from another entity is a financial asset. Trade receivables is a financial asset in this case and hence should be reclassified.
7. Cash is a financial asset. Hence it should be reclassified.
8. Other current financial assets:

Particulars	Amount (Rs.)
Interest accrued on bank deposits	57,720
Royalty receivable from dealers	69,650
Total	1,27,370

Prepaid expenses does not result into receipt of any cash or financial asset. However, it results into future goods or services. Hence, it is not a financial asset.

9. As per Ind AS 10, 'Events after the Reporting Period', If dividends are declared after the reporting period but before the financial statements are approved for issue, the dividends are not recognized as a liability at the end of the reporting period because no obligation exists at that time. Such dividends are disclosed in the notes in accordance with Ind AS 1 , Presentation of Financial Statements.
10. 'Other Equity' cannot be shown under 'Non-current liabilities'. Accordingly, it is reclassified under 'Equity'.
11. There are both 'equity' and 'debt' features in the instrument. An obligation to pay cash i.e. interest at 8% per annum and a redemption amount will be treated as 'financial liability' while option to convert the loan into equity shares is the equity element in the instrument. Therefore, convertible loan is a compound financial instrument.

Calculation of debt and equity component and amount to be recognised in the books:

S. No	Year	Interest amount @ 8%	Discounting factor @ 10%	Amount
Year 1	20X2	5,12,000	0.91	4,65,920
Year 2	20X3	5,12,000	0.83	4,24,960
Year 3	20X4	5,12,000	0.75	3,84,000
Year 4	20X5	69,12,000	0.68	47,00,160
Amount to be recognised as a liability				59,75,040
Initial proceeds				(64,00,000)
Amount to be recognised as equity				4,24,960

***** In year 4, the loan note will be redeemed; therefore, the cash outflow would be Rs. 69,12,000 (Rs. 64,00,000 + Rs. 5,12,000).

Presentation in the Financial Statements:

In Statement of Profit and Loss for the year ended on 31 March 20 X2

Finance cost to be recognised in the Statement of Profit and Loss	Rs. 5,97,504
(59,75,040 x 10%)	
Less: Already charged to the Statement of Profit and Loss	(Rs.5,12,000)
Additional finance charge required to be recognised in the Statement	
of Profit and Loss	Rs. 85,504

In Balance Sheet as at 31 March 20X2

Equity and Liabilities		
Equity		
Other Equity (8% convertible loan)		4,24,960
Non-current liability		
Financial liability [8% convertible loan	[(59,75,040+ 5,97,504– 5,12,000)]	60,60,544

12. Since entity has the intention to set off deferred tax asset against deferred tax liability and the entity has a legally enforceable right to set off taxes, hence their balance on net basis should be shown as:

Particulars	Amount (Rs.)
Deferred tax liability	4,74,850
Deferred tax asset	(2,54,150)
Deferred tax liability (net)	2,20,700

13. A liability that is a contractual obligation to deliver cash or another financial asset to another entity is a financial liability. Trade payables is a financial liability in this case.

14. 'Other current financial liabilities':

Particulars	Amount (Rs.)
Wages payable	21,890
Salary payable	61,845
Interest accrued on trade payables	35,564
Total	1,19,299

15. Liabilities for which there is no contractual obligation to deliver cash or other financial asset to another entity, are not financial liabilities. Hence, TDS payable should be reclassified from 'Other current financial liabilities' to 'Other current liabilities' since it is not a contractual obligation.

CHAPTER 35
INTEGRATED REPORTING

INTRODUCTION

In the last few decades, the concept of value is slowly and gradually shifting from price based or market value of an entity to asset based whether it is tangible or intangible assets. Since the dynamics of the global economy are changing, today's organizations require to assess the value created over the time by actively managing a wider range of resources. Resources like intangible assets such as intellectual capital, research and development, brand value, natural and human capital have become as important as tangible assets in many industries. However, these intangible assets are not universally assessed in current financial reporting frameworks even though they often represent a substantial portion of market value.

