PREFACE

In the curricular structure introduced by this University for students of Post-Graduate degree programme, the opportunity to pursue Post-Graduate course in a subject is introduced by this University is equally available to all learners. Instead of being guided by any presumption about ability level, it would perhaps stand to reason if receptivity of a learner is judged in the course of the learning process. That would be entirely in keeping with the objectives of open education which does not believe in artificial differentiation. I am happy to note that University has been recently accredited by National Assessment and Accreditation Council of India (NAAC) with grade 'A'.

Keeping this in view, study materials of the Post-Graduate level in different subjects are being prepared on the basis of a well laid-out syllabus. The course structure combines the best elements in the approved syllabi of Central and State Universities in respective subjects. It has been so designed as to be upgradable with the addition of new information as well as results of fresh thinking and analysis.

The accepted methodology of distance education has been followed in the preparation of these study materials. Co-operation in every form of experienced scholars is indispensable for a work of this kind. We, therefore, owe an enormous debt of gratitude to everyone whose tireless efforts went into the writing, editing, and devising of a proper layout of the materials. Practically speaking, their role amounts to an involvement in 'invisible teaching'. For, whoever makes use of these study materials would virtually derive the benefit of learning under their collective care without each being seen by the other.

The more a learner would seriously pursue these study materials the easier it will be for him or her to reach out to larger horizons of a subject. Care has also been taken to make the language lucid and presentation attractive so that they may be rated as quality self-learning materials. If anything remains still obscure or difficult to follow, arrangements are there to come to terms with them through the counselling sessions regularly available at the network of study centres set up by the University.

Needless to add, a great deal of these efforts are still experimental—in fact, pioneering in certain areas. Naturally, there is every possibility of some lapse or deficiency here and there. However, these do admit of rectification and further improvement in due course. On the whole, therefore, these study materials are expected to evoke wider appreciation the more they receive serious attention of all concerned.

Prof. (Dr.) Subha Sankar Sarkar
Vice-Chancellor

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Netaji Subhas Open University

Post Graduate Degree Programme

Subject : Commerce (M. Com)

Course : Corporate Financial Accounting and Reporting

Code : PGCO-VI

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Kishore Sengupta
Registrar

Netaji Subha Open University

Subject : **Post Graduate Commerce (M. Com)**
Course : Corporate Financial Accounting and Reporting
Code : PGCO-VI

Module - I

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Unit 1 □ Disclosures in Company Accounts and Accounting Standards

Structure

1.1 Objective

1.2 Introduction

1.3 Objectives of Disclosure

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1.5.1 Disclosure in Company Accounts as per Companies Act 2013

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1.5.3 Disclosures in Company Accounts as per SEBI Regulations

1.6 Summary

1.7 Exercises

1.1 Objective

After going through this unit, you will be able to:

- Understand the disclosure requirements as per the Companies Act, 2013;
- Know the disclosure requirements as per the Indian Accounting Standards notified by the Ministry of Corporate Affairs in India;
- Know the disclosure requirements as per the SEBI regulations

1.2 Introduction

Companies usually prepare financial statements to provide useful financial information to the users. However, preparation and presentation of some numbers through financial statements may not be enough to satisfy the information need of the large number of users as financial statements, by themselves, are not complete unless they are supplemented by relevant financial and non-financial information through formal disclosures. Thus, disclosures in and off the financial statements play an important role in shaping the decision-making exercises among stakeholders i.e., owners in specific and all other interested parties in general. However, disclosures

must be formal and well regulated to ensure greater comparability across the companies and over time.

In order to ensure adequate and effective corporate reporting in the interests of the investors and other users, disclosure requirements in India are guided by a number of regulations which will be discussed in the sections that follow.

1.3 Objectives of Disclosure

The primary objective of corporate reporting through disclosures is to make the company visible to its stakeholders and improve the reliability and relevance of the financial information reported through the financial statements. In particular, disclosures aim to achieve the following specific objectives:

a) To help the users better understand the numbers reported in the financial statements.

b) To assess whether the profit or loss is the result of transactions between independent or unrelated parties or is the result of some manipulated dealings.

c) To better assess the performance and financial state of various segments of the business.

d) To guide the users in making useful changes in the reported numbers before they are compared against other organizations or previous years having different accounting policies in place.

e) To better assess the management stewardship.

1.4 Need for Regulation of Disclosures through Corporate Reporting Practices

Accounting, at various levels of preparation of accounts and presentation of final results through financial statements allow use of alternative accounting policies which may have significant bearing on the financial performance and financial state of affairs disclosed in the financial statements. As a result, the users of accounting information must be supplied with additional information in form of disclosures to better comprehend such results and make informed judgements before arriving at any economic decision.

Till the first quarter of 20th century, when the objectives of the preparation of financial statements were primarily to reveal the wealth generated and income earned by the proprietor, self-regulation was considered sufficient. But now when accounting

provides more than one interested party with quantitative financial information that helps them to make decisions about employment and use of resources in business and non-business entities and the reports are consulted by a large section of the people (including government) who have a wide range of interest in them (through in varying degrees), self-regulation has to be replaced by regulation through some outside agencies. Thus, in modern times, accounting regulation means regulation by other outside agencies like the government or regulatory agencies established by the government.

Corporate form of business having separation between ownership and management came into existence during mid-eighteenth century, and it required quantities of capital greater than that could be provided by an individual or family. This was soon proved to be the most satisfactory form of business organisation and gradually were considered a cornerstone in the trading structure of the world. The separation between ownership and management has created another separation between 'financial function' and 'managerial function' as a result of which there has cropped up a number of accounting challenges and financial accounting and reporting has got an important social status. Since managers of corporate business houses manage other people's money rather than their own, it cannot be expected that they should look over it with the same anxious vigilance as the real owners do with respect to the management of the affairs of the business including financial function. In this situation, fraud and misappropriation of fund are also very likely to occur. During 1960 financial reporting system was made the subject of much criticism on some strong and reasonable grounds like (i) lack of uniformity in accounting practice that made difficult the comparison of different companies (ii) the multiplicity of accounting practices that made it possible for the management to select alternate representations of financial results which allowed earning to be manipulated and made it possible to conceal economic realities, etc.

Government cannot allow the situation and acts as a passive observer. It felt, therefore, the necessity of regulating the corporate accounting and management and started promulgating the Companies Act, keeping in view the objective for protecting the interest of investors and other interested parties. Again, every democratic government with an aim of maximizing the social welfare has the capacity of being an independent and impartial regulator. Moreover, accounting profession of almost all the countries is in favour of imposing regulation on corporate accounting and reporting. Thus, the regulation of accounting is not only desirable but also essential in the interest of all concerned. But there are many differences as to the approach of regulation among countries.

It is therefore, imperative to have external regulation in accounting. Accounting

has also accepted its importance for its healthy improvement and progress. Both maintenance of books of accounts and financial reporting are now guided by several provisions of the Companies Act, accounting standards and regulations by capital market regulators. It is to be remembered that accounting regulation should be consistent with some pre-determined objectives. These objectives cannot, again, be static and uniform in all countries and throughout all times. Rather they must be dependent on changing social economic need of the country concerned.

1.5 Disclosures in Company Accounts in India

In India, preparation of company accounts and presentation of financial statements are guided by three major regulations – (a) Companies Act (b) Accounting Standards, and (c) SEBI Regulations. Major provisions of these regulations are discussed below:

1.5.1 Disclosure in Company Accounts as per Companies Act 2013

The Companies Act 2013, which replaces the Companies Act 1956, contains a number of important provisions that facilitates preparation of company accounts and effective dissemination of financial information generated therefrom. The relevant provisions in this context have been included in the following sections.

- Requirement of keeping books of account (Section 128)
- Preparation of Financial Statements (Section 129)
- Central Govt. to prescribe Accounting Standards (Section 133)
- Financial Statements, Board's report etc. (Section 134)
- Corporate Social responsibility (Section 135)

Important provisions are discussed below (However, Section 135 has been discussed in detail in Unit No. 8):

⌘ Section 128 : Requirement of keeping books of account

(1) Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any, and explain the transactions effected both at the registered office and its branches and such books shall be kept on accrual basis and according to the double entry system of accounting. The books of accounts may be kept at a place other than the office of the company with due notification to the registrar. Moreover, the books of accounts or relevant papers may also be

kept in electronic format.

(2) For branch offices in India or outside India, books of account relating to such branch may be kept there. However, proper summarized returns periodically must be sent to the registered office.

(3) The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours, and in the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director. However, the inspection in respect of any subsidiary of the company shall be done only by the person authorized in this behalf by a resolution of the Board of Directors.

(4) Where an inspection is made under sub-section (3), the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

(5) Every company shall preserve the books of accounts together with all the relevant vouchers in good condition for a period of not less than next eight years. However, where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct the company that the books of account may be kept for such longer period as it may deem fit.

(6) The Act specifies the following persons to be in charge with the duty of complying with the provisions of maintenance of proper books of accounts –

  (i) Managing director;

  (ii) The whole-time director in charge of finance;

  (iii) The Chief Financial Officer; or

  (iv) Any other person of a company who has been charged by the Board in this respect.

Accordingly, if there is any contravention with regard to such provisions, the above persons shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

⌘ Section 129 : Preparation of Financial Statements

(1) The financial statements shall give a true and fair view of the state of affairs of the company or companies, complying with the accounting standards notified under section133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III:

(2) At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

(3) Where a company has one or more subsidiaries or associate companies, it shall additionally prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards. The consolidated financial statements shall also be laid before the annual general meeting of the company.

In addition, the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries and associate company or companies in such form as may be prescribed.

(4) The provisions of this Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, *mutatis mutandis,* apply to the consolidated financial statements.

(5) Where the financial statements of a company do not comply with the accounting standards, the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

Note : The financial statements shall be in the form or forms as may be provided for different class or classes of companies. Schedule III contains general instructions for preparation of balance sheet and statement of profit and loss account.

⌘ Section 133 : Central Govt. to prescribe Accounting Standards

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority.

Accordingly, the Companies (Indian Accounting Standard) Rules 2015 have been notified by the Ministry of Company Affairs on 27.02.2014.

⌘ Section 134 : Financial Statements, Board's report etc.

(1) The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed.

(2) The auditors' report shall be attached to every financial statement.

(3) A report by the BODs shall also be attached to the financial statements containing information such as the web address where annual return has been placed, number of board meetings held, a Director's Responsibility Statement, details of fraud reported to the Central Govt. etc. However, disclosures already made in the financial statements should not be repeated but referred appropriately.

(5) The Directors' Responsibility Statement referred to in clause (c) of sub-section (3) shall state that—

- (a) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;
- (b) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;
- (c) the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;
- (d) the directors had prepared the annual accounts on a going concern basis; and
- (e) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.
- (f) the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

(6) A signed copy of every financial statement, including consolidated financial statement, if any, shall be issued, circulated or published along with a copy each of—

- (a) any notes annexed to or forming part of such financial statement;

(b) the auditor's report; and

(c) the Board's report referred to in sub-section (3).

(7) If a company is in default in complying with the provisions of this section, the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

⌘ **Section 135 : Corporate Social responsibility**

This section provides that every company with a specified amount of net worth or turnover or net profit during any financial year must constitute the Corporate Social Responsibility Committee of the Board. The Committee shall formulate policy and specify as the areas listed in Schedule VII where the activities will be conducted. The content of the policy must be disclosed by the board in the website of the company. The section further provides that the Board shall ensure that at least two per cent of average net profits of the company made during three immediately preceding financial years shall be spent as per the policy every year. If the company fails to spend such amount the Board shall give in its report the reasons for not spending.

1.5.2 Disclosures in Company Accounts as per Accounting Standards

The main objective of accounting standard setting is to maintain uniformity in the presentation of economic data contained in the periodical accounts of corporate enterprises. In other words, it aims at harmonizing the diverse accounting policies and practices adopted by different enterprises and ensuring consistency in the reported information of an enterprise from year to year so that users of financial statements are in any position to understand and make proper use of financial statement for their decision purposes.

In India, accounting standards were traditionally issued by the Institute of Chartered Accountants of India to suit the Indian business conditions. This set of accounting standards is known as Accounting Standards (AS). Though the same is still in force as per Companies (Accounting Standards) Rules 2006, considering the growing level of internationalisation, a new set of converged accounting standards has been promulgated and is being implemented in a phased manner. The new set of accounting standards is known as Indian Accounting Standards (Ind AS) which has been notified by the Ministry of Corporate Affairs as per Companies (Indian Accounting Standards) Rules 2015. As mentioned earlier this new set of accounting standards is converged with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) and hence are more aligned with

the global best practices in the field of accounting with minor deviations to suit the Indian business conditions (the deviations are known as curve-ins or curve-outs).

Following is a complete list of Ind ASs notified by the Ministry of Corporate Affairs (MCA) in India (as on 15.01.2021).

Notifications	Description
Indian Accounting Standard (Ind AS) 101	First-time Adoption of Indian Accounting Standards
Indian Accounting Standard (Ind AS) 102	Share-based Payment
Indian Accounting Standard (Ind AS) 103	Business Combinations
Indian Accounting Standard (Ind AS) 104	Insurance Contracts
Indian Accounting Standard (Ind AS) 105	Non-current Assets Held for Sale and Discontinued Operations
Indian Accounting Standard (Ind AS) 106	Exploration for and Evaluation of Mineral Resources
Indian Accounting Standard (Ind AS) 107	Financial Instruments: Disclosures
Indian Accounting Standard (Ind AS) 108	Operating Segments
Indian Accounting Standard (Ind AS) 109	Financial Instruments
Indian Accounting Standard (Ind AS) 110	Consolidated Financial Statements
Indian Accounting Standard (Ind AS) 111	Joint Arrangements
Indian Accounting Standard (Ind AS) 112	Disclosure of Interests in Other Entities
Indian Accounting Standard (Ind AS) 113	Fair Value Measurement
Indian Accounting Standard (Ind AS) 114	Regulatory Deferral Accounts
Indian Accounting Standard (Ind AS) 115	Revenue from Contracts with Customers
Indian Accounting Standard (Ind AS) 1	Presentation of Financial Statements
Indian Accounting Standard (Ind AS) 2	Inventories
Indian Accounting Standard (Ind AS) 7	Statement of Cash Flows
Indian Accounting Standard (Ind AS) 8	Accounting Policies, Changes in Accounting Estimates and Errors
Indian Accounting Standard (Ind AS) 10	Events after the Reporting Period
Indian Accounting Standard (Ind AS) 12	Income TaxesIndian Accounting Standard (Ind AS) 16 Property, Plant and Equipment
Indian Accounting Standard (Ind AS) 17	Leases
Indian Accounting Standard (Ind AS) 19	Employee Benefits
Indian Accounting Standard (Ind AS) 20	Accounting for Government Grants and Disclosure of Government Assistance

Notifications	Description
Indian Accounting Standard (Ind AS) 21	The Effects of Changes in Foreign Exchange Rates
Indian Accounting Standard (Ind AS) 23	Borrowing Costs
Indian Accounting Standard (Ind AS) 24	Related Party Disclosures
Indian Accounting Standard (Ind AS) 27	Separate Financial Statements
Indian Accounting Standard (Ind AS) 28	Investments in Associates and Joint Ventures
Indian Accounting Standard (Ind AS) 29	Financial Reporting in Hyperinflationary Economies
Indian Accounting Standard (Ind AS) 32	Financial Instruments : Presentation
Indian Accounting Standard (Ind AS) 33	Earnings per Share
Indian Accounting Standard (Ind AS) 34	Interim Financial Reporting
Indian Accounting Standard (Ind AS) 36	Impairment of Assets
Indian Accounting Standard (Ind AS) 37	Provisions, Contingent Liabilities and Contingent Assets
Indian Accounting Standard (Ind AS) 38	Intangible AssetsIndian Accounting Standard (Ind AS) 40 Investment Property
Indian Accounting Standard (Ind AS) 41	Agriculture

In the above two categories of accounting standards may be found – one with serial number 1 to 41 and another with serial number 101 to 115. While the first set of Ind AS are the counterparts of International Accounting Standards with similar serial numbers the latter set corresponds to International Financial reporting Standards (IFRS) with the same serial numbers.

Out of the above accounting standards Ind AS 1: *Presentation of Financial Statements* deals with the overall structure of financial statements of companies while all the other Ind ASs (except Ind AS 101: *First-time Adoption of Indian Accounting Standards*) deal with specific problem areas.

I. Structure of Financial Statements

As per Section 129 of the Companies Act 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, *complying with the accounting standards notified under section133 and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.*

Accordingly, the type and content of financial statements must be in commensurate with Ind AS 1: Presentation of Financial Statements and Schedule III of Companies Act 2013.

(a) Ind AS 1: Presentation of Financial Statements

According to Ind AS 1, companies prepare general purpose financial statements to exhibit a true and fair view with respect to (i) financial position (namely assets, liabilities and equity), (ii) financial performance (income, expenses including gains and losses), (iii) cash flows and (iv) use of its resources by the management. Accordingly, the following statements are included in the complete list of financial statements to be prepared by a company:

- A balance sheet at the end of the period;
- A statement of profit and loss (including other comprehensive income) for the period;
- A statement of changes in equity for the period;
- A statement of cash flows for the period;
- Notes, comprising a summary of significant accounting policies and other explanatory information; and
- Comparative information in respect of the preceding period; and
- A balance sheet as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

The above financial statements must possess the following features or characteristics in order to be relevant and reliable:

- True and fair presentation and compliance with Ind ASs.
- Adherence to Going Concern assumption (accounting should be done assuming that the entity will continue its business for an unforeseeable future unless the management intends to liquidate it)
- Accrual basis of accounting (all financial statements excluding Cash Flow Statement should be prepared following accrual basis of accounting)
- Materiality and aggregation (each material class of similar items should be presented separately)
- Offsetting (assets and liabilities should not be offset unless permitted by Ind AS)
- Frequency of reporting (financial statements are to be prepared normally annually)
- Comparative information (information for the previous period should be disclosed unless exempted by Ind AS)

- Consistency of presentation (similar accounting policies should be continued; changes if any for appropriate presentation or as required by Ind AS will be allowed).

The structure and content of financial statements (especially for Balance Sheet, Statement of Profit and Loss and Statement of Changes in Equity) must conform to the structure given under Schedule III of the Companies Act 2013 as originally notified by the MCA on 06.04.2016 and amended from time to time. Also, the financial statements must clearly specify the presentation currency (e.g., in India, Indian rupee is the presentation currency) and the level of rounding off.

Sufficient disclosures should be made with respect to the following:

(i) Accounting Policies : The entity will have to disclose significant accounting policies like –
    - basis of measurement used in preparing the financial statements (e.g., historical cost, realisation, fair value etc.);
    - judgement made by the management in applying the accounting policy for recognition and measurement of the amount; and
    - each specific accounting policy relevant for understanding the financial statements (such as in the area of revenue recognition, capitalisation of borrowing cost, investment property, employee benefits, inventories etc.)

(ii) Estimation of Uncertainty : The entity will have to disclose the assumptions concerning the future and other major sources of estimation of uncertainty that have a significant risk of causing a material adjustment to the carrying value of assets and liabilities within the next financial years.

(iii) Capital Disclosure : The entity shall also disclose information as regards the process of managing the capital.

(iv) Other Disclosure : The entity will also have to disclose information concerning the domicile and legal form including country of incorporation, description and nature of operations and principal activities and the nature of the parent etc.

(b) Schedule III of the Companies Act 2013 :

As regards to the structure of financial statements to be prepared Schedule III of the Companies Act 2013 proposes three divisions as follows:

- Division I which is applicable for preparation of financial statements for a company whose financial statements are required to comply with the Companies (Accounting Standards) Rules, 2006.

- Division II which is applicable for preparation of financial statements for a company whose financial statements are required to comply with the Companies (Indian Accounting Standards) Rules, 2015.
- Division III which is applicable for preparation of financial statements for a Non-Banking Financial Company (NBFC) whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015.

Since in this book we shall discuss the topics for companies other than NBFCs with reference to Companies (Indian Accounting Standards) Rules, 2015, only Division II will be relevant here.

Division II contains the structure of Balance Sheet (Part I), Statement of Changes in Equity (Part I) and Statement of Profit and Loss (Part II). These are discussed below:

PART I-BALANCE SHEET

Name of the Company.............................

Balance Sheet as at .... (Rupees in.........)

Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
ASSETS			
Non-current assets			
(a) Property, Plant and Equipment			
(b) Capital work-in-progress			
(c) Investment Property			
(d) Goodwill			
(e) Other Intangible assets			
(f) Intangible assets under development			
(g) Biological Assets other than bearer plants			
(h) Financial Assets			
(i) Investments			
(ii) Trade receivables			
(iii) Loans			
(i) Deferred tax assets (net)			
(j) Other non-current assets			
Current assets			
(a) Inventories			
(b) Financial Assets			
(i) Investments			

(ii) Trade receivables (iii) Cash and cash equivalents (iv) Bank balances other than(iii) above (v) Loans (vi) Others (to be specified) (c) Current Tax Assets (Net) (d) Other current assets			
Total Assets			
<u>EQUITY AND LIABILITIES</u> EQUITY (a) Equity Share capital (b) Other Equity LIABILITIES Non-current liabilities (a) Financial Liabilities (i) Borrowings (ii) Trade Payables: (A) total outstanding dues of micro enterprises and small enterprises; and (B) total outstanding dues of creditors other than micro enterprises and small enterprises. (iii) Other financial liabilities (other than those specified in item (b), to be specified) (b) Provisions (c) Deferred tax liabilities (Net) (d) Other non-current liabilities Current liabilities (a) Financial Liabilities (i) Borrowings (ii) Trade Payables : (A) total outstanding dues of micro enterprises and small enterprises; and (B) total outstanding dues of creditors other than micro enterprises and small enterprises. (iii) Other financial liabilities (other than those specified in item (c) (b) Other current liabilities (c) Provisions (d) Current Tax Liabilities (Net)			
Total Equity and Liabilities			

STATEMENT OF CHANGES IN EQUITY

Name of the Company..............

Statement of Changes in Equity for the period ended ....

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

B. Other Equity

	Share application on money pending allotment	Equity component of compound financial instrument	Reserve and Surplus				Debt Instrument through other Compre-hensive Income	Equity Instrument through Other Comprehensive Income	Effective portion of Cash Flow Hedges	Revaluation Surplus	Exchange difference on translating the financial statement	Other items of Other Compr-ehensive Income	Money received against share capital	Total
			Capital Reserve	Securities Premium	Other Reserve (Specify nature)	Retained Earning								
Balance at the beginning of the reporting period														
Changes in accounting policy or prior period errors														
Restated balance at the beginning of the reporting period														
Total comprehensive														
Income for the year														
Dividends														
Transfer to retained earnings														
Balance at the end of the reporting period														

General Instructions for Preparation of Balance Sheet:

1. An entity shall classify an asset as current when -
   - (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle;
   - (b) it holds the asset primarily for the purpose of trading;
   - (c) it expects to realise the asset within twelve months after the reporting period; or
   - (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

An entity shall classify all other assets as non-current.

2. The operating cycle of an entity is the time between the acquisition of assets for processing and their realisation in cash or cash equivalents, When the entity's normal operating cycle is not clearly identifiable, it is assumed to be twelve months.
3. An entity shall classify a liability as current when -
   - (a) it expects to settle the liability in its normal operating cycle;
   - (b) it holds the liability primarily for the purpose of trading;
   - (c) the liability is due to be settled within twelve months after the reporting period; or
   - (d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

4. A receivable shall be classified as a 'trade receivable' if it is in respect of the amount due on account of goods sold or services rendered in the normal course of business.
5. A payable shall be classified as a 'trade payable' if it is in respect of the amount due on account of goods purchased or services received in the normal course of business.
6. A company shall disclose the following in the Notes:

A. Non-Current Assets

I. Property. Plant and Equipment:

(i) Classification shall be given as:

(a) Land

(b) Buildings

(c) Plant and Equipment

(d) Furniture and Fixtures

(e) Vehicles

(f) Office equipment

(g) Bearer Plants

(h) Others (specify nature)

(ii) Assets under lease shall be separately specified under each class of assets.

(iii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

II. Investment Property:

A reconciliation of the gross and net carrying amounts of each class of property at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related depreciation and impairment losses or reversals shall be disclosed separately.

III. Goodwill:

A reconciliation of the gross and net carrying amount of goodwill at the beginning and end of the reporting period showing additions, impairments, disposals and other adjustments.

IV. Other Intangible assets

(i) Classification shall be given as:

(a) Brands or trademarks

(b) Computer software

(c) Mastheads and publishing titles

(d) Mining rights

(e) Copyright, patents, other intellectual property rights, services and operating rights

(f) Recipes, formulae, models, designs and prototypes

(g) Licenses and franchises

(h) Others (specify nature)

(ii) A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments and the related amortization and impairment losses or reversals shall be disclosed separately.

V. Biological Assets other than bearer plants:

A reconciliation of the carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations and other adjustments shall be disclosed separately.

VI. Investment

(i) Investments shall be classified as:

(a) Investments in Equity Instruments;

(b) Investments in Preference Shares;

(c) Investments in Government or trust securities;

(d) Investments in debentures or bonds;

(e) Investments in Mutual Funds;

(f) Investments in partnership firms; or

(g) Other investments (specify nature)

Under each classification, details shall be given of names of the bodies corporate that are-

(i) subsidiaries,

(ii) associates,

(iii) joint ventures, or

(iv) structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid). Investments in partnership firms along with names of the firms, their partners, total capital and the shares of each partner shall be disclosed separately.

(ii) The following shall also be disclosed:

  (a) Aggregate amount of quoted investment and market value thereof:
  (b) Aggregate amount of unquoted investment: and
  (c) Aggregate amount of impairment in value of investment.

VII. Trade Receivables:

(i) Trade receivables shall be sub-classified as:

  (a) Trade Receivables considered good - Secured;
  (b) Trade Receivables considered good - Unsecured;
  (c) Trade Receivables which have significant increase in Credit Risk; and
  (d) Trade Receivables - credit impaired.

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

VIII. Loans:

(i) Loans shall be classified as -

  (a) Security Deposits;
  (b) Loans to related parties (giving details thereof); and
  (c) Other loans (specify nature).

(ii) Loans Receivables shall be sub-classified as:

  (a) Loans Receivables considered good - Secured;
  (b) Loans Receivables considered good - Unsecured;
  (c) Loans Receivables which have significant increase in Credit Risk; and
  (d) Loans Receivables - credit impaired.

(iii) Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.

(iv) Loans due by directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

IX. Bank deposits with more than 12 months maturity shall be disclosed under 'Other financial assets'.

X. Other non-current asset: Other non-current assets shall be classified as -

(i) Capital Advances; and
(ii) Advances other than capital advances;

(1) Advances other than capital advances shall be classified as:

(a) Security Deposits;
(b) Advances to related parties (giving details thereof); and
(c) Other advances (specify nature).

(2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated, ln case advances are of the nature of a financial asset as per relevant Ind AS, these are to be disclosed under 'other financial assets' separately.

(iii) Others (specify nature).

B. Current Assets

I. Inventories:

(i) Inventories shall be classified as -
- (a) Raw materials;
- (b) Work-in-progress;
- (c) Finished goods;
- (d) Stock-in-trade (in respect of goods acquired for trading);
- (e) stores and spares;
- (f) Loose tools; and
- (g) Others (specify nature).

(ii) Goods-in-transit shall be disclosed under the relevant sub-head of inventories.
(iii) Mode of valuation shall be stated.

II. Investment:

(i) Investments shall be classified as -
- (a) Investments in Equity Instruments;
- (b) Investment in Preference Shares;

(c) Investments in government or trust securities;
(d) Investments in debentures or bonds;
(e) Investments in Mutual Funds;
(f) Investments in partnership firms; and
(g) Other investments (specify nature).

Under each classification, details shall be given of names of the bodies corporate that are -

(i) subsidiaries,
(ii) associates,
(iii) joint ventures, or
(iv) structured entities,

in whom investments have been made and the nature and extent of the investment so made in each such body corporate (showing separately investments which are partly-paid)

(ii) The following shall also be disclosed
(a) Aggregate amount of quoted investments and market value thereof;
(b) Aggregate amount of unquoted investments;
(c) Aggregate amount of impairment in value of investments.

III. Trade Receivables

(i) Trade receivables shall be sub-classified as:
(a) Trade Receivables considered good - Secured;
(b) Trade Receivables considered good - Unsecured;
(c) Trade Receivables which have significant increase in Credit Risk; and
(d) Trade Receivables - credit impaired.

(ii) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(iii) Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

IV. Cash and cash equivalents: Cash and cash equivalents shall be classified as-

a. Balances with Banks (of the nature of cash and cash equivalents);

b. Cheques, drafts on hand;
c. Cash on hand; and
d. Others (specify nature).

V. Loans:

(i) Loans shall be classified as:
  (a) Security deposits;
  (b) Loans to related parties (giving details thereof); and
  (c) others (specify nature).

(ii) Loans Receivables shall be sub-classified as:
  (a) Loans Receivables considered good - Secured;
  (b) Loans Receivables considered good - Unsecured;
  (c) Loans Receivables which have significant increase in Credit Risk; and
  (d) Loans Receivables - credit impaired.

(iii) Allowance for bad and doubtful loans shall be disclosed under the relevant heads separately.

(iv) Loans due by directors or other officers of the company or any of them either severally or jointly with any other person or amounts due by firms or private companies respectively in which any director is a partner or a director or a member shall be separately stated.

VI. Other current assets (specify nature): This is an all-inclusive heading, which incorporates current assets that do not fit into any other asset categories. Other current assets shall be classified as-

(i) Advances other than capital advances

(1) Advances other than capital advances shall be classified as:
  (a) Security Deposits;
  (b) Advances to related parties (giving details thereof);
  (c) Other advances (specify nature)

(2) Advances to directors or other officers of the company or any of them either severally or jointly with any other persons or advances to firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
  (a) Earmarked balances with banks (for example. for unpaid dividend) shall be separately stated.

(b) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(c) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

C. Equity:

I. Equity Share Capital: For each class of equity share capital:

(a) the number and amount of shares authorised;

(b) the number of shares issued, subscribed and fully paid, and subscribed but not fully paid;

(c) par value per Share;

(d) a reconciliation of the number of shares outstanding at the beginning and at the end of the period;

(e) the rights, preferences and restrictions attaching to each class of shares including restrictions on the distribution of dividends and the repayment of capital;

(f) shares in respect of each class in the company held by its holding company or its ultimate holding company including shares held by subsidiaries or associates of the holding company or the ultimate holding company in aggregate;

(g) shares in the company held by each shareholder holding more than five per cent. shares specifying the number of shares held;

(h) shares reserved for issue under options and contracts or commitments for the sale of shares or disinvestment, including the terms and amounts;

(i) for the period of five years immediately preceding the date at which the Balance Sheet is prepared

- aggregate number and class of shares allotted as fully paid up pursuant to contract without payment being received in cash;
- aggregate number and class of shares allotted as fully paid up by way of bonus shares; and
- aggregate number and class of shares bought back;

(j) terms of any securities convertible into equity shares issued along with the earliest date of conversion in descending order starting from the farthest such date;

(k) calls unpaid (showing aggregate value of calls unpaid by directors and officers);

(l) forfeited shares (amount originally paid up).

II. Other Equity:

(i) 'Other Reserves' shall be classified in the notes as -

(a) Capital Redemption Reserve;

(b) Debenture Redemption Reserve;

(c) Share Options Outstanding Account; and

(d) others - (specify the nature and purpose of each reserve and the amount in respect thereof);

(Additions and deductions since last balance sheet to be shown under each of the specified heads)

(ii) Retained Earnings represents surplus i.e., balance of the relevant column in the Statement of Changes in Equity;

(iii) A reserve specifically represented by earmarked investments shall disclose the fact that it is so represented;

(iv) Debit balance of Statement of Profit and Loss shall be shown as a negative figure under the head 'retained earnings'. Similarly, the balance of 'Other Equity', after adjusting negative balance of retained earnings, if any, shall be shown under the head 'Other Equity' even if the resulting figure is in the negative; and

(v) Under the sub-head 'Other Equity', disclosure shall be made for the nature and amount of each item.

D. Non-Current Liabilities:

I. Borrowings:

(i) borrowings shall be classified as -

(a) Bonds or debentures

(b) Term loans

(I) from banks

(II) from other Parties

(c) Deferred payment liabilities

(d) Deposits

(e) Loans from related parties

(f) Long term maturities of finance lease obligations

(g) Liability component of compound financial instruments

(h) Other loans (specify nature);

(ii) borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case.

(iii) where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;

(iv) bonds or debentures (along with the rate of interest, and particulars of redemption or conversion, as the case may be) shall be stated in descending order of maturity or conversion, starting from farthest redemption or conversion date, as the case may be, where bonds/debentures are redeemable by instalments, the date of maturity for this purpose must be reckoned as the date on which the first instalment becomes due;

(v) particulars of any redeemed bonds or debentures which the company has power to reissue shall be disclosed;

(vi) terms of repayment of term loans and other loans shall be stated; and

(vii) period and amount of default as on the balance sheet date in repayment of borrowings and interest shall be specified separately in each case.

II. Provisions : The amounts shall be classified as -

(a) Provision for employee benefits; and

(b) Others (specify nature).

III. Other non-current liabilities :

(a) Advances; and

(b) Others (specify nature).

E. Current Liabilities:

I. Borrowings:

(i) Borrowings shall be classified as -

(a) Loans repayable on demand

(I) from banks

(II) from other parties

(b) Loans from related parties

(c) Deposits

(d) Other loans (specify nature);

(ii) borrowings shall further be sub-classified as secured and unsecured. Nature of security shall be specified separately in each case;

(iii) where loans have been guaranteed by directors or others, the aggregate amount of such loans under each head shall be disclosed;

(iv) period and amount of default as on the balance sheet date in repayment of borrowings and interest, shall be specified separately in each case.

II. Other Financial Liabilities: Other Financial liabilities shall be classified as -

(a) Current maturities of long-term debt;

(b) Current maturities of finance lease obligations;

(c) Interest accrued;

(d) Unpaid dividends;

(e) Application money received for allotment of securities to the extent refundable and interest accrued thereon;

(f) Unpaid matured deposits and interest accrued thereon;

(g) Unpaid matured debentures and interest accrued thereon; and

(h) Others (specify nature).

'Long term debt' is a borrowing having a period of more than twelve months at the time of origination

III. Trade Payables:

The following details relating to micro, small and medium enterprises shall be disclosed in the notes:

(a) the principal amount and the interest due thereon (to be shown separately) remaining unpaid to any supplier at the end of each accounting year;

(b) the amount of interest paid by the buyer in terms of section 16 of the Micro, Small and Medium Enterprises Development Act, 2006 (27 of 2006), along with the amount of the payment made to the supplier beyond the appointed day during each accounting year;

(c) the amount of interest due and payable for the period of delay in making payment (which has been paid but beyond the appointed day during the year) but without adding the interest specified under the Micro, Small and Medium Enterprises Development Act, 2006;

(d) the amount of interest accrued and remaining unpaid at the end of each accounting year; and

(e) the amount of further interest remaining due and payable even in the succeeding years, until such date when the interest dues above are actually paid to the small enterprise, for the purpose of disallowance of a deductible expenditure under section 23 of the Micro, Small and Medium Enterprises Development Act, 2006.

Explanation - The terms 'appointed day', 'buyer', 'enterprise', 'micro enterprise', 'small enterprise' and 'supplier', shall have the same meaning as assigned to them under clauses (b), (d), (e), (h), (m) and (n) respectively of section 2 of the Micro, Small and Medium Enterprises Development Act, 2006.]

IV. Other current liabilities:

The amounts shall be classified as-

(a) revenue received in advance;
(b) other advances (specify nature); and
(c) others (specify nature);

IV. Provisions: The amounts shall be classified as-

(i) provision for employee benefits; and

(ii) others (specify nature)

F. The presentation of liabilities associated with group of assets classified as held for sale and non-current assets classified as held for sale shall be in accordance with the relevant Indian Accounting Standards (Ind ASs)

G. Contingent Liabilities and Commitments:
(to the extent not provided for)

(i) Contingent Liabilities shall be classified as-
(a) claims against the company not acknowledged as debt;
(b) guarantees excluding financial guarantees; and
(c) other money for which the company is contingently liable.

(ii) Commitments shall be classified as-

(a) estimated amount of contracts remaining to be executed on capital account and not provided for;

(b) uncalled liability on shares and other investments partly paid; and
(c) other commitments (specify nature).

H. The amount of dividends proposed to be distributed to equity and preference shareholders for the period and title related amount per share shall be disclosed separately. Arrears of fixed cumulative dividends on irredeemable preference shares shall also be disclosed separately.

I. Where in respect of an issue of securities made for a specific purpose the whole

or part of amount has not been used for the specific purpose at the Balance sheet date, there shall be indicated by way of note how such unutilised amounts have been used or invested.

J. Every company shall disclose the details of Specified Bank Notes (SBN) held and transacted during the period 08/11/2016 to 30/12/2016 as provided in the Table below:

	SBNs	Other denomination notes	Total
Closing cash in hand as on 08.11.2016			
(+) Permitted receipts			
(−) Permitted payments			
(−) Amount deposited in Banks			
Closing cash in hand as on 30.12.2016			

Explanation : For the purposes of this clause, the term 'Specified Bank Notes' shall have the same meaning provided in the notification of the Government of India, in the Ministry of Finance, Department of Economic Affairs number S.O. 3407(E), dated the 8th November, 2016.".

7. When a company applies an accounting policy retrospectively or makes a restatement of items in the financial statements or when it reclassifies items in its financial statements, the company shall attach to the Balance Sheet, a "Balance Sheet" as at the beginning of the earliest comparative period presented.

8. Share application money pending allotment shall be classified into equity or liability in accordance with relevant Indian Accounting Standards. share application money to the extent not refundable shall be shown under the head Equity and share application money to the extent refundable shall be separately shown under 'Other financial liabilities'.

9. Preference shares including premium received on issue, shall be classified and presented as 'Equity' or 'Liability' in accordance with the requirements of the relevant Indian Accounting Standards. Accordingly, the disclosure and presentation requirements in that regard applicable to the relevant class of equity or liability shall be applicable mutatis mutandis to the preference shares. For instance, [plain vanilla] redeemable preference shares shall be classified and presented under 'non-

current liabilities' as 'borrowings' and the disclosure requirements in this regard applicable to such borrowings shall be applicable mutatis mutandis to redeemable preference shares.

10. Compound financial instruments such as convertible debentures, where split into equity and liability components, as per the requirements of the relevant Indian Accounting Standards, shall be classified and presented under the relevant heads in 'Equity' and 'Liabilities'

11. Regulatory Deferral Account Balances shall be presented in the Balance Sheet in accordance with the relevant Indian Accounting Standards.

PART II - Statement of Profit and Loss

Name of the Company........................

Statement of Profit and Loss for the period ended................

	Particulars	Note No.	Figures as at the end of current reporting period	Figures as at the end of previous reporting period
I	Revenue From operations			
II	Other Income			
III	Total Income (I + II)			
IV	Expenses:			
	Cost of materials consumed			
	Purchases of Stock-in-Trade			
	Changes in inventories of finished goods, Stock-in -Trade and work-in-progress			
	Employee benefits expense			
	Finance costs			
	Depreciation and amortization expenses			
	Other expenses			
	Total expenses (IV)			
V	Profit/(loss) before exceptional items and tax (I-IV)			
VI	Exceptional Items			
VII	Profit/ (loss) before exceptions items and tax(V-VI)			
VIII	Tax expense:(1) Current tax(2) Deferred tax			

IX	Profit (Loss) for the period from continuing operations (VII-VIII)			
X	Profit/(loss) from discontinued operations			
XI	Tax expenses of discontinued operations			
XII	Profit/(loss) from Discontinued operations (after tax) (X-XI)			
XIII	Profit/(loss) for the period (IX+XII)			
XIV	Other Comprehensive Income A. (i) Items that will not be reclassified to profit or loss (ii) Income tax relating to items that will not be reclassified to profit or loss B. (i) Items that will be reclassified to profit or loss (ii) Income tax relating to items that will be reclassified to profit or loss			
XV	Total Comprehensive Income for the period (XIII+XIV) comprising Profit (Loss) and Other comprehensive Income for the period			
XVI	Earnings per equity share (for continuing operation):(1) Basic(2) Diluted			
XVII	Earnings per equity share (for discontinued operation):(1) Basic(2) Diluted			
XVIII	Earning per equity share (for discontinued & continuing operation)(1) Basic(2) Diluted			

General Instructions for Preparing of Statement of Profit and Loss

1. The provisions of this Part shall apply to the income and expenditure account, in like manner as they apply to a Statement of Profit and Loss.
2. The Statement of Profit and Loss shall include:
   (1) Profit of loss for the Period;
   (2) Other Comprehensive Income for the period

The sum of (1) and (2) above is ‘Total Comprehensive Income’.

3. Revenue from operations shall disclose separately in the notes
   (a) sale of products (including Excise Duty);
   (b) sale of services; and
   (c) other operating revenues.

4. Finance Costs: Finance costs shall be classified as -
   - (a) interest;
   - (b) dividend on redeemable preference shares;
   - (c) exchange differences regarded as an adjustment to borrowing costs; and
   - (d) other borrowing costs (specify nature).
5. Other income: other income shall be classified as-
   - (a) interest Income;
   - (b) dividend Income; and
   - (c) other non-operating income (net of expenses directly attributable to such income)
6. Other Comprehensive Income shall be classified into -

   (A) Items that will not be reclassified to profit or loss
   - (i) Changes in revaluation surplus;
   - (ii) Remeasurements of the defined benefit plans;
   - (iii) Equity Instruments through Other Comprehensive Income;
   - (iv) Fair value changes relating to own credit risk of financial liabilities designated at fair value through profit or loss;
   - (v) Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and
   - (v) Share of Other Comprehensive Income in Associates and Joint Ventures, to the extent not to be classified into profit or loss; and
   - (vi) Others (specify nature).

(B) Items that will be reclassified to profit or loss;
   - (i) Exchange differences in translating the financial statements of a foreign operation;
   - (ii) Debt Instruments through Other Comprehensive Income;
   - (iiii) The effective portion of gains and loss on hedging instruments in a cash flow hedge;
   - (iv) Share of other comprehensive Income in Associates and Joint Ventures, to the extent to be classified into profit or loss; and
   - (v) Others (specify nature)

7. Additional Information: A Company shall disclose by way of notes, additional information regarding aggregate expenditure and income on the following items:
   - (a) employee Benefits expense (showing separately (i) salaries and wages, (ii) contribution to provident and other funds, (iii) share based payments to employees, (iv) staff welfare expenses).
   - (b) depreciation and amortisation expense;
   - (c) any item of income or expenditure which exceeds one per cent of the revenue from operations or Rs.10,00,000, whichever is higher, in addition to the consideration of 'materiality' as specified in clause 7 of the General Instructions for Preparation of Financial Statements of a Company;
   - (d) interest Income;
   - (e) interest Expense;
   - (f) dividend income;
   - (g) net gain or loss on sale of investments;
   - (h) net gain or loss on foreign currency transaction and translation (other than considered as finance cost);
   - (i) payments to the auditor as (a) auditor, (b) for taxation matters, (c) for company law matters, (d) for other services, (e) for reimbursement of expenses;
   - j) in case of companies covered under section 135, amount of expenditure incurred on corporate social responsibility activities; and
   - (k) details of items of exceptional nature;
8. Changes in Regulatory Deferral Account Balances shall be presented in the Statement of Profit and Loss in accordance with the relevant Indian Accounting Standards

II. Disclosure as per Other Ind ASs

Some of the important Ind ASs and disclosure requirements specified therein are discussed below:

Ind AS 2: Inventories

This standard deals with the principles of valuation of inventories for the purpose of financial statements. It defines inventories as assets (a) held for sale in the ordinary course of business, (b) in the process of production for such sale, or (c) in the form of materials or supplies to be consumed in the production process or in the rendering of

services. It also prescribes that valuation of inventories must be done at the lower of cost and net realisable value. While the cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition, the net realisable value shall mean the estimated selling price in the ordinary course of business less the estimated costs of completion and Ind AS 2, Inventories the estimated costs necessary to make the sale.

As regards to the disclosure requirements, Ind AS 2 states that the financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;
(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;
(c) the carrying amount of inventories carried at fair value less costs to sell;
(d) the amount of inventories recognised as an expense during the period;
(e) the amount of any write-down of inventories recognised as an expense in the period;
(f) the amount of any reversal of any write-down;
(g) the circumstances or events that led to the reversal of a write-down; and
(h) the carrying amount of inventories pledged as security for liabilities.

Ind AS 7: Statement of Cash Flows

The main objectives of Ind AS 7 is to disclose to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows.

Ind AS 7 states that the statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities. Cash flow from operating activities shall be reported using either (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or (b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Among other disclosure requirements, Ind AS 7 states that an entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.

Ind AS 8: Accounting Policies, Changes in Accounting Estimates and Errors

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

Ind AS 8 requires that an entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect. If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

In respect of prior period errors, the standard states that an entity shall disclose (a) the nature of the prior period error; (b) for each prior period presented, to the extent practicable, the amount of the correction (c) the amount of the correction at the beginning of the earliest prior period presented; and (d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Ind AS 10: Events after the Reporting Period

The objective of Ind AS 10 is to prescribe guidelines regarding (a) adjustments to be done to an entity's financial statements for events after the reporting period; and (b) the disclosures that an entity should give about the date when the financial statements were approved for issue and about events after the reporting period. The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting period indicate that the going concern assumption is not appropriate.

As regards to the disclosure requirements, Ind AS 10 states that an entity shall disclose the date when the financial statements were approved for issue and who gave that approval. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact. It also states that if an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information. Also, an entity shall disclose, for each material category of non-adjusting event after the reporting period, (a) the nature of the event, and (b) an estimate of its financial effect, or a statement that such an estimate cannot be done.

Ind AS 12: Income Taxes

The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of (a) the future recovery (settlement) of the carrying amount of assets (liabilities) that are recognised in an entity's balance sheet, and (b) transactions and other events of the current period that are recognised in an entity's financial statements.

> As regards to the disclosure requirements, Ind AS 12 states that an entity must disclose the major components of tax expense (income) separately. It also requires an entity to disclose separately (a) the aggregate current and deferred tax relating to items that are charged or credited directly to equity, (b) the amount of income tax relating to each component of other comprehensive income, (c) an explanation of the relationship between tax expense (income) and accounting profit, (d) an explanation of changes in the applicable tax rate(s) compared to the previous accounting period, (e) the amount (and expiry date, if any) of deductible temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised in the balance sheet etc.

Ind AS 16: Property, Plant and Equipment

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment includes recognition of the assets, the determination of their carrying amounts, the depreciation charges and impairment losses to be recognised in relation to them.

> Ind AS 16 requires an entity shall disclose, for each class of property, plant and equipment (a) the measurement bases used for determining the gross carrying amount; (b) the depreciation methods used; (c) the useful lives or the depreciation rates used; (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and (e) a reconciliation of the carrying amount at the beginning and end of the period. The Standard also requires that the financial statements of the entity shall disclose (a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; (b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction; (c) the amount of contractual commitments for the acquisition of property, plant and equipment; and (d) if it is not disclosed separately in the statement of profit and loss, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss

Ind AS 19: Employee Benefits

The objective of Ind AS 19 is to prescribe the accounting and disclosure for employee benefits. As per this standard, an entity shall recognise (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and (b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

Though the standard does not require disclose for specific items of employee benefits, other standards such as Ind AS 24 requires disclosure of information about related party transactions with post-employment benefit plans and post-employment benefits for key management personnel, Ind AS 37 requires that an entity must disclose information about contingent liabilities arising from post-employment benefit obligations and Ind AS 19 requires disclosure of employee benefits expense.

Ind AS 20: Accounting for Government Grants and Disclosure of Government Assistance

This Standard deals with accounting for, and in the disclosure of, government grants and in the disclosure of other forms of government assistance.

The Standard requires disclosure of (a) the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements; (b) the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the entity has directly benefited; and (c) unfulfilled conditions and other contingencies attaching to government assistance that has been recognised.

Ind AS 21: The Effects of Changes in Foreign Exchange Rates

The standard deals with the issues in accounting for foreign currency transactions and foreign operations. It also deals with the process of translating financial statements into a presentation currency. The principal issues covered by the Standard include selection of exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

As regards to the disclosure requirements, Ind AS 21 requires an entity to disclose (a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Ind AS 109; and (b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity,

and a reconciliation of the amount of such exchange differences at the beginning and end of the period. It also requires disclosure of the functional currency and the reason for using a separate presentation currency, if so done, reason for change in functional currency of the reporting entity or a significant foreign operation.

Ind AS 23: Borrowing Costs

This standard deals with the accounting of borrowing costs and disclosures thereof. Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds. As per this standard, borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Other borrowing costs are recognised as an expense.

According to Ind AS 23, an entity shall disclose: (a) the amount of borrowing costs capitalised during the period; and (b) the capitalisation rate used to determine the amount of borrowing costs eligible for capitalisation.

Ind AS 24: Related Party Disclosures

This standard deals with the reporting of related party relationships and transactions between a reporting enterprise and related parties. The Standard requires disclosure of related party relationships, transactions and outstanding balances, including commitments, in the consolidated and separate financial statements of a parent or investors with joint control of, or significant influence over, an investee presented in accordance with Ind AS 110, Consolidated Financial Statements, or Ind AS 27, Separate Financial Statements. This Standard also applies to individual financial statements.

For all entities, the Standard requires that relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. The entity shall also disclose key managerial personnel compensation both in total and under various specified categories. 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 Ind AS 24, Related Party Disclosures transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. Amounts incurred by the entity for the provision of key management personnel services that are provided by a separate management entity shall be disclosed.

Ind AS 27: Separate Financial Statements

The objective of this Standard is to prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

According to Ind AS 27, when a parent, elects not to prepare consolidated financial statements and instead prepares separate financial statements, it shall disclose in those separate financial statements (a) the fact that the financial statements are separate financial statements and that it has availed the exemption from consolidation (b) a list of significant investments in subsidiaries, joint ventures and associates and (c) a description of the method used to account for the investments listed under (b). When an investment entity that is a parent prepares separate financial statements as its only financial statements, it shall disclose that fact. When a parent or an investor with joint control of, or significant influence over an investee, prepares separate financial statements, the parent or investor shall identify the financial statements prepared in accordance with Ind AS 110, Ind AS 111 or Ind AS 28 to which they relate.

Ind AS 28: Investments in Associates and Joint Ventures

The objective of this Standard is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

As per Ind AS 28, an entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when the investment is exempted as per this standard. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income.

Ind AS 32: Financial Instruments- Presentation; Ind AS 107: Financial Instruments – Disclosures and Ind AS 109 – Financial Instruments

Under Ind AS, three Standards deal with accounting for financial instruments.

- Ind AS 32 *Financial Instruments: Presentation* deals with the presentation and classification of financial instruments as financial assets, financial liabilities or equity and sets out the requirements regarding offset of financial assets and financial liabilities in the balance sheet.
- Ind AS 107 *Financial Instruments: Disclosures* sets out the disclosures required in respect of financial instruments.
- Ind AS 109 *Financial Instruments* contains guidance on the recognition, de-recognition, classification and measurement of financial instruments, including impairment and hedge accounting.

Ind AS 107 prescribes the disclosures requirements for (a) different categories of financial assets (b) different categories of financial liabilities (c)re-classification of financial liabilities (d) de-recognition of financial assets and liabilities (e) financial assets pledged as collateral (f) allowances for credit losses (g) compound financial instruments with multiple embedded derivatives (h) defaults and breaches for loan payables (i) income, expense, gains or losses recognized in profit and loss (j) accounting policies followed (k) hedge accounting (l) fair value determination for financial assets and liabilities (m) risk disclosures.

Ind AS 33: Earning Per Share

The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share, so as to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity.

According to Ind AS 33, an entity shall disclose (a) the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to profit or loss attributable to the parent entity for the period, (b) the weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other, (c) instruments (including contingently issuable shares) that could potentially dilute basic earnings per share in the future, (d) a description of ordinary share transactions or potential ordinary share transactions that occur after the reporting period and that would have changed significantly the number of ordinary shares or potential ordinary shares outstanding at the end of the period if those transactions had occurred before the end of the reporting period.

Ind AS 34: Interim Financial Reporting

The objective of this Standard is to prescribe the minimum content of an interim financial report and to prescribe the principles for recognition and measurement in complete or condensed financial statements for an interim period. An interim period is a financial reporting period shorter than a full financial year. Interim financial report means a financial report containing either a complete set of financial statements (as described in Ind AS 1, Presentation of Financial Statements, or a set of condensed financial statements (as described in this Standard) for an interim period.

As per Ind AS 34, disclosures shall include (a) a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements (b) explanatory comments about the seasonality or cyclicality of interim operations (c) the nature and amount of items affecting assets, liabilities, equity, net income or cash flows that are unusual because of their nature, size or incidence (d) the nature and amount of changes in estimates of amounts reported in prior interim periods of the current financial year or changes in estimates of amounts reported in prior financial years (e) issues, repurchases and repayments of debt and equity securities (f) dividends paid (aggregate or per share) separately for ordinary shares and other shares, (g) segment information, (h) events after the interim period that have not been reflected in the financial statements for the interim period, (i) the effect of changes in the composition of the entity during the interim period, (j) information about fair value as required by Ind AS 113 and Ind AS 107, (k) the disaggregation of revenue from contracts with customers required by Ind AS 115.

Ind AS 36: Impairment of Assets

The objective of this Standard is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. An asset is carried at more than its recoverable amount if its carrying amount exceeds the amount to be recovered through use or sale of the asset. If this is the case, the asset is described as impaired and the Standard requires the entity to recognise an impairment loss. The Standard also specifies when an entity should reverse an impairment loss.

According to Ind AS 36, an entity shall disclose, among many things (a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of profit and loss in which those impairment losses are included. (b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) of the statement of profit

and loss in which those impairment losses are reversed. (c) the amount of impairment losses on revalued assets recognised in other comprehensive income during the period. (d) the amount of reversals of impairment losses on revalued assets recognised in other comprehensive income during the period. The Standard also requires disclosure of information on impairment loss recognised and reversals made with respect to each reportable segment. Again, for each individual assets or cash generating unit, information such as (a) the events leading to impairment, (b) amount of loss recognised or reversed along with the description of individual assets or cash generating units (c) recoverable amount and related information.

Ind AS 38: Intangible Assets

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

As regards to the general disclosures, Ind As 38 requires an entity to disclose, for each class of intangible assets (distinguishing between internally generated intangible assets and others), (a) whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortisation rates used; (b) the amortisation methods used for intangible assets with finite useful lives; (c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period; (d) the line item(s) of the statement of profit and loss in which any amortisation of intangible assets is included; (e) a reconciliation of the carrying amount at the beginning and end of the period. An entity shall also disclose (a) for an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life, (b) a description, the carrying amount and remaining amortisation period of any individual intangible asset that is material to the entity's financial statements, (c) for intangible assets acquired by way of a government grant and initially recognised at fair value – the fair value initially recognised, the carrying amount.

Ind AS 40: Investment Property

The objective of this Standard is to prescribe the accounting treatment for investment property and related disclosure requirements. According to this standard, an owned investment property shall be recognised as an asset when, and only when: (a) it is probable that the future economic benefits that are associated with the

investment property will flow to the entity; and (b) the cost of the investment property can be measured reliably. The owned investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

> As regards to the disclosure requirements, an entity shall disclose (a) its accounting policy for measurement of investment property, (b) the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business when classification is difficult, (c) the extent to which the fair value of investment property is based on a valuation by an independent valuer, (d) the amounts recognised in profit or loss for rental income from investment property, direct operating expenses arising from investment property that generated rental income during the period, direct operating expenses arising from investment property that did not generate rental income during the period, (e) the existence and amounts of restrictions on the realisability of investment property or the remittance of income and proceeds of disposal, and (f) contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements. In addition to above, the entity shall also disclose the depreciation method used, the useful lives or depreciation rate used, the gross carrying amount at the beginning and end of the period and a reconciliation between the two and the fair value of investment property.

Ind AS 41: Agriculture

The objective of this Standard is to prescribe the accounting treatment and disclosures related to agricultural activity. The standard applies to account for biological assets, agricultural produce at the point of harvest and government grant when they relate to agricultural activity.

> Among many items, the general disclosures required by Ind AS 41 include disclosure relating to the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets, description of each group of biological assets, the nature of its activities involving each group of biological assets and non-financial measures or estimates of the physical quantities of (i) each group of the entity's biological assets at the end of the period and (ii) output of agricultural produce during the period. Additionally, an entity shall disclose (a) the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities (b) the amount of commitments for the development or acquisition of biological assets and (c) financial risk management strategies related to agricultural activity. There are additional disclosure requirements as well for biological assets where fair value cannot be measured reliably and for government grants in this respect.

Ind AS 102: Share Based Payment

The objective of this Standard is to specify the financial reporting by an entity when it undertakes a share-based payment transaction. More specifically, it requires an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions, including expenses associated with transactions in which share options are granted to employees. According to this standard, an entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction. However, when the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses. For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

As regards to the disclosure requirements, the standard requires an entity to disclose information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period, how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined and the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position.

Ind AS 103: Business Combinations

This standard deals with the principles and requirements as to how the acquirer recognizes and measures, in its financial statements, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Standard requires an entity to account for each business combination by applying the acquisition method. (For details regarding the accounting for business combinations please refer to Unit 6)

As regards to the disclosure requirements, the Standard requires the acquirer to disclose, with respect to each business combination that occurs during the reporting period, the name and description of the acquiree, acquisition date, the percentage of voting equity interests acquired, the primary reason for combination and the process of obtaining control, a qualitative description of the factors that make up the goodwill recognised, the acquisition-date fair value of the total consideration transferred as well as of each major class, contingent consideration related information, amount recognised for each major class of assets acquired and liabilities assumed, goodwill and gain on bargain purchase etc.

Ind AS 108: Operating Segments

It deals with the disclosure of information on the basis of segment of an enterprise. The Standard prescribes the rules for identification of reportable segments and the aggregation criteria for aggregating two or more segments into one.

The disclosure requirements include both general information and entity wide disclosures. (For details, please refer to Unit 7)

Ind AS 110: Consolidated Financial Statements

The objective of this Indian Accounting Standard (Ind AS) is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. A parent shall present non-controlling interests in the consolidated balance sheet within equity, separately from the equity of the owners of the parent.

Ind AS 111: Joint Arrangements

The objective of this Indian Accounting Standard (Ind AS) is to establish principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e., joint arrangements). A joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. A joint arrangement can either be a joint operation or a joint venture.

Ind AS 113: Fair Value Measurement

This Standard provides the definition of fair value and set out a framework for measuring fair value and requires disclosures about fair value measurements. Fair value as the price that would be received to sell an asset or paid to transfer a liability in

an orderly transaction between market participants at the measurement date. To increase consistency and comparability in fair value measurements and related disclosures, this Ind AS establishes a fair value hierarchy that categorises into three levels, the inputs to valuation techniques used to measure fair value. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability.

The standard requires an entity to disclose information that helps users of its financial statements assess both of the following:

(a) for assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the balance sheet after initial recognition, the valuation techniques and inputs used to develop those measurements.

(b) for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on profit or loss or other comprehensive income for the period.

Ind AS 115: Revenue from contracts with Customers

Ind AS 115 provides a single model for revenue recognition from the contracts with customers. The core principle of Ind AS 115 is that revenue should be recognised from the transfer of goods and services to a customer in an amount that reflects the consideration that the entity expects to be entitled to in exchange for goods and services. Ind AS 115 suggests a five-step process for revenue recognition as follows:

Step 1: Identify the contracts with customer

Step 2: Identify the separate performance obligations

Step 3: Determine the transaction price

Step 4: Allocate the transaction price to the performance obligations

Step 5: Recognise revenue when (or as) a performance obligation is satisfied

According to Ind AS 115, an entity shall disclose qualitative and quantitative information about the contract with customers. It shall ensure a separate disclosure of revenue from contracts with customers from other sources of revenue; impairment loss recognised on receivable or contract assets should be disclosed separately from other impairment losses; disclosure should be there for aggregate revenue, contract balances i.e., receivables, contract assets and contract liabilities; there should be disclosure of performance obligations, disclosure of transaction price allocated to the remaining performance of the patients and disclosure of use of practical expedients.

Ind AS 116: Leases

This Standard sets out the principles for the recognition, measurement, presentation and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity. According to this standard, at inception of a contract, an entity shall assess whether the contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. At the commencement date, a lessee shall recognise a right-of use asset and a lease liability. The right-of-use asset shall be measured at cost. At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease, if that rate can be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate. After the commencement date, a lessee shall measure the right-of-use asset applying a cost model. After the commencement date, a lessee shall measure the lease liability by: (a) increasing the carrying amount to reflect interest on the lease liability; (b) reducing the carrying amount to reflect the lease payments made; and (c) remeasuring the carrying amount to reflect any reassessment or lease modifications.

A lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements. A lessee shall disclose, for the reporting period, (a) depreciation charge for right-of-use assets by class of underlying asset (b) interest expense on lease liabilities (c) the expense relating to short-term leases (d) the expense relating to leases of low-value assets (e) the expense relating to variable lease payments not included in the measurement of lease liabilities (f) income from subleasing right-of-use assets (g) total cash outflow for leases (h) additions to right-of-use assets (i) gains or losses arising from sale and leaseback transactions and (j) the carrying amount of right-of-use assets at the end of the reporting period by class of underlying asset.

A lessor shall disclose the following amounts for the reporting period: (a) for finance leases: (i) selling profit or loss; (ii) finance income on the net investment in the lease; and (iii) income relating to variable lease payments not included in the measurement of the net investment in the lease. (b) for operating leases, lease income, separately disclosing income relating to variable lease payments that do not depend on an index or a rate.

1.5.3 Disclosures in Company Accounts as per SEBI Regulations

Stock exchanges have a vital role in the development of capital markets for the benefit of the corporate sector. At the same time, they exert influence on the reporting practices of companies with a view to safeguard the interest of present and potential investors through the compliance of Listing Agreement on the admission of securities for listing. The listing agreement is the most influential aspect of stock exchange regulation as far as the financial reporting is concerned. It aims at securing a regular supply of information to investors and others, and at specifying the information which must be supplied by a company. It also ensures consistency of company financial reporting requiring the disclosure of reasons for deviations from an existing policy. Moreover, according to the Agreement Form, each company is generally required to publish in a form, approved by the stock exchange, periodical interim statement, total turnover, gross profit, depreciation, net profit etc. Thus, the role of stock exchange, as a regulatory body, in corporate accounting is essentially very important.

The Securities and Exchange Board of India (SEBI) came into existence in 1992 as an exclusive and regulatory body of Indian capital market. It has brought a new dimension in the field of securities transactions in India. During the last three decades, it has taken a number of steps in order to discharge the responsibility of regulating both the primary market (initial issue of securities) and secondary market (dealing with securities in the stock exchanges) with a view to bringing uniformity through the compliance of its guidance in the matter of financial reporting practices by the companies in the interests of both the present and potential investors.

SEBI guidelines in respect of financial accounting and reporting is mainly covered by the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 notified on 02.09.2015. The main provisions relating to accounting and reporting or disclosures are discussed below:

Chapter IV: Obligations of Listed Entity Which Has Listed Its Specified Securities
Clause 33: Financial Results

(1) While preparing financial results, the listed entity shall comply with the following:

(a) The financial results shall be prepared on the basis of accrual accounting policy and shall be in accordance with uniform accounting practices adopted for all the periods.

(b) The quarterly and year to date results shall be prepared in accordance with the recognition and measurement principles laid down in Accounting Standard 25 or Indian Accounting Standard 31 (AS 25/ Ind AS 34 – Interim

Financial Reporting), as applicable, specified in Section 133 of the Companies Act, 2013.

(c) The standalone financial results and consolidated financial results shall be prepared as per Generally Accepted Accounting Principles in India: Provided that in addition to the above, the listed entity may also submit the financial results, as per the International Financial Reporting Standards notified by the International Accounting Standards Board.

Clause 34: Annual Report

(2) The annual report shall contain the following:

(a) audited financial statements i.e., balance sheets, profit and loss accounts etc.

(b) consolidated financial statements audited by its statutory auditors;

(c) cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3 or Indian Accounting Standard 7, as applicable

(d) directors report;

(e) management discussion and analysis report - either as a part of director's report or addition thereto;

(f) for the five hundred listed entities based on market capitalization (calculated as on March 31 of every financial year), business responsibility report describing the initiatives taken by them from an environmental, social and governance perspective, in the format as specified by the Board from time to time. Other than top five hundred listed companies based on market capitalization and listed entities which have listed their specified securities on SME Exchange, may include these business responsibility reports on a voluntary basis in the format as specified.

(3) The annual report shall contain any other disclosures specified in Companies Act, 2013 along with other requirements as specified in Schedule V of these regulations.

Clause 43: Dividends

(1) The listed entity shall declare and disclose the dividend on per share basis only.

Clause 48: Accounting Standard

The listed entity shall comply with all the applicable and notified Accounting Standards from time to time.

Chapter V : Listed Entity Which Has Listed Its Nonconvertible Debt Securities or Nonconvertible Redeemable Preference Shares or Both

Clause 52: Financial Results

(1) The listed entity shall prepare and submit un-audited or audited financial results on a half yearly basis in the format as specified by the Board within forty-five days from the end of the half year to the recognised stock exchange(s).

(4) The listed entity, while submitting half yearly / annual financial results, shall disclose the following line items along with the financial results:

(a) credit rating and change in credit rating (if any); (b) asset cover available, in case of non-convertible debt securities; (c) debt-equity ratio; (d) previous due date for the payment of interest/ dividend for non-convertible redeemable preference shares/ repayment of principal of non-convertible preference shares /non-convertible debt securities and whether the same has been paid or not; and, (e) next due date for the payment of interest/ dividend of non-convertible preference shares /principal along with the amount of interest/ dividend of non-convertible preference shares payable and the redemption amount; (f) debt service coverage ratio; (g) interest service coverage ratio; (h) outstanding redeemable preference shares (quantity and value); (i) capital redemption reserve/debenture redemption reserve; (j) net worth; (k) net profit after tax; (l) earnings per share. However, the requirement of disclosures of debt service coverage ratio, asset cover and interest service coverage ratio shall not be applicable for banks or non-banking financial companies registered with the Reserve Bank of India.

(6) The listed entity which has listed its non-convertible redeemable preference shares shall make the following additional disclosures as notes to financials:

(a) profit for the half year and cumulative profit for the year; (b)free reserve as on the end of half year; (c) securities premium account balance (if redemption of redeemable preference share is to be done at a premium, such premium may be appropriated from securities premium account): Provided that disclosure on securities premium account balance may be provided only in the year in which non-convertible redeemable preference shares are due for redemption; (d) track record of dividend payment on non-convertible redeemable preference shares: Provided that in case the dividend has been deferred at any time, then the actual date of payment shall be disclosed; (e) breach of any covenants under the terms of the non-convertible redeemable preference shares: Provided that in case a listed entity is planning a fresh issuance of shares whose end use is servicing of the non-convertible redeemable preference shares (whether dividend or principle redemption), then the same shall be disclosed whenever the listed entity decided on such issuances.

Clause 53: Annual report

The annual report of the listed entity shall contain disclosures as specified in Companies Act, 2013 along with the following:

(a) audited financial statements i.e., balance sheets, profit and loss accounts etc; (b) cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3/ Indian Accounting Standard 7; (c) auditors report; (d) directors report; (e) name of the debenture trustees with full contact details (f) related party disclosures as specified in Para A of Schedule V.

Chapter VI: Listed Entity Which Has Listed Its Specified Securities and Either Non-convertible Debt Securities or Non-Convertible Redeemable Preference Shares or Both

Clause 63: Applicability of Chapters IV and V

(1) Entity which has listed its 'specified securities' and 'non-convertible debt securities' or 'non-convertible redeemable preference shares' or both on any recognised stock exchange, shall be bound by the provisions in Chapter IV of these regulations.

1.6 Summary

Proper and adequate disclosure of information through preparation and presentation of financial and non-financial statements, charts, diagrams etc. is the need of the hour not only in interest of a wide variety of users for taking right decisions but also in the interest of the companies themselves in the matter of compliance of disclosure requirements as required by the Companies Act 2013, Indian Accounting Standards notified by MCA and SEBI (LODR) Regulations 2015. MCA and SEBI have been playing a remarkable role in the development of corporate accounting and reporting with a view to harmonizing diverse accounting and reporting practices in India through the legal framework of Acts, Standards and Regulations respectively.

1.7 Exercises

1. What are the objectives of disclosure of information?
2. What is meant by regulation of corporate accounting and reporting? Why is external regulation essential?
3. Explain in brief the disclosure requirements in the financial statements as per the Companies Act 2013.

4. What is the necessity of accounting standards? Can accounting standards remove diverse financial accounting and reporting practices?
5. State the disclosure requirements in the financial statements for the following:
   a) Inventories (Ind AS 2)
   b) Statement of Cash Flows (Ind AS 7)
   c) Accounting Policies, Changes in Accounting Estimates and Errors (Ind AS 8)
   d) Events after the Reporting Period (Ind AS 10)
   e) Property, Plant and Equipment (Ind AS 16)
   f) Employee Benefits (Ind AS 19)
   g) The Effects of Changes in Foreign Exchange Rates (Ind AS 21)
   h) Borrowing Costs (Ind AS 23)
   i) Related party Disclosures (Ind AS 24)
   j) Earnings Per Share (Ind AS 33)
   k) Impairment of Assets (Ind AS 36)
   l) Intangible Assets (Ind AS 38)
   m) Share Based Payments (Ind AS 102)
   n) Financial Instruments: Disclosures (Ind AS 107)
   o) Fair Value Measurement (Ind AS 113)
   p) Leases (Ind AS 116)
6. State the provisions relating to accounting and reporting as per SEBI (LODR) Regulations, 2015 with respect to:

(a) listed entity which has listed its specified securities; and

(b) listed entity which has listed its non-convertible debt securities or non-convertible redeemable preference shares or both.

Unit 2 □ Valuation of Goodwill and Shares

Structure

2.1 Objective

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2.10 Using Relative Valuation

2.11 Summary

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2.1 Objective

After going through this unit, you will be able to:

- know the meaning of goodwill, its types and the factors affecting it;
- explain the need for valuation and methods of valuation;
- explain why valuation of shares is necessary and the methods of valuation.

2.2 Introduction

Goodwill is an intangible asset but not fictitious. Since it is an intangible asset, it cannot be used as tangible assets like land & building, plant & machinery, furniture & fittings; but like other tangible assets it contributes to the profit earning capacity of the business. Again, goodwill is a valuable asset if the business is profitable; it is value less if the business is a losing one. When a business is able to earn profits at a rate higher than its similar counterparts, the business is said to possess goodwill.

2.3 Meaning of Goodwill

Goodwill is the value of the reputation, connection or other advantage of the business judged in respect of its capacity to bring in, unaided, profits. It is that attractive force which brings customers into the business. Again, it is the value of excess earning power of a firm. Actually, it is the anticipated future excess earnings of an enterprise. Thus, goodwill may be defined as the value of the reputation of a business in respect of profits expected in future over and above the normal level of profit earned by the undertaking belonging to the same class of business.

2.4 Types of Goodwill

In business, there are two types of goodwill, namely, Purchased goodwill and Inherent or Non-purchased goodwill. Different types of goodwill are discussed in the paragraphs that follow.

2.4.1 Purchased Goodwill

It may arise when a business purchases another business. Purchased goodwill is the excess of the purchase consideration over and above the fair value of the separable net assets acquired with an expectation of better future prospects of the entity as a whole. It must not exist in a business except by business purchase. Conventionally, only purchased goodwill is recognized in accounting.

2.4.2 Non-purchased Goodwill

Internally generated goodwill is known as non-purchased, self-generated or inherent goodwill. It arises when a business generates its own goodwill over the years. It is not shown in the balance sheet.

2.5 Factors Contributing to Goodwill

The following factors contribute significantly in developing the goodwill of an organization.

1. Superior management team
2. Outstanding sales manager of organization
3. Weakness in the management of a competitor
4. Effective advertising
5. Secret or patented manufacturing
6. Good labour relations
7. Outstanding credit rating
8. Top flight training programme for employees
9. Good public 'image'
10. Unfavourable development in operation of a competitor
11. Favourable association with another company
12. Strategic location
13. Discovery of talents or resources
14. Favourable tax conditions
15. Favourable government regulations
16. Favourable attitudes of customers
17. Excellent reputation for quality and reliability of products
18. Number of outlets for products
19. Number of service locations for products
20. Favourable agency agreements
21. Established list of customers
22. Established license to trade
23. Experienced work-force
24. Good relations with suppliers
25. Superior pension fund resources

2.6 Need for Valuation of Goodwill

In case of a joint stock company, the need for valuation of goodwill arises in the following circumstances:

a. When the business of a company is taken over by another company for the purpose of amalgamation or absorption.

b. When the shares of the company are not quoted on the stock exchange and their valuation is to be made for the purpose of taxation etc.

c. When the business of a company is being taken over by the government.

d. When a person (or a company) wants to buy a large block of shares of a company with a view to exercising control over the management of the company concerned.

In case of a partnership organisation also valuation of goodwill may be necessary in case there is any change in the ownership structure of the organisation such as admission of a partner, retirement or death of a partner, change in profit sharing ratio etc.

2.7 Methods for Valuation of Goodwill

Generally, there are three popular methods for valuation of goodwill. They are: (1) Super Profit Method; (2) Capitalization of Average Profits Method, and (3) Annuity Method. These may be discussed in the following paragraphs:

2.7.1 Super Profit Method

The excess of average future maintainable profit over the normal profit is known as super profit. In this method, goodwill is taken as the sum of super profits of the future years for which such super profit is expected to be maintained. The elements to be taken into account in determining the value of goodwill are:

(a) Average future maintainable trading profit;

(b) Capital employed;

(c) Normal rate of return; and

(d) Number of year(s) for which super profit is expected to be maintained, i.e., number of years' purchase.

Super Profit = Future maintainable profit − (Capital employed × Normal rate of return)

Goodwill = Super profit × Number of year(s) for which super profit can be maintained.

Following illustration will clarify the above steps.

Illustration 1: Valuation of Goodwill under Super Profit Method; Simple Problem

Capital employed of Venus Ltd. was Rs. 20,00,000. Trading profits for the last 3 years were Rs. 2,90,000, Rs. 3,00,000 and Rs. 3,10,000 respectively. Normal rate of return is 12%. Super profit is expected to be maintained for 4 years. Determine the value of goodwill.

Solution:

Calculation of Super Profit

Av. future maintainable trading profit [(2,90,000 + 3,00,000 + 3,10,000) ÷ 3]	Rs. 3,00,000
Less: Normal return @ 12% on capital employed (Rs. 20,00,000 × 12%)	Rs. 2,40,000
	Rs. 60,000

Value of goodwill = Super profit × No. of year for which super profit can be maintained = Rs. 60,000 × 4 = Rs. 2,40,000.

The steps of calculation of goodwill under super profit method are now discussed in detail as follows:

(a) Future Maintainable Trading Profit

Future maintainable profit is an important factor in determining the value of goodwill. Future maintainable profit is ascertained by taking either simple average or weighted average, as the circumstance demands, of the past profits. Conventionally, profits of last 3 to 5 years are considered. When the past profits do not show any definite trend, simple average is used to ascertain the future maintainable profit. In case of existence of increasing or decreasing trend in the past profits, weighted average is taken in order to ascertain future maintainable profit. However, more weights are assigned to the profit figures of the immediate past years while less weights are given to the profit figures of the furthest past years. Moreover, only trading profits should be considered as goodwill in the result of organisation's operation and hence should not be affected by any non-trading expenses or losses and non-trading income.

Nevertheless, ascertainment of future maintainable trading profit requires following adjustments:

(1) Elimination of non-trading loss due to sale of asset(s), fire, earthquake, flood, strike, lock out, etc, from profit or loss.

(2) Elimination of any non-trading expenses such as interest on loan or interest on debentures.

(3) Elimination of non-trading income arising out of sale of asset(s), dividend or interest income, etc. from profit or loss because capital employed consists only of trading assets. But, in case of income received from trading investments, no adjustment is needed.

(4) In case of increase or decrease in the value of fixed assets on account of revaluation, under-charged or over-charged depreciation should be adjusted on the increased or decreased values.

(5) In case of change in the corporate tax rate, tax charged at old rate should be added back and tax should be charged at new rate.

(6) In case of change in accounting policy, profit or loss should be so adjusted to have profit or loss on the basis of uniform accounting policy.

(b) Capital Employed

It is the most important factor in valuation of goodwill because the volume of profit is significant only in relation to the capital used to earn it. Thus, while valuing the goodwill, capital employed refers to permanent resources used to earn operating or trading profit. Accordingly, capital employed means 'total assets minus non-trading assets minus fictitious assets minus current liabilities.' Alternatively, capital em-ployed means 'net-worth plus long-term debt.' This basically, gives us the Trading Capital Employed.

It is to be remembered that profit is expressed in terms of current prices. So, in order to make fair determination of capital employed, all assets and current liabilities (or, outside liabilities) are to be taken at current prices, because profit is measured at current price. In making so, all fixed assets and inventories are to be taken into account at current prices and the remaining current assets and current liabilities (or, outside liabilities) need not require any valuation as they are already stated at current prices. However, expected bad debt should be deducted from sundry debtors. Here, current prices will mean their fair value.

Since the capital employed changes over the year, it would be better to have an average capital employed instead of capital employed (i.e., closing capital employed) because average capital employed is the true representative of the capital employed while evaluating goodwill. It is determined by deducting half of the current year's trading profit (after tax) from the closing capital employed.

(c) Normal Rate of Return on capital employed

Normal rate of return is the third important factor in valuing goodwill. It means the rate of return that a similar business is earning with the similar resources (i.e.,

capital employed). Such a return differs from industry to industry. It comprises of two components:

(1) Risk-free rate : It is the pure interest rate prevailing in the concerned economy (the rate of return on fixed deposit in bank or government securities may be considered as risk-free rate).

(2) Risk premium : It is the premium in addition to risk-free rate for taking business risk for the industry to which the company belongs.

It is relevant to state that, higher is the business risk, the higher is the normal rate of return. In practice, industry average return is taken as normal rate of return.

Consider the following comprehensive illustration.

Illustration 2 : Valuation of Goodwill under Super Profit Method; Comprehensive Problem

From the following information, determine:

(a) Closing trading capital employed;

(b) Average trading capital employed; and

(c) Value of goodwill by super profit method (on the basis of 5 years' purchase of average super profit).

The summarized Balance Sheet of Z Ltd. as on December 31, 2020

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
20,000 Equity Shares of Rs. 10 each	2,00,000	Fixed Assets	3,50,000
1,000 9% Preference Shares of Rs. 100 each	1,00,000	Investments (6% Govt. Deposit)	45,000
Reserve and Surplus	1,80,000	Current Assets	2,00,000
10% Debentures	90,000	Fictitious assets	55,000
Creditors	60,000		
Provision for Taxation	20,000		
	6,50,000		6,50,000

The current market value of the plant included in fixed assets is Rs. 15,000 more. The average profit of the company (after deductions of interest and govt. taxes) is Rs. 68,000. The normal rate of return on capital employed is 12%. Depreciation rate on plant 10%. Tax rate is 40%.

Solution.

(a) Closing Trading Capital Employed

Particulars	Rs.
Total Assets as per given balance sheet	6,50,000
Less : Fictitious assets	(55,000)
Less : Investment (being non-trading)	(45,000)
Add : Increase in plant	15,000
Less : Provision for taxation	(20,000)
Creditors	(60,000)
Closing trading capital employed	4,85,000

(b) Average Trading Capital Employed

Particulars	Rs.
Closing Trading Capital Employed as in (a) above	4,85,000
Less : ½ of *current year's trading profit after taxes (70,880 × ½)	35,440
Average trading capital employed	4,49,560

* Here, it is assumed that current year's trading profit is same as the average maintainable trading profit.

(c) Valuation of Goodwill

(i) Super Profit Method:

Particulars	Rs.
Average profit after interest and tax	68,000
Less : Income from investments after tax (45,000 × 6% × 60%)	(1,620)
Less : Depreciation on the increased value of plant net of tax (15000 × 10% × 60%)	(900)
Add : Debenture Interest (90000 × 10% × 60%)	5,400
Average maintainable trading profit after tax	70,880.00
Less : Normal return on average trading capital employed (4,49,560 × 12%)	53,947.20
Super profit	16,932.80

Goodwill = Super Profit × No of years for which super profit can be maintained

= Rs.16,932.80 × 5 = Rs.84,664

2.7.2 Capitalization of Average Profits Method

Under this method, average future maintainable trading profit is capitalised using normal rate of return on capital employed to arrive at the value of the firm (including goodwill). Goodwill is taken as the excess of the value of the firm (including goodwill) over the value of capital employed (excluding goodwill) for which goodwill is calculated. In this method the following elements are to be taken into account:

(a) Average future maintainable trading profit;

(b) Capital employed in the business for which goodwill is to be calculated; and

(c) Normal rate of return in the industry to which the business belongs.

Value of the business = (Average future maintainable trading profit) / (Normal rate of return)

Value of goodwill = Value of the business − Value of capital employed

Illustration 3 : Valuation of Goodwill Under Capitalisation Method

Capital employed in Venus Company Ltd. is Rs. 20,00,000. Average future maintainable trading profit is Rs. 3,00,000. Normal rate of return is 12%. Find out the value of goodwill.

Solution :

Value of the business = (Average future maintainable trading profit)/Normal rate of return

= (Rs. 3,00,000)/ 12% = Rs. 25,00,000

Value of goodwill = (Value of the business) − (Value of capital employed)

= Rs. (25,00,000 − 20,00,000)

= Rs. 5,00,000

Illustration 4 : Valuation of Goodwill under Capitalization Method

Refer to Illustration 2. Compute goodwill under Capitalization Method.

Solution :

Capitalization Method

Value of the business = (Average future maintainable trading profit)/Normal rate of return

= (Rs. 70,880)/12% = Rs.5,90,667

Value of goodwill = (Value of the business) − (Value of capital employed)

= Rs. (Rs.5,90,667 − 4,85,000)

= Rs. 1,05,667

2.7.3. Annuity Method

This method is the refinement of the super profit method. Super profit is expected to arise usually at the end of each financial year, i.e., at different points of time. In order to find out the value of goodwill, it would be unfair to simply multiply the super profit by the number of years' purchase for which super profit is expected to be earned. So future values of super profit must be discounted using appropriate discount rate (i.e., normal rale of return) with a view to getting present value of super profits. In case of annual super profit, the Annuity Formula can be used suitably for discounting future values of super profit in order to convert them into the present value; or, annual super profits can be multiplied by the sum of present values of the appropriate discount rate to find out the value of goodwill.

Illustration 5 : Valuation of Goodwill Under Annuity Method

Super profit of Venus Ltd. Rs. 60,000 per year can be maintained for 4 year. Discount rate is 12%. Find the value of goodwill.

Solution :

Goodwill (V) = Super Profit × PVIFA (i, n)

Here, PVIFA $= \frac{1-1/(1+i)^n}{i} = \frac{1-1/1(1+0.12)^4}{0.12} = 3.0373$

So, Value of goodwill = Rs. 60,000 × 3.0373 = Rs. 1,82,238

Illustration 6 : Valuation of Goodwill Under Annuity Method

Refer to Illustration 2. Compute goodwill under annuity method assuming appropriate discounting rate is 12%.

Solution :

Annuity Method:

Goodwill = Super profit × Sum of present values at 12% for 5 years

= Rs. 16,932.80 × 3.6048 = Rs. 61,039

2.8 Need for Valuation of Shares

Shares of all public limited companies are not quoted on the stock exchange. Again, shares of private limited companies, in any case, will not be quoted. In case of change of hands of unquoted shares, value of such shares should be ascertained. Moreover, need for valuation of shares arises in the following circumstances:

(1) Assessments under the estate duty, gift tax, wealth tax, etc.

(2) Purchase of a block of shares generally involving acquisition of controlling interest in the company.

(3) Formulation of schemes of amalgamation, absorption, reconstruction, etc.

(4) Acquisition of interest of dissenting shareholders under a reconstruction scheme.

(5) Compensating shareholders on the acquisition of their shares, by the government under a nationalisation scheme.

(6) Conversion of preference shares into equity shares.

(7) Advancing loan on the security of shares.

(8) Purchase of shares by the employees of the company where the retention of such shares is limited up to the period of their retirement.

2.9 Methods of Valuation of Shares

Basically, there are two methods used for valuation of equity shares. They are explained as below:

2.9.1 Net Asset Method

This method is also known as asset backing method or intrinsic value method or break-up value method or balance sheet method. The essence of this method is the security, safety and asset cover of shares. Under this method, value per equity share is ascertained as follows:

Value per equity share = (Net assets available for equity shares)/(No. of equity shares)

The following important aspects should be considered while arriving at the 'net assets available for equity shares'.

(1) A proper value should be placed on the goodwill of the business. Valuation of goodwill should be made using any of the methods, as explained in the preceding pages.

(2) Proper valuation should be made for other intangibles like patents, trademarks, know-how, etc. They should be shown at their fair value.

(3) Fictitious assets like debit balance in the profit & loss account, preliminary expenses, discount on debentures etc. should be excluded from total assets.

(4) All tangible fixed assets and non-trading investments should be taken at their market values. In the absence of information relating to the market values of assets, balance sheet values may be taken as the market values.

(5) Stock of finished goods including stock of raw materials and work-in-progress, should be valued at cost or market price, whichever is lower.

(6) Adequate provision for bad and doubtful debts should be made against sundry debtors.

(7) In case of equity shares having same nominal value, but different paid-up values, it is advisable to make notional calls on unpaid shares in order to make the partly paid-up shares notionally fully paid up. Amount to be realised from notional calls is taken as if cash in hand.

(8) In case of equity shares having different nominal values and different paid-up values, it is advisable to distribute net assets available for equity shareholders before making notional calls among different groups of shares in proportion of paid up capital, and then make notional calls on unpaid shares to make them notionally fully paid up.

Following liabilities should be deducted from the total assets arrived at as discussed above, in order to find out the net assets available for equity shareholders.

(1) All long-term debts including outstanding interest.

(2) Current liabilities like bank overdraft, sundry creditors, bills payable, outstanding expenses, pre-received incomes or provision for taxation.

(3) All liabilities not provided for in the accounts,

(4) Preference share capital including arrear preference dividends, if any.

Valuation of shares under net asset method is useful for formulating scheme of amalgamation or when a person (or, a company) wants to acquire a controlling interest in the company. This method is also suitable for those who are risk averse.

Illustration 7 : Valuation of Shares Under Asset Backing / Net Assets Method

The following is the summarized Balance Sheet of X Ltd. as on March 31 2020:

Liabilities	Amount Rs.	Assets	Amount Rs.
2,000 Equity Shares of Rs. 100		Goodwill	10,000
each fully paid	2,00,000	Land & Building	2,10,000
1,000 Preference Shares of Rs. 100		Plant & Machinery	1,50,000
each fully paid	1,00,000	Investment in National	
General Reserve	30,000	Plan Certificates	10,000
Dividend Equalization Reserve	10,000	Stock at cost	90,000
Staff Welfare Fund	15,000	Sundry Debtors	40,000
Employees' Provident Fund	1,40,000	Bills Receivable	8,000
Employees' Compensation Fund		Cash at Bank	1,37,000
(represented by investments)	10,000	Cash in hand	10,000
Employees' Savings A/c	20,000	Preliminary Expenses	10,000
Profit & Loss Balance	60,000		
Provision for Taxation	40,000		
Sundry Creditors	50,000		
	6,75,000		6,75,000

On April 1, 2020, all Preference Shares were redeemed at a premium of 10% out of profit otherwise available for dividend.

You are required to ascertain the value of each Equity Share by Net Asset Method on the basis of the Balance Sheet immediately after redemption of Preference Shares taking into consideration of the following information:

(a) Goodwill is valued at Rs. 85,000.

(b) 10% of Sundry Debtors are to be considered as bad.

(c) A claim for compensation to an employee has been admitted on April 1, 2020, the amount involving being Rs. 5,000.