ORGANISATIONAL STRUCTURE/ ISSUING AUTHORITY

Integrated Reporting (<IR>) is a concept first introduced in South Africa. Later on, this concept travelled to many countries like German, France, Spain, Brazil and UK and integrated reporting was made along with their financial statements in one or the other manner. In 2010, the International Integrated Reporting Council (IIRC) was set up which aims to create the globally accepted integrated reporting framework.

The International Integrated Reporting Council (IIRC) is a global coalition of:

- Regulators
- Investors
- Companies
- Standard setters
- The accounting profession and NGOs

Together, this coalition shares the view that communication about value creation should be the next step in the evolution of corporate reporting. With this purpose they issued the International Integrated Reporting (IR) Framework. The framework has been developed keeping in mind the greater flexibility to be given to the entity and the management in the reporting but at the same time should target to report the value created by the organisation through various capital.

Integrated Reporting as the name suggest will integrate both financial and non- financial information. In future, it will become the only report to be issued by the organisation.

WHAT IS INTEGRATED REPORTING <IR>?

Integrated reporting is a concept that has been created to better articulate the broader range of measures that contribute to long-term value and the role organizations play in society. Integrated Reporting is enhancing the way organizations think, plan and report the story of their business. Central to this is the proposition that value is increasingly shaped by factors additional to financial performance, such as reliance on the environment, social reputation, human capital skills and others.

This value creation concept is the backbone of integrated reporting and is the direction for the future of corporate reporting. In addition to financial capital, integrated reporting examines five additional capitals that should guide an organization's decision-making and long-term success — its value creation in the broadest sense.

"Integrated Reporting reflects how our company thinks and does business. This approach allows us to discuss material issues facing our business and communities and show how we create value, for shareholders and for society as a whole." Dimitris Lois, CEO, Coca-Cola HBC

Organizations are using <IR> to communicate a clear, concise, integrated story that explains how all of their resources are creating value. <IR> is helping businesses to think holistically about their strategy and plans, make informed decisions and manage key risks to build investor and stakeholder confidence and improve future performance.

Integrated Reporting (<IR>) promotes a more cohesive and efficient approach to corporate reporting and aims to improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.

Integrated Reporting (<IR>) is shaped by a diverse coalition including business leaders and investors to drive a global evolution in corporate reporting.

An integrated report is a concise communication about how an organization's:

- Strategy
- Governance
- Performance And
- Prospects

in the context of its external environment

It leads to the creation of value over:

- Short
- Medium And
- Long term

It's a portal by which the organisation communicates a holistic view of:

- Its Current position
- Where it's going And
- How it intends to get there

The report enables readers to make an assessment of the organisation's ability to create value in the future, with value creation referring to the value created for both the organisation and for others.

PURPOSE OF INTEGRATED REPORTING

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time.

An integrated report benefits all stakeholders interested in an organization's ability to create value over time, including:

- Employees
- Customers
- Suppliers
- Business partners
- Local communities
- Legislators
- Regulators and
- Policy-makers

SALIENT FEATURES OF INTEGRATED REPORTING FRAMEWORK

❖ Principle Based Approach

The International <IR> Framework (the Framework) takes a principles-based approach. This Framework identifies information to be included in an integrated report for use in assessing an organization's ability to create value; it does not set benchmarks for such things as the quality of an organization's strategy or the level of its performance.

It intent to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations while enabling a sufficient degree of comparability across organizations to meet relevant information needs.

❖ Targets the Private Sector or Profit Making Companies

This Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

❖ Identifiable Communication

An integrated report may be prepared in response to existing compliance requirements, and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication. It should include, transitionally on a comply or explain basis, a statement by those charged with governance accepting responsibility for the report.