(d) All other assets are to be taken at their book values.

Solution :

Net assets available for equity shareholders:

Particulars	Rs.	Rs.
Total assets as per last balance sheet		6,75,000
Add : Increase in goodwill		75,000
Less : Decrease in bank balance for redemption of preference shares		(1,10,000)
Less : Decrease in sundry debtors for bad debt		(4,000)
Less : Preliminary expenses		(10,000)
Less : Current liabilities:		6,26,000
Staff welfare fund*	15,000	
Employees' provident fund	1,40,000	
Claim for compensation to an employee	5,000	
Employees' saving A/c	20,000	
Provision for taxation	40,000	
Sundry Creditors	50,000	
		2,70,000
		3,56,000

Value of each share = (Net assets available for equity shares)/Number of shares

= Rs. 3,56,000/2,000 = Rs. 178

*Staff Welfare Fund is treated as current liability according to conservatism concept.

2.9.2 Yield Method

Yield refers to effective rate of return from similar types of investment. Investors are interested in yield of the company and ultimately in dividend. The essence of this method is the return on investment. Hence, the valuation of shares should be based on return on investment of the company concerned. This method is also known as market value method or earning capacity method. Again, this method may be divided into two categories. They are: (1) Earnings Yield Method, and (2) Dividend Yield Method.

They are: (1) on the basis of expected rate of earning (for majority shareholders with long term view), and (2) on the basis of expected dividend (for minority shareholders with short term view). These are discussed below.

➢ **Earnings Yield Method:**

This basis of valuation is most suitable to the holders of large block of shares (i.e., controlling interest/majority holding with long term view about the company). The formula for determining the yield value per equity share is:

Yield value = [(Expected rate of return) × (Paid up value per share)] / (Normal Rate of Return)

In view of finding out the expected rate of return (or company yield), it is advisable to take the average of past years' earnings of the company. Moreover, it requires adjustment of the following aspects:

(1) Abnormal losses due to fire, theft, burglary, etc. should be eliminated from the figures of profit and loss.
(2) Non-recurring incomes and losses should be eliminated.
(3) Capital profit or loss on account of sale of fixed assets should be eliminated.
(4) Compensation paid to employees due to accident or voluntary retirement scheme (VRS) should be eliminated.
(5) Compensation received for acquiring land or property of the company by the government, should be eliminated.
(6) Adequate provision for taxation should be made.
(7) Transfer to general reserve should be made.
(8) Preference dividend should be considered.
(9) Normal rate of return to equity shareholders (not on capital employed) should be considered.

➢ **Dividend Yield Method:**

This basis of valuation is highly suitable to the holders of small block of shares (i.e., non-controlling interest/minority holding with short term view) because they are not interested in earning capacity of the company. As a result, expectation of the minority shareholders should be confined to the payment of dividend. The formula for ascertaining the yield value per share is:

Yield value = [(Expected rate of dividend) × (Paid up value per share)] / (Normal rate of return).

In determining the expected rate of dividend, average of the immediate past 3 to 5 years of actual dividend paid by the company may be taken.

This basis of valuation is preferred by investors who invest their funds with speculative motive and who are risk taker and are less interested in asset cover of their shares.

Illustration 8 : Valuation of Shares Under Yield Method

From the following information, find out the value of each equity share under yield method:

20,000, 12% Preference shares of Rs. 10 each fully paid	Rs. 2,00,000
25,000 Equity shares of Rs. 10 each fully paid	Rs. 2,50,000
20,000 Equity shares of Rs. 10 each Rs. 7.50 paid up	Rs. 1,50,000
Expected profit per year before taxes	Rs. 2,25,000

Rate of Tax: 40%

Transfer to general reserve: 20% of profit after taxes

Normal rate of return on equity capital: 15%

Rate of equity dividends for last 3 years are 14%, 13% and 15% respectively. Similar companies pay dividend @ 12.50% on paid up equity capital.

Solution :

- **Earnings Yield Method:**

Particulars	Rs.
Expected profit before taxes per year	2,25,000
Less : Taxes @ 40%	90,000
Distributable profit after tax per year	1,35,000
Less : Transfer to general reserve @ 20%	27,000
Profit available to shareholders	1,08,000
Less : Preference dividend @ 12% on Rs. 2,00,000	24,000
Profit available for equity dividend	84,000

Paid up equity capital = (Rs. 2,50,000 + Rs. 1,50,000) = Rs. 4,00,000

Expected rate of return = [(Profit available for equity shares) × 100]/ (Paid up equity capital)

= (Rs. 84,000 × 100)/Rs. 4,00.000 = 21%

Normal rate of return on equity capital = 15%

Yield value per share = [(Expected rate of return) × (Paid up value)]/ (Normal rate of return):

Fully paid up = (21% × Rs. 10)/15% = Rs. 14.00

Partly paid up = (21% × Rs. 7.50)/15% = Rs. 10.50

Dividend Yield Method:

Since the rates of dividend paid are fluctuating during the last 3 years, simple average is suitable in order to find out expected rate of dividend.

Expected rate of dividend = (14% + 13% + 15%) / 3 = 14%

Normal rate of dividend = 12.50%

Yield value per share

= [(Expected rate of dividend) × (Paid up value)]/ (Normal rate of dividend)

Fully paid up = (14% × Rs. 10)/12.50% = Rs. 11.20

Partly paid up = (14% × Rs. 7.50)/12.50% = Rs. 8.40

2.9.3 Preference Shareholders' Claim

The claim of Preference Shareholders may be ascertained under the following situations:

(1) When preference shares have priority as to the payment of capital only (i.e., non-cumulative), then preference shareholders' claim will be limited to paid up capital only.

(2) When preference shares are redeemable at a premium, then preference shareholders' claim will be paid-up capital plus premium payable on redemption.

(3) When preference shares have priority as to the payment of capital and arrear dividend (i.e., cumulative), the preference shareholders' claim will be limited to paid up capital plus arrear dividend.

(4) When preference shares are participating, then preference shareholders' claim will be paid-up capital plus share of surplus of assets, if any, after payment of both preference share capital plus equity share capital.

The question arrear preference dividend does not arise at all in case of non-cumulative preference shares. But when the shares are not specifically mentioned as non-cumulative, they should be considered as cumulative.

2.9.4 Fair Value of Share

This is, of course, no valuation, but a compromise formula for bringing parties to an agreement. The fair value is simply the average of the values obtained by net asset method and yield method. It is often argued that the average of net asset value and yield value incorporates the merits of both the methods. For this reason, such average is called fair value. Thus, fair value per share = (Net asset value + Yield value) / 2.

Illustration 9 : Valuation of Equity and Preference Shares

The following is the summarized Balance Sheet of Union Ltd. as on March 31, 2020.

Liabilities	Amount Rs.	Assets	Amount Rs.
6% Preference Shares of		Fixed Assets at cost	4,10,000
Rs. 10 each fully paid	2,00,000	Current Assets	2,48,000
Equity Shares of Rs. 10		Preliminary Expenses	10,000
each fully paid	3,00,000	Discount on debentures	5,000
General Reserve	12,000	Profit & Loss A/c	27,000
Debenture Redemption Fund	18,000		
Investment Fluctuation Fund	10,000		
5% Debentures	50,000		
Depreciation Fund	20,000		
Sundry Creditors	90,000		
	7,00,000		7,00,000

Current assets included investments of Rs. 60,000, market price of which is Rs. 64,000. Debtors included in current assets are doubtful to extent of Rs. 5,000 for which no provision has been made so far. Stock includes obsolete items of Rs. 6,000 and at the end of the year did not include a return of Rs. 1,000 though the transaction was properly recorded and posted.

Debenture interest is owing for one year and preference dividends are in arrear for two years. Other assets are worth book values.

You are required to find out the value of each equity and preference share under the flowing circumstances:

(1) When preference shares have priority both as to the payment of capital and of dividend in the event of liquidation.

(2) When preference have priority as to capital only; and

(3) When preference shares have priority as to payment of dividend only.

Solution :

I. *Net Assets available for shareholders:*

Particulars	Rs.	Rs.
Total assets as per last balance sheet		7,00,000
Add : Increase in the value of investments	4,000	
Return of goods not included in stock	1,000	5,000
		7,05,000
Less : Depreciation fund	20,000	
Provision for doubtful debts	5,000	
Obsolete items of stock	6,000	
Preliminary expenses	10,000	
Discount on debenture	5,000	
Debit balance of profit and loss A/c	27,000	73,000
Revalued total assets		6,32,000
Less : Outside liabilities:		
5% Debentures	50,000	
Outstanding debenture interest for one year	2,500	
Sundry creditors	90,000	1,42,500
		4,89,500

(a) When preference shares have priority both as to the payment of capital and arrear dividend (i.e., *cumulative preference shares) in the event of liquidation takes place:*

Particulars	Rs.	Rs.
Net assets available for shares as in (1) above		4,89,500
Less : Preference shareholders' claim:		
Paid up preference share capital	2,00,000	
Arrear dividends for 2 years	24,000	2,24,000
Net assets available for equity shares		2,65,500

Value of each share = (Net assets available for shares)/number of shares:

Preference share = Rs. 2,24,000/20,000 = Rs. 11.20

Equity share = Rs. 2,65,500/30,000 = Rs. 8.85

(b) When preference shares have priority as to the payment of capital only (i.e., non-cumulative preference shares):

Particulars	Rs.
Net assets available for shares as in (1) above	4,89,500
Less : Preference shareholders' claim:	
Paid up capital only	2,00,000
Net assets available for equity shares	2,89,500

Value of each share:

Preference share = Rs. 2,00,000/20,000 = Rs. 10.00

Equity share = Rs. 2,89,500/30,000 = Rs. 9.65

(c) When preferences shares have priority as to the payment of arrear dividend only:

Particulars	Rs.
Net assets available for shareholders as in (1) above	4,89,500
Less : Arrear preference dividend	24,000
Net assets available for shares after arrear preference dividend (1)	4,65,500

Distribution of assets as in (1) should be made between preference shares and equity shares in the paid-up capital ratio of 2,00,000: 3,00,000 i.e., in the ratio of 2:3.

Net assets available for shares	Preference	Equity
Share of net assets	1,86,200	2,79,300
Arrear preference dividend	24,000	Nil
	2,10,200	2,79,300

Value of each share:

Preference share = Rs. 2,10,200/20,000 = Rs. 10.51 (cum-dividend)

Equity share = Rs. 2,79,300/30,000 = Rs. 9.31(ex-dividend)

Illustration 8 : Comprehensive Problem on Calculation of Fair Value Per Share

The Summarized Balance Sheet of Sunflower Ltd, as on December 31, 2020 is as below.

Liabilities		Amount Rs.	Assets	Amount Rs.
Share Capital :			Fixed Assets :	
Equity shares of Rs. 100 each		7,50,000	Machinery	3,80,000
Less: Calls in arrear			Factory Shed	4,10,000
(Rs. 20 for final call)	30,000	7,20,000	Vehicles	1,05,000
8% Preference shares of			Furniture	40,000
Rs. 100 each		3,00,000	Patent	70,000
Reserves and Surplus :			*Investments*	1,60,000
General Reserve		2,80,000	Current Assets :	
Profit & Loss Balance		1,70,000	Stock-in-trade	3,00,000
Current Liabilities :			Sundry Debtors	5,25,000
10% Bank Loan		1,50,000	Cash at Bank	80,000
Sundry Creditors		4,50,000		
		20,70,000		20,70,000

Additional information :

(1) Fixed assets are worth 20% above book value. Depreciation on appreciated value of fixed assets not to be considered for valuation of goodwill. Patent is valueless.

(2) Of the investments, 70% is non-trading and the balance is trading. All investments are to be valued at 20% above cost. An uniform dividend @ 10% is earned on all investments.

(3) For the purpose of valuation of shares, goodwill is to be considered on the basis of 5 years' purchase of super profit based on average profit of last 3 years. Profit (after 40% tax) are as follows: 2018: Rs. 3,10,102; 2019 Rs. 3,54,148 and 2020: Rs. 3,87,162.

In similar business, return on capital employed is 15%.

(4) In 2018, new machinery costing Rs. 20,000 was purchased but wrongly charged to revenue. No effect has yet been given for rectifying the same.

Depreciation charged on machinery is 10% per annum under reducing balance method.

(5) The rate of equity dividend for last 3 years were 18%, 19% and 20% respectively. Similar companies pay dividend @ 16% and the share is quoted on the stock exchange at Rs. 120.

(6) 20% of the profit will be transferred to General Reserve. Use weights 1, 2, 3 for the year 2018, 2019 and 2020 for both profits and dividend.

Find out the ***fair value*** for each fully paid and partly paid equity share.

Solution:

Valuation of Goodwill :

(1) *Average trading profit after taxes of the last 3 years:*

Particulars	2018 Rs.	2019 Rs.	2020 Rs.
Profit after tax @ 40%	3,10,102	3,54,148	3,87,162
Add : Purchase of machine wrongly charged to revenue 20,000 × 60%	12,000	—	—
Less : Depreciation at 10% on machinery less tax 40%	(1,200)	(1,080)	(972)
Less : Income from non-trading investments, net of tax @ 40% (1,60,000 × 70% × 10% × 60%)	(6,720)	(6,720)	(6,720)
	3,14,182	3,46,348	3,79,470

Since there is a sharp increasing trend in profit, weighted average profit is suitable. Considering weights 1, 2 and 3 for the year 2018, 2019 and 2020 respectively, weighted average trading profit after taxes will be:

[(Rs. 3,14,182 × 1) + (3,46,348) × 2 = (3,79,470 × 3)]/ (1 + 2 + 3) = Rs. 3,57,548

(2) Average trading capital employed on 31.12.2020:

Particulars	Rs.
Machinery (3,80,000 + 20,000 × 90% × 90% × 90%)	3,94,580
Factory Shed	4,10,000
Vehicles	1,05,000
Furniture	40,000
Book value of fixed assets	9,49,580
Add : Increase in fixed assets @ 20%	1,89,916
Current market value of fixed assets	11,39,496
Trade Investments (1,60,000 × 30% × 120%)	57,600
Stock-in-trade	3,00,000
Sundry Debtors	5,25,000
Cash at Bank	80,000
Less : Current liabilities	21,02,096
10% Bank loan	1,50,000
Sundry creditors	4,50,000
Trading capital employed on 31.12.2020	15,02,096
Less : ½ of current year's trading profit after taxes (3,79,470 × 1/2)	1,89,735
Average trading capital employed on 31.12.2020	13,12,361

(3) Value of goodwill:

Particulars	Rs.
Weighted average annual maintainable trading profit after taxes	3,57,548
Less : Normal return on average capital employed (13,12,361 × 15%)	1,96,854
Super profit	1,60,694

Goodwill = Super profit × 5 years' purchase = Rs. 1,60,694 × 5 = Rs. 8,03,470

Valuation of Equity Shares (Net Asset Method)

Particulars	Rs.
Trading capital employed on 31. 12. 2020	15,02,096
Add : Goodwill	8,03,470
Market value of non-trading investments (1,60,000 x 70% x 120%)	1,34,400
Calls in arrear	30,000
Net assets available for shares	24,69,966
Less : Preference share capital	3,00,000
Net assets available to equity shares (a)	21,69,966

Number of shares (b) = 7,500

Value of each fully paid-up share [(a)/(b)] = Rs. 289.33

Value of each partly paid-up share (Fully paid up - unpaid call) = Rs.269.33

Note : Here, calls-in-arrear has been assumed to be realizable in full. This is a far more rational assumption than assuming it to be non-realizable, as in that case forfeiture of equity shares will be inevitable.

Valuation of Equity Shares (Yield Method):

Particulars	Rs.	Rs.
(a) Majority Shareholders (Earnings Yield):		
Weighted average trading profit after taxes		3,57,548
Add : *Non-trading investment income*		6,720
		3,64,268
Less : Transfer to General Reserve @ 20%	72,854	
Preference dividend (3,00,000 × 8%)	24,000	96,854
Profit available for equity shareholders		2,67,414

Expected rate of return = (Profit available for equity shares) × 100]/Paid up equity capital

= (Rs. 2,67,414 × 100)/Rs. 7,20,000 = 37.14%

Normal rate of return to ESH = [Dividend per share) × 100]/ (Market price per share)

= (Rs. 16 × 100)/Rs. 120. = 13.33%

Yield value per share

= [(Exp. Rate of return) × (Paid up value)] /(Normal rate of return to ESH):

Fully paid up = (37.14% × Rs. 100)/13.33%] = Rs. 278.62

Partly paid up = [37.14% × Rs. 80)/13.33%] = Rs. 222.90

Fair Value per share:

Fully paid up = Rs. (289.33 + 278.62)/2 = Rs. 283.98

Party paid up = Rs. (269.33 + 222.90)/2 = Rs. 246.12

(b) Minority Shareholders (Dividend Yield):

Average dividend = (18% × 1 + 19% × 2 + 20% × 3)/ (1 + 2 + 3) = 19.33%

Normal rate of return to ESH = 13.33%

ESH → Equity Share Holding

Yield value per share

= [(Exp. Rate of dividend) × (Paid up value)]/ (Normal rate of return to ESH)

Fully paid up = [19.33% × Rs. 100)/13.33% = Rs.145.00

Partly paid up = [(19.33% × Rs. 80)/13.33% = Rs. 116.00

Fair value of a share:

Fully paid up = Rs. (289.33 + 145.00)/2 = Rs. 217.17

Partly paid up = Rs. (269.33 + 116.00)/2 = Rs. 192.67

Note: Normal rate of return to ESH

As mentioned earlier, the concept of normal rate of return to ESH is to be aligned with the concept of cost of equity capital (the minimum rate of return expected by equity shareholders). Accordingly, the normal rate of return to ESH has been calculated for earnings yield (for majority shareholders). Note that the rate is not the same with normal rate of return on capital employed.

For dividend yield (i.e., for minority shareholders), the normal rate of dividend paid by other players in the industry should not be taken as the normal rate of return to ESH. This is because even a minority investor will also buy the shares of the company at Rs.120 per share and get dividend at 16% on face value of Rs.100 i.e., Rs.16. So, for him also the normal rate of return will be (16/120 *100) =13.33%.

2.10 Using Relative Valuation

This is a relatively new method of valuation which focuses on the industry dynamics and a firm's relative position in the industry. Under this method a valuation relative is first calculated that describes best a firm's relative position in the industry. The valuation relative can be – price earnings ratio (or P/E multiple), price to sales ratio, price to book value per share ratio, price to EBITDA per share ratio etc. The ratios are calculated for a firm which can be considered as the peer (comparable) of the firm whose valuation is under consideration. In the absence of any peer, the industry average can be taken. Once the valuation relative is finalized, it is then multiplied with the relevant characteristic value of the company to arrive at the per share value.

Consider the following illustration.

Illustration 11 : Relative Valuation

X Ltd. has a profit after tax of Rs. 2000000. It has 8%, Preference Share Capital of Rs. 1000000 and Equity Shares of Rs. 10 each fully paid for Rs. 1500000. The P/E ratio of a peer firm in the industry is 12. Calculate the value per equity share of X Ltd.

Solution :

Calculation of EPS of X Ltd.

Profit After Tax	Rs. 2000000
Less: Preference Share Dividend (1000000 × 8%)	Rs. 80000
Earnings available for equity shareholders	Rs. 1920000

Earnings per share = 1920000/ 150000 = Rs.12.80

Value per equity share = EPS of the company × P/E ratio of the peer firm

= Rs.12.80 × 12 = Rs.153.60

2.11 Summary

Valuation of shares demands valuation of goodwill. Valuation of goodwill and shares are the most controversial issues in financial accounting. Determination of capital employed, future maintainable profit, super profit, and the number of years for which either future maintainable profit or super profit can be maintained requires subjective judgment. Thus, result of subjective judgment of anyone may differ with the result of another, even it may differ between attitudes of oneself at different circumstances. Nevertheless, valuation of goodwill and shares are made using popular methods and conventions so that the chance of variation of computed result is minimum.

2.12 Exercises

■ Theoretical Questions

1. What is goodwill? Explain different methods of valuation of goodwill. Which method of Valuation of goodwill is considered to be the best?
2. Can goodwill be sold alone? State the special features of goodwill. What are the circumstances where the need for valuation of goodwill arises in case of a company?
3. Why is average capital employed preferable in valuing goodwill? Why is 'Equity Approach' more acceptable over 'Long Term Fund Approach' in the light of valuation of shares of a company?

4. Explain different methods of valuation of shares. State the choice of the particular method by equity shareholders who demand safety, security and asset cover. Also state the choice of the method by the holders of large block of shares for speculative motive and by the holders of small block of shares for receiving regular dividend and capital gain motive.

■ Practical Problems

Problem 1:

Following information of Eastern Ltd. are available:

1. Profits earned after taxes: 2001 Rs. 80,000; 2002 Rs. 88,000 and 2003 Rs. 84,000
2. Normal rate of return: 10%
3. Capital employed: Rs. 7,50,000 including 8% debentures of Rs. 1,50,000
4. Present value of an annuity of rupee one for 5 years at 10% is Rs. 3.78
5. Profits included non-recurring profits on an average Rs. 4,000 out of which it was deemed that even non-recurring profits had a tendency of appearing at the rate of Rs. 1,000 per year.
6. Tax rate is 40%.

You are asked to ascertain the value of goodwill using.

(a) Super profit method, assuming super profit can .be maintained for 5 years;

(b) Capitalization of (i) future maintainable profit and (ii) super profit; and (c) Annuity method.

Answers:

Value of goodwill:

(a) Super profit method	Rs.96,000
(b) Capitalisation method, for both (i) & (ii)	Rs.1,92,000
(c) Annuity method	Rs.72,576

Problem 2 :

The capital structure of Z Ltd. is made up as follows:

15,000 Equity Shares of Rs. 100 each fully paid	Rs. 15,00,000
9,000 10% Preference Shares of Rs. 100 each fully paid	Rs. 9,00,000

The preference share are participating and they are entitled to a profit of 20% after payment of preference dividend and an equity dividend of 15%. The balance

of profit of will be available for equity shareholders. It is the practice of the company to transfer 10% of profit after tax to general reserve.

Average profit after tax of the company is Rs. 7,50,000. Normal rates of return for this type of company are 12% for preference shares and 16% for equity shares.

On the basis of above information, find out the value of each share, preference and equity using yield method.

Answer : value of each share: preference Rs. 150.00 and equity Rs. 213.75

Problem 3 :

The Summarized Balance Sheet of Blue Ltd. as on March 31, 2003 was as follows:

Liabilities	Amount Rs.	Assets	Amount Rs.
Share Capital :		*Fixed Assets :*	
1,000 6% Preference Shares	1,00,000	Goodwill	22,000
of Rs. 100 each fully paid		Land & Buildings	5,40,000
3,000 Equity Shares of		Plant & Machinery	1,00,000
Rs. 100 each fully paid	3,00,000	8% Investments	
4,000 Equity Shares of		(Nominal value	58,000
Rs. 100 each Rs. 50 per	2,00,000	Rs. 60,000)	
share paid		Stock-in-trade	1,80,000
		Sundry Debtors	1,60,000
Reserves and Surplus :		Cash at Bank	20,000
General Reserve	50,000		
Profit & Loss A/c	80,000		
Secured Loans :			
7% Debentures	2,00,000		
Current Liabilities :			
Provision for Taxation	50,000		
Sundry Creditors	1,00,000		
	10,80,000		10,80,000

Additional information :

1. The revaluation of assets were made as follows:

Land & Buildings Rs. 5,80,000; Plan, & Machinery Rs. 1,40,000 and investments are 105 above the nominal value and current assets are to be taken at their book values.

2. Of the investments, 60% is trading and the balance is non-trading.

3. For the purpose of valuation of shares, goodwill is to be considered on the basis of 4 years' purchase of super profit based on weighted average profit after taxes of last 3 years. The weights are 1, 2 and 3 for the year 2000-01. 2001-02 and 2002-03 respectively. Profits after 40% taxes are as follows:

   2000-01: Rs. 99,000; 2001-02: Rs. 1,18,500 and 2002-03: Rs. 1,34,100 In similar business, normal return on capital employed is 14%.

4. The rates of dividend paid for last 3 years were 16%, 18% and 20% respectively.

   Similar companies pay dividend @ 16% and the shares are quoted on the stock exchange at Rs. 125 each.

5. At the beginning of 2000-01, a machine costing Rs. 16,000 was purchased but wrongly charged to revenue. No rectification has yet been made in the books of account. Depreciation was charged on plant and machinery @ 10% and on land and buildings @ 5% under diminishing balance method,

Compute fair value of each equity share.

Answer : Closing capital employed (using equity approach) Rs 781 264; Average capital employed Rs. 7,16,979; Value of goodwill Rs. 81 916, Net asset value per share: fully paid Rs. 141.37, partly paid Rs. 91.37; Yield value per share: earnings yield (using weighted average)-fully paid Rs.145.86, partly paid Rs.72.93; Fair value per share: fully paid Rs.141.55 and /or Rs.143.62 and partly paid Rs.70.86 and /or Rs.82.15.

Problem 4:

X Ltd. has earned a revenue of Rs.5000000 during the year. It has Equity Shares of Rs. 10 each fully paid for Rs. 2500000. The industry average price to sales ratio is 10. Calculate the value per equity share of X Ltd.

Answer : Value per equity share Rs.200

Unit 3 □ Accounting for Liquidation of Companies

Structure

3.1 Objective

3.2 Meaning of Liquidation

3.3 The Legal Framework of Liquidation or Winding Up in India

3.4 Modes of Winding Up/Liquidation

3.5 Liquidator

3.6 Statement of Affairs

3.6.1 Procedure for Preparation of Statement of Affairs

3.6.2 Deficiency Account (As per List H)

3.6.3 Illustrations on Preparation of Statement of Affairs

3.7 Liquidator's Final Statement of Account

3.7.1 Priority Chart for Payment towards Various Parties

3.7.2 Priority Chart Items Explained

3.7.3 Overriding Preferential Payments

3.6.4 Illustrations on Preparation of Liquidator's Final Statement of Account

3.8 Summary

3.9 Exercises

3.1 Objective

After going through this unit, you will be able to:

- understand the legal provisions of liquidation with respect to its types according to the Companies Act, 2013; and
- know the procedure of the preparation of Statement of Affairs (by the company) and Liquidator's Final Statement of Account (by the liquidator).

3.2 Meaning of liquidation

A company is an artificial person which is the creation of law. Thus, the life of a company can come to an end only through the process of law. The process of law undertaken to bring end to the life of a company is known as *liquidation or winding up.* It is not necessary that only insolvent company be liquidated. Sometimes, also it

is essential to liquidate solvent and prosperous company.

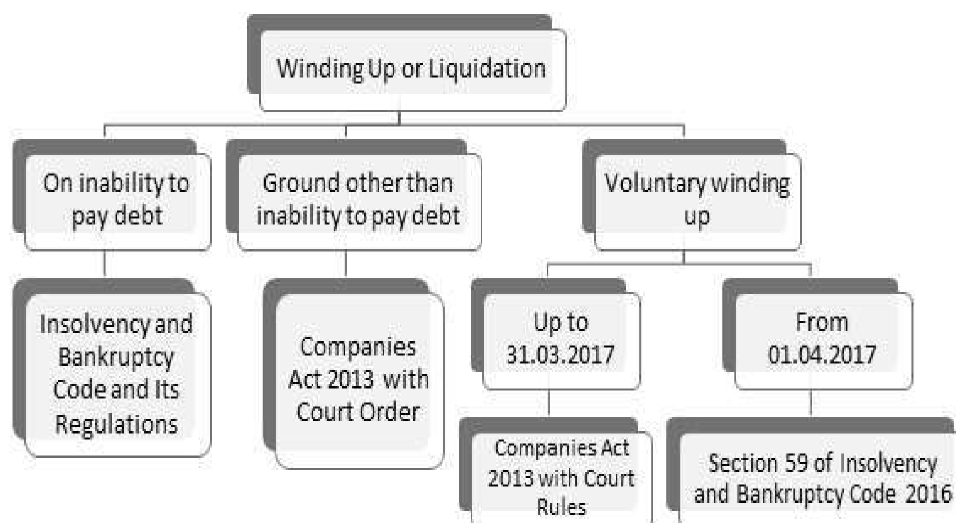
3.3 The Legal Framework of Liquidation or Winding Up in India

Prior to Companies Act 2013, liquidation procedure of companies was guided by Companies Act 1956. The new Companies Act 2013, incorporated in it, Chapter XX, Winding Up for liquidation of companies. The provisions were narrated in Section 270 to 365. However, enforcement of those sections was deferred and the provisions of the 1956 Act were continued even after the implementation of 2013 Act. The same went on until the Insolvency and Bankruptcy Code (IBC) was introduced in May 2016.

On 15.11.2016, Section 255 of the IBC was notified and by virtue of Section 255, the 2013 Act stands amended in accordance of schedule XI of the Code.

The Code, for the first time, introduced a definition of "winding up" in section 2 (94A) of Companies Act 2013, whereby winding up means winding up under the Act or liquidation under the Code, thus harmonising both statutes. The Code also introduced ancillary changes to the Act.

3.4 Modes of Winding Up/Liquidation



The above diagram shows the different modes of liquidation of a company in

India as per the present legal framework discussed earlier.

It is clear from the above diagram that, at present, Insolvency and Bankruptcy Code, 2016 primarily govern the liquidation process. Liquidation of a company in the event of inability of the company to pay debt and all voluntary liquidations on or after 01.04.2017 come under the purview of Insolvency and Bankruptcy Code, 2016. Only compulsory liquidations for grounds other than inability to pay debt is covered by Companies Act 2013.

● **Winding up by the Tribunal**

As per Section 270 of the Companies Act 2013, the procedure for winding up of a company can be initiated either: (a) By the tribunal or, (b) Voluntary. However, Section 304 of Companies Act, allowing voluntary winding ups of companies, has now been omitted and therefore Section 59 of the Insolvency and Bankruptcy Code 2016 is applicable from 1/4/2017 to deal with voluntary winding up cases. Moreover, the distinction between members' voluntary winding up and creditors' voluntary winding up has also been eliminated.

As per section 271 of the Companies Act 2013, a company can be wound up by a tribunal in the following circumstances:

1. If the company has by special resolution resolved that the company be wound up by the tribunal.
2. If the company has acted against the interest of the integrity or morality of India, security of the state, or has spoiled any kind of friendly relations with foreign or neighbouring countries.
3. If the company has not filed its financial statements or annual returns for preceding five consecutive financial years.
4. If the tribunal by any means finds that it is just and equitable that the company should be wound up.
5. If the company in anyway is indulged in fraudulent activities or any other unlawful business, or any person or management connected with the formation of company is found guilty of fraud, or any kind of misconduct.

Section 272 provides that a winding up petition is to be filed in the prescribed form. The petition for compulsory winding up can be presented by the following persons only:

- The company

- The creditors; or
- Any contributory or contributories
- By the central or state govt.
- By the registrar of any person authorized by central govt., for that purpose

The winding up petition has to be accompanied with a Statement of Affairs (to be discussed later in this unit).

The tribunal after hearing the petition has the power to dismiss it or to make an interim order as it think appropriate or it can appoint the provisional liquidator of the company till the passing of winding up order.

- **Voluntary Winding up**

Chapter V of Part II of the Insolvency and Bankruptcy Code contains Section 59 that deals with voluntary liquidation. As per Section 59 of the Code, the voluntary liquidation process can only be initiated by a corporate person, which has not committed any default.

The company can be wound up voluntarily by the mutual agreement of members of the company, if: (i) The company passes a Special Resolution stating about the winding up of the company. (ii) The company in its general meeting passes a resolution for winding up as a result of expiry of the period of its duration as fixed by its Articles of Association or at the occurrence of any such event where the articles provide for dissolution of company.

Steps for Voluntary Winding up Process of Company as per Section 59 of the Insolvency and Bankruptcy Code, 2016

1. Declaration of Solvency duly verified by an Affidavit by Majority of Directors of the Company. Affidavit to be accompanied by: (i) Audited Financial Statement of past two years/Since Incorporation whichever is later. (ii) Records of Business Operations of past two year/Since Incorporation whichever is later. (iii) Report by the Registered Valuer about the valuation of the assets of the Company. (iv) Latest Financial Position of the Company, if any.
2. Within 4 weeks of Declaration of Solvency, Voluntary Winding up of the Company shall happen and there shall be an appointment of Insolvency Professional to act as Liquidator subject to the approval of the Members in General Meeting and creditors owing 2/3rd of the Value of the Debt of the Company through Special Resolution within 7 days of approval of liquidation of Company. Intimation of the same has to be made to the Registrar of Companies.
3. Company has to intimate Insolvency and Bankruptcy Board of India (IBBI)

regarding initiation of Voluntary Winding up within 7 days of approval of liquidation of Company/subsequent approval by the creditors.

4. Within 5 days of Appointment of Insolvency Professional as Liquidator: (i) A Public Announcement to be made in one English Newspaper and one Regional Language Newspaper having wide circulation where the registered office and the principal office if any, of the Company is situated. (ii) Public Announcement to be updated on website of the Company, if any.
5. Liquidator has to open a Bank Account in the Name of the Company followed by the words "in voluntary liquidation" in a scheduled bank within one month of passing of Special Resolution.
6. Intimate the Income Tax Department within One month of passing resolution regarding Voluntary Winding up of the Company and to obtain NOC for the same.
7. Prepare a Preliminary Report to be submitted within 45 days from the commencement of the liquidation process consisting details of: (i) Capital Structure of the Company (ii) Estimates of assets and liabilities as on the liquidation commencement (iii) Any further inquiry relating to promotion/ formation/conduct of the business (iv) Proposed plan of action by liquidator including the timeline within in which he proposes to carry it out and the estimated liquidation costs.
8. The liquidator shall verify the claims submitted within 30 days from the last date for receipt of claims and may either admit or reject the claim.
9. Liquidator has to prepare list of stakeholders within 45 days from the last date for receipt of claims and also has to maintain Particulars/Minutes about any consultation with Stakeholders.
10. Liquidator has to value and sell the assets in the manner and mode approved by the Company and have to deposit proceeds of distribution in Bank Account
11. Liquidator has to distribute the Proceeds to the stakeholders within 6 months from the receipt of amount.
12. Liquidator has to maintain accounts for liquidation period and conduct audit for the same.
13. The entire process to be completed within 12 months from the date of commencement of liquidation.
14. If the liquidation process extends for more than 12 months, the liquidator shall – Within 15 days from the end of 12 months hold meeting of contributories and Present a Annual Report indicating: (i) Settlement of

List of Stakeholders (ii) Details of Assets remaining to be sold (iii) Distribution made to the stakeholders.

15. To prepare Final Report with details of Audited Accounts of Liquidation and send it to: (i) The Registrar of Companies (ii) The Insolvency and Bankrutpcy Board of India (iii) The Adjudicating Authority, i.e., NCLT (National Company Law Tribunal).

3.5 Liquidator

The person appointed for conducting the liquidation proceedings of the company is called 'Liquidator'. Under IBC, "liquidator" means an insolvency professional appointed as a liquidator in accordance with the provisions of Chapter III or Chapter V of this Part, as the case may be. In case of Voluntary winding up by an Insolvency Professional, the company must submit a Statement of Affairs to the liquidator. The general duties of the liquidator are to take into his custody all the property of the company and actionable claims and make the payments as per the order laid down in the Companies Act.

3.6 Statement of Affairs

When the liquidator officially takes charge of the company from the BODs, the directors are required to communicate the present financial status of the company. Accordingly, apart from the Statement of Profit and Loss for the period ended on the liquidation and a balance sheet with carrying amount of assets and liabilities on the date of liquidation, they are also to prepare and submit a statement showing the estimated realisable value of assets and liabilities of the company under liquidation. The statement must also include the estimated Deficiency, if any. Such a statement is known as Statement of Affairs.

In case of winding up by Tribunal, Section 272(5) of the Companies Act, 2013, provides that a petition prescribed by the company for winding up before the Tribunal shall be admitted only if accompanied by a statement of affairs in such form and in such manner as may be prescribed.

3.6.1 Procedure for Preparation of Statement of Affairs

The procedure of the preparation of Statement of Affairs is furnished hereunder:

1. Include all assets not specifically pledged (as per list A). The amount expected to be realised from individual asset including unpaid calls would be extended to the 'estimated realisable value' column.

2. Include all assets specifically pledged (as per list B). The amount expected to be realised from individual asset would be compared with the amount due to the secured creditor(s) concerned. Surplus, if any, is to be extended to both the *'surplus carried to last column' and 'estimated realizable value'* column. A deficit arising out of the amount due to the. secured creditors exceeding the amount realisable from the asset is to be added to unsecured creditors.
3. The total of assets is available for all creditors excluding secured creditors as already covered by assets specifically pledged would be the sum of the amounts as in-paragraph (1) and (2) above.
4. Find the *'Summary of Gross Assets'*. The amount would be the total of *'estimated realisable value of assets not specifically pledged'* and *'other assets (gross estimated realisable value of assets specifically pledged).* The amount of the gross assets would be shown in the main body of the statement of affairs but not in the 'estimated realisable value' column.
5. Place the amount of secured creditors to the extent to which claims are estimated to be covered by assets specifically pledged in the *'Gross Liabilities'* column only (as per list B).
6. From the total assets available, the following should be placed in the *'Gross Liabilities'* column and also should be deducted one by one and struck the balance at each stage:
    a. Preferential creditors (as per list C);
    b. Debenture-holders having a floating charge (as per list D);
    c. Unsecured creditors (as per list E);
    d. Paid up Preference share capital (as per list F); and
    e. Paid up Equity share capital (as per list G).

In case of minus balance, there would be deficiency as regards members, otherwise there would be surplus (as per list G).

3.6.2 Deficiency Account (As per List H)

The official liquidator will specify a date for period (minimum 3 years) beginning with the date on which information is supplied for preparation of an account to explain the deficiency or surplus. On that date either assets would exceed capital plus liabilities, that is, there would be a reserve or there would be a deficit or debit balance in the Profit or Loss Account. The Deficiency Account is divided into two parts:

1. The first part starts with the deficit (on the given date) and contains every item that increases deficiency (or reduces surplus such as losses, dividend etc.)
2. The second part starts with the surplus on the given date and includes all profits.

If the total of the first exceeds that of the second, there would be a deficiency to the extent of the difference, and if the total of the second part exceeds that of the first, there would be a surplus.

3.5.3 Illustrations on Preparation of Statement of Affairs

Illustration 1 :

Metal Ltd. went into liquidation on March 31, 2021. The following balances are extracted from the books on that date:

Liabilities	**Amount Rs.**	**Assets**		**Amount Rs.**
Capital:		Buildings		1,50,000
50,000 Equity Shares of		Plant & Machinery		2,10,000
Rs. 10 each	5,00,000	Stock-in-trade		95,000
Debentures (secured by		Book Debts	75,000	
floating charge)	2,00,000	Less : Provision	10,000	65,000
Bank Overdraft	30,000	Calls in Arrears		1,00,000
Creditors	40,000	Cash on hand		10,000
		Profit and Loss Account		1,40,000
	7,70,000			7,70,000

Plant & Machinery and Buildings are valued at Rs. 1,60,000 and Rs. 1,20,000 respectively. On realisation, losses of Rs. 25,000 are expected on stock, Book Debts will realise Rs. 70,000. Calls in arrears are expected to realise 90%. Bank overdraft is secured against Buildings, Preferential Creditors for taxes and wages are Rs. 6,000 and Miscellaneous Expenses outstanding Rs. 2,000.

Prepare a Statement of Affairs to be submitted.

Solution :

Metal Ltd. (in liquidation) Statement of Affairs as on March 31. 2021

Gross Liabilities (f)	Particulars					Estimated realisable value (Rs.)
	Assets not specifically pledged (as per list A) :					
	Plant & Machinery					1,60,000
	Stock-in-trade					70,000
	Book Debts					70,000
	Unpaid Calls (Calls in Arrear)					90,000
	Cash on hand					10,000
						4,00,000
	Assets specifically pledged (as per list B):					
		(a)	(b)	(c)	(d)	
		Estimated Realisable Value	Due to Secured Creditors	Deficiency ranked as unsecured	Surplus carried to last column	
	Building	1,20,000	30,000	—	90,000	
	Estimated surplus from assets specifically pledged					90,000
	Estimated total assets available for Preferential Creditors, Debenture-holders secured by floating and unsecured creditors					4,90,000
	Summary of Gross Assets (e):					
	Gross realisable value of assets specifically pledged				1,20,000	
	Other assets				4,00,000	
	Gross Assets				5,20,000	
Rs.						Rs.
30,000	Secured Creditors (as per list B) to the extent to which claims are estimated to be covered by assets specifically pledged					
	Preferential Creditors (as per list C):					
6,000	Creditors for taxes and wages					6,000
	Estimated balance of assets available for Debenture-holders secured by a floating charge and unsecured creditors					4,84,000
2,00,000	Debenture-holders secured by a floating charge (as per list D)					2,00,000
	Estimated surplus as regards Debenture-holders					2,84,000
34,000	Unsecured Creditors (as per list E)					34,000
2,70,000	Estimated surplus as regards creditors [(e) - (f)]					2,50,000
	Issued and Called up Capital:					
	Preference Shares (as per list F)				Nil	
	5,000 Equity Shares of Rs. 100 each fully paid (as per list G)				5,00,000	5,00,000
	Estimated deficit as regards members					2,50,000

Illustration 2 :

The following particulars were extracted from the books of Silver Ltd. as on March 31, 2019 on which date a winding up order was made:

Particulars	Rs.
Equity Share Capital:	
2,000 Shares of Rs. 100 each, Rs. 50 paid up	1,00,000
6% Preference Share Capital:	
2,000 Shares of Rs. 100 each fully paid	2,00,000
6% First Mortgage Debentures, secured by a floating charge on the whole of the assets of the company, exclusive of the uncalled capital	1,50,000
Fully Secured Creditors (value of securities, Rs. 35,000)	35,000
Partly Secured Creditors (value of securities, Rs. 10,000)	20,000
Preferential Creditors for rates, taxes, wages etc.	6,000
Unsecured Creditors	70,000
Bills Payable	1,00,000
Bank Overdraft	10,000
Bills Receivable in hand	15,000
Bills Discounted (one bill for Rs. 10,000 known to be bad)	40,000
Book Debts — Good	10,000
— Doubtful (estimated to produce 40%)	7,000
— Bad	6,000
Land & Building (estimated to produce Rs. 1,00,000)	1,50,000
Stock-in-trade (estimated to produce Rs. 40,000)	50,000
Machinery, Tools etc. (estimated to produce Rs. 2,000)	5,000
Cash in hand	2,100

Prepare Statement of Affairs and Deficiency Account.

Solution :

In order to find out the position of Reserve and Surplus as on March 31, 2019 the following Trial Balance is prepared:

Liabilities	**Amount Rs.**	**Assets**	**Amount Rs.**
Land & Building	1,50,000	Equity Share Capital	1,00,000
Machinery, Tools etc.	5,000	6% Pref. Share Capital	2,00,000
Investments	45,000	6% Mortgage Debentures	1,50,000
Stock-in-trade	50,000	Fully Secured Creditors	30,000
Book Debts	23,000	Partly Secured Creditors	20,000
Bills Receivable	15,000	Preferential Creditors	6,000
Cash in hand	2,100	Unsecured Creditors	70,000
Profit & Loss (Balancing fig.)	3,95,900	Bills Payable	1,00,000
		Bank Overdraft	10,000
	6,86,000		6,86,000

Silver Ltd. (in liquidation) ***Statement of Affairs as on March 31, 2019***

						Estimated to realise
	Assets not specifically pledged (as per list A):					Rs.
	Cash in hand					2,100
	Land & Building					1,00,000
	Machinery, Tools etc.					2,000
	Stock-in-trade					40,000
	Book Debts					12,800
	Bills Receivable					15,000
	Assets specifically pledged (as per list B):					1,71,900
		(a)	(b)	(c)	(d)	
		Estimated Realisable Value	Due to Secured Creditors	Deficiency ranked as unsecured	Surplus carried to last columan	
		Rs.	Rs.	Rs.	Rs.	
	Investments	35,000	30,000	—	5,000	
	Investments	10,000	20,000	10,000	—	
		45,000	50,000	10,000	5,000	

	Estimated surplus from assets specifically pledged	5,000
	Estimated total assets available for preferential creditors, debenture-holders secured by a floating charge and unsecured creditors	1,76,900
	Summary of Gross Assets (e) : Gross realisable value of assets specifically pledged 45,000 Other assets 1,71,900 Gross Assets 2,16,900	
Gross Liabilities (f)	Liabilities (to be deducted from surplus or be added to deficiency as the case may be)	
Rs. 40,000	Secured Creditors (as per list B) to the extent to which claims are estimated to be covered by assets specifically pledged	
6,000	Preferential Creditors (as per list C)	6,000
	Estimated balance of assets available for Debenture-holders secured by a floating charge and unsecured creditors	1,70,900
1,50,000	Debenture-holders secured by a floating charge (as per list D)	1,50,000
	Estimated surplus as regards Debenture-holders	20,900
	Unsecured Creditors (as per list E):	
10,000	Unsecured balance of partly secured creditors 10,000	
70,000	Unsecured Creditors 70,000	
1,10,000	Bills Payable 1,00,000	
10,000	Bank Overdraft 10,000	
10,000	Bills Discounted 10,000	2,00,000
3,96,000	Deficiency as regards creditors	1,79,100
	Issued and Called up Capital: 2,000 6% Pref. Shares of Rs. 100 each fully paid (as per list F) 2,00,000 2,000 Equity Shares of Rs. 100 each, Rs. 50 paid up (as per list G) 1,00,000	3,00,000
	Estimated deficiency as regards members (as per list H)	4,79,100

List H-Deficiency Account

			Rs.
A.	Items contributing to deficiency (or reducing surplus):		
1.	Excess of capital and liabilities over assets on 1.4. 2016 (at least 3 years before the date of winding up order)		Nil
2.	Net dividends and bonuses declared during the period from 1.4.2016 to 31. 3.2019		Nil
3.	Net trading losses after charging depreciation, taxation, interest on Debentures, etc. for the same period.		3,95,900
4.	Losses other than trading losses		Nil
5.	Estimated losses now written off or for which provision has been made for the purpose of preparing the statement.		
	Land & Building (1,50,000 - 1,00,000)	50,000	
	Machinery, Tools etc. (5,000 - 2,000)	3,000	
	Stock-in-trade (50,000 - 40,000)	10,000	
	Book Debts (23,000 - 12,800)	10,200	
	Bills Discounted	10,000	83,200
6.	Other items contributing to deficiency		Nil
Total (A)			4,79,100
B.	Items reducing deficiency (or contributing to surplus)		Nil
7.	Excess of assets over capital and liabilities on 1.4.2016		Nil
8.	Net trading profits after charging depreciation, taxation, interest on Debentures, etc. during the period from 1.4.2016 to 31.3.2019		Nil
9.	Profits and income other than trading profits during the same period		Nil
10.	Other items reducing deficiency		Nil
Total (B)			
	Deficiency as shown by the Statement of Affairs (A – B)		4,79,100

3.7 Liquidator's Final Statement of Account

Liquidator's Final Statement of Account is a statement to be prepared by the liquidator with details regarding the actual realizations of assets and payment to creditors. The same will be submitted to the appointing authority of the liquidator. Though named 'Account', this is basically a 'Statement' and not a 'Ledger Account'.

3.7.1 Priority Chart for Payment towards Various Parties

While making payment towards various parties out of the amount realised from the assets of the company under liquidation, the liquidator is to abide by the following payment hierarchy. It is also known as the Priority Chart.

1. Secured creditors up to the amount available from the asset secured.
2. Cost of Liquidation

   a) Liquidator's remuneration
   b) Legal expenses
   c) Other expenses
3. Preferential Creditors
4. Debenture holders covered by floating charge on all assets
5. Unsecured creditors
6. Preference shareholders
7. Equity shareholders

3.7.2 Priority Chart Items Explained

The individual items of priority chart are explained below.

1. **Secured Creditors :** Secured creditors refer to the liabilities against which some assets have been kept as pledge. They are paid up to the extent of amount realised from secured assets or the claim amount, whichever is lower. The surplus, if any, is utilised to pay others in the priority chart. The claim of secured creditors primarily includes principal amount of loan plus outstanding interest, if any, up to the date of liquidation. This claim is covered by the amount realised from the secured assets. However, in case they are paid on a date later than the liquidation date, they are also entitled to get lag period interest (i.e. interest from the date of liquidation up to the date of payment). However, lag period interest is paid only if the company is solvent. A company is called solvent if it has sufficient amount left after paying in full all the liabilities up to the ordinary unsecured creditors.
2. **Cost of Liquidation:** This includes – (a) Liquidator's remuneration, (b) legal charges (drafting charges for legal documents), and (c) other charges (travelling expenses, printing and stationery).
3. **Preferential creditors:** These are unsecured creditors who are paid in preference to others. As per Sec. 327 of the Companies Act, 2013, preferential creditors include the following:
   a) Due to Government: All revenues, taxes, cesses and rates due to the Central, State Government or to a local authority which have become due and payable within twelve months before the date of winding up order.
   b) Salary and Wages Outstanding: All wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any employee in respect of services rendered

to the company and due for a period not exceeding four months within the twelve months immediately before the liquidation date, subject to the condition that the amount payable under this clause to any workman shall not exceed Rs. 20000 per claimant.

c) All amounts due in respect of contribution payable during the twelve months under the Employees' State Insurance Act, 1948 or any other law.

d) Compensation due under Workmen's Compensation Act, 1923 in respect of death or disablement of any employee of the company.

e) Any amount due to any employee from provident fund, pension fund, gratuity fund for the welfare of the employees maintained by the company.

f) Accrued holiday remuneration becoming payable to the employee or in case of his death, to any other person in his right, on termination of his employment before, or by the effect of the winding up.

g) The expenses of any investigation held in pursuance of Sec. 213 or 216 in so far as they are payable by the company.

Note : Here, the term 'workmen', in relation to a company, means the employees of the company, being workmen within the meaning of clause (s) of section 2 of the Industrial Disputes Act, 1947 (14 of 1947). Hence, persons working in the managerial capacity are not workmen.

4. **Debenture holders Covered by Floating Charge:** Their claim includes (a) principal amount and, (b) outstanding interest up to the date of liquidation. Also, lag period interest, if any, may be payable if the company is solvent.
5. **Ordinary Unsecured Creditors:** They are unsecured creditors other than preferential creditors.
6. **Preference Shareholders:** Their claim includes (a) capital, and (b) arrear dividend. However, arrear dividend will be payable only if the shares are cumulative and the arrear dividend is stated to be payable on liquidation as per the terms of issue of the shares. There is no question of any lag period dividend.
7. **Equity Shareholders:** They are paid at the end, if any surplus remains after payment to preference shareholders.

3.7.3 Overriding Preferential Payments:

As per Section 326 of Companies Act 2013, overriding preferential payments are to be paid in priority to all other debts as per the said Act. They include:

(a) Dues to workmen, and

(b) Debts due to secured creditors to the extent such debts rank to the security of every creditor shall be deemed to be subject to pari passu charge in favour of the workmen to the extent of workmen's portion therein.

3.7.4 Preparation of Liquidator's Final Statement of Accounts

Illustration 3 :

The following particulars relate to Copper Ltd., which has gone into voluntary liquidation on March 31, 2021. You are required to prepare the Liquidator's Statement of Account for the period ending on 30.06.2021, allowing for his remuneration @ 3% on the amount realised, and 2% on the amount distributed to unsecured creditors:

Particulars	Rs.
Preferential Creditors	10,000
Unsecured Creditors	32.000
Debentures	10,000
The assets realised the following sums:	
Land and Building	20,000
Plant and Machinery	18,700
Fixtures and Fittings	1,000
The liquidation expenses amounted to Rs. 1,000.	

Solution :

Liquidator's Statement of Account for the period ending on June 30,2021

Receipts Rs.	Amount	Payment Rs.	Amount
To Assets realised:			
Land & Building	20,000	By Liquidator's Remuneration	1,534
Plant & Machinery	18,700	By Liquidation Expenses	1,000
Fixtures & Fittings	1,000	By Preferential Creditors	10,000
		By Debenture holders (assume having a floating charge)	10,000
		By Unsecured Creditors	17,166
	39,700		39,700

Working Note:

(1) Liquidator's Remuneration

Particulars	Rs.	Rs.
Assets realised		39,700
Less: 3% on assets realised	1,191	
Liquidation Expenses	1,000	
Preferential Creditors	10,000	
Debenture-holders having a floating charge	10,000	
		22,191
Amount available for unsecured creditors subject to remuneration		17,509
Less: Payment to Unsecured Creditors (17,509 × 100/102)		17,166
Remuneration on Unsecured Creditors		343
Total remuneration (1,191 + 343)		1,534

Illustration 4 :

The Balance Sheet of Picture Ltd. as on March 31, 2021 is given below:

Liabilities	Amount Rs.	Assets	Amount Rs.
Share Capital:		Land & Buildings	1,50,000
3,000 6% Pref. Shares of		Plant & Machinery	3,75,000
Rs. 100 each fully paid	3,00,000	Patents	60,000
1,500 Equity Shares of		Stock	82,500
Rs. 100 each, Rs. 75 paid	1,12,500	Sundry Debtors	1,65,000
4,500 Equity Shares of		Cash at Bank	45,000
Rs. 100 each, Rs. 60 paid	2,70,000	Profit & Loss Account	1,80,000
5% Debentures (having a			
floating charge on all assets)	1,50,000		
Interest Due on Debentures	7,500		
Creditors	2,17,500		
	10,57,500		10,57,500

The preference dividends were in arrear for two years. Creditors include a loan of Rs. 75,000 on the mortgage of Land & Buildings. The assets were realised as follows:

Land & Buildings Rs. 1,80,000; Plant & Machinery Rs. 3,00,000; Patents Rs. 46,000; Stock Rs. 89,000 and Sundry Debtors Rs. 1,20,000.

The expenses of liquidation amounted to Rs. 16,350. The liquidator is entitled to a commission of 3% on all assets realised except Cash at Bank and a commission of 2% on amounts distributed among unsecured creditors. Preferential creditors amount to Rs. 22,500. All payments were made on September 30, 2021.

Prepare the Liquidator's Statement of Account.

Solution :

Liquidator's Statement of Account from 1.4.2021 to 30.9.2021

Receipts	**Amount Rs.**	**Payments**		**Amount Rs.**
To Realisation of Assets :		By Liquidator's Remuneration		24,900
Bank	45,000	(Note 3)		
Sundry Debtors	1,20,000	Liquidation Expenses		16,350
Stock	89,000	Preferential Creditors		22,500
Plant & Machinery	3,00,000	Debenture-holders (having		
Patents	46,000	a floating charge):		
Surplus from Land and		5% Debentures	1,50,000	
Buildings (Note 1)	1,05,000	Interest (Note 2)	11,250	1,61,250
		Unsecured 'Creditors		1,20,000
		Pref. Shareholders:		
		Pref. Sh. Capital	3,00,000	
		Arrear Dividend	36,000	3,36,000
		Eq. Shareholders (Note 6):		
		Rs. 75 paid (1,500 x 15.25)		22,875
		Rs. 60 paid. (4,500 x 0.25)		1,125
	7,05000			7,05,000

Working Notes :

1. Surplus from Land & Buildings

Amount realized	1,80,000
Less : Mortgage Loan	75,000
	1,05,000

2. Interest on Debentures

As per last Balance Sheet	7,500
Add : Interest from 1.4.19 to 3.9.19, i.e. for 6 months @ 5% on Rs. 1,50,000 (lag period interest)	3,750
	11,250

3. Liquidator's remuneration

Realisation of assets except Cash at Bank	7,35,000
(1,20,000 + 89,000 + 3,00,000 + 46,000 + 1,80,000)	
3% on assets realised (7,35,000 × 3%)	22,050
2% on payment to Unsecured Creditors including Preferential Creditors [(2,17,500 − 75,000) × 2%]	2,850
	24,900

4. Amount available for Equity Shareholders

Amount available for payments.		7,05,000
Less: Payments for:		
Liquidator's remuneration	24,900	
Liquidation expenses	16,350	
Preferential Creditors	22,500	
Debenture-holders including interest	1,61,250	
Unsecured Creditors	1,20,000	3,45,000
Amount available for Shareholders		3,60,000
Less : Amount to be returned to Pref. Shareholders:		
Paid up Pref. Capital	3,00,000	
Arrear dividend for 2 years	36,000	3,36,000
Amount Available		24,000

5. Deficiency for Equity Shareholders

Paid up Equity Share Capital (1,12,500 + 2,70,000)	3,82,500	
Less : Amount available (Note 4)	24,000	
Total Deficiency		3,58,500
% Deficiency = (Total deficiency × 100) / (Nominal value of shares) = (Rs. 3,58,500 × 100) / 6,00,000 = 59.75%		

6. Payment to Equity Shareholders

	I Rs.	II Rs.
Net amount returnable per share:		
Paid up value per share	75.00	60.00
Less : Deficiency per share @59.75% of nominal value (Note 5)	59.75	59.75
	15.25	0.25

Illustration 5 :

Iron Ltd. went into voluntary liquidation on December 31, 2021. On that day the details relating to the liquidation are as follows:

Share Capital :	Rs.
4,000 6% Preference Shares of Rs. 100 each fully paid	4,00,000
Class 'A' 4,000 Equity Shares of Rs. 100 each, Rs. 75 paid	3,00,000
Class 'B' 3,200 Equity Shares of Rs. 100 each, Rs. 60 paid	1,92,000
Class 'C' 2,800 Equity Shares of Rs. 100 each, Rs. 50 paid	1,40,000

Assets excluding Machinery realised Rs. 6,79,000. Liquidation expenses (including liquidator's remuneration Rs. 21,000) amount to Rs. 30,000. Iron Ltd. has taken a loan of Rs. 1,00,000 from State Bank of India against the mortgage of Machinery which realised Rs. 1,61,000. In the books of the company salaries of 8 Clerks for 4 months @ Rs. 300 per month and salaries of 8 Peons for 3 months @ Rs. 150 per month, are due for payment. In addition to this, the books of the company show the Creditors worth Rs. 1,74,800.

Prepare Liquidator's Statement of Account.

Solution :

Liquidator's Final Statement of Account for period ended 31.12.2021

Receipts	Amount Rs.	Payments	Amount Rs.
To Assets realized	6,79,000	By Liquidator's remuneration	21,000
Surplus from Machinery	61,000	Liquidation expenses	9,000
(1,61,000 – 1,00,000)		Preferential Creditors	11,600
Eq. Shareholders (Note):		(Note 1)	
Proceeds of Call @		Unsecured Creditors	1,76,400
Re. 1 per share on class C	2,800	Pref. Shareholders	4,00,000
(1 × 2800)		Equity Shareholders (Note 4)	
		4000 on class A shares (24 × 4000)	96,000
		3200 on class B shares (9 × 3200)	28,800
	7,42,800		7,42,800

Working Notes :

1. Payment to Preferential Creditors

	Rs.
Salary of clerks : For 8 Clerks for 4 months at Rs. 1,200 each.	
limited to Rs. 1.000 each (Rs. 1,000 × 8)	8,000
Salary of Peons: For 8 Peons for 3 months at Rs. 450 (450 × 8)	3,600
	11,600

2. Amount available to equity shareholders :

	Rs.
Assets realised (679000 + 161000)	8,40,000
Less : Payment up to unsecured creditors (21000 + 9000 + 100000 + 11600 + 174800 + 200 × 8 salary of clerks)	3,18,000
Amount available to shareholders	5,22,000
Less : Preference shareholders' claim	4,00,000
Amount available for equity shareholders	1,22,000

3. Deficiency for Equity Shareholders

	Rs.
Paid up Equity Capital	6,32,000
Less : Amount available (Note 2)	1,22,000
Total deficiency	5,10,000
% Deficiency = (Total deficiency × 100)/Nominal value of shares	
= (Rs. 5,10,000 × 100)/10,00,000 = 51%	

4. Amount Receivable or Payable to Equity Shareholders

	'A' shares Rs.	'B' shares Rs.	'C' shares Rs.
Paid up value per share	75.00	60.00	50.00
Less: 51% deficiency of nominal value per shares	51.00	51.00	51.00
Per share net payable/receivable (–)	24.00	9.00	(–) 1.00

3.8 Summary

The legal process to bring an end of the corporate life of any company is known as liquidation of company. The Statement of Affairs and Deficiency Account are prepared by the company while the Liquidator's Statement of Account is prepared by the liquidator. For accounting purposes, the preparation of these statements, requires knowledge over the legal provisions regarding liquidation of company in particular and accounting knowledge in general. Actually, they are pro-forma based accounting which must comply with the legal requirements.

3.9 Exercises

- Theoretical Questions

1. What do you mean by liquidation of companies? What are the effects of liquidation? What are the different modes of liquidation?
2. What is Statement of Affairs? How is such statement prepared? Why is it prepared?
3. What is Deficiency Account? What are its objectives?
4. What is meant by preferential creditors? What are the items that are to be included in preferential creditors?

5. What do you mean by Liquidators Final Statement of Account? Can it be called a cash book? State the order of payment followed in preparation of this statement.

● **Practical Problems**

Problem 1

Mention the correct answer:

(i) A contributory is —

(a) a creditor; (b) a shareholder; (c) a debenture-holder

(ii) The wages for 3 workers for a period of 5 months prior to the date of liquidation was in arrear. If the wages of each worker is Rs.1,400 per month, the amount to be included in preferential creditors will be —

(a) Rs.21,000; (b) 16,800; (c) Rs.3,000.

(iii) Mr X is the liquidator of a company. He is entitled to a commission @ 2% on assets realised and 3% on the amount distributed to shareholders. The assets realised Rs.2,00,000 including cash balance of Rs.6,000. The amount available for distribution to shareholders before his commission was Rs.92,700. The commission of Mr. X will be (a) Rs.6,200; (b)Rs.6,800; (c) Rs.6,580.

Problem 2

The Capital of a company consisted of:

(a) 20,000 Equity Shares of Rs. 10 each fully paid

(b) 20,000 Equity Shares of Rs. 10 each, Rs. 5 paid

Funds available for Equity shareholders after liquidation and after making payments to all other parties is Rs. 60,000.

Calculate the loss per share and amount receivable from or refundable to shareholders.

Answer : Loss per share Rs. 6; Refundable to fully paid shareholders Rs. 4 per share and receivable from partly paid shareholders Rs.1 per share.

Problem 3

The following particulars were extracted from the books of Alpha Limited as on March 31, 2021 on which date a winding up order was made:

Equity Share Capital	Rs.
4,000 Shares of Rs. 100 each, Rs. 50 called up	2,00,000
Calls in arrear (estimated to produce Rs. 10,000)	12,000
6% Preference Share Capital:	
4,000 shares of Rs.100 each, fully called up	4,00,000
5% Debentures secured by first floating charge	3,00,000
Bank Overdraft secured by second floating charge	30,000
Fully Secured Creditors (secured on investments)	60,000
Partly Secured Creditors (secured on investments)	40,000
Investments with fully secured creditors (estimated 80,000 to produce Rs. 70,000)	80,000
Investments with partly secured creditors (estimated to produce Rs. 20,000)	50,000
Rate & Taxes	2,000
Wages & Salaries	4,000
Bills Payables	1,80,000
Sundry Creditors	1,60,000
Bills Receivable in hand	24,000
Sundry Debtors (estimated to produce Rs. 33,000)	52,000
Land & Building (estimated to produce Rs. 2,00,000)	2,80,000
Stock-in-trade (estimated to produce Rs. 80,000)	1,20,000
Machinery (estimated to produce Rs. 4,000)	6,000
Cash in hand	400
Bills Discounted Rs. 60,000, likely to be dishonoured	20,000
Contingent Liability Rs. 20,000, likely to be paid	14,000

You are asked to prepare (i) Statement of Affairs and, (ii) Deficiency Account assuming that no journal entry was made for outstanding rent Rs. 5,000.

Hints: Trial Balance is not given. It is necessary to prepare the Trial Balance. The difference between and credit should be considered as either accumulated loss or profit which will be taken to Deficiency Account.

Answer : Total deficiency Rs. 9,73,600

Problem 4

The Surprise Ltd. went into voluntary liquidation in January 1, 2017. The liquidator is entitled to a commission of 3% on realisation of all assets and 2% on distribution to shareholders. The following was the position of the company as on December 31, 2021.

	Rs.
Cash on realisation of assets	5,00,000
Expenses on liquidation	9,000
Unsecured Creditors (including salaries and wages for one month prior to liquidation, Rs. 6,000)	68,000
15,000 6% Preference Shares of Rs. 10 each (dividend paid up to December 31, 2002)	1,50,000
1,000 Equity Shares of Rs. 100 each, Rs. 90 per share called and paid up	90,000

Under the Articles of Association of the company the Preference Shareholders have the right to receive third of the surplus remaining after repaying Equity Share Capital.

Answer : Liquidator's remuneration Rs.23,000; Payment to shareholders: Preference Shareholders Rs. 2,09,333; Equity Shareholders Rs. 1,90,667.

Problem 5 :

XYZ Ltd. went into voluntary liquidation on 31.03.2021. On that date the Trial Balance of the Company was as follows:

Trial Balance as on 31.03.2021

Debit Balances	**Amount Rs.**	**Credit Balances**	**Amount Rs.**
Good will	20,000	10000, 6% Preference Shares of Rs. 100 fully paid	10,00,000
Land and Building	6,00,000	5000 Equity shares of Rs.100 each, Rs.75 paid up	3,75,000
Plant & Machinery	11,50,000	15,000 Equity Shares of Rs. 100 each, Rs. 60 paid up	9,00,000

Stock	2,75,000	5% Debentures of Rs. 100 each (Secured by floating charge on allassets of the company)	5,00,000
Sundry Debtors	5,50,000	Interest due on Debentures	25,000
Cash at Bank	1,50,000	Bank Overdraft (secured on Land and Building)	2,00,000
Profit and Loss (Dr.)	8,00,000	Taxes due to Govt.	25,000
		Outstanding Salaries and wages	1,50,000
		Trade Creditors	3,70,000
	35,45,000		35,45,000

The liquidator is entitled to a remuneration of 5% on all assets realized and 1% on amount distributed among unsecured creditors other than preferential creditors.

The assets realized as follows: Rs.

Land and Building 600000

Plant and Machinery 1000000

Stock 300000

Sundry Debtors 400000

Outstanding salaries and wages include salaries payable to the Managing Director of the

company Rs.30000.

Expenses of liquidation amounted to Rs.54750. Dividend on Preference Shares are in arrear for two years and to be paid in priority to the claims of equity shareholders as per the terms of issue.

All payments were made on 1.7.2021, excepting bank overdraft and taxes due to the Govt.

were paid immediately after liquidation.

You are required to prepare Liquidator's Final Statement of accounts

Answer : Loss per share Rs.69.75;

Unit 4 □ Accounting for Financial Instruments

Structure

4.1 Objective
4.2 Introduction
4.3 Meaning of Some Important Terms (As per Ind AS)
4.4 Financial Liability and Equity Instruments: Principles of Classification
4.5 Classification of Financial Assets
4.6 Classification of Financial Liability
4.7 Recognition of Financial Assets and Liabilities
4.8 Measurement of Financial Instruments
4.8.1 Initial Recognition
4.8.2 Subsequent Measurement
4.9 De-recognition of Financial Instruments
4.9.1 De-recognition of Financial Assets
4.9.2 De-recognition of Financial Liabilities
4.10 Compound Financial Instruments
4.10.1 Accounting for Compound Financial Instruments
4.11 Hedge Accounting
4.11.1 Qualifying Criteria for Hedge Accounting
4.11.2 Classification of Hedging Relationship
4.12 Disclosure Requirements for Financial Instruments
4.13 Summary
4.14 Exercise

4.1 Objective

After going through this unit you will be able to understand:

- The meaning of financial instruments
- The process of identification of financial instruments
- How are financial instruments recognized in the financial statements?
- How are financial statements measured?
- What are the minimum disclosure requirements with respect to financial instruments?

4.2 Introduction

The term 'Financial Instrument' refers to a document which has some monetary value. For example, draft, cheques, bills of exchange and promissory notes. However, for the purpose of Indian Accounting Standards (Ind AS), financial instruments include a wide spectrum of assets and liabilities of entities. Contrary to the popular impression, it is not limited to investments or merely the capital market instruments and negotiable instruments mentioned above, rather, it includes, within its ambit, receivables, loans, cash deposits, investments, payables, debentures bonds etc.

Every company, in its normal course of business or in process of investing its surplus funds deal with financial instruments. Because of this widespread use and typical character, accounting for financial instruments demands a detail discussion.

This chapter will try to provide the students a basic understanding on identification, recognition, measurement and disclosure of financial instruments. Accordingly, the chapter will cover some important aspects (and not all) of three Indian Accounting Standards (Ind Ass) namely – (a) Ind AS 32 Financial Instruments: Presentation; (b) Ind AS 107 Financial Instruments: Disclosures (c) Ind AS 109 Financial Instruments.

4.3 Meaning of Some Important Terms (As per Ind AS)

1. Financial Instrument:

As explained earlier, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

For example, while draft, cheques, bills of exchange and promissory notes are financial liability from the viewpoint of the issuer, they are, at the same time, financial assets from the viewpoint of the holder. Similarly, while debentures and equity shares are financial liability from the viewpoint of the issuer, they are, indeed, financial assets from the viewpoint of the investor. In general, they are financial instruments.

2. Financial Asset:

A financial asset is any asset that is:

a) cash;

b) an equity instrument of another entity;

c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or

(d) A contract that will or may be settled in the entity's own equity instruments that is:

(i) A non-derivative for which the entity is or may be obliged to receive a variable number of entity's own equity instruments; or

(ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

Some common examples of financial assets include (a) trade receivables, (b) notes receivables, (c) loans receivables, and (b) bonds receivals etc.

However, physical assets (such as inventories, landed property), leased assets, intangible assets (such as copyright, patent), prepaid expenses or income tax refunds are not financial assets.

Examples of some typical financial assets are given below:

- Suppose, A Ltd. Has invested in the equity shares of B Ltd. The investment in equity instruments of B Ltd. is a financial asset to A Ltd.
- Trade receivable is a contractual right to receive cash from another party and hence is a financial asset.
- Suppose X Ltd. has bought a call option on shares of Y Ltd. When the option will be in the money X Ltd. can exercise the same. It is a financial asset to X Ltd.

3. Financial Liability:

A financial liability is any liability that is a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or

For example, trade payables, bank loans, debentures and bond payables etc. Basically, whatever is a financial asset to an entity (the holder) is a financial liability to the issuer.

However, income tax payable, excise duty payable, GST payable etc. are not financial liability.

4. Equity Instruments:

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

For example, ordinary shares issued by X Ltd. is an equity instruments from the viewpoint of X Ltd.

4.4 Financial Liability and Equity Instruments: Principles of Classification

A financial instrument or its component parts should be classified by the issuer upon initial recognition as a financial liability or an equity instrument according to the substance of the contractual arrangement, rather than its legal form, and the definitions of a financial liability and an equity instrument. Hence, for some financial instruments, although their legal form may be equity, the substance of the arrangements is that they are liabilities. The appropriate classification as a financial liability, equity or a combination of both is determined by the entity when the financial instrument is initially recognized and that classification is not generally changed subsequently unless the terms of the instrument change.

Nevertheless, the following principles will be considered for classifying a financial instrument under financial liability or equity instrument.

1. Mandatory redemption and/or mandatory interest payments
2. Contractual obligation that is not explicit
3. Contingent settlement provisions

The following examples will clarify the contention further.

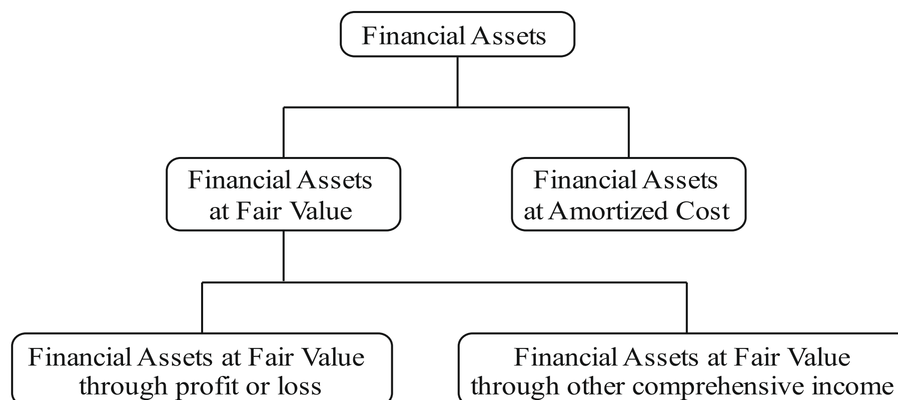
- Contrary to its legal form, redeemable preference shares carrying fixed rate of dividend is classified as a financial liability because of its mandatory principal and dividend payment clause. Only non-redeemable preference shares with dividend payable at the discretion of the issuer can be treated as equity instruments.
- Perpetual loans carrying fixed rate of interest payable periodically are financial liability for its mandatory interest payment clause, though the principal payment is not mandatory.
- Similarly, preference shares redeemable after 5 years but not mandatorily in cash but may be through transfer of any landed property with equal value

is also a financial liability as the contractual obligation is implicit and not explicit.

- Again, financial instruments without any dividend or interest obligation and even not redeemable in the normal course of business must be treated as financial liability if the same becomes redeemable upon the occurrence of any contingent event.

4.5 Classification of Financial Assets

As per Ind AS 109, financial assets are classified as follows:



The above classification is based on the following two criteria –

(i) the entity's Business Model (BM) for managing the financial assets; and

(ii) The Contractual Cash Flow Characteristics (CCFC) of the financial assets.

- **Business Model (BM)**

An entity's business model may be to hold a portfolio of investments that it manages in order to collect ***contractual cash flows*** and another portfolio of investments that it manages in order to ***trade to realize*** fair value changes.

Similarly, in some other cases, the entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of ***collecting contractual cash flows*** and manages the other loans with an objective of selling them.

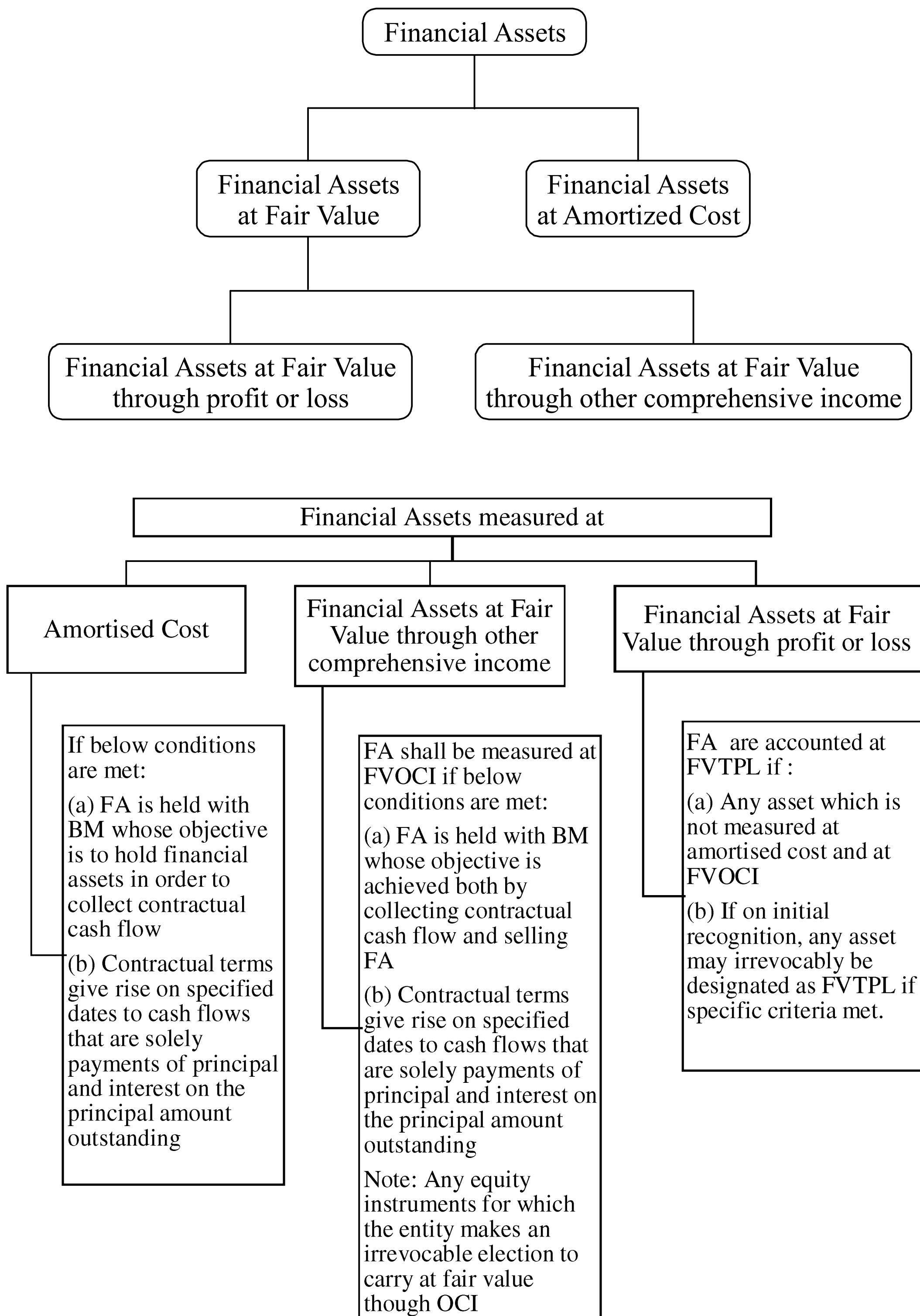
For example, a company may buy debentures to receive the contractual cash flow (i.e. regular periodical interest as well as principal amount at the maturity) or may buy ordinary shares with the objective to make profit as the share price increases.

● **Contractual Cash Flow Characteristics:**

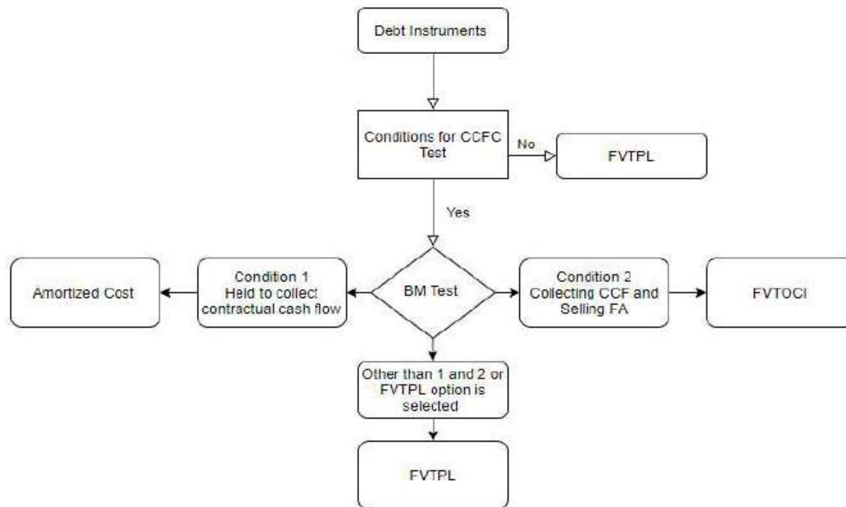
Ind AS-109 requires an entity to classify a financial asset on the basis of its contractual cash flow characteristics if the financial asset is held within a business model whose objective is to hold assets to collect contractual cash flows or within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets. To do so, an entity has to determine whether the asset's contractual cash flows are solely payments of principal and interest on the principal amount outstanding.

- Example of contractual cash flows that are solely payments of principal and interest is a bond with a stated maturity date and when payments are linked with an inflation index.
- Example of contractual cash flows that are not solely payments of principal and interest is a bond that is convertible into a fixed number of equity instruments.

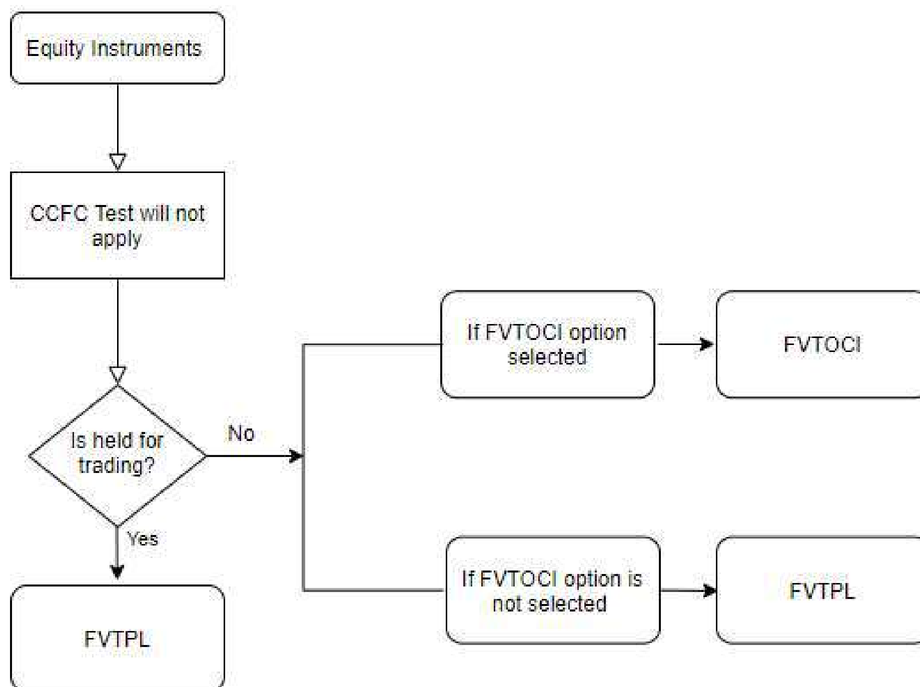
Financial assets should be classified into the three broad categories (namely, Financial Assets carried at Amortized Cost, Financial assets carried at Fair Value Through Profit or Loss and Financial assets carried at Fair Value Through Other Comprehensive Income) based on Business Model (BM) test and Contractual Cash Flow Characteristics (CCFC) as under:


Financial Assets
Financial Assets at Fair Value
Financial Assets at Amortized Cost
Financial Assets at Fair Value through profit or loss
Financial Assets at Fair Value through other comprehensive income
Financial Assets measured at
Amortised Cost
Financial Assets at Fair Value through other comprehensive income
Financial Assets at Fair Value through profit or loss
If below conditions are met:
(a) FA is held with BM whose objective is to hold financial assets in order to collect contractual cash flow
(b) Contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
FA shall be measured at FVOCI if below conditions are met:
(a) FA is held with BM whose objective is achieved both by collecting contractual cash flow and selling FA
(b) Contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding
Note: Any equity instruments for which the entity makes an irrevocable election to carry at fair value though OCI
FA are accounted at FVTPL if :
(a) Any asset which is not measured at amortised cost and at FVOCI
(b) If on initial recognition, any asset may irrevocably be designated as FVTPL if specific criteria met.

The following diagram will clarify the process of classifying a debt instrument.



The following diagram will clarify the process of classifying an equity instrument.



Note : Derivative classified as financial assets would be measured at fair value through profit or loss (FVTPL) only.

4.6 Classification of Financial Liability

An entity shall classify all financial liabilities as -

(i) Financial liabilities measured at amortized cost

(ii) Financial liabilities at fair value through profit or loss (FVTPL)

4.7 Recognition of Financial Assets and Liabilities

An entity shall recognise a financial asset or financial liability in its balance sheet when, and only when, the entity becomes party to the contractual provisions of the instrument. This principle will be applied on the following:

(a) Receivables and Payables

Unconditional receivables and payables are recognised as financial assets or financial liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.

(b) Firm Commitment to Purchase or Sell Goods or Services

Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered.

(c) Forward Contract

A forward contract that is within the scope of this Standard is recognised as a financial asset or a financial liability on the commitment date, instead of on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.

(d) Option Contracts

Option contracts that are within 'the scope of this Standard' are recognised as assets or liabilities when the holder or writer becomes a party to the contract.

4.8 Measurement of Financial Instruments

4.8.1 Initial Recognition

- **Financial Assets:** An entity shall measure a financial asset except trade receivable at its fair value plus *in the case of a financial asset that is not at fair value through profit or loss*, transaction costs that are directly attributable to the acquisition of the financial asset. Trade receivables are measured at the transaction price as per Ind AS 115.

  In case of financial asset that is at FVTPL, transaction cost is written off in profit and loss statement.

- **Financial Liability:** An entity shall measure a financial liability at its fair value minus in the case of a financial liability that is not at fair value through profit or loss, transaction costs that are directly attributable to issuing of the financial liability. In case of financial liability that is at FVTPL, transaction cost is charged to profit and loss statement (SPL).

4.8.2 Subsequent Measurement

Financial Assets	At Amortised Cost	Initial recognition value minus repayment plus interest using effective interest* method
	At FVOCI	• Fair value changes credited to OCI • On derecognition, cumulative gain/ loss transferred to SPL • Dividend/Interest credited to SPL
	At FVTPL	• Fair value changes credited to SPL • Dividend/Interest credited to SPL
Financial Liabilities	At Amortised Cost	• At effective interest rate method
	At FVTPL	• Fair value changes relating to changes in own credit risk are presented through OCI (own credit risk is measured as the amount of fair value change not attributable to changes in market risk such as changes in benchmark interest rate) • All other fair value changes are presented in SPL

*Effective interest rate is the rate of discount at which the sum total of the present value of future cash flow is equal the initial payments. It is basically the internal rate of return (IRR) of the instrument.

4.9 De-recognition of Financial Instruments

De-recognition of financial instruments means removal of an asset or a liability from the books as a result of sale, repayment, re-negotiation or default by the counter party. It is the end of the life cycle of an asset or a liability that begins with its recognition.

4.9.1 De-recognition of Financial Assets

An entity de-recognises a financial asset only when:

(a) The contractual rights to the cash flows from the financial asset expires

(b) It transfers the financial asset and the transfer qualifies de-recognition

For a financial asset carried at amortised cost, de-recognition takes place at the final carrying amount which is itself the maturity value (as the carrying amount is calculated at effective interest rate method). For financial asset carried as FVTOCI, cumulative gain/ loss is transferred to SPL on the date of sale or transfer. For financial asset carried as FVTPL, the gain or loss on the date of sale is charged to SPL.

4.9.2 De-recognition of Financial Liabilities

A financial liability (or a part thereof) is de-recognised only when the liability is extinguished. That is obligation under the contract is discharged or cancelled or expired. The obligation is discharged by paying the creditor in cash, other financial assets or goods or services, or obligation is legally released.

If a new debt instruments is issued with a different terms and conditions in exchange of the existing debt instrument then the debtor should recognise new financial liability and de-recognise the existing one with the difference being charged to SPL.

Similarly, when a business transfers a financial asset to settle a financial liability, it should de-recognise the asset at fair value and de-recognise the financial liability with the difference being changed to SPL.

Consider the following illustrations.

Illustration 1 : Debt instrument carried at amortised cost, de-recognition

On 01.01.2021, X Ltd. purchased Rs.2,00,000 face value, 3 year, 8% bonds of M Ltd. for Rs.1,89,848 which provides an effective interest rate of 10%. The bonds pay semi-annual interest on June 30 and December 31. Show how the bond will be accounted for in the books of X Ltd.

Date	Effective Interest 5% semi annually	Cash Interest	Excess of (2) over (3) to be added to carrying amount	Carrying amount
(1)	(2)	(3)	(4)	(5)
01.01.2021	—	—	—	189848
30.06.2021	9492 (189848 × 5%)	8000 (200000 × 8%x1/2)	1492	191340
31.12.2021	9568(191340×5%)	8000	1568	192908
30.06.2022	9646	8000	1646	194554
31.12.2022	9728	8000	1728	196282
30.06.2023	9814	8000	1814	198096
31.12.2023	9904	8000	1904	200000

The journal entries in the books of X Ltd. will be as under.