An integrated report is intended to be more than a summary of information in other communications (e.g., financial statements, a sustainability report, analyst calls, or on a website); rather, it makes explicit the connectivity of information to communicate how value is created over time.

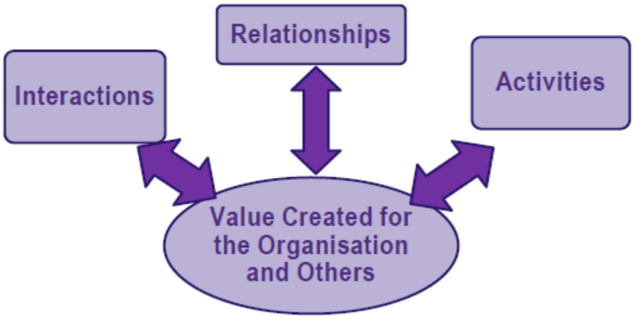
❖ Financial and Non-financial Items

The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates value over time. It, therefore, contains relevant information, both financial and other.

❖ Value Creation

Value created by an organization over time manifests itself in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs. That value has two interrelated aspects – value created for:

- The organization itself, which enables financial returns to the providers of financial capital
- Others (i.e., stakeholders and society at large)



THE CAPITALS

The capitals are stocks of value that are increased, decreased or transformed through the activities and outputs of the organization.

This is interrelated with the value the organization creates for stakeholders and society at large through a wide range of activities, interactions and relationships. When these are material to the organization's ability to create value for itself, they are included in the integrated report.

The concept of capitals seeks to assist an organisation in identifying all the resources and relationships it uses and affects to report in a comprehensive manner.

The Framework has categorise the capital into 6 main forms. However, at the same time, it stresses upon that not necessary the same categorisation of capital be followed by the entities in their integrated reporting.

❖ Financial Capital

The pool of funds

- 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

❖ 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)

> **Note:** Manufactured capital is often created by other organizations, but includes assets manufactured by the reporting organization for sale or when they are retained for its own use.

❖ 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

❖ Human Capital

People’s competencies, capabilities and experience, and their motivations to innovate, including their:

- Alignment with and support for an organization’s governance framework, risk management approach, and ethical values
- 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

❖ Social and Relationship Capital

The institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective well-being.

Social and relationship capital includes:

- Shared norms, and common values and behaviours
- Key stakeholder relationships, and the trust and willingness to engage that an organization has developed and strives to build and protect with external stakeholders
- Intangibles associated with the brand and reputation that an organization has developed
- An organization’s social licence to operate

❖ Natural Capital

All renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organization.

It includes:

- Air, water, land, minerals and forests
- Biodiversity and eco-system health

> **Note:** Not all capitals are equally relevant or applicable to all organizations. While most organizations interact with all capitals to some extent, these interactions might be relatively minor or so indirect that they are not sufficiently important to include in the integrated report.

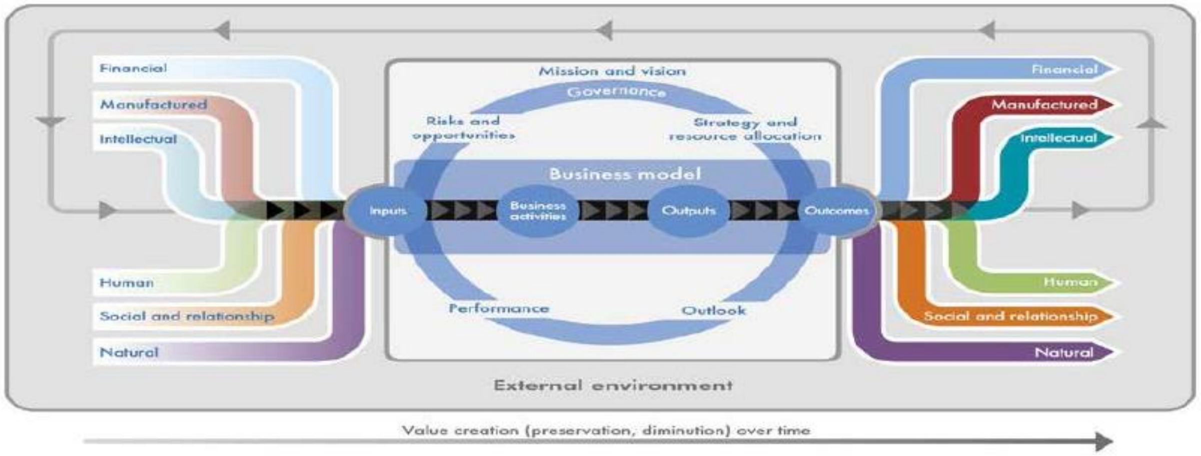
CONTRIBUTION OF CAPITALS IN VALUE CREATION

The stock of capitals available to the organization are increased, decreased or transformed as a result of the value it is creating through various activities. The connectivity and interdependence among the various capitals or inputs — specifically their influence on the organization's long-term financial performance — should be communicated in an integrated report.

The capitals not only interact with each other, but they are also influenced by external factors.

These include the economic climate, technological progress, social changes and environmental issues. Many a times, the capitals become an internally generated intangible asset.

To understand how an organization uses its capitals, how they relate to each other and the influence of external factors, it's vital to define the strategy, and a series of KPIs, to measure the strategy's progress.


Financial
Manufactured
Intellectual
Human
Social and relationship
Natural
Mission and vision
Governance
Risks and opportunities
Strategy and resource allocation
Business model
Inputs
Business activities
Outputs
Outcomes
Performance
Outlook
Financial
Manufactured
Intellectual
Human
Social and relationship
Natural
External environment
Value creation (preservation, diminution) over time

(Source of the above diagram: Framework of IR issued by IIRC)

GUIDING PRINCIPLES FOR PREPARATION AND PRESENTATION OF INTEGRATED REPORT

One of the distinguishing features of Integrated Reporting is that in contrast to compliance based reporting, there can be no model report.

Every report must be built around the unique business model of the preparer. This requires a very different mind -set when looking at examples of good reporting.

There are many good illustrations of how to report specific matters but examples can only provide a starting point for a company's own reporting, not a template.

The starting point for understanding how Integrated Reporting works is considering the application of the content elements and guiding principles of the IIRC's Integrated Reporting framework.

The following Guiding Principles underpin the preparation and presentation of an integrated report, informing the content of the report and how information is presented:

❖ Strategic Focus and Future Orientation

An integrated report should provide:

- Insight into the organization’s strategy and
- How it relates to the organization’s ability

  to create value and to its use of and effects on the capitals in:

  ♦ Short

  ♦ Medium and

  ♦ Long term
- An integrated report should answer the question that where does the organization wants to go and how does it intend to get there?
- The report should clearly show the linkages between strategy, risks and opportunities, current performance, as well as future outlook and targets.

Extract of ABC LTD Sustainability Report Year 2016

Building Natural Achievements and Social Capital

ABC’s vision of sustainable and inclusive growth has led to the adoption of a Triple Bottom Line approach that simultaneously builds economic, social and environmental capital.

It’s Social Investment Programmes, including Social Forestry, Soil & Moisture Conservation, Sustainable Agriculture, Livestock Development, Biodiversity, Women Empowerment, Education, Skilling & Vocational Training and Health & Sanitation, have had a transformational impact on rural India.

These Programmes strive to empower stakeholder communities to conserve, manage and augment their natural resources, create sustainable on and off-farm livelihood sources and improve social infrastructure in rural areas.

Through its Businesses and associated value chains, ABC has supported the generation of around 6 million livelihoods, touching the lives of many living at the margins in rural India. In line with its commitment to environmental goals, ABC has constantly strived to reduce the impact of its Businesses, processes, products and services and create a positive footprint.