Journal Entries

Date	Particulars	Dr.	Cr.
01.01.21	Investment in 8% Bonds A/c..............................Dr. To Bank A/c	189848	189848
30.06.21	Bank A/c ....Dr. Investment in 8% Bonds A/c ....Dr. To Interest A/c	8000 1492	 9492
31.12.21	Bank A/c …..........……………………………..Dr. Investment in 8% Bonds A/c……........……….Dr. To Interest A/c	8000 1568	 9568
31.12.21	Interest A/c……………………........………….Dr. To Profit and Loss A/c	19060	 19060
30.06.22	Bank A/c ……………………........…………..Dr. Investment in 8% Bonds A/c…........………….Dr. To Interest A/c	8000 1646	 9646

31.12.22	Bank A/c ………………………………..Dr. Investment in 8% Bonds A/c………….....Dr. To Interest A/c	8000 1728	 9728
31.12.22	Interest A/c…………………………….....Dr. To Profit and Loss A/c	19374	 19374
30.06.23	Bank A/c ………………………………..Dr. Investment in 8% Bonds A/c………..….Dr. To Interest A/c	8000 1814	 9814
31.12.23	Bank A/c ………………………………..Dr. Investment in 8% Bonds A/c……………Dr. To Interest A/c	8000 1904	 9904
31.12.23	Interest A/c………………………………Dr. To Profit and Loss A/c	19718	 19718
31.12.23	Bank A/c…………………………………..Dr To Investment in 8% Bonds A/c	200000	 200000

Note : In the books of M Ltd. The above instrument will be treated as a financial liability and interest will be a periodic obligation only. The values at which they are to be recorded will be exactly the same as shown above.

Illustration 2 : Financial asset at FVTOCI, transaction cost given

A company invested in equity shares of another company on 12.03.2021 for Rs. 20,000. Transaction cost is Rs. 400 (not included in Rs. 20,000). Fair value on Balance Sheet date i.e. 31.03.2019 is Rs. 24,000. Assume that the asset has been classified as FVTOCI. Show how the financial asset is recorded in the balance sheet.

Solution :

In the books of the **Investor**

Journal Entries

Date	Particulars	Dr.	Cr.
12.03.2021	Investment in Shares A/c…………..….Dr. To Bank A/c	20400	 20400
31.03.2021	Investment in Shares A/c…………..….Dr. To Fair Value Gain A/c	3600	 3600
31.03.2021	Fair Value Gain A/c………………..….Dr. To OCI A/c	3600	 3600
31.03.2021	OCI A/c…………………………....….Dr. To Fair Value Reserve A/c	3600	 3600

Note : When the above shares will be sold, the cumulative gain or loss previously recognised in OCI is transferred to SPL. For example, if the shares are sold on 10.04.2021 at Rs. 23,000, the following entry should be passed.

Bank A/c……………………………………...…Dr 23000

Fair Value Reserve A/c…………………………Dr 3600

To Investment in Shares A/c 24000

To Profit and Loss A/c 2600

Illustration 3 : Financial asset at FVTPL, transaction cost given

A company invested in equity shares of another company on 12.03.2021 for Rs. 20,000. Transaction cost is Rs. 400 (not included in Rs. 20,000). Fair value on Balance Sheet date i.e. 31.03.2021 is Rs. 24,000. Assume that the asset has been classified as FVTPL. Show how the financial asset is recorded in the balance sheet.

Solution :

In the books of the **Investor**
Journal Entries

Date	Particulars	Dr.	Cr.
12.03.2021	Investment in Shares A/c……………Dr. Transaction Cost A/c…………………Dr. To Bank A/c	20000 400	 20400
31.03.2021	Investment in Shares A/c………………Dr. To Fair Value Gain A/c	4000	 4000
31.03.2021	Fair Value Gain A/c…………………Dr. To P&L A/c	4000	 4000
31.03.2021	P & L A/c……………………………Dr. To Transaction Cost A/c	400	 400

Note: When the above shares will be sold, any further gain or loss should be adjusted through SPL. For example, if the shares are sold on 10.04.2021 at Rs. 26,000, the following entry should be passed.

Bank A/c……………………………………...…Dr 26000

To Investment in Shares A/c 24000

To Profit and Loss A/c 2000

4.10 Compound Financial Instruments

Not all financial instruments are either debt or equity. There may be some instruments which contain characteristics of both. These financial instruments are known as compound financial instruments. Examples of such instruments are convertible bonds which are convertible into equity shares whether mandatorily or at the option of the holder.

4.10.1 Accounting for Compound Financial Instruments

A financial instrument that contains the characteristics of both liability and equity should be accounted for based on their substance rather than the legal form of the instrument. Accordingly, both the component parts should be separately identified and accounted for. Ind ASs emphasizes application of split accounting for compound instruments.

The component parts maybe separated into liability and equity as per the following steps:

Step 1 : Determine the carrying amount of the liability component by measuring the fair value of a similar liability that does not have an associated equity component. The fair value of the liability component is the sum total of the present value of all future cash flows associated with the instrument.

Step 2 : The value of the liability component should then be deducted from the initial issue proceeds of the instrument to get the carrying amount of the equity component as a residual figure.

The allocation of the instrument into its component parts should be performed on initial recognition of the compound instrument such that no gain or loss is recognised.

On conversion of a convertible instrument at maturity, the entity de-recognise the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item to another within equity to another). There is no gain or loss on conversion at maturity.

Illustration 4 : Y Ltd. has issued 10,000 convertible debentures with a face value of Rs. 100 per debenture. The interest rate on the debentures is 5%. The debenture holders have the option of converting these debentures into ordinary shares at the end of four years. The prevailing market rate for a similar debt which does not have a conversion right is 7%. Determine the carrying amount of liability and equity components. Also pass the journal entry on initial recognition.

If 10 convertible debentures are to be converted into 2 equity shares of the company of Rs.10 each, show the journal entry on conversion.

Solution :

Carrying amount of the liability portion

Particulars	Rs.
Present value of interest	
= 10,00,000 × 5% × PVIFA (7%, 4 years)	
= 50,000 × 3.387	1,69,350
Present value of principal amount	
= 10,00,000 × PVIF (7%, 4 years)	
= 10,00,000 × 0.763	7,63,000
Carrying amount of the liability portion	9,32,350

Carrying amount of the equity portion

Particulars	Rs.
Proceeds of the issue (10,000 × 100)	10,00,000
Less: Carrying amount of the liability portion	9,32,350
Carrying amount of the equity portion	67,650

The journal entry on initial recognition will be as follows:

Bank A/c…………………………..Dr 10,00,000
To 5% Convertible Debentures (Liability component) A/c 9,32,350
To 5% Convertible Debentures (Equity component) A/c 67,650

Note : The equity component will be shown under 'Equity' section of the Balance Sheet and the liability component will be carried as per the Effective Interest Method (refer to illustration 1) with the effective interest rate of 7%. The equity component may also be named as 'conversion option'.

The journal entries on conversion will be as follows :

(a) 5% Convertible Debentures (Liability Component) A/c…….Dr 10,00,000
To Equity Share Capital A/c 20,000
To Securities Premium A/c 9,80,000
(Issue of 2000 equity shares of Rs. 10 each at a premium of Rs.490)

(b) 5% Convertible Debentures (Equity Component) A/c……………Dr. 67,650

To Securities Premium A/c 67,650

(Equity portion of the convertible debentures transferred to Securities Premium A/c)

Note : Alternatively, the equity portion may be transferred to Capital Reserve.

4.11 Hedge Accounting

Companies are often exposed to various types of financial risks such as interest rate risk and exchange risk. In order to minimise the loss due to such risks, entities use a risk management strategy known as hedging. Under hedging, companies resort to various derivative and non-derivative instruments to protect itself from the possible loss. Derivative instruments such as forward contracts, future contracts, option contracts and swaps are used to hedge.

The basic principle in Ind AS 32 is that all derivatives are carried at fair value with gains and losses in the profit and loss account. However, derivatives are commonly used to hedge recognised assets and liabilities that are measured at cost, amortised cost or at fair value with gains and losses recognised in equity etc. This creates a mismatch in the timing of gain and loss recognition.

Hedge accounting seeks to correct this mismatch by changing the timing of recognition of gains and losses on either the hedged item or the hedging instrument. This avoid much of the volatility that may arise if the derivative gains and losses were recognised in the profit and loss account, as required by the normal accounting principles.

4.11.1 Qualifying Criteria for Hedge Accounting

An entity is allowed to apply hedge accounting if it meets the specified qualifying criteria, which are as below:

- There has to be eligible hedged item – it is an asset, liability or transaction that exposes an entity to risks regarding changes in the fair value or future cash flows. For example, suppose, X Ltd. has imported a machinery at $50000 payable in 3 months from now. Here the liability of $50000 is a hedged item.
- There has to be eligible hedging instrument – it is a financial instrument, whose fair value or cash flows are expected to offset the changes in the fair value or cash flows of a designated hedged item. In the above example, suppose the company has entered into a future contract to buy $50000 after

3 months. The future contract will be a hedging instrument.

- There has to be a relationship between the hedged item and the hedging instrument with formal designation and documentation.
- The hedge relationship meets the hedge effectiveness – it is the degree to which a hedging instrument offsets the changes in fair value or cash flow of the hedged item.

4.11.2 Classification of Hedging Relationship

As per Ind AS 109, hedging relationships can be of three categories.

(a) A fair value hedge, which hedges the exposure to changes in the fair value of an item or transaction.

(b) A cash flow hedge, which hedges the exposure to changes in the expected cash flows.

(c) Hedges of a net investment in an overseas operation, which reduce the exposure of an entity to foreign operations.

- **Fair Value Hedge**

As mentioned earlier, in case of a fair value hedge the fair value changes of the hedged instrument is offset by the gain or loss on the hedging instrument. For example:

(i) A potato grower may fix the value of the potato inventory by entering into a future contract.

(ii) An entity may buy a put option to protect the fall in the value of its equity securities.

Accounting for fair value hedge involves the following.

(i) The gain or loss on the hedging instruments shall be recognised in profit or loss (or other comprehensive income if the hedging instrument hedges an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income).

(ii) The hedging gain or loss on the hedged item shall adjust the carrying amount of the hedged item (if applicable) and be recognised in profit or loss.

(iii) If the hedged item is a financial asset (or a component thereof) that is measured at the fair value through other comprehensive income, the hedging gain or loss on the hedged item shall be recognised in profit or loss. However, if the hedged item is an equity instrument for which an entity has elected to present changes in fair value in other comprehensive income, those amounts shall remain in other comprehensive income.

Illustration 5 : Fair value hedge on cardamom

X Ltd. owns inventories of cardamom of 5 kg which was purchased at Rs.5000 per kg three months ago. Management is concerned that the price may fall and hence the firm will have to incur losses on sale. The firm, therefore entered into a futures contract to sell the cardamom at Rs.5500 on 31.03.2020.

At the year-end on 31.12.2019, X Ltd finds that the fair value of the cardamom has fallen to Rs.4800 per kg and the future price for delivery on 31.03.2020 is now Rs.5300 per kg. Management has designated the cardamom as a hedged item and the future contract as the hedging instrument. The hedge is deemed to be effective.

Pass necessary accounting entries if (a) hedge accounting is not used, and (b) if hedge accounting is used.

Solution :

(a) The future contract will be recognised as a derivative asset at a value of Rs. (5500 − 5300) × 5 = Rs.1000 and the inventory will still be measured at cost of Rs. 25000. The accounting entries will be:

Derivative Asset A/c…………………………Dr	1,000	
To Profit & Loss A/c		1,000

The gain on the futures contract is recognised immediately in profit or loss but no loss would be recognised on the value of inventory, causing a mismatch.

(b) The future contract will be recognised as a derivative asset at a value of Rs. (5500 − 5300) × 5 = Rs.1000 and the inventory will now be measured at Rs.4800 × 5 = Rs. 24000, so matching the gain and loss in profit or loss in the same period. The accounting entries will be as follows:

Derivative Asset A/c…………………………Dr	1,000	
To Profit & Loss A/c		1,000
Profit & Loss A/c……………………………..…Dr	1000	
To Inventory A/c		1,000

This time both the gain and the loss affect profit or loss in the same period; hedge accounting has made it possible.

- **Cash Flow Hedge**

Future cash flows might relate to existing assets and liabilities such as future interest payment or receipts and floating rate debt. Future cash flows can also relate

to forecasting sales or purchases in a foreign currency. Volatility in future cash flows will result from changes in the interest rates, exchange rates, equity prices or commodity prices.

Cash flow hedge attempts to hedge this exposure to changes in the expected cash flows. Some examples of common cash flow hedges are:

(a) an interest rate swap converting a floating rate loan to a fixed rate.

(b) a forward foreign exchange contract hedging forecast future sale of inventory in a foreign currency or a forecast future purchase of inventory or equipment in a foreign currency.

Accounting for cash flow hedge involves the following.

(i) Provided the hedge is effective, changes in the fair value of the hedging instruments are initially recorded in OCI and taken to a separate component of equity.

(ii) The amount recognised in OCI should be lower of

a. the cumulative gain or loss on the hedging instruments from the inception of the hedge; and

b. the cumulative change in fair value (that is present value) of the expected future cash flows on the hedged items from the inception of the hedge.

(iii) If the cumulative change in the hedging instrument exceeds the changes in the hedged item (referred to as over-hedge) ineffectiveness will be recognised for the excess in P&L. If the cumulative change in the instrument is less than the change in the hedged item (sometimes referred to as under-hedge) no ineffectiveness will be recognised.

(iv) For cash flow hedges of a forecast transaction which subsequently results in the recognition of a non-financial item such as fixed asset inventory or where a hedged forecast transaction for a non-financial asset or liability becomes a farm commitment for which fair value hedge accounting is applied, the carrying value of the item must be adjusted for the accumulated gain or losses recognise directly in equity (often referred to as basis adjustment).

(v) For other cash flow hedge the accumulated game and losses recorded in equity should be reclassified to profit and loss in the same period or periods during which the hedged expected future cash flow affects P&L (for example, where interest income or expense is recognised or a forecast sale occurs). Where there is a cumulative loss on the hedging instrument and it is no

longer expected that the loss will be recovered it must be immediately recognised in P&L.

Illustration 6 : Cash Flow Hedge

P Ltd. has items of inventory whose selling price is based upon the fair value of their commodity content. P Ltd. is concerned that the fair value of the committee will fall and so reduce the cash flow on the sale of the inventory. The company enters into a forward contract to sell the inventory at a fixed price in future. The cash flow from forecast sale of inventory is designated hedge item and the forward contract is designated as the hedging instruments. The heading is effective and qualified as a cash flow hedge.

Suppose, the fair value of the commodity falls by Rs. 600, and due to a perfect hedge, the fair value of the forward contract increases exactly by Rs. 600.

Pass necessary accounting entries if (a) hedge accounting is not used and (b) if hedge accounting is used.

Solution :

(a) Hedge accounting is not used

The accounting entries, if hedge accounting is not used would be:

Derivative Asset A/c…………………………Dr	600	
To Profit & Loss A/c		600

The sale proceeds will be Rs.600 lower (or more) when the inventory is sold, presumed to be in the following period in this example. Therefore, there is a mismatch in profit.

(b) Hedge accounting is used

The accounting entries, if hedge accounting is used would be:

Derivative Asset A/c…………………………Dr	600	
To Other Comprehensive Income (then equity) A/c		600

The Rs. 600 gain, which was included as other comprehensive income, will be reclassified through profit or loss when the cash flow impact of the inventory affects profit or loss (i.e. when the inventory is sold). Using hedge accounting has allowed the gain to be matched with the loss.

- **Hedge of a Net Investment in Foreign Operation**

An entity may have overseas subsidiaries, associates, joint ventures or branches. It may hedge the currency risk associated with the translation of the net assets of these foreign operations into the group's presentation currency.

Hedge of net investment in foreign operation shall be accounted for in the same way as cash flow hedge, i.e. the effective portion should be recognised in other comprehensive income and the ineffective element should be recognised directly in the profit or loss. The gain or loss on the instrument relating to the effective portion of The Hedge that has been recognised directly in the equity account, should be recognised in the statement of profit and loss on disposal of the foreign operation.

4.12 Disclosure Requirements for Financial Instruments

Ind AS 107 prescribes the disclosures requirements for:

(a) Different categories of financial assets
(b) Different categories of financial liabilities
(c) Re-classification of financial liabilities
(d) De-recognition of financial assets and liabilities
(e) Financial assets pledged as collateral
(f) Allowances for credit losses
(g) Compound financial instruments with multiple embedded derivatives
(h) Defaults and breaches for loan payables
(i) Income, expense, gains or losses recognized in profit and loss
(j) Accounting policies followed
(k) Hedge accounting
(l) Fair value determination for financial assets and liabilities
(m) Risk disclosures

Some important points of the above disclosure requirements are discussed below:

- **Disclosure for Financial Assets**

(i) The entity should disclose the carrying amounts of each of the following categories of financial assets:

- Financial assets at fair value through profit or loss

- Held to maturity investments
- Loan and receivable
- Available for sale financial assets

(ii) For loans and receivable at fair value through profit and loss account. Entity should disclose:

- the maximum exposure to credit risk
- impact of related credit derivative on credit exposures
- change in fair value of loans and receivables for during the period and cumulative
- change in fair value of any related credit derivative for during the year and cumulative

● Disclosure for Financial Liabilities

Entity should disclose the following financial liabilities at fair value through profit and loss account:

(i) Change in fair value of a financial liability, during the period and cumulatively, attributable to changes that give rise to market risk.

(ii) Changes in market conditions that give to market risk include changes in benchmark interest rate, the price of another entity's financial instrument, a commodity price, Forex rate etc. The entity should also disclose the carrying amount of the financial liabilities measured at amortize cost.

● Disclosure for Re-classification

If the entity has reclassified a financial asset as one measured at cost or amortized cost, rather than at fair value; or at fair value, rather than at cost or amortized cost, it should disclose the amount re-classified into and out of each category and the reason for that re-classification.

● Disclosure for De-recognition

An entity may have transferred financial assets in such a way that part or all of them do not qualify for de-recognition. If the entity either continues to recognize all of the assets or continues to recognize the assets to the extent of its continuing involvement, the entity should disclose:

(i) The nature of the financial asset

(ii) The extent of the entity's continuing involvement and any associated liabilities.

● **Disclosure for Compound Financial Instruments with Embedded Derivatives**

If the entity has issued an instrument that contains both a liability and an equity component and the instrument has multiple embedded derivatives whose values are independent (such as a callable convertible debt instrument), it should disclose the existence of those features.

● **Disclosure for Income, Expense, Gains or Losses Recognized in Profit and Loss Account**

The profit and loss account disclosures requirements include the following:

(i) Net gains or losses for each category of financial assets and liabilities.

(ii) Available for sale gains or losses recognised in equity, in addition to those amounts re-classified from equity to profit or loss.

(iii) Total interest income and total interest expense from financial assets and financial liabilities that are not measured at fair value through profit or loss.

(iv) Fee income and expense (other than the one considered for effective interest rate purposes) for financial assets and financial liabilities not measured at fair value through profit or loss.

(v) Fee income and expense from trust and other fiduciary activities.

(vi) Interest accrued on impaired financial assets.

(vii) Impairment losses for each category of financial asset.

● **Disclosure for Accounting policies**

Ind AS- 1 requires disclosure of an entity's significant accounting policies but Ind AS- 107 prescribes specific disclosure of certain policies relating to financial instruments such as:

(i) The criteria for designating financial assets and financial liabilities as at fair value through profit or loss

(ii) The criteria for designated financial assets as available for sale

(iii) The criteria for use of an allowance account (i.e. bad debt reserve), including writing off amount charges to such an account

(iv) Whether trade date or settlement date accounting is used for regular way purchase or sale of financial assets

(v) Accounting policy for financial assets that are subject to re-negotiation terms.

- **Disclosure for Hedge Accounting**

Ind AS 107 requires the following disclosures for each of the three types of hedge:

(i) Description of the hedging instrument and their fair values at reporting date and nature of risk hedged

(ii) When cash flows are expected to occur and when they are expected to affect P&L.

(iii) Forecast transactions no longer expected to occur.

(iv) Amount recognised in equity and re-classification to P&L

(v) Gains and losses from hedging instruments and hedged risk

(vi) Ineffectiveness recognised in P&L

- **Risk Disclosure**

(a) Qualitative Risk Disclosure – for each of the three type of risks (i.e., credit risk, liquidity risk and market risk), the entity should disclose the following:

  (i) The exposure to the risk and how they arise

  (ii) The entity's objective, policies and processes for managing the risk and the methods used to measure the risk

  (iii) Any changes to these disclosures from the previous reporting period

(b) Quantitative Risk Disclosure – the specific disclosure requirements for the three types of risks are as follows:

  (i) Credit Risk – The maximum credit exposure, description of collateral, credit quality of financial assets etc.

  (ii) Liquidity Risk – financial liabilities must be disclosed by contractual maturity based on undiscounted cashflows.

  (iii) Market Risk – disclosure of market risk sensitivity analysis

4.13 Summary

Financial instruments are contracts that are either financial assets or financial liabilities or equity instruments. The same instrument is an asset to its holder while financial liability or equity instruments to its issuer. The identification of financial instrument as a liability or equity instrument is very crucial and determine the accounting for such instruments. The accounting also depends on the categorisation of financial assets and liabilities. All items of financial instruments are carried at fair value though the concept of such fair value differs a lot for liabilities and assets

based on their classification. The instruments are often found to be used as hedging instruments and hence their accounting as hedging instruments is equally important.

4.14 Exercises

- **Theoretical Questions**

1. What do you mean by financial instruments?
2. What is a financial asset?
3. State the principles that are applied in differentiating a financial liability from equity instruments.
4. How will you classify financial assets and liabilities?
5. Discuss about the accounting treatment of different categories of financial assets.
6. What is a compound financial instrument? How is it accounted for?
7. In what way a compound financial instrument is different from a financial liability instrument?
8. When and how a financial asset and liability de-recognised?
9. What is hedge accounting? Why is it important?
10. What are the different types of hedging relationships?
11. Define a fair value hedge. How is it different from cash flow hedge?
12. State the disclosure requirements with respect to the following:
    (a) Different categories of financial assets
    (b) Different categories of financial liabilities
    (c) Re-classification of financial liabilities
    (d) De-recognition of financial assets and liabilities
    (e) Compound financial instruments with multiple embedded derivatives
    (f) Income, expense, gains or losses recognized in profit and loss
    (g) Accounting policies followed
    (h) Hedge accounting
    (i) Risk disclosures

- **Practical Problems**

Problem 1: Identify whether the following instruments are financial liabilities or equity instruments.

(a) Redeemable preference shares with discretionary dividend payment
(b) Perpetual debt instrument with discretionary interest payment
(c) A debt instruments whose principal amount may be repaid by transferring a non-current asset having at least equal value
(d) A compulsorily convertible preference share

[**Ans.** (a) Financial Liability (b) Equity Instrument (c) Financial Liability (d) Financial Liability]

Practical 2: On 01.01.2021, Y Ltd. purchased Rs.1,00,000 face value, 3 year, 8% bonds of R Ltd. for Rs.94,924 which provides an effective interest rate of 10%. The bonds pay semi-annual interest on June 30 and December 31. Show how the bond will be accounted for in the books of Y Ltd and R Ltd.

Practical 3: A company invested in equity shares of another company on 20.03.2021 for Rs. 10,000. Transaction cost is Rs. 200 (not included in Rs. 10,000). Fair value on Balance Sheet date i.e., 31.03.2021 is Rs. 12000. Assume that the asset has been classified as FVTOCI. Show how the financial asset is recorded in the balance sheet. If the asset is sold on 10.04.2021, how the same would be recorded.

Practical 4: Z Ltd. has issued 20,000 convertible debentures with a face value of Rs.100 per debentures. The interest rate on the debentures is 5%. The debenture holders have the option of converting these debentures into ordinary shares at the end of four years. The prevailing market rate for a similar debt which does not have a conversion right is 7%. Determine the carrying amount of liability and equity components. Also pass the journal entry on initial recognition.

If 10 convertible debentures are to be converted into 2 equity shares of the company of Rs.10 each, show the journal entry on conversion.

Practical 5: P Ltd. owns inventories of mustard of 500 kg which was purchased at Rs.100 per kg three months ago. Management is concerned that the price may fall and hence the firm will have to incur losses on sale. The firm, therefore entered into a futures contract to sell the mustard at Rs.110 on 31.03.2020.

At the year-end on 31.12.2021, P Ltd finds that the fair value of the mustard has fallen to Rs.96 per kg and the future price for delivery on 31.03.2022 is now Rs.106 per kg. Management has designated the cardamom as a hedged item and the future contract as the hedging instrument. The hedge is deemed to be effective.

Pass necessary accounting entries if (a) hedge accounting is not used and (b) if hedge accounting is used.

Practical 6: K Ltd. has items of inventory whose selling price is based upon the fair value of their commodity content. K Ltd. is concerned that the fair value of the committee will fall and so reduce the cash flow on the sale of the inventory. The company enters into a forward contract to sell the inventory at a fixed price in future. The cash flow from forecast sale of inventory is designated hedge item and the forward contract is designated as the hedging instruments. The heading is effective and qualified as a cash flow hedge.

Suppose, the fair value of the commodity falls by Rs.1200, and due to a perfect hedge, the fair value of the forward contract increases exactly by Rs.1200.

Pass necessary accounting entries if (a) hedge accounting is not used and (b) if hedge accounting is used.

Unit 5 □ Consolidated Accounts

Structure

5.1 Objective
5.2 Introduction
5.3 Benefits of Consolidated Financial Statements
5.4 Regulatory Framework of Consolidation in India
5.5 Consolidation as per Ind AS 110
  5.5.1 Objective of Ind AS 110
  5.5.2 Scope of Ind AS 110
  5.5.3 Meaning and Evaluation of Control
  5.5.4 Consolidation Procedure for Subsidiaries
5.6 Summary
5.7 Exercises

5.1 Objective

After going through this unit, you will be able to:

- Understand when consolidation is to be done as per Ind AS 110;
- Prepare Consolidated Financial Statements on the date of acquisition;
- Prepare Consolidated Financial Statements on subsequent reporting dates.
- How are financial statements measured?
- The minimum disclosure requirements with respect to financial instruments?

5.2 Introduction

In today's business scenario, companies are often found to do business by creating group companies in order to garner benefits like tax savings, higher efficiency in operation etc. As a result, separate financial statements prepared by companies under a group fails to provide a complete picture of how the group, as a whole, performs. This is why preparation of consolidated financial statements is considered to be of immense benefit for the users of financial information. In addition, the same is a legal requirement as well.

5.3 Benefits of Consolidated Financial Statements

The major benefits of preparation of consolidated financial statements include the following:

a. Consolidated financial statements provide a complete overview of the parent and all its other group companies.

b. Consolidated financial statements are easy to comprehend by the investors as otherwise they are to deal with numerous separate financial statements of group companies to evaluate the parent before making any decision.

c. Since group companies may indulge in transactions between themselves, separate financial statements fail to present the net impact of these transactions on the consolidated entity.

5.3 Regulatory Framework of Consolidation in India

In India, consolidation is regulated by –

(a) The Companies Act 2013; and

(b) Accounting Standards (presently Indian Accounting Standards i.e., Ind ASs)

Major provisions of these two are discussed below.

(a) The Companies Act, 2013:

As per Section 129(3), where a company has one or more subsidiaries, it shall, in addition to standalone financial statements, prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards.

However, the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries and associate company or companies in such form as may be prescribed.

As per Section 2(6) "associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation—For the purposes of this clause -

(a) the expression "significant influence" means control of at least twenty per

cent of total voting power, or control of or participation in business decisions under an agreement; and

(b) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Again, as per Section 2(87) **"subsidiary company"** or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company—

(*i*) controls the composition of the Board of Directors; or

(*ii*) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation—For the purposes of this clause —

(*a*) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (*i*) or sub-clause (*ii*) is of another subsidiary company of the holding company;

(*b*) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors.

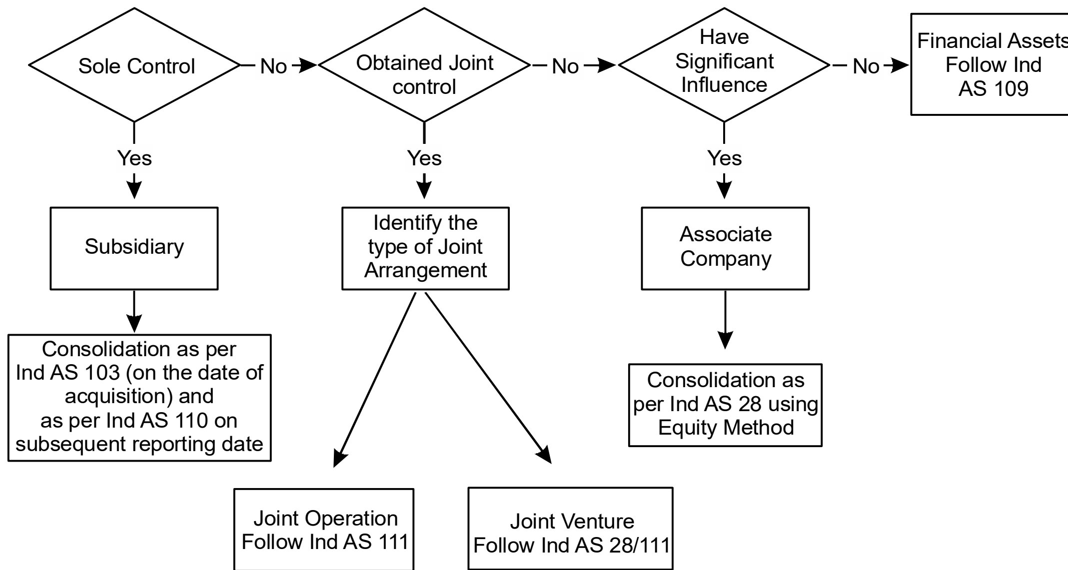
Thus, according to the Companies Act, 2013, consolidation is a legal requirement for companies having subsidiaries, associates or investment in joint venture.

(b) Accounting Standards (i.e., Indian Accounting Standards):

Companies (Indian Accounting Standards) Rules, 2015 prescribes the following Ind ASs that deal with preparation of Consolidated Financial Statements and Separate Financial Statements of group entities.

- Ind AS 103: Business Combinations
- Ind AS 110: Consolidated Financial Statements
- Ind AS 111: Joint Arrangements
- Ind AS 112: Disclosures of Interest in Other Entities
- Ind AS 27: Separate Financial Statements
- Ind AS 28: Investments in Associates and Joint Ventures

The consolidation requirements as per the above Ind ASs can be summarized as follows:



As per the above diagram, consolidation is required for subsidiaries, associates as well as for joint arrangements (joint operation or joint control). Disclosures in these cases are made as per Ind AS 112. However, for all other type of investments in another entity, the same is treated as a financial asset and accounted as per Ind AS 109. Disclosures for this situation is done following Ind AS 107 (follow Unit 4).

It is to be noted in this context that, even if the consolidated financial statements are prepared in the above cases, separate financial statements shall also be prepared (Ind AS 27) by the investor company and investments are valued at cost or as per Ind AS 109.

Though consolidation is required for subsidiaries, associates as well as joint arrangements, in this chapter our focus will be only on the first category of relationships i.e., on a parent-subsidiary relationship. For other two type of relationships (i.e., associates and joint arrangements) students may follow the respective Ind ASs.

5.5 Consolidation as per Ind AS 110

5.5.1 Objective of Ind AS 110

The objective of Ind AS 110 is to provide principles of when and how an entity should prepare consolidated financial statements.

5.5.2 Scope of Ind AS 110

Ind AS 110 requires that only a parent should prepare consolidated financial statements (i.e., Consolidated Income Statement, Consolidated Balance Sheet, Consolidated Statement of Changes in Equity and Consolidated Cash Flow Statement along with Notes to Accounts).

There are, however, certain *exemptions* regarding application of Ind AS 110.

As per Ind AS 110, a parent that meets all of the following conditions is ***exempt*** from the compulsion of preparing consolidated financial statements:

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 consolidated financial statements that are available for public use and comply with Ind ASs.

Similar provisions have been included in Rule 6 of Companies (Accounts) Rules 2014.

5.5.3 Meaning and Evaluation of Control

An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement 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:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

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

Hence, absence of any one of the above elements will lead to absence of control. In such cases, the investor will not be treated as a parent and consolidation requirement will not arise.

In order to avoid intricacies, control through acquisition of majority shareholding has been considered in this study materials. However, students must note that it is possible that an investor obtains control though means other than majority shareholding. In those cases, the investor will be a parent and consolidation as per Ind AS 110 cannot be avoided.

Note : An investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control stated above.

5.5.4 Consolidation Procedure for Subsidiaries

Consolidation of an investee i.e., subsidiary shall start from the date the investor i.e., parent obtains control of the subsidiary and will cease when the parent loses control of the subsidiary. Thus, accounting for consolidation will start on the date of acquisition itself and the parent will need to prepare consolidated financial statements for each of the following reporting date.

A Non-Controlling Interest (NCI) is an ownership of less than 50% in a Company, where the equity state gives the investors a little influence NCI is also known as minority interest. NCI do hot account for potential voting rights.

I. Accounting on the Date of Acquisition

Since the acquiree company (i.e., subsidiary company) does not cease to exist after acquisition of its control by the acquirer, there will be no entry in the books of the subsidiary on the date of acquisition. However, the acquirer i.e., holding company shall have to measure the identifiable net assets acquired from

subsidiary at fair value, measure the NCI and goodwill or gain on bargain purchase on the date of acquisition and prepare a consolidated balance sheet (CBS) as on the date of acquisition after incorporating the same.

The holding company shall pass the following entry in its consolidated accounts on the date of acquisition:

Journal

Particulars	Dr. (Rs.)	Cr. (Rs.)
Assets A/c (at fair value) ………………………….…. Dr.		
Goodwill A/c……………………………………..….Dr.		
To Liabilities (at fair value) A/c		
To Consideration A/c		
To NCI A/c		
To Gain on Bargain Purchase A/c		
Consideration A/c………………………………….…. Dr.		
To Cash A/c (if consideration is paid in cash)		
To Equity Share Capital A/c (if shares are issued)		
To Securities Premium A/c (if shares are issued at premium)		

Accordingly, the fair value of assets and liabilities of subsidiary company will be merged to the corresponding assets and liabilities of the holding company in the CBS. The NCI will appear under 'Equity' separately and Goodwill will appear under Non-Current Assets while the Gain from Bargain Purchase will be credited to Capital Reserve and appear under 'Other Equity' separately. NCI may be measured at proportionate fair value of net identifiable assets or at fair value (calculated at per share basis or at market price).

Goodwill or Gain from Bargain Purchase will be calculated as follows:

(i) Ascertain the fair value of identifiable net assets on the date of acquisition (DOA).

Fair value of identifiable net assets $= \sum FV\ Assets\ - \sum FV\ \ of\ Liabilites.$

or,

Fair value of identifiable net assets = Share capital + Other Equity (± difference in fair value)

(ii) Ascertain the purchase consideration paid by the holding company.

(iii) Ascertain the value of NCI either as proportionate fair value of identifiable net assets or at fair value of proportionate shareholding. This depends on the policy of the parent.

Now, if [(ii) + (iii)] is higher than (i) above, the result is Goodwill and if [(ii) + (iii)] is lower than (i) above, the result is Gain on Bargain Purchase.

In case NCI is measured at fair value, the result Goodwill is known as Full Goodwill as it includes the share of both NCI and Parent but if NCI is measured at proportionate fair value of identifiable net assets, the resultant Goodwill is Partial Goodwill representing parent's portion only.

In case of wholly owned subsidiary, there will be no NCI.

Illustration 1: NCI is measured at proportionate fair value of identifiable net assets.

P Ltd. acquires 70% of S Ltd. for Rs.8,50,000 and issued equity shares at par. Fair value of S Ltd.'s identifiable net assets amount to Rs.9,00,000. Calculate NCI and Goodwill and show the treatment in the books of P Ltd. Assume that P Ltd. measures NCI at proportionate fair value of net identifiable assets.

Solution :

Fair value of net assets = Rs.9,00,000. Purchase Consideration = Rs.8,50,000

NCI (at proportionate fair value of net assets) = 30% of Rs.9,00,000 = Rs.2,70,000.

Goodwill = Purchase consideration + NCI – Fair value of net assets

= Rs.8,50,000 + Rs.2,70,000 – Rs.9,00,000 = Rs.2,20,000

P Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Net Assets A/c……………………………………. Dr.	9,00,000	
Goodwill A/c………………………………………Dr.	2,20,000	
To Consideration A/c		8,50,000
To NCI A/c		2,70,000
Consideration A/c…………………………………. Dr.	8,50,000	
To Equity Share Capital A/c		8,50,000

In the standalone accounts of H Ltd., the journal entry will be:

P Ltd. (in Standalone Accounts)
Journal

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment in S Ltd. A/c……………………Dr.	8,50,000	
To Equity Share Capital A/c		8,50,000

Note : Students may note that since NCI has been valued at proportionate fair value of identifiable net assets, Goodwill represents partial goodwill i.e., parent's share only.

Parent's share in Goodwill = P.C – Parent's share in net assets = 8,50,000-70% of 9,00,000 = Rs.2,20,000

NCI's share in Goodwill = 2,70,000 – 30% of 9,00,000 = Nil

Illustration 2 : Gain on bargain purchase

Refer to Illustration 1. What will be your answer if purchase consideration is only Rs.6,00,000?

Solution :

Fair value of net assets = Rs.9,00,000. Purchase Consideration = Rs.6,00,000

NCI (at proportionate fair value of net assets) = 30% of Rs.9,00,000 = Rs.2,70,000.

Gain on bargain purchase = Fair value of net assets – (Purchase consideration + NCI) = Rs.6,00,000 + Rs.2,70,000 – Rs.9,00,000 = Rs.30,000

P Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Net Assets A/c……………………………………. Dr.	9,00,000	
To Consideration A/c		6,00,000
To NCI A/c		2,70,000
To Gain on Bargain Purchase A/c		30,000
Consideration A/c……………………………… Dr.	6,00,000	
To Equity Share Capital A/c		6,00,000

In the standalone accounts of H Ltd., the journal entry will be:

P Ltd. (in Standalone Accounts)
Journal

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment in S Ltd. A/c……………………Dr.	6,00,000	
To Equity Share Capital A/c		6,00,000

Illustration 3: Non-controlling interest is measured at fair value but separate fair value of NCI is not given

X Ltd. acquires 70% of Y Ltd. for Rs. 8,40,000 and issued equity shares at Rs. 12 per share (including Rs.2 as premium). Fair value of Y Ltd.'s identifiable net assets amount to Rs. 9,60,000. Calculate NCI and Goodwill and show the treatment in the books of X Ltd. Assume that X Ltd. measures NCI at fair value.

Solution :

Since, no separate fair value is given for NCI, we measure the fair value of NCI at per share basis (i.e., taking purchase consideration as base).

Fair value of net assets = Rs.9,60,000. Purchase Consideration = Rs.8,40,000 (for 70%)

NCI (at fair value) = Rs.8,40,000 × $\frac{30\%}{70\%}$ = Rs.3,60,000 (considering PC as base)

Goodwill = Purchase consideration + NCI – Fair value of net assets
= Rs.8,40,000 + Rs.3,60,000 – Rs.9,60,000 = Rs.2,40,000

Number of equity shares issued = Rs.8,40,000 ÷ Rs.12 = 70,000

X Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Net Assets A/c…………………………………. Dr.	9,60,000	
Goodwill A/c……………………………………Dr.	2,40,000	
To Consideration A/c		8,40,000
To NCI A/c		3,60,000
Consideration A/c…………………..………. Dr.	8,40,000	
To Equity Share Capital A/c (70,000 × Rs.10)		7,00,000
To Securities Premium A/c (70,000 × Rs.2)		1,40,000

X Ltd. requires to pass the following entry in its books for preparation of separate financial statements.

X Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment A/c……………………..............................…Dr.	8,40,000	
To Equity Share Capital A/c		7,00,000
`To Securities Premium A/c		1,40,000

Investment A/c…………………………………………. Dr.To Equity Share Capital A/c To Securities Premium A/c 8,40,000 7,00,000 1,40,000

Illustration 4 : Non-controlling interest is measured at fair value but separate fair value of NCI is given

P Ltd. acquires 70% of Q Ltd. for Rs. 8,40,000 payable in cash. Fair value of Y Ltd.'s identifiable net assets amount to Rs. 9,60,000. NCI measured at fair value of Rs. 4,00,000. Calculate NCI and Goodwill and show the treatment in the books of P Ltd. Assume that P Ltd. measures NCI at fair value.

Solution :

Fair value of net assets = Rs.9,60,000. Purchase Consideration = Rs.8,00,000

NCI (at fair value) = Rs.3,00,000 (given)

Goodwill = Purchase consideration + NCI – Fair value of net assets

= Rs.8,00,000 + Rs.3,00,000 – Rs.9,60,000 = Rs.1,40,000

P Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Net Assets A/c………………………………………. Dr.	9,60,000	
Goodwill A/c…………………………………………Dr.	1,40,000	
To Consideration A/c		8,00,000
To NCI A/c		3,00,000
Consideration A/c…………………………………. Dr.	8,00,000	
To Bank A/c		8,00,000

P Ltd. requires to pass the following entry in its books for preparation of separate financial statements.

P Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment A/c……………………...............................…Dr.	8,00,000	
To Bank A/c		8,00,000

Note : Students may note that since NCI has been valued at fair value, Goodwill represents full goodwill i.e., parent's share as well as NCI's share.

Parent's share in Goodwill = P.C – Parent's share in net assets = 8,00,000-70% of 9,60,000 = Rs.1,28,000

NCI's share in Goodwill = 3,00,000 – 30% of 9,60,000 = Rs.12,000

Total Goodwill = 1,28,000 + 12,000 = Rs.1,40,000.

Illustration 5 : Preparation of CBS on the date of acquisition, NCI at proportionate net assets

On 31.03.2021, H Ltd. acquired 70% equity shares of S Ltd. at Rs. 6,300 in cash and obtained control. The balance sheets of the companies along with the fair value of assets and liabilities of S Ltd. on the date of acquisition were as follows:

Particulars	H Ltd.	S Ltd.	
	Carrying Amount (Rs.in lakh)	Carrying Amount (Rs.in lakh)	Fair Value (Rs.in lakh)
Assets			
Non-current Assets			
PPE	10,500	4,500	4,950
Investment in S Ltd.	6,300	—	—
Current Assets			
Inventories	1,050	750	900
Trade receivables	450	375	375
Cash and Cash Equivalent	4,950	1,050	1,050
Total	23,250	6,675	
Equity and Liabilities			
Equity			
Share Capital (Rs. 10)	7,500	3,000	
Other Equity	15,300	3,450	
Non-current Liabilities	—	—	
Current Liabilities			
Trade Payables	450	225	225
Total	23,250	6,675	

Prepare the consolidated Balance Sheet as on 31.03.2021 of the group entities i.e., H Ltd. and S Ltd. Assume NCI is measured at proportionate fair value of net identifiable assets.

Solution : (Rs. in lakh)

Since, H Ltd. acquired 70% of S Ltd., remaining 30% shares represents NCI.

Fair value of Identifiable Net assets = 4,950 + 900 + 375 + 1050 – 225 = Rs.7,050

or, Fair value of Identifiable Net assets = Share capital + Other equity +/– fair value changes = 3,000 + 3,450 + (4,950 – 4,500) + (900 – 750) = Rs.7,050

NCI (at proportionate fair value of net identifiable assets) = 30% of 7,050 = Rs. 2,115

Goodwill = Purchase Consideration + NCI – Fair value of Identifiable Net assets

= Rs.6,300 + 2,115 – 7,050 = Rs.1,365

Note : Since, NCI is measured at proportionate fair value of net identifiable assets, computed value of Goodwill represents only the holding company's portion.

Now, the CBS will be as follows :

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2021

Particulars	**Amount** (Rs. in lakh)
Assets	
Non-current Assets	
PPE (10,500 + 4,950)	15,450
Goodwill	1,365
Current Assets	
Inventories (1,050 + 900)	1,950
Trade receivables (450 + 375)	825
Cash and Cash Equivalent (4,950 + 1,050)	6,000
Total	25,590
Equity and Liabilities	
Equity	
Share Capital (Rs. 10)	7,500
Other Equity	15,300
NCI	2,115
Non-current Liabilities	—
Current Liabilities	
Trade Payables (450 +225)	675
Total	25,590

Illustration 6 : Preparation of CBS on the date of acquisition, NCI at fair value

Refer to Illustration 5, how will your answer change if NCI is measured based on current market price of Rs. 28 per share.