ABC has adopted a low-carbon growth strategy through reduction in specific energy consumption and enhancing use of renewable energy sources.

ABC also endeavours to reduce specific water consumption and augment rainwater harvesting activities both on site and off site at watershed catchment areas, as well as minimise waste generation, maximise reuse & recycling and use external post-consumer waste as raw material in its units.

❖ Connectivity of Information

An integrated report shows the connections between the different components:

- Organisation's business model
- External factors that affect the organisation
- Various resources and relationships on which the organisation and its performance are dependent upon

Note: The report should highlight the connection, for example, between past, present and future performance, between financial and non-financial information, and between qualitative and quantitative information.

Sample Report

Schiphol Group Company – An Extract

Mission

We aim to rank among the world's leading airport companies. We create sustainable value for our stakeholders by developing Airport Cities and by positioning Amsterdam Airport Schiphol as Europe's preferred airport. Schiphol ranks among the most efficient transport hubs for air, rail and road connections and offers its visitors and the businesses located at Schiphol the services they require 24 hours a day, seven days a week.

Profile

XYZ Group is an airport operator, focusing particularly on Airport Cities. A prime example of an Airport City is Amsterdam Airport Schiphol. Europe's fifth-largest airport in terms of passengers and third-largest in terms of cargo.

In addition to our Dutch operations (Amsterdam Airport Schiphol, Rotterdam The Hague Airport, Eindhoven Airport and Lelystad Airport), we have direct and indirect operations in the United States, Australia, Italy, Indonesia, Aruba and Sweden.

Activities

The operation of airport and development of airport cities involve 3 inextricably linked business areas: Aviation, Consumers and Real Estate. The integrated activities of Aviation, Consumers and Real Estate form the core of the Airport City concept. This concept is not only applied to Amsterdam Airport Schiphol but also – either in part or in full – to other airports, particularly through the Alliances & Participations business area. Our revenues derived from this broad range of activities are made up for the most part of airport charges, concession fees, parking fees, retail sales, rents and leases, and income from our international activities.

Amsterdam Airport Schiphol is an important contributor to the Dutch economy. It serves as one of the home bases for Air France-KLM and its Sky Team partners, from which these airlines serve their European and intercontinental destinations. Amsterdam Airport Schiphol offers a high-quality network serving 301 destinations.

Strategy

The maintenance and reinforcement of the Main Port's competitive position, and that of Amsterdam Airport Schiphol in particular, is the single most important objective on which our strategy is focused. This strategy combines the airport's socio-economic function with our entrepreneurial business operations.

The interconnection and interaction between these two elements are crucial for the robust and future-proof development of Schiphol Group going forward. Corporate Responsibility is an integral part of this strategy and has been permeating increasingly all aspects of our operations.

Stakeholders

Schiphol Group has many stakeholders and their interests can be quite divergent. We do our utmost to conduct an active dialogue with all our stakeholders. In this, and in everything else that we do, our core values play a key role: reliability, efficiency, hospitality, inspiration and sustainability. Achieving the ambition to be Europe's preferred airport calls for a culture driven by a desire to fulfil or, better yet, surpass the expectations of customers and local stakeholders.

❖ Stakeholder Relationships

An integrated report should provide insight into:

- Nature and Quality of the organization's relationships with its
- Key stakeholders

including how and to what extent the organization understands, takes into account and responds to their legitimate needs and interests.

❖ Materiality

An integrated report should disclose information about matters that substantively affect the organization's ability to create value over:

- Short
- Medium
- Long term

Note: A focus on materiality should assist in avoiding irrelevant and detailed information from cluttering the report. The integrated report is a high-level, concise report that contains only the most material matters and information affecting the organisation and its ability to create value over time. Additional information can be placed in supporting reports.

❖ Conciseness

An integrated report should be concise.