Solution: (Rs. in lakh)

When NCI is measured at fair value based on market price of Rs. 28 per share.

NCI = 300 shares x 30% x 28 = Rs.2,520

Goodwill = Rs.6,300 + 2,520– 7,050 = Rs.1,770

Note : Here, Goodwill represents the full value of Goodwill (i.e., the portion of both H Ltd. and NCI).

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2021

Particulars	Amount (Rs. in lakh)
Assets	
Non-current Assets	
PPE (10,500 + 4,950)	15,450
Goodwill	1,770
Current Assets	
Inventories (1,050 + 900)	1,950
Trade receivables (450 + 375)	825
Cash and Cash Equivalent (4,950 + 1,050)	6,000
Total	25,995
Equity and Liabilities	
Equity	
Share Capital (Rs. 10)	7,500
Other Equity	15,300
NCI	2,520
Non-current Liabilities	—
Current Liabilities	
Trade Payables (450 +225)	675
Total	25,995

II. Accounting on Any Subsequent Reporting Date

After the date of acquisition, on all subsequent reporting dates the holding company shall continue to prepare the consolidated balance sheet (CBS) until its

control over the subsidiary is lost. The following points must be considered in preparing a CBS on subsequent reporting date.

1. The Goodwill should be measured at the value computed on the date of acquisition as per Ind AS 103 less impairment loss, if any. Thus, Goodwill will not be amortized.
2. For consolidation on subsequent date the share of NCI in post-acquisition profit or loss of the subsidiary must be added to acquisition date value of NCI.
3. In the subsequent CBS, the non-current items of the subsidiary are taken acquisition date fair value plus subsequent change in book value after adjustment of any depreciation or amortization on the fair value gain or loss (i.e., difference between carrying amount and fair value on the date of acquisition). This may be termed as fair value adjustment.
4. In the subsequent CBS, the current items of the subsidiary should be taken at reporting date book value (i.e., they will be merged with parent's current assets item-by-item basis based on the value as per standalone balance sheets on the date of reporting). However, the fair value gain or loss on the date of acquisition on any current item should be reverted to the post acquisition retained earnings on the assumption that the item no longer exists on the reporting date i.e., realized during the year (assuming FIFO movement).
5. Thus, the post-acquisition profit or loss should be calculated as follows :

   Post-acquisition profit or loss of Subsidiary = Profit/ Loss reported by the subsidiary during the year – fair value changes in respect of current items reverted (see point 4) – fair value adjustment (see point 3) – any other items (such as unrealized profit etc.).

   The post-acquisition profit or loss, thus arrived will be shared by the parent and NCI in proportion of their shareholding. While parent's share will be credited to its 'other equity', the share of NCI will be added to the value of NCI on the acquisition date (see point no. 2).
6. Adjustment for inter-co transactions such as sale of goods, sale of fixed assets, inter-co debt, bonus issue by the subsidiary and dividend declared by the subsidiary should also have impact on the CBS (will be discussed in due course).
7. Parent's share of impairment loss on goodwill will be deducted from Consolidated Other Equity and NCI's share of impairment loss on goodwill (only in case NCI is measured at fa value) will be deducted from reporting date NCI (refer to point 2).

Illustration 7 : Preparation of CBS on subsequent reporting date

On 31.03.2021, H Ltd. acquired 70% equity shares of S Ltd. at Rs.6,300 in cash and obtained control. After one year, i.e., on 31.03.2022, the balance sheets of the companies were as follows:

Particulars	H Ltd.	S Ltd.
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Non-current Assets		
PPE	9,750	4,125
Investment in S Ltd.	6,300	—
Current Assets		
Inventories	1,200	825
Trade receivables	570	450
Cash and Cash Equivalent	6,705	2,130
Total	**24,525**	**7,530**
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)	7,500	3,000
Other Equity	16,500	4,275
Non-current Liabilities	—	—
Current Liabilities		
Trade Payables	525	255
Total	**24,525**	**7,530**

The income statements of the two companies for the year ended on 31.03.2022 are given below:

Statement of Profit and Loss for the year ended on 31.03.2022

Particulars	H Ltd.	S Ltd.
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Revenue	4,500	2,850
Cost of sales	(-2,700)	(-1,500)
Administrative expenses	(-600)	(-525)
Profit for the year	**1,200**	**825**

H Ltd. estimates that goodwill has impaired by Rs.147 lakh. The fair value adjustment to PPE was in respect to a plant having remaining useful life of 20 years with estimated residual value of zero. H Ltd. uses SLM for depreciation on PPE. All the inventory held by S Ltd. on the date of acquisition was sold during 2021-2022.

Prepare the Consolidated Balance Sheet as on 31.03.2021 of the group entities i.e., H Ltd. and S Ltd.

Solution : (Rs. in lakh)

This problem should be considered as a continuation of Illustration no.5.

1. Goodwill = Goodwill on the DOA – Impairment during the year
   = Rs.1,365 – Rs.147 = Rs.1,218

2. Calculation of post-acquisition profit :

Particulars	Amount (Rs. in lakh)
Profit during the year reported by S Ltd.	825
Less: Fair value changes in respect of current items now reverted	
Inventory (900-750)	(150)
Less: Fair value adjustment	
Depreciation on fair value gain on PPE [(4,950 -4,500)/20]	(22.5)
	652.5

3. NCI = Acquisition date NCI + share of post-acquisition profit
   = 2,115 + 30% of 652.5 = 2,310.75

4. Consolidated 'Other Equity'

Particulars	Amount (Rs. in lakh)
Other equity of H Ltd.	16,500.00
Add. Share of post-acquisition profit (70% of 652.5)	456.75
	16956.75
Less. Impairment of goodwill	(147)
	16809.75

Note : Since, NCI was measured at proportionate fair value of identified net assets, goodwill represents partial goodwill i.e., parent's portion only. Hence, impairment adjustment for goodwill should be done against parent only and not against the NCI. When NCI is measured at fair value, goodwill represents full value

of goodwill. Then the impairment of goodwill will be adjusted proportionately against parent as well as NCI.

5. Balance of PPE

PPE (Reporting date) = Combined book value of H and S + fair value gain on acquisition – Adjustment on fair value gain = 9,750 + 4,125 +450 – 22.5 = Rs.14302.5 lakh

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 31.03.2022

Particulars	Amount (Rs. in lakh)
Assets	
Non-current Assets	
PPE	14,302.50
Goodwill	1,218.00
Current Assets	
Inventories (1,200 + 825)	2,025.00
Trade receivables (570 +450)	1,020.00
Cash and Cash Equivalent (6,705 + 2,130)	8,835.00
Total	**27,400.50**
Equity and Liabilities	
Equity	
Share Capital (Rs. 10)	7,500.00
Other Equity	16,809.75
NCI	2,310.75
Non-current Liabilities	—
Current Liabilities	
Trade Payables (525 + 255)	780
Total	**27400.50**

Note: Students may note that if Other Equity may be further classified into Reserves and Retained Earnings (i.e., Profit and Loss balance), then post-acquisition reserves and post-acquisition retained earnings may be separately determined. However, respective share of both of them will be subsequently added to Consolidated Other Equity (may be separately into Reserve and Retained Earnings head).

- **Adjustments for Inter-company Transactions**

➢ **Inter-company/Mutual debt, Cash-in-transit, Goods-in-transit**

In the consolidated balance sheet, any inter-company (i.e., mutual debt) should be eliminated in full. In other words, in the CBS, the mutual amount is to be deducted

from both trade receivables and trade payables. In case the inter-co trade receivable is found to be higher than inter-co trade payables, the difference may be treated as cash-in-transit and goods-in transit and should be adjusted accordingly. While cash-in-transit is to be deducted from inter-company trade receivable, goods-in-transit is to be added to inter-company trade payables. Again cash-in-transit should be included in Cash and Cash Equivalent while goods-in-transit will be included in Inventories. Finally, the mutual indebtedness (now being equal) will be deducted from both trade receivables and trade payables in the CBS.

➢ **Unrealized Profit on Inventory**

When a parent sold goods to a subsidiary or vice-versa at a price higher than its cost and a portion of such goods still remains unsold on the date of preparation of CBS, the question of adjustment of unrealized profit on inventory arises. The transaction can be of two types – downstream transaction (parent selling goods to subsidiary) and upstream transaction (subsidiary selling goods to parent). On consolidation, this unrealized profit must be eliminated in full. Accordingly, in the CBS inventories must be reduced by the amount of unrealized profit so calculated.

In case of a downstream transaction (where the entire profit is included in parent's retained earnings), the full unrealized profit will be deducted from Other Equity of the parent.

However, in case of an upstream transaction (where the entire profit is included in subsidiary's retained earnings and hence is to be proportionately shared by parent and NCI), the proportionate unrealized profit should be deducted from the Consolidated Retained Earnings in Other Equity and NCI.

Illustration 8 : Preparation of CBS on subsequent reporting date; NCI at fair value calculated on per share value basis

On 31.03.2022, the balance sheets of H Ltd. and S Ltd. were as follows:

Particulars	H Ltd.	S Ltd.
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Non-current Assets		
PPE	9,200	4,600
Investment in S Ltd.	5,000	—

Current Assets		
Inventories	5,000	800
Trade receivables (including Rs.80 due from S Ltd.)	1,000	350
Cash and Cash Equivalent	5,800	2,000
Total	26,000	7,750
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)	8,000	3,000
Other Equity	17,500	4,500
Non-current Liabilities	—	—
Current Liabilities		
Trade Payables (including Rs. 60 due to H Ltd.)	500	250
Total	**26,000**	**7,750**

PPE – Property, Plant and Equipment

On 01.04.2021, S Ltd. had an issued and subscribed capital of 300 lakh shares of Rs.10 each fully paid and a balance of Rs.3000 lakh in its Other Equity. On that date H Ltd. acquired 80% shares of S Ltd. by issuing equity shares at fair value of Rs. 5,000 lakh, paid up value Rs. 2,000 lakh. The aggregate identifiable net assets of S Ltd. as on 01.04.2021 included PPE and inventory standing in the books of S Ltd. at Rs. 3,500 lakh and Rs. 500 lakh having fair value of Rs.3,800 lakh and Rs.200 lakh respectively. The rate of depreciation on PPE is 10% p.a. NCI was valued at fair value calculated at per share value basis (i.e., taking purchase consideration as base). H Ltd. sold goods worth Rs.100 lakh to S Ltd. on credit at a profit of 20% on sales. 50% of the goods were still laying unsold. Ignore tax.

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2022.

Solution : (Rs. in lakh)

1. Calculation of NCI and Goodwill on the DOA:

Fair value of identifiable net assets on the DOA = Share capital + Other equity +/– Change in fair value = 3,000 + 3,000 +(3,800-3,500) – (500-200) = Rs.6,000

Purchase Consideration = Rs.5,000

NCI (measured at fair value) = Rs.5,000 x $\frac{20\%}{80\%}$ = Rs.1,250

Goodwill = Purchase Consideration + NCI – Fair value of Identifiable Net assets

= 5,000 + 1,250 – 6,000 = Rs.250

2. Goodwill on 31.03.2020 = Rs. 250 (Since there is no impairment)

3. Calculation of post-acquisition profit:

Particulars	Amount (Rs. in lakh)
Profit during the year (cl. balance – op. balance i.e., 4,500 – 3,000)	1,500
Add : Fair value loss in respect of inventory now reverted*	300
	1,800
Less : Fair value adjustment	
Depreciation on fair value gain on PPE (3,800-3,500) x 10%	30
	1,770

*It is assumed that the corresponding inventory is realized during the year.

4. Unrealized profit on inventory = 50% of Rs.100 x 20% = Rs.10 (downstream transaction)
5. NCI on the reporting date
   = Acquisition date NCI + share of post-acquisition profit
   = 1,250 + 20% of 1,770 = Rs.1,604
6. Consolidated 'Other Equity'

Particulars	Amount (Rs. in lakh)
Other equity of H Ltd.	17,500
Add.: Share of post-acquisition profit (80% of 1,770)	1,416
	18,916
Less : Unrealized profit on inventory	10
	18,906

7. Balance of PPE for CBS

PPE (Reporting date) = Combined book value of H and S + fair value gain on acquisition – Adjustment on fair value gain = 13,800 + 300 – 30 = Rs.14,070

8. Balance of Inventories for CBS

Inventories (Reporting date) = Combined book value of H and S – unrealized profit = 5,800 – 10 = Rs. 5,790

9. We assume that the difference between inter-company trade receivables and payables i.e., (80 – 60) = Rs.20 represent cash in transit. So, it is added to Cash and Cash Equivalent and deducted from Trade receivable and finally the mutual debt is deducted.

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd.
as on 31.03.2022

Particulars	Note	Amount (Rs. in lakh)
Other		
Assets		
Non-current Assets		
PPE	8	14,070
Goodwill	1	250
Current Assets		
Inventories	9	5,790
Trade receivables (1,000+350 – 20 - 60)		1,270
Cash and Cash Equivalent (5,800+2,000 +20)		7,820
Total		29,200
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)		8,000
Other Equity	6	18,906
NCI	5	1,604
Non-current Liabilities		
Current Liabilities		
Trade Payables (500+250-60)		690
Total		29,200

➢ **Unrealized profit on sale of assets**

Treatment for any unrealized profit on inter-company sale of fixed assets will be similar to that of sale of goods.

In addition, as the buyer has charged depreciation on the value at which it acquired the asset from the seller, there arises a question of depreciation being overcharged for consolidation purpose. The depreciation so overcharged must be calculated and deducted from the corresponding asset. The same must be added in full to the Consolidated Retained Earnings in Other Equity in case of a downstream transaction and proportionately to the Consolidated Retained Earnings in Other Equity and NCI in case of an upstream transaction.

Illustration 9 : Preparation of CBS on subsequent reporting date; NCI at fair value; unrealized profit on inter-company sale of non-current assets.

On 31.03.2022, the balance sheets of H Ltd. and S Ltd. were as follows:

Particulars	H Ltd.	S Ltd.
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Non-current Assets		
PPE	18,400	9,200
Investment in S Ltd.	10,000	—
Current Assets		
Inventories	10,000	1,600
Trade receivables	2,000	700
Cash and Cash Equivalent	11,600	4,000
Total	**52,000**	**15,500**
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)	16,000	6,000
Other Equity	35,000	9,000
Non-current Liabilities	—	—
Current Liabilities		
Trade Payables	1000	500
Total	**52,000**	**15,500**

On 01.04.2021, S Ltd. had an issued and subscribed capital of 600 lakh shares of Rs. 10 each fully paid and a balance of Rs. 6000 lakh in its Other Equity. On that date H Ltd. acquired 80% shares of S Ltd. in cash at a premium of Rs. 400 lakh over market price per share of Rs. 20 each. i.e., at a fair value of Rs. 10,000 lakh. The aggregate identifiable net assets of S Ltd. as on 01.04.2019 included items of PPE and inventory whose fair value was lower than the book value by Rs. 300 lakh and Rs. 50 lakh respectively. NCI was valued at fair value calculated at the market price per share. S Ltd. sold an item of PPE worth Rs. 200 lakh to H Ltd. at a profit of $33\frac{1}{3}\%$ on cost. The rate of depreciation on PPE is 10%. Goodwill has been impaired by Rs. 100 lakh.

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2022.

Solution : (Rs. in lakh)

1. Calculation of NCI and Goodwill on the DOA:

Fair value of identifiable net assets on the DOA = Share capital + Other equity +/– Change in fair value = 6,000 + 6,000 – 300 – 50 = Rs.11,650

Purchase Consideration = 600 × 80% × 20 +400 = Rs.10,000

NCI (measured at market price) = 600 × 20% × 20 = Rs.2,400

Goodwill = Purchase Consideration + NCI – Fair value of Identifiable Net assets = 10,000 + 2,400 – 11,650 = Rs.750

Share of H Ltd. = (10,000 – 80% of 11,650) = Rs.680

Share of NCI = 2,400 – 20% of 11,650 = 70

2. Goodwill on 31.03.2020 = Rs.750 – Rs.100 (impairment loss) = Rs.650

3. Calculation of post-acquisition profit:

Particulars	**Amount** (Rs. in lakh)
Profit during the year (cl. balance – op. balance i.e., 9,000 – 6,000)	3,000
Add : Fair value loss in respect of inventory now reverted*	50
Add : Fair value adjustment	30
Depreciation on fair value loss on PPE (300 x 10%)	3,080

*It is assumed that the corresponding inventory is realized during the year.

4. Unrealized profit on sale of PPE = 200 × 25% = Rs.50 ($33\frac{1}{3}\%$ on cost i.e., 25% on sales)

Depreciation on the above = 50 × 10% = Rs. 5

5. NCI on the reporting date

= Acquisition date NCI + share of post-acquisition profit – share of unrealized profit -share of impairment of goodwill

= 2,400 + 20% of 3,080 – 20% of 50 – (100 × 70/750) = Rs. 2996.67

6. Consolidated 'Other Equity'

Particulars	**Amount** (Rs. in lakh)
Other equity of H Ltd.	35,000
Add. : Share of post-acquisition profit (80% of 3,080)	2,464
	37,464
Less.: Unrealized profit on inventory (80% of 50)	40
Add. : Depreciation overcharged on unrealized profit	5
Less.: Share of impairment loss on goodwill (100 x 680/750)	90.67
	37,338.33

7. Balance of PPE for CBS

PPE (Reporting date) = Combined book value of H and S – fair value loss on acquisition + Adjustment on fair value loss – unrealized profit + depreciation on unrealized profit

= 27,600 – 300 + 30 – 50 + 5 = Rs.27,285

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as on 31.03.2022

Particulars	H Ltd.
	Carrying Amount (Rs. in lakh)
Assets	
Non-current Assets	
PPE	27,285.00
Goodwill	650.50
Current Assets	
Inventories	11,600.00
Trade receivables	2,700.00
Cash and Cash Equivalent	15,600.00
Total	57,835.00
Equity and Liabilities	
Equity	
Share Capital (Rs. 10)	16,000.00
Other Equity	37,338.33
NCI	2,996.67
Non-current Liabilities	—
Current Liabilities	
Trade Payables	1,500.00
Total	57,835.00

➢ **Adjustment for Dividend from Subsidiary Company**

According to Ind AS 109, dividends are recognized in profit or loss by an investor entity when:

- The entity's right to receive dividend is established,
- It is probable that the economic benefits associated with dividend will flow to the entity, and

- the amount of dividend can be reliably measured.

Again, as per Ind AS 27, an entity shall recognize a dividend from a subsidiary in its separate financial statements when its right to receive the dividend is established.

Based on the above provisions, the following treatments regarding dividend from subsidiary company can be suggested:

a. Proposed Dividend : Since the same is not approved, it won't have any adjustment in the separate or consolidated balance accounts of the subsidiary and parent. The subsidiary will only mention it in the foot note of its balance sheet as a contingent liability. Thus, in the CBS, the net liability towards the NCI should be reported in the footnote.

b. Dividend Payable : In some cases, subsidiary company may be found to have declared dividend and adjusted the same in its accounts, though not yet made the payment. In such a case, in the standalone balance sheet of the subsidiary company Other Equity will be shown net of dividend and a Dividend Payable account will appear in the Current Liability section. So, no further adjustment will be required in the standalone balance sheet of subsidiary company. However, in the standalone balance sheet of the holding company the following adjustment must be performed:

(i) If the dividend is declared out of pre-acquisition profit: Holding company will make the following entry –

Dividend Receivable A/c…………..Dr

To Investment in Subsidiary Company A/c

Thus, if the holding company has wrongly included the above profit in its Profit and Loss A/c, the following rectification entry should be passed –

Profit and Loss A/c…………..Dr

To Investment in Subsidiary Company A/c

Accordingly, the amount (i.e., holding company's share of dividend) will be deducted from Other Equity and also from Investment in the standalone balance sheet of the holding company.

(ii) If the dividend is declared out of post-acquisition profit: Holding company will make the following entry –

Dividend Receivable A/c…………..Dr

To Profit and Loss A/c

(iii) If the dividend is declared partly out of pre-acquisition profit and partly out of post-acquisition profit: Holding company will make the following entry–

Dividend Receivable A/c…………..Dr

To Investment in Subsidiary Company A/c

(portion from pre-acquisition profit)

To Profit and Loss A/c (portion out of post-acquisition profit)

Now, the adjustment in the CBS will be as follows:

In situation (i), no adjustment will be required for Goodwill and NCI as the same is calculated considering the pre-acquisition profit on DOA. The Dividend Receivable by holding company will be set off against the Dividend Payable by subsidiary in the CBS. Thus, in the CBS, only NCI's portion of dividend receivable will appear in the Current Liability section.

In situation (ii), once the adjustment is done in the standalone balance sheet of the holding company, the post-acquisition profit should be calculated ignoring such dividend and should be shared accordingly. The Dividend Receivable by holding company will be set off against the Dividend Payable by subsidiary in the CBS.

In situation (iii), if dividend is declared from both pre and post-acquisition profits, then for respective parts the adjustments will be done as stated above. Finally, Dividend Receivable by holding company will be set off against the Dividend Payable by subsidiary in the CBS.

c. Dividend Paid: For dividend paid no adjustment will be required as the accounts have already been settled and nothing is outstanding. However, for dividend out of pre-acquisition profit received by holding company the rectification needs to be done if the share of dividend has been credited by the holding company to its Profit and Loss A/c.

➢ **Inter-company Bills, Contingent Liability for Bills Discounted:**

Inter-company bills not yet discounted will be deducted from both assets (from Bills Receivable) and liability (Bills Payable).

Contingent liability for bills discounted, if any, appears in the footnote of the standalone balance sheet of the holding and/or subsidiary (as applicable). In the footnote of CBS, the same should be shown net of inter-co bills discounted.

Illustration 10 : Adjustment for pre-acquisition dividend, contingent liability

The balance sheets of H Ltd. and S Ltd. as on 31.03.2021 were as follows:

Particulars	H Ltd.	S Ltd.
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Non-current Assets		
PPE	7,400	3,000
Investment in S Ltd.	2,900	—
Current Assets		
Inventories	1,300	1,000
Trade Receivables – Sundry debtors	2,000	700
Bills Receivable (including inter-co bills Rs.10)	—	300
Total	13,600	5,000
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)	5,000	2,000
Other Equity	8,000	2,500
Non-current Liabilities	—	—
Current Liabilities		
Trade Payables – Sundry creditors	400	300
Bills Payable (including inter-co bills Rs.15)	200	—
Dividend Payable		200
Total	13,600	5,000

Note : Contingent liability for bills discounted = Rs.20 lakh

On 01.04.2020, S Ltd. had Rs.1,500 in its Other Equity. H Ltd. acquired 80% share of S Ltd. on 01.04.2020 at a consideration of Rs.2,900 payable in cash. The fair values of identifiable assets and liabilities were not different from the book values on the date of acquisition. NCI was to be measured at proportionate fair value of net identifiable assets. Assume that dividends were declared out of pre-acquisition profit.

Prepare the Consolidated Balance Sheet of the group and the Separate Balance Sheet of H Ltd. on 31.03.2021.

Solution : (Rs. in lakh)

While solving the sum, the students must know that calculation of NCI and

Goodwill on the date of acquisition should be done ignoring the dividend declared out of pre-acquisition profit.

1. Calculation of Goodwill

   Fair value of identifiable net assets (represented by equity) = 2,000+1,500 = Rs.3,500

   NCI = 20% of Rs.3,500 = Rs.700

   Goodwill = Purchase Consideration + NCI – Fair value of identifiable net assets = 2,900 + 700 – 3,500 = Rs.100
2. Goodwill on the reporting date = Rs.100
3. Post-acquisition profit = cl. balance – adj. op. balance = 2,500 – (1,500-200) = Rs.1,200
3. NCI on the reporting date = NCI on DOA + share of post-acquisition profit – share of pre-acquisition dividend included in NCI on DOA = 700 + 20% of 1200 – 20% of 200 = Rs.900
4. Investment to be shown in the separate balance sheet of H Ltd. = 2,900 – 80% of 200 = Rs.2,740.
5. Consolidated Other Equity = H Ltd.'s balance + Share of post-acquisition profit = 8,000 + 80% of 1,200 = Rs.8,960

Balance Sheet as on 31.03.2021

Particulars	H Ltd. (Separate B/S)	H Ltd. (Consolidated B/S)	
	Carrying Amount (Rs.in lakh)	(Rs.in lakh)	
Assets			
Non-current Assets			
PPE	7,400	7,400+3,000	10,400
Goodwill	—	See note 2	100
Investment in S Ltd.	**2,740**	Set off	—
Current Assets			
Inventories	1,300	1,300+1,000	2,300
Trade Receivables – Sundry debtors	2,000	2,000+700	2,700
Bills Receivable (including inter-co bills Rs.10)	—	300-10	290
Dividend receivable	160	Set off	—
Total	13,600		15,790
Equity and Liabilities			
Equity			5,000
Share Capital (Rs. 10)	5,000	—	8,960

Other Equity	8,000	See note 5	900
NCI	—	See note 3	—
Non-current Liabilities	—	—	
Current Liabilities			700
Trade Payables – Sundry creditors	400	300	190
Bills Payable (including inter-co bills Rs.15)	200	200-10	40
Dividend Payable	—	200-160	15,790
Total	13,600		

Note : Contingent liability for bills discounted = Rs.20 – Rs.5 = Rs.15 lakh

Illustration 11 : Dividend out of post-acquisition profit, contingent liability

Refer to Illustration 10. Assume that the dividend has been paid out of post-acquisition profit.

Identify the changes to the answer in Illustration 10.

Solution : (Rs. in lakh)

1. Goodwill on the DOA = Rs.100
2. Goodwill on the reporting date = Rs.100
3. NCI on the DOA = Rs.700
4. Post-acquisition profit = 2,500 -1,500 = Rs.1,000
5. NCI on the reporting date = 700 + 20% of 1000 = Rs.900
6. Balance of other equity of H Ltd. in the standalone balance sheet = 8,000 + 80% of 200 (dividend) = Rs.8,160 (Accordingly, Dividend Receivable will appear in the Asset of H Ltd.)
7. Consolidated Other equity = 8,160 + 80% of 1,000 = Rs.8,960

Balance Sheet as on 31.03.2021

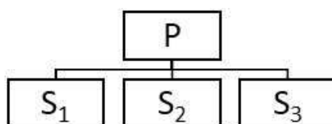
Particulars	H Ltd. (Separate B/S)	H Ltd. (Consolidated B/S)	
	Carrying Amount (Rs.in lakh)	(Rs.in lakh)	
Assets			
Non-current Assets			
PPE	7,400	7,400+3,000	10,400
Goodwill	—	See note 2	100
Investment in S Ltd.	**2,900**	Set off	—

Current Assets			
Inventories	1,300	1,300+1,000	2,300
Trade Receivables – Sundry debtors	2,000	2,00+700	2,700
Bills Receivable (including inter-co bills Rs.10)	—	300-10	290
Dividend receivable	160	Set off	—-
Total	13,600		15,790
Equity and Liabilities			
Equity			5,000
Share Capital (Rs. 10)	5,000	—	8,960
Other Equity	***8,160***	See note 5	900
NCI	—	See note 3	—
Non-current Liabilities	—	—	
Current Liabilities			700
Trade Payables – Sundry creditors	400	300	190
Bills Payable (including inter-co bills Rs.15)	200	200-10	40
Dividend Payable	—	200-160	15,790
Total	13,600		

Note: Contingent liability for bills discounted = Rs.20 – Rs.5 = Rs.15 lakh

● Consolidation of Multiple Independent Subsidiaries

A parent may have multiple independent subsidiaries by acquiring control over each of them separately. The structure looks like as follows:

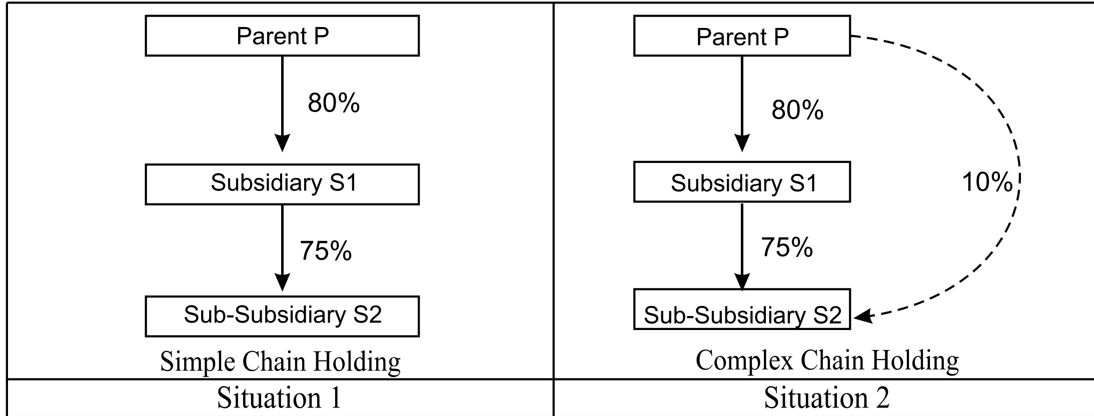


In such a situation, calculation for Goodwill on the DOA, NCI on the DOA, post-acquisition profit, Goodwill on the reporting date (after impairment) and NCI on the reporting date should be done separately. However, Consolidated Other equity must include parent's share of post-acquisition profit from all the subsidiary companies.

● Chain Holding

However, parent-subsidiary relationship may be of such type where a parent controls a subsidiary which may control another subsidiary (say, ultimate subsidiary) and thus, the parent eventually gains control over the ultimate subsidiary. This structure is known as Chain Holding.

It can again be of the following two forms :



Simple Chain Holding	Complex Chain Holding
Situation 1	Situation 2

Though all the steps in preparation of CBS remains the same in case of chain holding also, two important points should be kept in mind here. These are – determination of interest of Group and NCI and calculation of NCI on the reporting date.

1. Determination of interest of the Group and NCI:

Situation 1: In the ultimate subsidiary interest will be of Group and NCI (combined) only.

		S_1	S_2
Interest in S_1			
Group (i.e., P)		80%	
NCI		20%	
Effective Interest in S_2			
Group (i.e., P) = 80% of 75%			60%
NCI – Indirect = 20% of 75%	15%		
- Direct	25%		40%

Situation 2: In the ultimate subsidiary interest will be of Group and NCI (combined) only.

		S_1	S_2
Interest in S_1			
Group (i.e., P)		80%	
NCI		20%	
Effective Interest in S_2			
Group (i.e., P) – Direct	10%		
- Indirect = 80% of 75%	60%		70%
NCI – Indirect = 20% of 75%	15%		
- Direct (100 – 10-60-15)	15%		30%

2. Calculation of NCI on the reporting date:

After the usual process of determination of NCI on the reporting date, NCI's share in the investment in S_2 (20% in both the examples above) has to be deducted. Also, Goodwill calculation will consider only parent's portion of cost of investment (here 80%).

Note : all other adjustments will be carried out in the usual manner.

Consider the following illustration.

Illustration 12 : Preparation of CBS under Chain Holding Structure

On 31.03.2020, the balance sheets of H Ltd. A Ltd. and B Ltd. were as follows:

Particulars	Carrying Amount (Rs.in lakh)		
	H Ltd.	A Ltd.	B Ltd.
Assets			
Non-current Assets			
PPE	9,200	4,600	800
Investment of 80% shares in A Ltd.	5,000	—	—
Investment of 75% shares in B Ltd.	—	1,200	—
Current Assets			
Inventories	5,000	800	500
Trade receivables	1,000	350	200
Cash and Cash Equivalent	5,800	800	200
Total	26,000	7,750	1,700
Equity and Liabilities			
Equity			
Share Capital (Rs. 10)	8,000	3,000	1,000
Other Equity	17,500	4,500	600
Non-current Liabilities	—	—	—
Current Liabilities			
Trade Payables	500	250	100
Total	26,000	7,750	1,700

Additional information :

a) H Ltd. acquired 80% shares in A Ltd. and A Ltd. acquired 75% shares in B Ltd. All the shares were acquired on 30.09.2019. Profits have been earned evenly during the year.

b) On 01.04.2019, the balance in Other Equity were Rs.3,000 lakh and Rs.500 respectively.

c) The aggregate identifiable net assets of S Ltd. as on 01.04.2019 included

PPE and inventory standing in the books of S Ltd. at Rs.3,500 lakh and Rs.500 lakh having fair value of Rs.3,800 lakh and Rs.200 lakh respectively. The rate of depreciation on PPE is 10% p.a.

d) H Ltd. sold goods worth Rs.100 lakh to S Ltd. on credit at a profit of 20% on sales. 50% of the goods were still laying unsold. Ignore tax.

e) NCI was valued at fair value calculated at per share value basis (i.e., taking purchase consideration as base).

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2020.

Solution : (Rs. in lakh)

1. Determination of interest of the Group and NCI

		A	B
Interest in S_1			
Group (i.e., H)		80%	
NCI		20%	
Effective Interest in S_2			
Group (i.e., H) = 80% of 75%			60%
NCI – Indirect = 20% of 75%	15%		
- Direct	25%		40%

2. Analysis of Other Equity

	A Ltd.		B Ltd.	
Other Equity on 01.04.2019		3,000		500
Increase during 2019-20 (cl. bal. – op. bal.)	1,500		100	
Increase up to 30.09.2019 (i.e., for 6 months)		750		50
Other Equity on 30.09.2019		3,750		550
Post-acquisition profit		750		50
Add: Fair value loss on current item reverted (500-200)		300		
Less: Adjustment for fair value gain on NCA (3800-3500) × 10%		30		
		1,020		

3. Fair value of identifiable net assets

	A Ltd.	B Ltd.
Share capital	3,000	1,000
Add. Other Equity on 30.09.19	3,750	550
Add. fair value gain on PPE (3800-3500)	300	
Less. fair value loss on inventory (500-200)	300	
	6,750	1,550

4. Goodwill on the DOA

	A Ltd.	B Ltd.
Purchase Consideration	5,000	(80% of 1,200) 960
Add. NCI at fair value		
(5000 × 20%/80%)	1,250	
(1200 × 40%/75%)		640
Less. Fair value of identifiable net assets	6,750	1,550
Gain on bargain purchase	500	
Goodwill		50

Capital reserve = 500 – 50 = Rs. 450

5. NCI on the reporting date:

	A Ltd.	B Ltd.
NCI at fair value on DOA	1,250	640
Add. NCI's share of Post-acquisition profit	(20% of 1020)204	(40% of 50)20
Less. NCI's share in investment of B Ltd.	(20% of 1,200)240	—
	1,214	660

6. Consolidated Other Equity

	A Ltd.
Average	
Balance of H Ltd.	17,500
Add. Share of Post-acquisition profit from A Ltd. (80%)	816
Add. Share of Post-acquisition profit from B Ltd. (60%)	30
Less. Unrealized profit on inventory (100 x 50% x 20%)	10
	18,336

Consolidated Balance Sheet of H Ltd. and its Subsidiaries as on 31.03.2020

Particulars	Amount (Rs.)
Assets	
Non-current Assets	
PPE (14,600 +300-30)	14,870
Current Assets	
Inventories (6,300 – 10)	6,290
Trade receivables	1,550
Cash and Cash Equivalent	6,800
Total	29,510
Equity and Liabilities	
Equity	
Share Capital (Rs. 10)	8,000
Other Equity – Capital Reserve	450
- others	18,336
NCI (1,214+660)	1,874
Non-current Liabilities	—
Current Liabilities	
Trade Payables	850
Total	29,510

Illustration 13 : Preparation of CBS, Complex Chain

On 31.03.2020, the balance sheets of H Ltd. A Ltd. and B Ltd. were as follows:

Particulars	Carrying Amount (Rs.in lakh)		
	H Ltd.	A Ltd.	B Ltd.
Assets			
Non-current Assets			
PPE	9,200	4,600	800
Investment of 80% shares in A Ltd.	5,000	—	—
Investment of 75% shares in B Ltd.	—	1,200	—
Investment of 10% shares in B Ltd.	160	—	—
Current Assets			
Inventories	5,000	800	500
Trade receivables	1,000	350	200
Cash and Cash Equivalent	5,640	800	200
Total	26,000	7,750	1,700

Equity and Liabilities			
Equity			
Share Capital (Rs. 10)	8,000	3,000	1,000
Other Equity	17,500	4,500	600
Non-current Liabilities	—	—	—
Current Liabilities			
Trade Payables	500	250	100
Total	26,000	7,750	1,700

Additional information:

a) H Ltd. acquired 80% shares in A Ltd. and A Ltd. acquired 75% shares in B Ltd. All the shares were acquired on 30.09.2019. Profits have been earned evenly during the year.

b) On 01.04.2019, the balance in Other Equity were Rs.3,000 lakh and Rs.500 respectively.

c) NCI was valued at fair value calculated at per share value basis (i.e., taking purchase consideration as base).

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2020.

Solution : (Rs. in lakh)

1. Determination of interest of the Group and NCI

		S_1	S_2
Interest in S_1			
Group (i.e., P)		80%	
NCI		20%	
Effective Interest in S_2			
Group (i.e., P) – Direct	10%		
- Indirect = 80% of 75%	60%		70%
NCI – Indirect = 20% of 75%	15%		
- Direct (100 – 10-60-15)	15%		30%

2. Analysis of Other Equity

	A Ltd.		B Ltd.	
Other Equity on 01.04.2019		3,000		500
Increase during 2019-20 (cl. bal. – op. bal.)	1,500		100	
Increase up to 30.09.2019 (i.e., for 6 months)		750		50
Other Equity on 30.09.2019		3,750		550
Post-acquisition profit		750		50

3. Fair value of identifiable net assets

	A Ltd.	B Ltd.
Share capital Add. Other Equity on 30.09.19	3,000 3,750	1,000 550
	6,750	1,550

4. Goodwill on the DOA

	A Ltd.	B Ltd.
Purchase Consideration	5,000	1,120
Add. NCI at fair value		(80% of 1,200+160)
(5000 × 20%/80%)	1,250	
(1200 × 30%/75%)		480
Less. Fair value of identifiable net assets	6,750	1,550
Gain on bargain purchase	500	
Goodwill		50

5. NCI on the reporting date:

	A Ltd.	B Ltd.
NCI at fair value on DOA	1,250	480
Add. NCI's share of Post-acquisition profit	(20% of 750)150	(30% of 50)15
Less. NCI's share in investment of B Ltd.	(20% of 1,200)240	—
	1,160	495

6. Consolidated Other Equity

	A Ltd.
Balance of H Ltd.	17,500
Add. Share of Post-acquisition profit from A Ltd. (80% of 750)	600
Add. Share of Post-acquisition profit from B Ltd. (70% of 50)	35
	18,135

Consolidated Balance Sheet of H Ltd. and its Subsidiaries as on 31.03.2020

Particulars	Amount (Rs.)
Assets	
Non-current Assets	
PPE	14,600
Current Assets	
Inventories	6,300
Trade receivables	1,550
Cash and Cash Equivalent	6,640
Total	29,090
Equity and Liabilities	
Equity	
Share Capital (Rs. 10)	8,000
Other Equity – Capital Reserve	450
- others	18,135
NCI (1,160+495)	1,655
Non-current Liabilities	—
Current Liabilities	
Trade Payables	850
Total	29,090

● Consolidated Income Statement

In addition to CBS, in a holding-subsidiary arrangement, the group also needs to report consolidated total comprehensive income i.e., Consolidated Statement of Profit and Loss and Other Comprehensive Income. The process of preparing the same is as follows:

1. Consolidate (i.e., merge) all the items of revenue from operation and other income line by line and eliminate inter-company transactions from the total. Inter-company revenue items may include sales by subsidiary (or by parent) to the parent (or subsidiary), interest received, royalty received, dividend received etc.
2. Consolidate (i.e., merge) all the items of expenditure such as purchase, operating expenses, finance costs etc. line by line and eliminate inter-company transactions from the total. Inter-company transactions may include purchase by subsidiary (or by parent) from the parent (or subsidiary), interest paid, royalty paid etc.
3. Determine the consolidated profit before tax.
4. Deduct consolidated tax expenses to get consolidated profit after tax.
5. Show profit attributable to parent and NCI.

6. Incorporate items of other comprehensive income and calculate the consolidated other comprehensive income after eliminating any inter-company items.
7. Show other comprehensive income attributable to parent and NCI.

Note : Take special care to treat inter-company dividend (out of pre-acquisition and post-acquisition profit). This will however reflect in the Statement of Changes in Equity only.

Consider the following Illustration.

Illustration 14 : Preparation of Consolidation Statement of Comprehensive Income

Following are the Statements of Comprehensive Income and Statement of Changes in Equity prepared by H Ltd. and S Ltd. for the year ended on 31.03.2020:

Statement of Comprehensive Income
For the year ended on 31.03.2020

Particulars	Note	H Ltd. (Rs.)	S Ltd. (Rs.)
I. Statement of Profit and Loss			
Sales	1	2,40,000	96,000
Other income	2	3,600	—
Total revenue		2,43,600	96,000
Expenses:			57,600
Raw materials consumed	3	1,32,000	-3,600
Change in finished stock inventories	4	-6,000	12,000
Employee benefit expenses		36,000	1,200
Finance costs	5	3,240	4,800
Depreciation and amortization		8,400	7,248
Other expenses	6	12,420	79248
Total expenses		1,86,060	16,752
Profit before tax		57,540	
Tax expenses:			4,800
Current tax		18,000	1,200
Deferred tax		2,400	6,000
		20,400	10,752
Profit after tax		37,140	
II. Statement of Other Comprehensive Income			
Fair value gain on investment in subsidiary	7	1,200	0
Fair value gain on other non-current investments		600	300

Statement of Changes in Equity
For the year ended on 31.03.2020 (Figures in Rs.)

H Ltd.	Share Capital	General Reserve	Profit & Loss	Fair Value Reserve	Total
Balance on 01.04.2019	24,000	1,20,000	24,000		1,68,000
Dividend paid			(9,600)		(9,600)
Dividend received from S Ltd.			2,016		2,016
Profit for the year			37,140		37,140
Fair value gain on investment in subsidiary				1,200	1,200
Fair value gain on other non-current investment				600	600
Transfer to reserve		24,000	(24,000)		
Balance on 31.03.2020	24,000	1,44,000	29,556	1,800	1,99,356
S Ltd.					
Balance on 01.04.2019	12,000	36,000	12,000		60,000
Dividend paid			(2,880)		(2,880)
Profit for the year			10,752		10,752
Fair value gain on other non-current investment				300	300
Transfer to reserve		6,000	6,000		
Balance on 31.03.2020	12,000	42,000	13,872	300	68,172

Notes:

Particulars	**H Ltd.**	**S Ltd.**
1. Sales		
Sales to S Ltd.	24,000	0
Outside sales	2,16,000	96,000
	2,40,000	96,000
2. Other Income		
Interest from Q Ltd.	1,200	
Royalty form Q Ltd.	2,400	
	3,600	
3. Raw materials Consumed		
Opening stock	12,000	6,000
Purchase from H Ltd.	0	24,000
Outside purchase	1,44,000	36,000
Closing stock	24,000	8,400
	1,80,000	57,600

4. Change in inventories of finished stock		
Opening stock Closing stock	12,000 18,000 6,000	6,000 9,600 3600
5. Finance cost		
Interest paid to outsiders Interest paid to H Ltd.	3,240 0 3,240	0 1,200 1,200
6. Other expenses		
Long term provisions Short term provisions Royalty to H Ltd. Others Acquisition expenses	120 60 0 12,000 240 12,420	36 12 2,400 4,800 0 7,248
7. Fair value of non-current investments		
Investment in subsidiaries Other investments	44,400 6,600 51,000	0 1500 1,500

The group has paid dividend for the year 2019-20 and transferred to reserve out of profit for the year as follows: (Figures in Rs.)

	H Ltd.	S Ltd.		
	Rs.	Share of H Rs.	Share of NCI Rs.	Total Rs.
Dividend paid	9,600	2,016	864	2,880
Transfer to reserve out of profit	24,000			

NCI was calculated at Rs.16,500. Prepare Consolidated Statements of Comprehensive Income and Statement of Changes in Equity for the year ended on 31.03.2020.