Note: Conciseness implies more than 'as short as possible'. It implies that the information should be accessible through crisp presentation, the omission of immaterial information, and a logical easy-to-follow structure.

❖ Reliability and Completeness

An integrated report should include all material matters, both positive and negative, in a balanced way and without material error.

Note: Integrated reporting requires that consideration is given to both good and bad news and performance. Furthermore, both the increases and reductions in the value of the important capitals should be reflected. Where the information is not perfectly accurate, estimates should be used and appropriate processes in place to ensure that the risk of material misstatement is reduced.

❖ Consistency and Comparability

The information in an integrated report should be presented:

- On a basis that is consistent over time.
- In a way that enables comparison with other organizations to the extent it is material to the organization's own ability to create value over time.

Note: The use of industry benchmarks, indicators of best practice, and ratios are tools that can improve reporting consistency and industry comparability.

CONTENTS OF INTEGRATED REPORTING

An integrated report includes the eight Content Elements.

The Content Elements are fundamentally linked to each other and are not mutually exclusive. The order of the Content Elements is not the only way they could be sequenced.

The Content Elements are not intended to serve as a standard structure for an integrated report with information about them appearing in a set sequence or as isolated, standalone sections. Rather, information in an integrated report is presented in a way that makes the connections between the Content Elements apparent.

The content of an organization's integrated report will depend on the individual circumstances of the organization. The Content Elements are therefore stated in the form of questions rather than as checklists of specific disclosures. Accordingly, judgement needs to be exercised in applying the Guiding Principles to determine what information is reported, as well as how it is reported.

The eight content elements suggested by the Framework are:

❖ Organizational Overview and External Environment

Question to be answered through this element in the integrated reporting is

"What does the organisation do and what are the circumstances under which it operates?"

- **Organisational Overview:** An integrated report identifies the organization's mission and vision, and provides essential context by identifying matters such as:

  A. The organization's:

  - ♦ Culture, ethics and values
  - ♦ Ownership and operating structure
  - ♦ Principal activities and markets
  - ♦ Competitive landscape and market positioning (considering factors such as the threat of new competition and substitute products or services, the bargaining power of customers and suppliers, and the intensity of competitive rivalry)

- ♦ Position within the value chain

B. KQI: Key quantitative information

Example:

- ♦ Number of employees
- ♦ Revenue
- ♦ Number of countries in which the organization operates
- ♦ Highlighting, in particular, significant changes from prior periods

C. Significant factors

- ♦ Significant factors affecting the external environment and the organization's response

- **External Environment:** Significant factors affecting the external environment include aspects of:
  - Legal
  - Commercial
  - Social
  - Environmental
  - Political context

  That affects the organization's ability to create value in the short, medium or long term

> **Note:** They can affect the organization directly or indirectly (e.g., by influencing the availability, quality and affordability of a capital that the organization uses or affects).

❖ Governance

Question to be answered through this element in the integrated reporting is

"How does the organisation's governance structure support its ability to create value in the short, medium and long term?"

An integrated report provides insight about how such matters as the following are linked to its ability to create value:

- The organization's leadership structure, including the skills and diversity (e.g., range of backgrounds, gender, competence and experience) of those charged with governance and whether regulatory requirements influence the design of the governance structure.
- Specific processes used to make strategic decisions and to establish and monitor the culture of the organization, including its attitude to risk and mechanisms for addressing integrity and ethical issues

- Particular actions those charged with governance have taken to influence and monitor the strategic direction of the organization and its approach to risk management
- How the organization's culture, ethics and values are reflected in its use of and effects on the capitals, including its relationships with key stakeholders
- Whether the organization is implementing governance practices that exceed legal requirements
- The responsibility those charged with governance take for promoting and enabling innovation
- How remuneration and incentives are linked to value creation in the short, medium and long term, including how they are linked to the organization's use of and effects on the capitals.

❖ Business Model

Question to be answered through this element in the integrated reporting is "What is the organisation's business model?"

An integrated report describes the business model, including key:

- Inputs
- Business activities
- Outputs
- Outcomes

➢ Inputs

An integrated report shows how key inputs relate to the capitals on which the organization depends, or that provide a source of differentiation for the organization, to the extent they are material to understanding the robustness and resilience of the business model.

➢ Business Activities

An integrated report describes key business activities. This can include:

- How the organization differentiates itself in the market place?

> **Example:** Through product differentiation, market segmentation, delivery channels and marketing

- The extent to which the business model relies on revenue generation after the initial point of sale

> **Example:** Extended warranty arrangements or network usage charges

- How the organization approaches the need to innovate?
- How the business model has been designed to adapt to change?

➢ Outputs

An integrated report identifies an organization's key products and services. There might be other outputs, such as by-products and waste (including emissions), that need to be discussed within the business model disclosure depending on their materiality.

➢ Outcomes

An integrated report describes key outcomes, including:

- Both internal outcomes (e.g., employee morale, organizational reputation, revenue and cash flows) and external outcomes (e.g., customer satisfaction, tax payments, brand loyalty, and social and environmental effects)
- Both positive outcomes (i.e., those that result in a net increase in the capitals and thereby create value) and negative outcomes (i.e., those that result in a net decrease in the capitals and thereby diminish value).

❖ Risks and Opportunities

Question to be answered through this element in the integrated reporting is

"What are the specific risks and opportunities that affect the organisation's ability to create value over the short, medium and long-term, and how is the organisation dealing with them?"

An integrated report identifies the key risks and opportunities that are specific to the organization, including those that relate to the organization's effects on, and the continued availability, quality and affordability of, relevant capitals in the short, medium and long term.

❖ Strategy and Resource Allocation

Question to be answered through this element in the integrated reporting is

"Where does the organisation want to go and how does it intend to get there?"

An integrated report ordinarily identifies:

- The organization's short, medium and long term strategic objectives
- The strategies it has in place, or intends to implement, to achieve those strategic objectives
- The resource allocation plans it has to implement its strategy
- How it will measure achievements and target outcomes for the short, medium and long term.

❖ Performance

Question to be answered through this element in the integrated reporting is

"To what extent has the organisation achieved its strategic objectives for the period and what are its outcomes in terms of effects on the capitals?"

An integrated report contains qualitative and quantitative information about performance that may include matters such as:

- Quantitative indicators with respect to targets and risks and opportunities, explaining their significance, their implications, and the methods and assumptions used in compiling them
- The organization's effects (both positive and negative) on the capitals, including material effects on capitals up and down the value chain
- The state of key stakeholder relationships and how the organization has responded to key stakeholders' legitimate needs and interests
- The linkages between past and current performance, and between current performance and the organization's outlook

❖ Outlook

Question to be answered through this element in the integrated reporting is

“What challenges and uncertainties is the organisation likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?”

An integrated report ordinarily highlights anticipated changes over time and provides information, built on sound and transparent analysis, about:

- The organization’s expectations about the external environment the organization is likely to face in the short, medium and long term
- How that will affect the organization
- How the organization is currently equipped to respond to the critical challenges and uncertainties that are likely to arise.

❖ Basis of Preparation and Presentation

Question to be answered through this element in the integrated reporting is

“How does the organization determine what matters to include in the integrated report and how are such matters quantified or evaluated?”

An integrated report describes its basis of preparation and presentation, including:

- A summary of the organization’s
  - ♦ Materiality determination process
- A description of:
  - ♦ Reporting boundary and how it has been determined
- A summary of
  - ♦ Significant frameworks and methods used to quantify or evaluate material matters

General Reporting Guidance

The following general reporting matters are relevant to various Content Elements:

- Disclosure of Material matters
- Disclosures about Capitals
- Time frames for short, medium and long term
- Aggregation and disaggregation

INTERNATIONAL ACCOUNTING STANDARDS BOARD LOOKING AT THE ROLE OF WIDER REPORTING

The International Accounting Standards Board (IASB) as part of its 'better communication' work is studying and consulting on wider corporate reporting, including developments in Integrated Reporting, as it considers the role the IASB may take going forward.