Solution :

Consolidated Statement of Comprehensive Income
For the year ended on 31.03.2020 (Figures in Rs.)

Particulars	H Ltd.	S Ltd.	Adjustment	Group
I. Consolidated Statement of Profit and Loss				
Sales	2,40,000	96,000	–24,000	3,12,000
Other income	3,600	—	–3,600	0
Total revenue	2,43,600	96,000		3,12,000
Expenses:				1,65,600
Raw materials consumed	1,32,000	57,600	-24,000	-9,600
Change in finished stock inventories	-6,000	-3,600		48,000
Employee benefit expenses	36,000	12,000		3,240
Finance costs	3,240	1,200	-1,200	13,200
Depreciation and amortization	8,400	4,800		17,268
Other expenses	12,420	7,248	-2,400	2,37,708
Total expenses	1,86,060	79248		74,292
Profit before tax	57,540	16,752		
Tax expenses:				22,800
Current tax	18,000	4,800		3,600
Deferred tax	2,400	1,200		26,400
	20,400	6,000		47,892
Profit after tax	37,140	10,752		
Profit attributable to:				
H Ltd.				44,666
NCI				3,226
II. Statement of Other Comprehensive Income				
Fair value gain on investment in subsidiary				
Fair value gain on other non-current investments	1,200	0	-1,200	0
	600	300		900
	1,800	300		900
Profit attributable to:				
H Ltd.				810
NCI				90

Statement of Changes in Equity

For the year ended on 31.03.2020 (Figures in Rs.)

H Ltd.	Share Capital Rs.	General Reserve Rs.	Profit & Loss Rs.	Fair Value Reserve Rs.	Total Rs.	NCI Rs.	Group Total Rs.
Balance on 01.04.2019	24,000	1,20,000	24,000		1,68,000	19,800	1,87,800
			(9,600)		(9,600)		(9,600)
Dividend paid							
Dividend received			2,016		2,016		2,016
from S Ltd.			44,666		44,666	3,226	47,892
Profit for the year							
Fair value gain on							
investment in subsidiary				810	810	90	900
Fair value gain on other							
non-current investment		24,000	(24,000)		0		0
Transfer to reserve			(2,016)		(2,016)	(864)	(2,880)
Dividend from S Ltd.							
Balance on 31.03.2020	24,000	1,44,000	35,066	810	2,03,876	22,252	2,26,128

5.6 Summary

Preparation of consolidated financial statements is a legal compulsion in India as per the Companies Act 2013 as well as Ind AS 110, except for a few specific situations. The format and the process of consolidation have also been defined in the regulations. Consolidated financial statements help to provide a complete overview of the performance of the group as a whole and thereby help investors in making informed judgement before taking the decisions.

5.7 Exercises

- **Theoretical Questions**

1. State the advantages of preparing consolidated financial statements.
2. State the provisions of the Companies Act, 2013 regarding consolidation of accounts.
3. State the provisions of Indian Accounting Standards regarding consolidation of accounts.

4. State the conditions to be satisfied by a parent in order to be exempted from preparing consolidated financial statements.
5. How will you evaluate 'control' by a parent in a subsidiary?

● **Practical Problems**

1. A Ltd. acquires 80% of B Ltd. by paying cash consideration of Rs.240 crore. The fair value of non-controlling interest on the date of acquisition is Rs.60 crore. The value of subsidiary's identifiable net assets as per Ind AS 103 is Rs. 260 crore. Determine the value of goodwill and pass the journal entry when (i) NCI is measured at fair value, and (ii) NCI is measured proportionate fair value of identifiable net assets.

   [Answer: (i) Goodwill Rs.40 crore (ii) Goodwill Rs.32 crore]

2. X Ltd. acquires 60% of Y Ltd. by paying cash consideration of Rs.1,500 lakh. The fair value of non-controlling interest on the date of acquisition is Rs.960 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is Rs. 2,000 lakh. Determine the value of goodwill and pass the journal entry when (i) NCI is measured at fair value, and (ii) NCI is measured proportionate fair value of identifiable net assets.

   [Answer: (i) Goodwill Rs.460 lakh, (ii) 300 lakh]

3. A Ltd. acquires 80% of B Ltd. by paying cash consideration of Rs.800 lakh. The fair value of non-controlling interest on the date of acquisition is Rs.200 lakh. The value of subsidiary's identifiable net assets as per Ind AS 103 is Rs. 1,040 lakh. Determine the gain on bargain purchase and pass the journal entry when (i) NCI is measured at fair value, and (ii) NCI is measured proportionate fair value of identifiable net assets.

   [Answer: Gain on bargain purchase (i) Rs.40 lakh (ii) 32 lakh.

4. On 31.03.2021, H Ltd. acquired 70% equity shares of S Ltd. at Rs.12,600 in cash and obtained control. The balance sheets of the companies along with the fair value of assets and liabilities of S Ltd. on the date of acquisition were as follows:

Particulars	H Ltd.	S Ltd.	
	Carrying Amount (Rs.in lakh)	Carrying Amount (Rs.in lakh)	Fair Value (Rs.in lakh)
Current Assets			
Inventories	2,100	1,500	1,800
Trade receivables	900	750	750
Cash and Cash Equivalent	9,900	2,100	2,100
Total	46,500	13,350	
Equity and Liabilities			
Equity			
Share Capital (Rs. 10)	15,000	6,000	
Other Equity	30,600	6,900	
Non-current Liabilities	—	—	
Current Liabilities			
Trade Payables	900	450	450
Total	46,500	13,350	

Prepare the consolidated Balance Sheet as on 31.03.2021 of the group entities i.e., H Ltd. and S Ltd. Assume NCI is measured at proportionate fair value of net identifiable assets.

[Answer: NCI Rs.4,230 lakh, Goodwill Rs.2,730 lakh, CBS total Rs.51,180]

5. On 31.03.2022, the balance sheets of H Ltd. and S Ltd. were as follows:

Particulars	**H Ltd.**	**S Ltd.**
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Non-current Assets		
PPE	18,400	9,200
Investment in S Ltd.	10,000	—
Current Assets		
Inventories	10,000	1,600
Trade receivables (including Rs.160 due from S Ltd.)	2,000	700
Cash and Cash Equivalent	11,600	4,000
Total	**52,000**	**15,500**
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)	16,000	6,000
Other Equity	35,000	9,000
Non-current Liabilities	—	—
Current Liabilities		
Trade Payables (including Rs. 120 due to H Ltd.)	1,000	500
Total	**52,000**	**15,500**

On 01.04.2021, S Ltd. had an issued and subscribed capital of 600 lakh shares of Rs. 10 each fully paid and a balance of Rs. 6000 lakh in its Other Equity. On that date H Ltd. acquired 80% shares of S Ltd. by issuing equity shares at fair value of Rs. 6,000 lakh, paid up value Rs. 4,000 lakh. The aggregate identifiable net assets of S Ltd. as on 01.04.2019 included PPE and inventory standing in the books of S Ltd. at Rs. 7,000 lakh and Rs. 1,000 lakh having fair value of Rs. 7,600 lakh and Rs. 400 lakh respectively. The rate of depreciation on PPE is 10% p.a. NCI was valued at fair value calculated at per share value basis (i.e., taking purchase consideration as base). H Ltd. sold goods worth Rs. 200 lakh to S Ltd. on credit at a profit of 20% on sales. 50% of the goods were still laying unsold. Ignore tax.

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2022.

[Answer: NCI Rs. 3,208 lakh, Goodwill Rs. 500 lakh, CBS total Rs. 58,400]

6. The balance sheets of H Ltd. and S Ltd. as on 31.03.2021 were as follows:

Particulars	H Ltd.	S Ltd.
	Carrying Amount (Rs. in lakh)	Carrying Amount (Rs. in lakh)
Assets		
Non-current Assets		
PPE	14,800	6,000
Investment in S Ltd.	5,800	—
Current Assets		
Inventories	2,600	2,000
Trade Receivables – Sundry debtors	4,000	1,400
Bills Receivable (including inter-co bills Rs.20)	—	600
Total	27,200	10,000
Equity and Liabilities		
Equity		
Share Capital (Rs. 10)	10,000	4,000
Other Equity	16,000	5,000
Non-current Liabilities	—	—
Current Liabilities		
Trade Payables – Sundry creditors	800	600
Bills Payable (including inter-co bills Rs.30)	400	—
Dividend Payable	—	400
Total	27,200	10,000

Note: Contingent liability for bills discounted = Rs.40 lakh

On 01.04.2020, S Ltd. had Rs.3,000 in its Other Equity. H Ltd. acquired 80% share of S Ltd. on 01.04.2020 at a consideration of Rs.5,800 payable in cash. The fair values of identifiable assets and liabilities were not different from the book values on the date of acquisition. NCI was to be measured at proportionate fair value of net identifiable assets. Assume that dividends were declared out of pre-acquisition profit.

Prepare the Consolidated Balance Sheet of the group and the Separate Balance Sheet of H Ltd. on 31.03.2021.

[Answer: NCI Rs.900 lakh, Goodwill Rs.100 lakh, CBS total Rs.31,580]

7. On 31.03.2022, the balance sheets of H Ltd. A Ltd. and B Ltd. were as follows:

Particulars	Carrying Amount (Rs.in lakh)		
	H Ltd.	A Ltd.	B Ltd.
Assets / Non-current Assets			
PPE	18,400	9,200	1,600
Investment of 80% shares in A Ltd.	10,000	—	—
Investment of 75% shares in B Ltd.	—	2,400	—
Current Assets			
Inventories	10,000	1,600	1,000
Trade receivables	2,000	700	400
Cash and Cash Equivalent	11,600	1,600	400
Total	52,000	15,500	3,400
Equity and Liabilities			
Equity			
Share Capital (Rs. 10)	16,000	6,000	2,000
Other Equity	35,000	9,000	1,200
Non-current Liabilities	—	—	—
Current Liabilities			
Trade Payables	1,000	500	200
Total	52,000	15,500	3,400

a) H Ltd. acquired 80% shares in A Ltd. and A Ltd. acquired 75% shares in B Ltd. All the shares were acquired on 30.09.2021. Profits have been earned evenly during the year.

b) On 01.04.2021, the balance in Other Equity were Rs.6,000 lakh and Rs.1,000 respectively.

c) The aggregate identifiable net assets of S Ltd. as on 01.04.2021 included PPE and inventory standing in the books of S Ltd. at Rs.7,000 lakh and Rs.1,000 lakh having fair value of Rs.7,600 lakh and Rs.400 lakh respectively. The rate of depreciation on PPE is 10% p.a.

d) H Ltd. sold goods worth Rs. 200 lakh to S Ltd. on credit at a profit of 20% on sales. 50% of the goods were still laying unsold. Ignore tax.

e) NCI was valued at fair value calculated at per share value basis (i.e., taking purchase consideration as base).

Prepare Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as on 31.03.2022.

[Answer: NCI Rs.3,748 lakh, Gain from bargain purchase (net of goodwill) Rs. 900, CBS total Rs. 59,020]

Unit 6 ☐ Scheme for Corporate Restructuting

Structure

6.1 Objective

6.2 Introduction

6.3 Corporate Restructuring; Concept and Types

6.4 External Restructuring – Mergers and Acquisition

6.5 Ind AS 103: Business Combination

6.6 Scheme for Internal Reconstruction

6.6.1 Circumstances of Internal Reconstruction

6.6.2 Steps for Internal Reconstruction

6.7 Summary

6.8 Exercises

6.1 Objective

After going through this unit, you will be able to:

- Know the meaning of corporate restructuring, mergers and acquisitions and internal reconstruction
- Understand the types of scheme, its accounting aspects and formalities
- Have guidelines for preparation of different schemes
- Get in touch with the drafted schemes

6.2 Introduction

In today's business world mergers and acquisitions, also known as business combination is the most popular means of expansion within and beyond the geographical territories of a country. However, the success of a business combination largely depends on how well the scheme for such merger and acquisitions is designed. Since accountants have the clear idea about the possible impact of business combination on the future course of action of the amalgamating companies, they are the best one to design such schemes. Also, companies suffering from severe financial crisis and accumulated losses may try to revive them through the process of internal reconstruction. Since many stakeholders are to compromise their interest in such an

event, only a properly designed internal reconstruction scheme can get acceptance from all parties. This also requires active involvement on the part of the accountants in designing such a scheme.

The following sections of this chapter discuss in detail the process of designing the schemes. Also, the chapter discusses about the accounting treatment of merger and acquisition in the context of the newly introduced Ind AS 103, Business Combination.

6.3 Corporate Restructuring; Concept and Types

Corporate restructuring is a process to modify the capital structure or operations of a corporate organization significantly. Corporate restructuring can be driven by a need for change in the organizational structure or business model of a company, or it can be driven by the necessity to make financial adjustments to its assets and liabilities. Frequently, it involves both.

Companies may need to restructure either to expand itself in new products, new markets, to ensure uninterrupted supply of raw materials or to increase control over the distribution channels or to revive itself from extreme financial crisis. Accordingly, corporate restructuring can broadly be classified into two types – (a) External Restructuring (or Reconstruction), and (b) Internal Restructuring (or Reconstruction).

6.4 External Restructuring – Mergers and Acquisition

The term 'external corporate restructuring' essentially means modifying the capital structure or operations of a corporate organization significantly by the intervention of any *external party*. External restructuring can be further segregated into mergers and acquisitions.

Merger is a process in which two or more existing companies unifies into another existing company or a new company is formed to take over the business of two or more existing companies. As a result, the shareholders of the old companies become the shareholders of the new company.

Mergers can be either congeneric (i.e., taking place between firms belonging to the same industry) or conglomerate (i.e., taking place between firms belonging to different industries).

Again, congeneric merger can be either a horizontal integration (i.e., between two firms at the same level of operations, e.g., both are manufacturer of the same products in same or different markets) or vertical integration (i.e., between firms

located at different level of the value chain).

Vertical integration can again be subdivided into forward integration (i.e., a manufacturer combining with a distributer) or backward integration (a manufacturer combining with a supplier of raw materials).

On the other hand, an acquisition is a process where an existing company purchases another company and as a result the acquired companies goes into liquidation while the acquirer company continues the business of acquired company under its own name.

Both the above two types of corporate restructuring are currently governed by Indian Accounting Standard (Ind AS) 103. Practically, Ind AS 103 covers all forms of business combinations.

6.5 Ind AS 103: Business Combination

- **Definition of Business Combination:**

According to Ind AS 103, a business combination is a transaction or other event in which an acquirer obtains control of one or more businesses. Accordingly,

- A business combination is strictly different from merely an 'asset acquisition' where the acquirer acquires only one asset or a group of assets which can never amount to a business.
- For business combination, the control by one entity of another is sufficient and both the entity may continue to exist. In other words, business combination will certainly include all mergers and acquisition and also will include acquisition of less than 100% shares of the acquired company.
- In business combination, the acquired companies may cease to exist or may exist (even 100% subsidiary is possible).

- **Accounting for Business Combination**

A business combination is accounted for applying ***acquisition method***. Application of acquisition method has the following steps:

a) Identifying the acquirer
b) Determining the acquisition date
c) Recognizing and measuring the identifiable assets acquired and liabilities assumed and any non-controlling interest in the acquire.
d) Recognizing and measurement of goodwill or gain from bargain purchase
e) Disclosures

The steps are discussed below:

a) *Identifying the acquirer* : Most of the time, the acquirer is usually the investor who acquires an investment or a subsidiary. The acquiree is the business that the acquirer obtains control of in business combination. The following factors as described in Ind AS-103 shall be taken into consideration in deciding who is the acquirer:

- In a business combination effected primarily by transferring cash or other assets or by in-curring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests.
- The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.
- In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.
- A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Note : In case of a *reverse acquisition,* the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquire because its equity interests were acquired. However, the private entity will be the accounting acquirer and the public entity will be the accounting acquiree.

b) *Determine the acquisition date* : The acquisition date is the date on which the acquirer obtains control of the acquiree. It is generally the date on which the acquirer legally transfers the consideration (the payment for the investment), acquires the assets and assumes the liabilities of the acquiree -the closing date. However, it can be earlier or later than the closing date, too. It depends on the contractual arrange-ments in the written agreements, if something like that exists.

c) *Recognize and measure the identifiable assets acquired, the liabilities assumed and the non-controlling interest in the acquiree*: An acquirer or investor shall recognize all identifiable assets acquired, liabilities assumed and non-controlling interests in the acquiree separately from goodwill. The acquirer shall recognize even those assets and liabilities that have so far not been recognized by the acquiree. All assets and liabilities must be measured at acquisition-date fair value. In case the acquirer acquires less than 100% of shares in the acquiree, it shall also recognize non-controlling interest (NCI). Non-controlling interest may be measured using the (i) Fair value method; or (ii) Proportionate share method.

d) *Recognizing and Measurement Goodwill*: Goodwill is measured at the acquisition date as the excess of 1 over 2 below:

1. The aggregate of

★ The fair value of consideration transferred

★ The amount of any non-controlling interest recognized

★ In a business combination achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree

2. The assets and liabilities recognized in accordance with Ind AS-103.

Goodwill may arise in the acquiring group's consolidated financial statements when a new subsid-iary is acquired. Goodwill can also arise in the separate financial statements of an acquiring entity where it purchases the business and assets of another company.

If the goodwill is negative as explained above, then it is a gain on a bargain purchase. That negative goodwill (excess) is recognized as gain on bargain purchase directly in equity as capital reserve.

e) *Disclosures*: The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either:

- during the current reporting period; or
- after the end of the reporting period but before the financial statements are approved for issue.

Note : When Acquiree Company ceases to exist due to business combination the accounting will be reflected on the stand-alone balance sheet of the acquirer company. But when Acquiree Company exists (i.e., Non-Controlling Interest exists) after business combination, accounting for business combination will reflect on consolidated balance sheet. In such cases reference to both Ind AS 103 and Ind AS 110 (Consolidated Financial Statements) is made for consolidation.

- **Illustrations on Accounting for Business Combination**

Situation 1 : Acquiring company acquires less than 100% shares in acquiree company.

Illustration 1 : Non-controlling interest is measured at proportionate net assets value; Goodwill

X Ltd. acquires 70% of Y Ltd. for Rs.8,40,000 and issued equity shares at par. Fair value of Y Ltd.'s identifiable net assets amount to Rs.9,00,000. Calculate NCI and Goodwill and show the treatment in the books of both X Ltd. and Y Ltd. Assume that X Ltd. measures NCI at proportionate fair value of net identifiable assets.

Solution :

Fair value of net assets = Rs.9,00,000. Purchase Consideration = Rs.8,40,000

NCI (at proportionate fair value of net assets) = 30% of Rs.9,00,000 = Rs.2,70,000.

Goodwill = Purchase consideration + NCI – Fair value of net assets

= Rs.8,40,000 + Rs.2,70,000 – Rs.9,00,000 = Rs.2,10,000

X Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Net Assets A/c…………………………………. Dr.	9,00,000	
Goodwill A/c……………………………………Dr.	2,10,000	
To Consideration A/c		8,40,000
To NCI A/c		2,70,000
Consideration A/c…………………………… Dr.	8,40,000	
To Equity Share Capital A/c		8,40,000

Since Y Ltd. exists, the above entries are passed in the consolidated accounts of X Ltd. However, X Ltd. requires to pass the following entry in its books for preparation of separate financial statements.

X Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment A/c………………………………… Dr.	8,40,000	
To Equity Share Capital A/c		8,40,000

Note : Since Y Ltd. exists, no entry is required in the books of Y Ltd.

Illustration 2 : Non-controlling interest is measured at proportionate net assets value; Gain on bargain purchase

P Ltd. acquires 80% of Q Ltd. for Rs.8,64,000 payable in cash. Fair value of Q Ltd.'s identifiable assets amount to Rs.14,00,000 and that of identifiable liabilities Rs.200,000. Calculate NCI and Goodwill and show the treatment in the books of both P Ltd. and Q Ltd. Assume that P Ltd. measures NCI at proportionate fair value of net identifiable assets.

Solution :

Fair value of net identifiable assets = Rs.14,00,000 – Rs.2,00,000 = Rs.12,00,000

Purchase Consideration = Rs.8,64,000

NCI (at proportionate fair value of net assets) = 20% of Rs.12,00,000 = Rs.2,40,000.

Gain on bargain purchase = Fair value of net assets – (Purchase consideration + NCI)

= Rs.12,00,000 - (Rs.8,64,000 + Rs.2,40,000) = Rs.96,000

P Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Assets A/c……………………………………… Dr.	14,00,000	
To Liabilities A/c		2,00,000
To Consideration A/c		8,64,000
To NCI A/c		2,40,000
To Gain on Bargain Purchase A/c		96,000
Consideration A/c……………………………… Dr.	8,64,000	
To Cash A/c		8,64,000

Since Q Ltd. exists, the above entries are passed in the consolidated accounts of P Ltd. However, P Ltd. requires to pass the following entry in its books for preparation of separate financial statements.

P Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Assets A/c……………………………………… Dr.	8,64,000	
To Cash A/c		8,64,000

Note: Since Q Ltd. exists, no entry is required in the books of Q Ltd.

Illustration 3 : Non-controlling interest is measured at fair value; Goodwill

X Ltd. acquires 70% of Y Ltd. for Rs. 8,40,000 and issued equity shares at Rs. 12 per share (including Rs. 2 as premium). Fair value of Y Ltd.'s identifiable net assets amount to Rs. 9,00,000. Calculate NCI and Goodwill and show the treatment in the books of both X Ltd. and Y Ltd. Assume that X Ltd. measures NCI at fair value.

Solution :

Fair value of net assets = Rs. 9,00,000. Purchase Consideration = Rs. 8,40,000

NCI (at fair value) = Rs. $8,40,000 \times \frac{30\%}{70\%}$ = Rs. 3,60,000 (considering PC as base)

Goodwill = Purchase consideration + NCI – Fair value of net assets

= Rs. 8,40,000 + Rs. 3,60,000 – Rs. 9,00,000 = Rs. 3,00,000

Number of equity shares issued = Rs.8,40,000 ÷ Rs.12 = 70,000

X Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Net Assets A/c……………………………………… Dr.	9,00,000	
Goodwill A/c…………………………………………Dr.	3,00,000	
To Consideration A/c		8,40,000
To NCI A/c		3,60,000
Consideration A/c………………………………… Dr.	8,40,000	
To Equity Share Capital A/c (70,000 × Rs.10)		7,00,000
To Securities Premium A/c (70,000 × Rs.2)		1,40,000

Since Y Ltd. exists, the above entries are passed in the consolidated accounts of X Ltd. However, X Ltd. requires to pass the following entry in its books for preparation of separate financial statements.

X Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment A/c………………………………………. Dr.	8,40,000	
To Equity Share Capital A/c		7,00,000
To Securities Premium A/c		1,40,000

Note: Since Y Ltd. exists, no entry is required in the books of Y Ltd.

Situation 2 : Acquiring company acquires 100% shares in acquiree company and acquiree company ceases to exist

Illustration 4 :

M Ltd. acquired all shares of N Ltd. M Ltd. issued 1,20,000 equity shares (face value Rs.10), the market value of which was Rs.240 per share. The fair value of identifiable net assets of N Ltd. was Rs.2,70,00,000. Show the treatment in the books of M Ltd. Assume that after the business combination N Ltd. ceased to exist

Solution :

Since M Ltd. acquired all shares of N Ltd. there is no NCI.

So, Goodwill = Purchase consideration – Fair value of identifiable net assets

= Rs. (120000 x 240) – Rs.2,70,00,000 = Rs.18,00,000

M Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Inves		
Net Assets A/c……………………………………. Dr.	2,70,00,000	
Goodwill A/c…………………………………….Dr.	18,00,000	
To Consideration A/c		2,88,00,000
Consideration A/c……………………………. Dr.	2,88,00,000	
To Equity Share Capital A/c (1,20,000 × Rs.10)		12,00,000
To Securities Premium A/c (1,20,000 × Rs.230)		2,76,00,000

Since N Ltd. ceased to exists, the above entries are reflected in the stand-alone balance sheet of M Ltd.

Note: N Ltd. will pass entries for closing all the accounts through Realisation A/C and Equity Shareholders A/c

Situation 3 : Acquiring company acquires 100% shares in acquiree company and acquiree company does not cease to exist.

Refer to Illustration 4. How will your answer change if N Ltd. does not cease to exist?

Solution :

In this case, the entries prepared by M Ltd. will be passed only in the consolidated accounts as N Ltd. exists. However, in the stand-alone accounts of M Ltd. the acquisition will be recorded as follows:

M Ltd.
Journal Entry

Particulars	Dr. (Rs.)	Cr. (Rs.)
Investment A/c.. Dr.	2,88,00,000	
To Equity Share Capital A/c		12,00,000
To Securities Premium A/c		2,76,00,000

Note : Since N Ltd. exists, no entry is required in the books of N Ltd.

● **Accounting for Merger and Acquisition**

Our previous discussion on accounting for business combination clearly suggests that Ind AS 103 covers all forms of business combinations including mergers and acquisitions where the acquired entity compulsorily goes into liquidation (Situation 2 only). While the accounting entries in the books of acquirer has been already discussed, the same for acquiree entity need to be discussed with more detail.

■ **Entries to close the books of Acquiree Company in case of merger and acquisition**:

For transfer the assets: Realisation A/c .... Dr. To All Assets A/c	With book value of assets
For transfer external liabilities: All External Liabilities A/c...................Dr. To Realisation A/c	With book value of external liabilities
For purchase consideration due: Acquirer Company A/c To Realisation A/c	With the amount of total purchase consideration

For transfer of equity: Equity Share Capital A/c…………………..Dr. Other Equity A/c……………………………….Dr. To Equity Shareholders A/c	
For transfer of accumulated loss, if any Equity Shareholders A/c……………Dr. To Profit and Loss A/c	
For amount payable to Preference Shareholders Preference Share Capital A/c………… Dr. Realisation A/c…………………………Dr. To Preference Shareholders A/c To Realisation A/c	 Excess payment Deficit amount
For receiving purchase consideration Equity Shares in Acquirer Company A/c…………..Dr Preference Shares in Acquirer Company A/c………Dr Debentures in Acquirer Company A/c…………..Dr Cash or Other Assets A/c………………………..Dr. To Acquirer Company A/c	
For payment to preference shareholders Preference Shareholders A/c…………Dr. To Equity Shares in Acquirer Company A/c To Preference Shares in Acquirer Company A/c To Debentures in Acquirer Company A/c To Cash A/c	
For realisation of assets not taken over Bank A/c ……………..Dr To Realisation a/c	
For settlement of liabilities not taken over Realisation A/c……………..Dr To Bank A/c	
For payment of Liquidation expenses Realisation A/c……………Dr To Bank A/c	

For transfer of realisation profit Realisation A/c………………Dr To Equity Shareholders A/c	

For settlement of equity shareholders
Equity Shareholders A/c…………………….Dr
    To Equity Shares in Acquirer Company A/c
    To Preference Shares in Acquirer Company A/c
    To Debentures in Acquirer Company A/c
    To Cash A/c	

■ **Entries in the books of Acquirer Company (Also refer to Situation 2 earlier)**

For acquisition of identifiable net assets
Assets A/c………………………………………Dr.
Goodwill A/c………………………………….Dr.
    To Liabilities A/c
    To Consideration A/c
    To Gain on Bargain Purchase A/c
	
	At fair value
	
	At fair value

For discharge of purchase consideration
Consideration A/c …………………………Dr
    To Equity Shares in Acquirer Company A/c
    To Preference Shares in Acquirer Company A/c
    To Debentures in Acquirer Company A/c
    To Cash A/c	

For payment of Liquidation expenses Goodwill A/c …………….Dr To Bank A/c	

Note : After acquisition, the acquirer company share make adjustment for inter-company items such as inter-company owing, inter-company bills, unrealised profit on inter-company purchases of assets or goods.

■ **Illustration on Accounting for Mergers and Acquisitions**

Illustration 5 : Merger of companies

Particulars	Note	A Ltd. (Rs. in '000)	B Ltd. (Rs. in '000)
I. Assets			
(1) Non-current Assets			
(a) Property, Plant and Equipment			
(i) Tangible assets:			
Land and Buildings		12,000	-
Plant and Machinery		31,000	-
Motor Vehicles		-	800
Furniture		-	500
(ii) Intangible Assets – Patent		4,000	1,400
(2) Current Assets			
(a) Current Investments		2,300	-
(b) Inventories		7,000	4,780
(c) Trade Receivables – Debtors		1,600	1,240
(d) Cash and Cash Equivalents: cash at bank		900	340
Total		58,800	9,060
II. Equity and Liabilities			
(1) Shareholders' Fund			
(a) Share Capital	(1)	40,000	8,000
(b) Other Equity – General reserve		16,000	-
- Profit & Loss (Cr.)		1,800	640
(2) Non-current Liabilities		-	-
(3) Current Liabilities		-	-
(a) Short term borrowings			
(b) Trade payables		-	-
		1,000	420
Total		58,800	9,060

Notes to Accounts :

(1) Share Capital

Particulars	Rs. ('000)	Rs. ('000)
Issued, subscribed and paid-up capital:		
30,00,000 equity shares of Rs.10 each	30,000	–
1,00,000 Preference shares of Rs.100 each	10,000	–
8,00,000 Equity shares of Rs.10 each		8,000

A new company, C Ltd., was formed to acquire the business of A Ltd. Abd B Ltd. The terms of acquisition were as follows:

a) C Ltd would have an authorised capital of Rs.7,00,00,000 divided into 1,00,000, 13% Preference shares of Rs.100 each and 60,00,000 equity shares of Rs.10 each.

b) Business of A Ltd. was valued at Rs.6,00,00,000; settlement being Rs.1,20,00,000 cash and balance by issue of fully-paid equity shares at Rs.12.

c) Business of B Ltd. was valued at Rs.48,00,000; to be satisfied by issue of fully-paid equity shares at Rs.12.

d) Preference shares of A Ltd. were redeemed.

e) C Ltd. made a public issue of 60,000 preference shares at par and 6,00,000 equity shares at Rs.12. The issue was underwritten at a commission of Rs.3,30,000 and was fully subscribed. All obligations were met.

Pass journal entries in the books of all the parties and prepare a Balance Sheet of C Ltd.

Solution :

In the books of A Ltd.
Journal

Date	Particulars	L.F	Dr. Rs. ('000)	Cr. Rs. ('000)
2020 March 31	Realisation A/c................................ Dr.		588,00	
	To Patents A/c			40,00
	To Land and Buildings A/c			120,00
	To Plant and Machinery A/c			310,00
	To Investment A/c			23,00
	To Inventories A/c			70,00
	To Debtors A/c			16,00
	To Bank A/c			9,00
	Creditors A/c................................ Dr.		10,00	
	To Realisation A/c			10,00
	C Ltd. A/c................................ Dr.		6,00,00	
	To Realisation A/c			6,00,000
	Realisation A/c................................ Dr.		22,00	
	To Equity Shareholders A/c			22,00

	Equity shares in C Ltd. A/c………………. Dr. Bank A/c…………………………......…. Dr. To C Ltd. A/c		4,80,00 1,20,00	 6,00,00
	Preference Share Capital A/c……………. Dr. To Preference Shareholders A/c		100,00	 100,00
	Preference Shareholders A/c……....……. Dr. To Bank A/c		100,00	 100,00
	Equity Share Capital A/c……........……. Dr. General Reserve A/c ……..............……. Dr. Profit and Loss A/c……….................…. Dr. To Equity Shareholders A/c		300,00 160,00 18,00	 478,00
	Equity Shareholders A/c (2200+47800).... Dr. To Equity Shares in C Ltd. A/c To Bank A/c (120,00 – 100,00)		500,00	 480,00 20,00

In the books of B Ltd.
Journal

Date	Particulars	L.F	Dr. Rs. ('000)	Cr. Rs. ('000)
2020 March 31	Realisation A/c……………………………. Dr. To Patents A/c To Motor Vehicle A/c To Furniture A/c To Inventories A/c To Debtors A/c To Bank A/c		90,60	 14,00 8,00 5,00 47,80 12,40 3,40
	Creditors A/c……………………………. Dr. To Realisation A/c		4,20	 4,20
	C Ltd. A/c……………………………. Dr. To Realisation A/c		96,00	 96,00
	Realisation A/c……………………………. Dr. To Equity Shareholders A/c		9,60	 9,60
	Equity shares in C Ltd. A/c………………. Dr. To C Ltd. A/c		96,00	 96,00

	Equity Share Capital A/c Profit and Loss A/c To Equity Shareholders A/c		80,00 6,40	 86,40
	Equity Shareholders A/c .... Dr. To Equity Shares in C Ltd. A/c		96,00	 96,00

In the books of C Ltd.
Journal

Date	Particulars	L.F	Dr. Rs. ('000)	Cr. Rs. ('000)
2020 March 31	Goodwill A/c (Bal. Fig) ....Dr.		31,60	
	Patents A/c..............................Dr.		54,00	
	Land and Buildings A/c..................Dr.		120,00	
	Plant and Machinery A/c ....Dr.		310,00	
	Motor Vehicle A/c........................Dr.		8,00	
	Furniture A/c..............................Dr.		5,00	
	Investment A/c..............................Dr.		23,00	
	Inventories A/c..............................Dr.		117,80	
	Debtors A/c..............................Dr.		28,40	
	Bank A/c..............................Dr.		12,40	
	To Creditors A/c			14,20
	To Consideration (A Ltd.) A/c			600,00
	To Consideration (A Ltd.) A/c			96,00
	Consideration (A Ltd.) A/c..............Dr.		600,00	
	Consideration (B Ltd.) A/c..............Dr.		96,00	
	To Equity Share Capital A/c			480,00
	To Securities Premium A/c			96,00
	To Bank A/c			120,00
	Bank A/c ....Dr.		132,00	
	To Equity Share Capital A/c			60,00
	To Securities Premium A/c			12,00
	To Preference Share Capital A/c			60,00
	Underwriting Commission A/c		3,30	
	To Bank A/c			3,30

Balance Sheet of C Ltd. as on 31.03.2020

Particulars	Note	A Ltd. (Rs. in '000)
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment		
(i) Tangible assets:		
Land and Buildings		120,00
Plant and Machinery		310,00
Motor Vehicles		8,00
Furniture		5,00
(ii) Intangible Assets – Goodwill		31,60
- Patent		54,00
(2) Current Assets		
(a) Current Investments		23,00
(b) Inventories		117,80
(c) Trade Receivables – Debtors		28,40
(d) Cash and Cash Equivalents: cash at bank		21,10
(9,00+3,40+132,00-120,00-3,30)		
Total		718,90
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital	1	600,00
(b) Other Equity	2	104,70
	-	
(2) Non-current Liabilities		-
(3) Current Liabilities		
(a) Short term borrowings		-
(b) Trade payables		14,20
Total		718,90

Notes to Accounts :

(1) Share Capital

Particulars	Rs. ('000)
Authorised capital:	
60,00,000 Equity shares of Rs.10 each	6,00,00
1,00,000 13% Preference shares of Rs. 100 each	1,00,00
	7,00,00

Issued and Subscribed Capital:	
54,00,000 Equity shares of Rs. 10 each	540,00
60,000, 13% Preference shares of Rs.100 each	60,00
	600,00

(2) Other Equity

Particulars	Rs. ('000)
Securities Premium	108,00
Underwriting commission	(3,30)
	104,70

Illustration 6 : One of the transferor company holding shares in the other

The balance sheets of P Ltd. and Q Ltd. as on 31.03.2020 were as follows :

Particulars	P Ltd. (Rs.)	Q Ltd. (Rs.)
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment		
(i) Tangible assets:	14,00,000	8,30,000
(ii) Intangible Assets	-	-
(b) Non-current Investment -5,000 shares in Q	80,000	-
(2) Current Assets	9,60,000	6,50,000
Total	24,40,000	14,80,000
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital (Equity shares of Rs.10)	10,00,000	6,00,000
(b) Other Equity – Securities Premium	2,00,000	-
– General reserve	2,60,000	2,50,000
- Profit & Loss (Cr.)	1,80,000	1,60,000
(2) Non-current Liabilities – 10% Debentures	5,00,000	-
- Secured loan	3,00,000	3,00,000
(3) Current Liabilities		
(a) Trade payables – Sundry creditors	-	1,70,000
Total	24,40,000	14,80,000

R Ltd. an existing company took over all the assets and liabilities of P and Q except 10% Debentures of P.

a) The shares of P and Q are valued at Rs.18 per share and Rs.20 per share respectively.

b) A contingent liability of P of Rs.60,000 is to be treated as a real liability.

c) The shareholders of P and Q will be issued sufficient number of equity shares in R Ltd at par.

d) The shares of R Ltd. are issued at par.

You are required to show :

(i) The calculation of the number of shares to be issued by R Ltd.

(ii) Journal entries in the books of R Ltd.

Solution :

(i) Calculation of number of shares to be issued

Particulars	P Ltd. (Rs.)	Q Ltd. (Rs.)
Existing shares	1,00,000	60,000
Less. Held by P Ltd.	-	5,000
	1,00,000	55,000
Agreed value per share (Rs.)	18	20
Total value of shares to be issued (Rs.)	18,00,000	11,00,000
No of shares to be issued at Rs.10 each	1,80,000	1,10,000

Total number of shares to be issued = 2,90,000

(ii)

In the books of R Ltd.
Journal

Date	Particulars	L.F	Dr. Rs.	Cr. Rs.
2020	Goodwill A/c (Bal. Fig) ....Dr.		3,90,000	
March	Non-current Assets A/c..................Dr.		22,30,000	
31	Current Assets A/c..................Dr.		16,10,000	
	To Secured Loan A/c			6,00,000
	To Trade Payable A/c			1,70,000
	To Other Current Liability* A/c			60,000
	To Consideration (P Ltd.) A/c			23,00,000
	To Consideration (Q Ltd.) A/c			11,00,000
	Consideration (P Ltd.) A/c.....................Dr.		23,00,000	
	Consideration (Q Ltd.) A/c.....................Dr.		11,00,000	
	To 10% Debentures A/c.....................Dr.			5,00,000
	To Equity Share Capital A/c			29,00,000

*Contingent liability recognised.

Illustration 7 : Acquirer (transferee) company holding shares in the acquiree (transferor) company

The balance sheets of K Ltd. and L Ltd. as on 31.03.2020 were as follows:

Particulars	P Ltd. (Rs.)	Q Ltd. (Rs.)
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment	10,00,000	3,00,000
(b) Non-current Investment -15,000 shares in L	1,50,000	-
- Loan to L Ltd.	5,00,000	-
(2) Current Assets	1,00,00,000	67,00,000
Total	1,16,50,000	70,00,000
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital (Equity shares of Rs.10)	6,00,000	2,50,000
(b) Other Equity	44,00,000	5,00,000
(2) Non-current Liabilities – Loan from K Ltd.	-	5,00,000
(3) Current Liabilities	66,50,000	57,50,000
Total	1,16,50,000	70,00,000

On 31.03.2020, K Ltd. absorbed L Ltd. The members of L Ltd. are to receive one equity share of K Ltd. issued at a premium of Rs. 2 per share for every five-equity share held in L Ltd. The necessary approvals are obtained.

You are required to show journal entries in the books of both the companies.

Solution :

In the books of L Ltd
Journal

Date	Particulars	L.F	Dr. Rs.	Cr. Rs.
2020 March 31	Realisation A/c................................ Dr.		70,00,000	
	To Non-current Assets A/c			3,00,000
	To Current Assets A/c			67,00,000
	Loan from K Ltd. A/c.................. Dr.		5,00,000	
	Current Liabilities A/c.................. Dr.		57,50,000	
	To Realisation A/c			62,50,000
	K Ltd. A/c................................ Dr.		60,000	
	To Realisation A/c			60,000

	Equity Shareholders A/c………………. Dr. To Realisation A/c		6,90,000	 6,90,000
	Equity shares in K Ltd. A/c………………. Dr. To K Ltd. A/c		24,000	 24,000
	Equity Shareholders A/c……………..Dr. To K Ltd. A/c		36,000	 36,000
	Equity Share Capital A/c………………. Dr. Reserve & Surplus A/c…………………Dr. To Equity Shareholders A/c		2,50,000 5,00,000	 7,50,000
	Equity Shareholders A/c ……………. Dr. To Equity Shares in C Ltd. A/c		24,000	 24,000

In the books of K Ltd.
Journal

Date	Particulars	L.F	Dr. Rs. ('000)	Cr. Rs. ('000)
2020 March	Profit & Loss A/c………………………Dr. To Investment A/c (150000 -36000)		1,14,000	 1,14,000
31	Non-current Assets A/c……………..Dr. Current Assets A/c……………..Dr. To Loan from K Ltd. A/c To Current Liabilities A/c57,50,000 To Consideration A/c To Investment A/c To Gain from Bargain Purchase A/c		3,00,000 67,00,000	 5,00,000 24,000 36,000 6,90,000
	Consideration A/c…………………Dr. To Equity Share Capital A/c (2000 × 10) To Securities Premium A/c (2000 × 2)		24,000	 20,000 4,000
	Loan from K Ltd. A/c…………………Dr. To Loan to L Ltd. A/c		5,00,000	 5,00,000

Working Note : Purchase Consideration

Particulars	**Rs. ('000)**
Purchase consideration (25000 × 1/5) × 12	60,000
Equity shares of Rs.12 each belonging to K Ltd. (3/5 × 60,000)	36,000
Equity shares payable to other shareholders (2/5 × 60,000)	24,000
Number of shares to be issued to other shareholders (24,000/12) = 2,000	

Illustration 8 : Acquiree company holds shares in Acquirer company

The balance sheets of M Ltd. and N Ltd. as on 31.03.2020 were as follows :

Particulars	M Ltd. (Rs.)	N Ltd. (Rs.)
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment	5,00,000	2,00,000
(b) Non-current Investment -10,000 shares in M	-	1,00,000
(2) Current Assets	2,50,000	1,50,000
Total	7,50,000	4,50,000
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital (Equity shares of Rs.10)	5,00,000	300,000
(b) Other Equity	1,00,000	55,000
(3) Non-current Liabilities –	-	-
(4) Current Liabilities (Sundry creditors)	1,50,000	95,000
Total	7,50,000	4,50,000

On 31.03.2020, M Ltd. absorbed N Ltd. on the basis of intrinsic value of shares. The purchase consideration is to be discharged by M Ltd. in form of fully paid shares. A sum of Rs.20,000 is due to M Ltd. by M Ltd. Included in the stock of M Ltd. Rs.30,000 goods supplied by N Ltd at cost plus 20% basis. Give journal entries in the books of both the parties.

Solution :

In the books of N Ltd
Journal

Date	Particulars	L.F	Dr. Rs. ('000)	Cr. Rs. ('000)
2020 March 31	Realisation A/c…………………………… Dr.		3,50,000	
	To Non-current Assets A/c			2,00,000
	To Current Assets A/c			1,50,000
	Sundry Creditors A/c……………… Dr.		95,000	
	To Realisation A/c			95,000
	M Ltd. A/c…………………………… Dr.		2,55,000	
	To Realisation A/c			2,55,000
	Equity shares in M Ltd. A/c……………… Dr.		2,55,000	
	To M Ltd. A/c			2,55,000
	Equity Share Capital A/c……………… Dr.		3,00,000	

	Reserve & Surplus A/c…………………Dr. To Equity Shareholders A/c		55,000	 3,55,000
	Equity Shareholders A/c ……………. Dr. To Equity Shares in M Ltd. A/c		3,55,000	 3,55,000

Working Note 1 : Intrinsic value of shares

Particulars	M Ltd. (Rs.)	N Ltd. (Rs.)
Non-current Assets	5,00,000	2,00,000
Current Assets	2,50,000	1,50,000
Investment in M Ltd. 10000 shares at rs.12 each	-	1,20,000
	7,50,000	4,70,000
Less. Creditors	1,50,000	95,000
Net assets (A)	6,00,000	3,75,000
No. of shares (B)	50,000	30,000
Intrinsic value per share (Rs.) (A + B)	12	12.5

Working Note 2 : Purchase Consideration

No. of shares of N Ltd	30,000
Value of shares @ Rs.12.50	3,75,000
No. of shares of M Ltd to be issued at Rs.12.00 (375000/12)	31,250
No. of shares already held by N Ltd.	10,000
Net shares to be issued (31,250 – 10000)	21,250
Total Consideration (21,250 × Rs. 12)	2,55,000

In the books of M Ltd.