One possibility is that the IASB might consider a project to revise and update its existing Practice Statement Management Commentary.

Businesses that are looking to communicate a broader story of value creation can use the International IR Framework alongside IFRS.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

SEBI vide its circular no. SEBI/HO/CFD/CMD/CIR/P/2017/10 February 6, 2017 has advised top 500 companies [to whom Business Responsibility Report (‘BRR’) have been mandated under Regulation 34(2)(f) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("SEBI LODR")], to adopt Integrated Reporting on a voluntary basis from the financial year 2017-18.

The objective behind recommending voluntary adoption of Integrated Reporting is to improve disclosure standards. An integrated report aims to provide a concise communication about how an organisation's strategy, governance, performance and prospects create value over time so that interested stakeholders may make investment decisions accordingly. Today an investor seeks both financial as well as non-financial information to take a well-informed investment decision.

Therefore, towards the objective of improving disclosure standards, in consultation with industry bodies and stock exchanges, the listed entities are advised to adhere to the following:

(a) The information related to Integrated Reporting may be provided in the annual report separately or by incorporating in Management Discussion & Analysis or by preparing a separate report (annual report prepared as per IR framework).

(b) In case the company has already provided the relevant information in any other report prepared in accordance with national/international requirement / framework, it may provide appropriate reference to the same in its Integrated Report so as to avoid duplication of information.

(c) As a green initiative, the companies may host the Integrated Report on their website and provide appropriate reference to the same in their Annual Report.

QUESTIONS FROM ICAI STUDY MATERIAL

Q1. State the categories defined in the International IR Framework for capitals. Comment whether an organisation has to follow these categories rigidly.

Ans: Various categories of capital are:

- Financial
- Manufactured
- Intellectual
- Human
- Social and Relationship
- Natural

Organizations preparing an integrated report are not required to adopt this categorization or to structure their report along the above lines of the capitals.

Q2: Can a Not-for Profit organisation do the Integrated Reporting as per the Framework?

Ans: The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by public sector and not-for-profit organizations.

Q3: Can an integrated reporting be done in compliance to the requirements of the local laws to prepare a management commentary or other reports?

Ans: An integrated report may be prepared in response to existing compliance requirements. For example, an organization may be required by local law to prepare a management commentary or other report that provides context for its financial statements. If that report is also prepared in accordance with this Framework it can be considered an integrated report. If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

Q4: With respect to Integrated Reporting, state whether following statements are true or f alse with reason for your answer:

(i) An integrated report is necessarily to be a stand-alone report;

(ii) The framework of Integrated reporting is written primarily for private companies;

(iii) A report prepared as required by local law containing a management commentary or other report that provides context for its financial statements can serve the purpose of Integrated reporting; and

(iv) An integrated report should include only positive material matters.

Exam Paper January 2021 (6 Marks)

Ans: (i) **False.** An integrated report may be prepared in response to existing compliance requirements and may be either a standalone report or be included as a distinguishable, prominent and accessible part of another report or communication.

(ii) **True.** The Framework is written primarily in the context of private sector, for-profit companies of any size but it can also be applied, adapted as necessary, by pub lic sector and not-for-profit organizations.

(iii) **True.** If the report is required to include specified information beyond that required by this Framework, the report can still be considered an integrated report if that other information does not obscure the concise information required by this Framework.

(iv) **False.** An integrated report should include all material matters, both positive and negative, in a balanced way and without material error. Both the increases and reductions in the value of the important capital should be reflected. Where the information is not perfectly accurate, estimates should be used and appropriate processes should be in place to insure that the risk of material misstatement is reduced.