Journal

Date	Particulars	L.F	Dr. Rs. ('000)	Cr. Rs. ('000)
2020 March 31	Non-current Assets A/c………………Dr. Current Assets A/c………………Dr. To Sundry Creditors A/c To Consideration A/c		2,00,000 1,50,000	 95,000 2,55,000
	Consideration A/c…………………Dr. To Equity Share Capital A/c (21250 × 10) To Securities Premium A/c (21250 × 2)		2,55,000	 2,12,500 42,500
	Sundry Creditors …………………Dr. To Sundry Debtors (in Current Assets) A/c		20,000	 20,000
	Goodwill A/c……………..Dr. (30000 × 20/120) To Inventory (in Current Assets)* A/c		5,000	 5,000

*adjustment for unrealised profit on stock.

Illustration 9 : Cross Holding

The balance sheets of X Ltd. and Y Ltd. as on 31.03.2020 were as follows:

Particulars	X Ltd. (Rs.)	Y Ltd. (Rs.)
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment	30,00,000	1,50,000
(b) Non-current Investment - 3,000 shares in Y	4,50,000	-
- 9,000 shares in X	-	15,00,000
(2) Current Assets	27,84,000	13,50,000
Total	62,34,000	30,00,000
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital (Equity shares of Rs.100)	45,00,000	15,00,000
(b) Other Equity	11,34,000	3,30,000
(3) Non-current Liabilities – 14% Debentures	-	9,00,000
(4) Current Liabilities (Sundry creditors)	6,00,000	2,70,000
Total	62,34,000	30,00,000

On 31.03.2020 X Ltd absorbs Y ltd on the basis of intrinsic value of the shares of both companies. The fair value of shares of X Ltd. is Rs.120

You are required to calculate the number of shares to be issued to Y Ltd., the purchase consideration and show the final balance sheet after absorption.

Solution :

1. Computation of net assets excluding inter-company investments

Particulars	X Ltd.	Y Ltd.
Non-current Assets	57,84,000	15,00,000
Less : 14% Debentures	-	(9,00,000)
Less : Current Liabilities	(6,00,000)	(2,70,000)
	51,84,000	3,30,000

2. Intrinsic value of Equity Shares

Let 'a' as the intrinsic value (Net Assets including Inter Company Investments) of Equity Shares of X Ltd. and

'b' as the intrinsic value of Equity Shares of Y Ltd.

a = 51,84,000 +1/5b….. (1)

b = 3,30,000 + 1/5a….. (2)

or, b = 3,30,000 + 1/5(51,84,000 + 1/5b)

or, b = 3,30,000 + 10,36,800 + b/25

or, b-(b/25) = 13,66,800

or, b = 13,66,800 × 25/24 = 14,23,750

Putting the value of b in equation (1), we get, a = 51,84,000 + 1/5 x 14,23,750 = 54,68,750 Intrinsic value of shares of X Ltd. = 54,68,750/45,000 = 121.53

Intrinsic value of shares of Y Ltd. = 14,23,750/15,000 = 94.92 (approximately)

3. Calculation of Purchase Consideration

Value of shares held by outsiders in Y Ltd.	= 12000 × 94.92 = 11,39,000
Shares to be issued by X Ltd	= 11,39,000/121.53 = 9,372 shares
Less. Shares held by Y Ltd	= 9,000 shares
No. of shares to be issued	= 372 shares
Purchase consideration	= 372 × 120 = Rs. 44,640

4. Calculation of Gain on Bargain Purchase or Goodwill

Particulars	Rs.
Assets taken over Less. Liabilities taken over	15,00,000 11,70,000
Net Assets Less. Purchase Consideration	3,30,000 44,640
Gain on Bargain Purchase	2,85,360

In the books of X Ltd.
Journal

Date	Particulars	L.F	Dr. Rs.	Cr. Rs.
2020 March 31	Profit & Loss A/c……………………….Dr. To Investment A/c (450000 -360000)		90,000	 90,000
	Non-current Assets A/c………………Dr. Current Assets A/c………………Dr.		1,50,000 13,50,000	

	Goodwill A/c……………………Dr. (bal. fig)		74,640	
	To 14% Debentures A/c			9,00,000
	To Current Liabilities A/c			2,70,000
	To Consideration A/c			44,640
	To Investment A/c (3000 × 120)			3,60,000
	Consideration A/c…………………Dr.		24,000	
	To Equity Share Capital A/c (2000 × 10)			20,000
	To Securities Premium A/c (2000 × 2)			4,000
	Loan from K Ltd. A/c…………………Dr.		5,00,000	
	To Loan to L Ltd. A/c			5,00,000

Balance Sheet of X Ltd. as on 31.03.2020

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment	31,50,000
(b) Goodwill	74,640
(2) Current Assets	41,34,000
Total	73,58,640
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital (Equity shares of Rs.100) *	45,37,200
(b) Other Equity - securities premium*	7,440
- others (11,34,000 - 90,000)	10,44,000
(3) Non-current Liabilities – 14% Debentures	9,00,000
(4) Current Liabilities (Sundry creditors)	8,70,000
Total	73,58,640

*(45000 + 372) × 100 = 45,37,200

**(372 × 20) = 7,440

● Designing Merger and Acquisition Schemes

Mergers and acquisitions need to be approved by the shareholders. Thus, schemes are to be prepared beforehand with all possible implications shown on accounts and financial statements and placed before the shareholders. Acceptance of any merger and acquisition proposal largely depend on how clearly the schemes are drawn. The task of drawing the scheme may be given to some experts like a chartered accountants' firm.

In order to draft the scheme of merger and acquisition, the following aspects should be carefully looked into:

a) All assets including goodwill and liabilities of both the transferor company and the transferee company should be valued for the purpose of valuation of shares.

b) Instead of taking full value of goodwill, differential goodwill may be taken in determining the value of shares.

c) A convenient exchange ratio is to be ascertained.

d) Some cash payment may be made in order to avoid fractional value of shares.

e) Provision for liquidation expenses of the two or more companies to be amalgamated should be made. Again, provision for formation expenses should be made. In the case of insufficiency of cash in the hands of amalgamated company, arrangement of cash should be made with bank or shares may be sold, to the promoters or people for cash.

Illustration 10 :

A Ltd. is a public company having a paid-up share capital of Rs. 10 lakh consisting of 1,00,000 equity shares of Rs. 10 each. Its net-worth as per last Balance Sheet as on 31.3.2020 is Rs. 15 lakh. The fixed assets of this company, the book value of which is Rs. 5 lakh, have a market value of Rs. 10 lakh. It was declaring dividend @ 10% p.a. for the last 3 years.

B Ltd. is a public company having a paid up share capital of Rs. 1 crore consisting of 1,00,000 shares of Rs. 100 each. Its net-worth as per last Balance Sheet as on 31.3.2020 is Rs. 5 crore. Fixed assets of this company, the book value of which is Rs. 1.50 crore, have a market value of Rs. 2.50 crore. It was declaring dividend @ 20% p.a. for the last 3 years. The management of both the companies have agreed that A Ltd. should merge with B Ltd. Draft a scheme of merger of A Ltd. with B Ltd.

Solution :

A & Co.
Chartered Accountants
Kolkata 700 073
Date : March.24, 2004

The Board of Directors

………………………

Kokkata-700 001

Sub : Scheme of merger of A Ltd. with B Ltd.

Dear Sirs

As requested, we have the pleasure in submitting hereunder the scheme of merger of A Ltd. with B Ltd. for your consideration:

1. Valuation of Shares :

Particulars	A Ltd. Rs.	B Ltd. Rs.
A. Assets-backing value :		
(a) Net-worth :		
As per last balance sheet	15,00,000	5,00,00,000
Add : Increase in fixed assets	5,00,000	1,00,00,000
	20,00,000	6,00,00,00
(b) Number of paid up share	1,00,000	1,00,000
(c) Value per share [(a)/(b)]	Rs. 20	Rs. 600
B. Yield value :		
(a) Company rate of dividend	10%	20%
(b) Market rate of dividend (assumed)	10%	10%
(c) Paid up value per share	Rs. 10	Rs. 100
(d) Value per share [{(a)/(b)} X (c)]	Rs. 10	Rs. 200
C. fair value per share :		
[(Asset-backing value) + (Yield value)}/2]	Rs. 15	Rs. 400

II. Exchange Ratio :

Let fair value per share of A Ltd. is A and that of B Ltd. is B.

Now, exchange ratio is

A : B = 15 : 400 or, A/B = (15)/(400) or, 400A = 15B or 80A = 3B

Therefore, B Ltd. will issue 3 shares for every 80 shares in A Ltd.

Total number of shares to be issued by B Ltd. to A Ltd. is [(1,00,000) × 3/(80)] = 3,750

III. *Purchase Consideration, Gain on Bargain Purchase and Revaluation Reserve :*

(a) Purchase consideration at nominal value is Rs. 100 x 3,750 = Rs. 3,75,000

(b) Gain on bargain purchase on merger is as follows:

(i) Net assets acquired from A Ltd. at market value	Rs.20,00,000
(ii) Issue of shares at nominal value	Rs.3,75,000
(iii) Gain on bargain purchase [(i)—(ii)]	Rs.16,25,000

(c) Revaluation Reserve of B Ltd. is as follows:

(i) Market value of fixed assets	Rs.2,50,00,000
(ii) Book value of fixed assets	Rs.1,50,00,000
(iii) Revaluation reserve [(i)—(ii)]	Rs.1,00,00,000

IV. If our scheme is accepted, the proposed Balance Sheet of B Ltd. will be:

Before preparation of the proposed Balance Sheet of B Ltd. (after merger), it is required to find out the missing figures.

Net worth of B Ltd. = Rs.5,00,00,000

Book value of fixed assets = Rs.1,50,00,000

So, Book value of current assets = Rs.3,50,000

Share Capital = Rs.1,00,00,000

So, Other Equity = Rs. (5,00,00,000 – 1,00,00,000) = Rs.4,00,00,000

Net worth of A Ltd. = Rs.15,00,000

Book value of fixed assets = Rs.5,00,000

So, Book value of current assets = Rs.10,00,000

Share Capital = Rs.10,00,000

So, Other Equity = Rs.5,00,000

Balance Sheet of B Ltd. as on 31.03.2020 (after merger)

Particulars	**(Rs.)**
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment (2,50,00,000 + 10,00,000)	2,60,00,000
(2) Current Assets (3,50,00,000 + 10,00,000)	3,60,00,000
Total	6,20,00,000
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital (1,03,750 Equity shares of Rs.100) *	1,03,75,000
(b) Other Equity – Capital Reserve (Gain on bargain purchase)	16,25,000
- Revaluation Reserve	
-Others	1,00,00,000
(2) Non-current Liabilities –	4,00,00,000
(3) Current Liabilities	–
	–
Total	6,20,00,000

We shall be glad to furnish you with any further information as you may require.

Thanking you,

Yours faithfully

(Signature of the partner with seal)

Chartered Accountants

Illustration 11 :

X Ltd. and Y Ltd. propose to merge. Their proposed Balance Sheets as on March 31, 2020 were (Rs. in thousand):

Particulars	X Ltd. (Rs.)	Y Ltd. (Rs.)
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment	4,95,000	1,50,000
(b) Non-current Investments: 4% Tax free bonds (F.V Rs.120000)	1,08,000	-
(2) Current Assets	5,13,750	1,68,750
Total	11,16,750	3,18,750
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital (Equity shares of Rs.10)	6,00,000	2,00,000
(b) Other Equity – General reserve	2,70,000	47,500
- Profit and Loss (Cr.)	90,000	34,500
(2) Non-current Liabilities	-	-
(3) Current Liabilities (Sundry creditors)	1,56,750	36,750
Total	11,16,750	3,18,750

Net profit after taxation:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
For the year ended 31.3.2018	1,48,750	40,500
For the year ended 31.3.2019	1,64,250	47,100
For the year ended 31.3.2020	1,84,500	62,250

Goodwill may be valued at 4 years' purchase of average super profit from trading on the basis of 10% normal trading profit on closing capital employed. Z Ltd. is formed for the purpose of amalgamation of both the companies.

Advise upon capitalization of Z Ltd. and suggest a scheme of exchange of shares for that purpose (consider only break-up value). Also draft the Balance Sheet of Z Ltd.

Solution :

B & Co
Chartered Accountants .
Kolkata 700 001
Date: March 25, 2020

The Board of Directors
………………………
Kokkata-700 001

Sub : Scheme of merger of X Ltd. with Y Ltd.

Dear Sirs

As requested, we have the pleasure in submitting hereunder the scheme of merger of X Ltd. with Y Ltd. for your consideration:

I. *Valuation of Shares including Goodwill:*

While formulating the scheme of merger of X Ltd. and Y Ltd., importance is to be given to evaluate the special advantage attached to the companies. In other words, value of goodwill of the companies is to be determined. This will determine the shareholders' equity and the amount they can claim in the amalgamated company. The valuation of goodwill is as follows:

(i) Closing Trading Capital Employed:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
PPE	4,95,000	1,50,000
Current Assets	5,13,750	1,68,750
Total Assets	10,08,750	3,18,750
Less. Creditors	1,56,750	36,750
Capital employed	8,52,000	2,82,000

(ii) Average Maintainable Profits:

Since the profits are showing an upward trend, it would be appropriate to use weighted average method for determining average profits. This is calculated as follows:

Weight Average Profits and Average maintainable profits

Year	X Ltd			Y Ltd		
	Profits	Weights	Product	Profits	Weights	Product
	Rs.		Rs.	Rs.		Rs.
2001-02	1,48,500	1	1,48,500	40,500	1	40,500
2002-03	1,64,250	2	3,28,500	47,100	2	94,200
2003-04	1,84,500	3	5,53,500	62,250	3	1,86,750
		6	10,30,500		6	3,21,450
Weighted Average profits*1,71,750			53,575			
Less. Income from investment(120000 × 4%)			4,800			–
Average maintainable profits1,66,950			53,575			

*Weighted average Profits of X Ltd. [(10,30,500)/6]; Y Ltd. [(3,21,450)/6]

(iii) Super Profits and Value of Goodwill:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
Average maintainable profits	1,66,950	53,575
Less. Normal return on capital employed @10%	85,200	28,200
Super Profit	81,750	25,375
No of years' purchase	4	4
Goodwill at 4 years' purchase of super profits	3,27,000	1,01,500

(iv) Valuation of Shares:

	X Ltd. (Rs.)	Y Ltd. (Rs.)
Closing trading capital employed	8,52,000	2,82,000
Add. Goodwill	3,27,000	1,01,500
Add. Tax free bonds (non-trading)	1,08,000	-
Net assets	12,87,000	3,83,500
No of shares	60,000	20,000
Intrinsic value per share	21.45	19.175

II. *Exchange Ratio of Shares, Number of Shares to be issued and cash Requirement*:

It is difficult to find out a suitable exchange ratio of shares having regard to value of shares arrived at. It would be better to make some cash payment (as there is sufficient cash at bank) in order to find out a convenient exchange ratio. This can be achieved as follows:

The value of 10 shares of X Ltd. is Rs. 21.45 × 10 = Rs. 214.50

The value of 10 shares of Y Ltd. is Rs. 19.175 × 10 = Rs. 191.75

Therefore, Z Ltd. will make payment to the shareholders of vendor companies as follows:

(1) Z Ltd. will issue 21 shares of Rs. 10 each and pay Rs. 4.50 in cash every 10 shares in X. Ltd.

(2) Z Ltd. will issue 19 shares of Rs. 10 each and pay Rs. 1.75 in cash every 10 shares in Y Ltd.

As a result, the total number of shares to be issued by Z Ltd. will be as follows:

(1) Shareholders of X Ltd. [(60,000) × (21)/(10)]	1,26,000 shares
(2) Shareholders of Y Ltd. [(20,000) × (19)/(10)]	38,000 shares
	1,64,000 shares

Requirement of cash of Z Ltd. will be as follows:	Rs.
To pay shareholders of X Ltd. [(60,000) × (4.50)/(10)]	27,000
To pay shareholders of Y Ltd. [(20,000) × (1.75)/(10)]	3,500
Liquidation expenses of X Ltd. (assumed)	4,000
Liquidation expenses of Y Ltd. (assumed)	4,000
	38,500

III. *If our scheme is accepted, the Balance Sheet of Z Ltd. will be:*

Balance Sheet of Z Ltd. as on 31.03.2020

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment (4,95,000 + 1,50,000)	6,45,000
(b) Goodwill (327000+101500+4000+4000)	4,36,500
(b) Non-current Investments: 4% Tax free bonds (F.V Rs.120000)	1,08,000
(2) Current Assets (513750+168750-38,500)	6,44,000
Total	18,33,500
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital (1,64,000 Equity shares of Rs.10)	16,40,000
(b) Other Equity	-
(2) Non-current Liabilities	-
(3) Current Liabilities (Sundry creditors)	1,93,500
Total	18,33,500

We shall be glad to furnish you with any further information as you may require.

Thanking you,

Yours faithfully

(Signature of the partner with seal)

Chartered Accountants

6.6 Scheme for Internal Reconstruction

The need for reconstruction arises when a company has accumulated huge losses or when a company finds itself over-capitalized, which means either that the value placed on assets is very high compared to their earning capacity or that the profits generated by the company is not sufficient to pay a proper dividend. Considering these aspects, a company is required to be reorganized to inject fresh blood to save the company from its unwanted liquidation. In order to reorganize a company, the Board of Directors place a scheme before all the interested parties for their consent and get it approved by the Court for its implementation. When this is done without altering the name of the existing company, it is known as internal reconstruction. In other words, implementation of a scheme after it is consented to by all the interested parties, viz., shareholders, debenture-holders, creditors, etc., having the approval of the court with a view to bringing equilibrium between assets

and liabilities for better future without liquidation and change in the name of the existing company is known as scheme of internal reconstruction.

6.6.1 Circumstances of Internal Reconstruction

Internal reconstruction is advisable or preferable under the circumstances noted below:

(1) The present position of the company is bad but good days are ahead.

(2) The shareholders, debenture-holders and creditors, specifically bankers have not only agreed to sacrifice but are also ready to subscribe to further capital.

(3) The company is interested to carry forward its past losses or is interested to get the benefit of set off of past losses against future profits. This will ultimately minimize the tax burden for a few years,

(4) The proposal for internal construction is consented to by all the interested groups of the company without any delaying tactics such as legal objections and dissensions.

(5) The company is not willing to lose its present legal entity or the company is likely to have a fresh chance of avoiding liquidation.

6.6.2 Steps for Internal Reconstruction

The fundamental basis of any reconstruction proposal is the earning capacity of the company. Even the payment of debenture interest is not possible unless the activities of the company are profitable. A very careful estimate should, therefore, be made as to the future anticipated profits of the company. Unless profits arc sufficient to meet all expenses including adequate depreciation, interest on borrowed; capital, preference dividend and a reasonable return on equity capital, reconstruction would be useless because the need for another reconstruction will arise soon again. Thus, internal reconstruction should be made very carefully because when a company is once reconstructed, it must survive potentially for an indefinite long period. The essence of internal reconstruction is that the reconstructed company has the potentiality to generate sufficient profits in future.

The equity shareholders will have to bear a higher proportion of losses because they are the real owners of the company. In course of distribution of losses to be written off among the various interested groups of the company, the control over the affairs of the company by the equity shareholders must not be overlooked.

The requirement of working capital should not be ignored. Cash may be required to pay off some dissenting creditors or even to pay arrear preference dividend. The

willingness by the shareholders, debenture-holders, etc. to provide required cash fund is, thus, a basic requirement for the success of a reconstruction scheme.

In order to implement the scheme of internal reconstruction, the following steps may be advocated:

Statement of Estimated Total Loss

Particulars	**(Rs.)**
Fictitious Assets like debit balance in the profit and loss account, preliminary expenses, discount on issue of shares and debentures, underwriting commission, reconstruction expenses, etc.	xxx
Add: Intangible Assets like goodwill, patents and trademarks to the extent they lost their values.	xxx
Add: Contingent liabilities like cumulative arrear preference dividend, etc.	xxx
Add: Loss on revaluation of assets and liabilities	xxx
	xxx
Less: Profit on revaluation of assets and liabilities	xxx
Net loss to be written off	xxx

(2) *Estimation of realizable value of assets (in case of forced liquidation) and its likely distribution*:

Estimated realizable value of assets can be obtained by summing up all assets after valuation on the basis of forced sales (or, going concern value basis). Likely distribution of assets may be shown as follows:

Particulars	(Rs.)	(Rs.)
Estimated realizable value of all assets		xxx
Less : Preferential Creditors:		
Tax liability	xxx	
Workers' dues	xxx	xxx
Surplus assets available for secured creditors, unsecured		xxx
Creditors and shareholders		
Less : Secured Creditors:		
Debenture-holders (secured against assets)	xxx	
Other secured creditors	xxx	xxx
Surplus assets available for unsecured creditors and shareholders		xxx

Less : Unsecured Creditors Trade creditors, bills payable, etc.	xxx	xxx
Surplus/Deficiency for shareholders		xxx
Less : Preference Shareholders' Claim: Preference share capital Arrear preference dividend	 xxx xxx	 xxx
Surplus/Deficiency for equity shareholders		xxx
Less : Equity share capital		xxx
Deficiency as regards equity shareholders		xxx

(3) *Writing off loss:*

This is a very crucial aspect of the scheme of internal reconstruction. If preferential creditors, secured creditors (i.e., debenture-holders) and Unsecured creditors are fully covered by the realizable value of assets, naturally they will not bear any loss. They are affected only if the realizable value of assets is insufficient to cover even their liabilities. In such an eventuality, they will have to make sacrifice. The order of their sacrifice will be (a) preferential creditors (no sacrifice), (b) secured creditors (sacrifice depending on the value of securities), and (c) unsecured creditors (heaviest sacrifice). The same principle is applicable to preference shareholders as to refund of their capital. They may be persuaded to share loss in a situation when the refund of preference capital is uncertain by the availability or otherwise of the realizable value of assets after its likely distribution to preferential creditors, secured creditors and unsecured creditors. In that situation, they will naturally forego arrear preference dividend and bear loss which will be relatively higher than that of the creditors. But the sharing of loss by the preference shareholders will be much lower than that of the equity shareholders.

(4) *Compensation to debenture-holders, other creditors and preference shareholders for bearing loss:*

The debenture-holders may be compensated by means of increase in the rate of interest in such a manner so that their total earnings on account of interest will remain the same as before. The same principle may be applied to preference shareholders. In case of need, non-participating preference shares may be converted into participating preference shares without disturbing the control of equity shares over the affairs of the company or, participating preference shares may be converted into equity shares if the existing control of the equity shares is not changed. Payment of arrears of dividend to cumulative preference shareholders in cash may immediately invite difficulties. In such a case, a good method is to issue deposit certificates to them to avoid immediate burden on liquid resources. But arrears of dividend on non-cumulative

preference shares are usually cancelled. As a part of compensation, some portion of unsecured creditors may be paid in cash through the arrangement of liquid funds.

(5) *Arrangement of working capital:*

Working capital is the life-blood of the business. Therefore, it is necessary that the reconstructed company should have adequate working capital at its disposal. It can be raised by further call on existing reduced shares sale of investments, issuance of new debentures and shares, arrangement of overdraft and the like.

(6) *Estimation and disposal of expected future profits*:

This is the last step but not the least in importance in the scheme of internal reconstruction. Under this section, due care should be given in estimating future profits and its disposal so that return on equity capital is fair.

Illustration 12 :

The following is the Balance Sheet of Unfortunate Ltd. as on March 31, 2020:

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment (Plant and Machinery)	5,40,000
(b) Goodwill	1,80,000
(2) Current Assets	
Stock	1,74,000
Debtors	1,20,000
Cash at Bank	6,000
Total	10,20,000
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital - 60,000 Equity shares of Rs.10	6,00,000
- 1,200, 6% Cumulative Preference shares of Rs.100	1,20,000
(b) Other Equity – Profit and Loss (Dr.)	(3,00,000)
(2) Non-current Liabilities	-
(3) Current Liabilities	6,00,000
Total	10,20,000

Preference share dividends are in arrear for 3 years. Draft a suitable scheme of internal reconstruction which would help the company to reorganize in the following lines:

(a) To write off the profit and loss account and goodwill.

(b) To depreciate plant and machinery by 10%.

(c) To satisfy the arrears of preference dividends.

(d) To provide Rs. 60,000 as liquid resources.

Solution :

Y & Co.
Chartered Accountants
Kolkata-700012
Date: March 29, 2020

The Board of Directors
Unfortunate Ltd.
Kolkata-700 001

Ref: Scheme of Internal Reconstruction of Unfortunate Ltd.

Dear Sirs,

With reference to your letter dated 10.03.2020, we are submitting the scheme of internal reconstruction hereunder:

(1) *Total loss to be written off:*

Particulars	**(Rs.)**
Debit balance in the profit and loss account	3,00,000
Goodwill	1,80,000
Depreciation on plant and machinery (5,40,000 × 10%)	54,000
Arrear preference dividends (1,20,000 x 6% × 3)	21,600
	5,55,600

(2) Estimated realizable value of assets (in case of forced liquidation) and its likely distribution:

Particulars	Rs.	Rs.
Realizable value of assets:		
Plant and Machinery (5,40,000 x 90%)	4,86,000	
Stock	1,74,000	
Debtors	1,20,000	
Cash at Bank	6,000	7,86,000
Less: Unsecured Creditors (Current Liabilities)		6,00,000
Surplus available for Shareholders		1,86,000
Less: Preference Shareholders' Claim:		
6% Preference Share Capital	1,20,000	
Arrear preference dividend	21,600	1,41,600
Surplus available for Equity Shareholders		44,400
Less: Equity Share Capital		6,00,000
Deficiency as regards Equity Shareholders		5,55,600

(3) *Writing off Loss:*

In the context of the above relative position in liquidation loss to be written off should be shared as follows:

(a) Current Liabilities: Since their claim is fully covered in case of force liquidation, naturally they will not sacrifice anything.

(b) Preference Shareholders: The claim of preference shareholders is also fully covered even if force liquidation takes place. But in order to smoothen implementation of the scheme, equity shareholders cannot be asked to sacrifice more than 90% of their claim i.e., Rs.9 per share. In this situation, preference shareholders will be asked to sacrifice a bit, only Rs.15600 (i.e., Rs.5,55,600 – Rs.9 x 60,000) which will reduce their value by Rs.13 (i.e., Rs.15600/1,200) per share. The value after sacrifice will be Rs.87 (i.e., Rs.100 – Rs.13) per share. As a part of the compensation the rate of dividend may be increased from 6 % to 7.5%.

(c) Equity Shareholders: In case of forced liquidation equity shareholders will get a very negligible amount considering time and expense on account of liquidation. In view of maintaining control over the affairs of the company equity shareholders will be asked to sacrifice lion's share, Rs.9 per share (i.e., Rs.10 x 90%). As a result, paid up value will be Re.1 (i.e., Rs.10 – Rs.9) per share.

(4) *Arrangement of Liquid Funds:*

Particulars	Rs.	Rs.
Payment of arrears of preference dividend	21,600	
Add: Requirement of liquid resources	60,000	81,600
Less: Cash at bank		6,000
Additional requirement of liquid resources		75,600

The above amount may be arranged as loan from bank at 10% p.a. (assumed) by the mortgage of plant and machinery by means of floating charge.

(5) *If your scheme is accepted, the Balance Sheet of Unfortunate Ltd. will be as below:*

Balance Sheet of Unfortunate Ltd. as on 31.03.2020 (and reduced)

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment (Plant and Machinery)	4,86,000
(2) Current Assets	
Stock	1,74,000
Debtors	1,20,000
Cash at Bank	60,000
Total	8,40,000
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital - 60,000 Equity shares of Re.1 each	60,000
- 1,200, 7.5% Cumulative Preference shares of Rs.87	1,04,400
(2) Non-current Liabilities – 10% Bank Loan on Mortgage	75,600
(3) Current Liabilities	6,00,000
Total	8,40,000

(6) *Estimation and disposal of expected future profits:*

In estimating future expected profits, it is required to ascertain the capital employed. Capital employed after reconstruction of the company will be Rs. 2,40,000, which consists of equity capital, preference capital and loan from bank, (i.e., Rs. 60,000 + Rs. 1,04,400 + Rs. 75,600). The company will not have to pay tax for the coming few years because of the tax benefit due to set off of past losses. Therefore, a reasonable rate of return before interest @ 12% on Rs. 2,40,000, capital employed is expected to meet the claims for interest on bank loan, dividends and others as follows:

		Rs.
(i)	For interest on bank loan (75,600 × 10%)	7,560
(ii)	For preference dividend (1,200 × 87 × 7.50%)	7,830
(iii)	For equity dividend (60,000 × 1 × 12%)	7,200
(iv)	For transfer to reserve (assumed)	5,760
(v)	For balance carried forward in the profit and loss account	450
(vi)	Estimated future expected profits [(i) + (ii) + (iii) +(iv) + (v)]	28,800

We shall be glad to furnish you with any further information that you may require.

Thanking you,

Yours faithfully,

(Signature of the partner with seal)

Chartered Accountants

Illustration 13 :

The Balance Sheet of Progressive Ltd. as on March 31, 2020 is as follows:

Particulars	(Rs.)
(1) Non-current Assets	
(a) Property, Plant and Equipment – Building	90,000
- Plant and Machinery	40,000
(b) Goodwill	50,000
(c) Investment (Market value Rs.25,000)	20,000
(2) Current Assets	
Stock (Market value Rs.12,000)	15,000
Debtors	30,000
Total	2,45,000
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital - 15,000 Equity shares of Rs.10 each	1,50,000
- 10,000, 7% Preference shares of Rs.10	1,00,000
(b) Other Equity – Profit and Loss (Dr.)	(1,01,500)
(2) Non-current Liabilities – 10% Debentures (Secured against Plant)	30,000
(3) Current Liabilities – Workmen accidental compensation fund	10,000
-Profit sharing fund	10,000
-Staff welfare fund	5,500
-Creditors	41,000
Total	2,45,000

Prepare an internal reconstruction scheme and redraft the Balance Sheet after incorporating your proposal for submission to the Board of Directors.

The following are certain relevant facts that may be considered in formulating the scheme:

(a) Estimated liability on account of workmen's accident compensation fund is Rs. 9,000.

(b) Preference Shares are cumulative and preferential as regards dividend as well as capital. The preference dividends are in arrears for two years.

(c) The company needs to have liquid resources of Rs. 25,000 for working capital purposes.

(d) Bad debts are estimated at Rs. 1,500.

(e) Current year's interest on debenture is outstanding.

(f) Sundry Creditors include tax liability of Rs. 5,000.

Solution :

The Board of Directors
Progressive Ltd,
Kolkata-700 012

Z & Co.
Chartered Accountants
Kolkata-700 001
Date: April 2, 2020

Ref: Scheme of Capital Reduction of Progressive Ltd.

Dear Gentlemen

With reference to your letter dated 14. 03. 04, we have the pleasure in submitting a scheme for capital reduction of your company for your consideration in the following lines:

(1) *Total loss to be written off:*

Particulars	Rs.	Rs.
Debit balance in the profit and loss account		1,01,500
Goodwill		50,000
Plant and machinery		2,000
Stock		3,000
Debtors		5,000
Arrear preference dividends (1,00,000 x 7% x 2)		14,000
Outstanding interest on debentures		3,000
		1,78,500
Less: Increase in the value of investment	5,000	
Decrease in WACF	1,000	6,000
		1,72,500

(2) *Estimated realizable value of assets (in case of forced liquidation) and its likely distribution:*

Particulars	Rs.	Rs.
Building		90,000
Plant and Machinery (40,000 - 2,000)		38,000
Investments		25,000
Stock		12,000
Debtors (30,000 - 5,000)		25,000

Assets available for distribution		1,90,000
Less: Preferential Creditors:		
Tax liability	5,000	
Workmen's accident compensation fund	9,000	14,000
Surplus assets available for secured creditors, unsecured creditors and shareholders		1,76,000
Less: Secured Creditors (10% Debenture with interest due)		33,000
Surplus assets available for unsecured creditors and Shareholders		1,43,000
Less: Unsecured Creditors		
Staff welfare fund	5,500	
Profit sharing fund	10,000	
Sundry Creditors (41,000 - 5,000)	36,000	51,500
Surplus assets available for preference and equity shareholders		91,500
Less: Preference shareholders' claim:		
7% Preference share capital	1,00,000	
Arrear preference dividend	14,000	1,14,000
Deficiency as regards preference shareholders		22,500
Less: Equity share capital		1,50,000
Deficiency as regards equity shareholders		1,72,500

(3) *Writing off Loss*

In view of the above relative position in liquidation, the loss may be written off as below:

(a) Preferential Creditors—As they are sufficiently covered, they will not sacrifice anything.

(b) Secured Creditors (Debenture-holders) - They are also covered. Therefore, they cannot be asked to sacrifice anything.

(c) Preference and Equity Shareholders - Since the preference shareholders have got the priority as to the return of capital as well as dividend at the time of liquidation, they usually cannot be asked to sacrifice anything. But the available surplus assets are not sufficient to pay their claims in full. Naturally, they may be persuaded to sacrifice something, and the equity shareholders' claim cannot be completely wiped of which means liquidation of the company. In these situations, the equity share value may be reduced to a token value of Re. 1 per share. Therefore, balance of loss of Rs. 37,500 [i.e., Rs. 1,72,500 - (Rs. 1,50,000 - Re. 1 x 15,000)] should be sacrificed by the preference shareholders. As a result, preference shares of Rs. 10 each fully paid will be reduced by Rs. 3.75 [i.e., Rs. 37,500/ 10,000] per share.

In view of making compensation to preference shareholders, the rate of dividend may be raised from 7% to 9%.

(4) *Arrangement of Working capital:*

In order to provide Rs. 25,000 for working capital, the company may be advised to sell the investments at the market value rather than collection of liquid funds from borrowing which is now difficult. This will not impose any burden of interest on operation of the company for taking loan. For paying arrears of preference dividend, Deposit Certificate may be issued in lieu of cash payment. This is preferable because it will not give any voting right and the certificate can be redeemed as soon as opportunity arises.

(5) *If your scheme is accepted, the Balance Sheet of Progressive Ltd. will be as below:*

Balance Sheet of Progressive Ltd. as on 31.03.2020 (and reduced)

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment – Building	90,000
- Plant and Machinery	38,000
(2) Current Assets	
Stock	12,000
Debtors	25,000
Cash at Bank	25,000
Total	1,90,000
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital - 15,000 Equity shares of Re.1 each	15,000
- 10,000, 9% Preference shares of Rs.6.25 each	62,500
(2) Non-current Liabilities – 10% Debentures (Secured against Plant)	30,000
- Outstanding debenture interest	3,000
- Deposit Certificates	14,000
(3) Current Liabilities – Workmen accidental compensation fund	9,000
-Profit sharing fund	10,000
-Staff welfare fund	5,500
-Creditors	41,000
Total	1,90,000

(6) *Disposal of expected future profits:*

In order to determine the expected future profits, it is required to ascertain the amount of capital employed. The capital employed after reconstruction of the company will be Rs. 1,07,500 consisting of equity share capital, 9% preference share capital and 10% debentures. Since tax liability will not arise for the coming few years because of the set off of past losses, earnings before interest may be taken to be, at a conservative estimate, at about 12% on capital employed, which will generate Rs. 13,000 per annum. The likely disposal will be:

		Rs.
(i)	For debenture interest (30,000 x 10%)	3,000
(ii)	For preference dividend (62,500 x 9%)	5,625
(iii)	For transfer to reserve (assumed)	2,580
(iv)	For balance carried forward in the profit and loss account	1,795
(v)	Estimated future profits before tax [(i) + (ii) +-(iii) + (iv)]	13,000

We shall be glad to furnish you with, any further clarification that you may require.

Thanking you,

Yours faithfully,

(Signature of the partner with seal)

Chartered Accounts

Illustration 14 :

The Balance Sheet of Paradise India Ltd. as on March 31, 2020 is as follows:

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment – Building at cost	1,56,000
- Plant and Machinery at cost	3,09,600
(b) Goodwill	72,000
(c) Patent (estimated value Rs.36,000)	96,000
(2) Current Assets	
Stock (Market value)	76,000
Debtors (considered good)	68,000
Total	7,77,600

II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital – 2,400 Equity shares of Rs.100 each	2,40,000
- 6% Cumulative preference shares of Rs.100 each	3,60,000
(b) Other Equity – Profit and Loss (Dr.)	(1,05,600)
(2) Non-current Liabilities – 10% Debentures (Secured by floating charges)	1,20,000
- Outstanding interest on debentures	14,400
(3) Current Liabilities – Sundry creditors	1,20,000
-Bank overdraft (Limit Rs.30,000)	28,800
Total	7,77,600

Dividends on preference shares are in arrear for two years. The directors of the company are of the opinion that if an additional plant is installed at a cost of Rs.1,20,000 and working capital needs are fully met, the company will earn enough profit to pay equity dividend @10% subject to a suitable scheme of internal reconstruction being put through. The existing buildings and plant & machinery are considered being worth Rs. 1,82,400 and Rs. 2,40,000 on a going concern basis.

Debenture-holders are anxious to be paid the interest due to them but are willing to provide half of the additional capital required on suitable basis. Preference shareholders are willing to accept a reasonable sacrifice provided they are given berth in the equity capital.

Suggest a suitable scheme of internal reconstruction.

Solution :

The Board of directors	T & Co.
Paradise India Ltd,	Chartered Accountants
16, Gokhele Road	Kalyani-741 235
Kolkata-700 022	Date: April 5, 2020

Sub : Internal Reconstruction of your Company

Dear Sirs,

As requested, we have given below our suggestions for a scheme of internal reconstruction for your consideration and for placing them before the different-classes of creditors and shareholders.

(1) *Accumulated and expected loss to be written off:*

Particulars	Rs.	Rs.
Debit balance in the profit and loss account		1,05,600
Goodwill		72,000
Patent (96,000 – 36,000)		60,000
Plant and machinery (3,09,600 – 2,40,000)		69,600
Arrear preference dividends (3,60,000 × 6% × 2)		43,200
		3,50,400
Less: Increase in the value of building (1,80,000 – 1,56,000)		24,000
		3,26,400

(2) *Estimated realizable value of assets (in case of forced liquidation) and its likely distribution:*

Particulars	Rs.	Rs.
Patent		36,000
Building		1,80,000
Plant and Machinery		2,40,000
Stock		76,000
Debtors (30,000 - 5,000)		68,000
Total Assets available for distribution		6,00,000
Less: Creditors having floating charges		
6% Debenture holders	1,20,000	
Interest due on above	14,400	1,34,400
Surplus assets available for unsecured creditors and Shareholders		4,65,600
Less: Unsecured Creditors		
Sundry Creditors	1,20,000	
Bank overdraft	28,800	1,48,800
Surplus assets available for preference and equity shareholders		3,16,800
Less: Preference shareholders' claim:		
6% Cumulative Preference share capital	3,60,000	
Arrear preference dividend	43,200	4,03,200
Deficiency as regards preference shareholders		86,400
Less: Equity share capital		2,40,000
Deficiency as regards equity shareholders		3,26,400

(3) *Writing off Losses:*

In the context of the above relative position, the loss of Rs.3,26,400 is suggested to be shared by different interested groups as below:

(a) Creditors having floating charge - Debentures having floating charge are fully covered, Thus, they cannot be asked to bear any loss.

(b) Unsecured Creditors - Since they are sufficiently covered, they also will not bear any loss.

(c) Preference Shareholders - The claim to preference shareholders is not fully covered. Surplus assets available for likely distribution between preference and equity shareholders is Rs.3,16,800 out of which the claim of preference shareholders including arrears of dividend is Rs. 4,03,200. In this situation, they will not only lose Rs. 86,400 but will also lose even more, considering time and expense in liquidation: Hence, they will find no alternative but to make an inevitable sacrifice. Since they are interested in getting berth in the equity capital, their sacrifice will naturally be commensurate to their aspiration and must be acceptable to the existing equity shareholders. It will be reasonable for them to forgo the arrears of preference dividend in full and to accept Rs. 2,40,000 9% cumulative preference shares of Rs. 100 each of the existing preference shares.

This will mean that in future they will continue to receive Rs. 21,600 dividend which was earned by them previously and, therefore, their sacrifice will not be as heavy as it appears. In view of the higher rate of dividend, the market value of preference shares will rise and the greater likelihood of the dividend being paid regularly.

(d) Equity Shareholders - The equity shareholders will be prepared to bear the balance of loss of Rs. 1,63,200 [i.e., Rs. 3,26,400 - (Rs. 4,03,200 - Rs. 2,40,000]. The loss will be Rs. 68 [i.e., Rs.1,63,200/2,400] per share. As a result, paid up value per share should be reduced from Rs.100 to Rs.32.

(4) *Arrangement of working capital:*

It is required to calculate the working capital need of the proposed reconstructed company in order to make the scheme viable before the arrangement of working capital. The working capital need is calculated as follows

Particulars	Rs.	Rs.
To install a new plant		1,20,000
To pay outstanding debenture interest		14,400
To introduce further working capital so as to make current assets double the current liabilities:		
Current liabilities [(1,20,000 + 28,800) × 2]		
Less: Existing current assets (76,000 + 68,000)	2,97,600	
	1,44,000	1,53,600
		2,88,000

It is assumed that existing debenture-holders will provide half of the working capital need, Rs. 1,44,000 (i.e., Rs. 2,88,000 × 1/2) by taking up additional debentures at an increased rate of 10%. The remaining amount may be raised from the existing equity shareholders because there is little scope for bank assistance in the form of loan. But the existing preference shareholders are desirous of an interest in the equity capital. However, it is not likely that equity shareholders would like to lose their control over the affairs of the company and they must retain the majority of shares. Under these situations, in order to retain control and to honour desire of the existing preference shareholders, remaining funds of Rs. 1,44,000 may be provided by two classes of shareholders equally, i.e., Rs. 72,000 each by equity and preference holders in the form of total 4,500 equity shares of Rs. 32 each fully paid.

(5) Capital Structure after proposed reconstruction:

The capital structure of the company will be as follows:

		Rs.
(i)	2,400, 9% Cumulative preference shares of Rs.100 each fully paid	2,40,000
(ii)	6,900 Equity shares of Rs.32 each fully paid	Rs.2,20,800
(iii)	6% Debentures	Rs.1,20,000
(iv)	10% Debentures	Rs.1,44,000
(v)	Total [(i)+(ii)+(iii)+(iv)]	Rs.7,24,800

The authorized capital may be suggested at Rs.8,00,000 consisting of 4,000, 9% cumulative preference shares of Rs.100 each and 12,500 equity shares of Rs.32 each.

(6) If the scheme is implemented, the Balance Sheet of the company will be as follows:

Balance Sheet of Paradise India Ltd. as on March 31, 2020 (and reduced)

Particulars	(Rs.)
(1) Non-current Assets	
(a) Property, Plant and Equipment – Building at cost	1,80,000
- Plant and Machinery (2,40,000+1,20,000)	3,60,000
(b) Patent	36,000
(2) Current Assets	
Stock (Market value)	76,000
Debtors (considered good)	68,000
Cash at bank (2,80,000 – 1,20,000 – 14,400)	1,53,600
Total	8,73,600

II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital – 6,900 Equity shares of Rs.32 each	2,20,800
-2,400, 9% Cumulative preference shares of Rs.100 each	2,40,000
(2) Non-current Liabilities – 6% Debentures (Secured by floating charges)	1,20,000
- 10% Debentures	1,44,000
(3) Current Liabilities – Sundry creditors	1,20,000
-Bank overdraft (Limit Rs.30,000)	28,800
Total	8,73,600

(7) *Expected future profit and its likely disposal:*

Unless the company, after internal reconstruction, is not sure of earning a profit of about 16% of its capital employed, i.e., Rs. 1,12,600 before interest and taxes, it will not be worthwhile to go ahead with the scheme. The likely disposal of expected profit will be:

		Rs.
(i)	For debenture interest (7,200 + 14,400)	21,600
(ii)	For preference dividend (2,40,000 × 9%)	21,600
(iii)	For equity dividend (2,20,800 × 10%)	22,080
(iv)	For transfer to reserve (assumed)	10,920
(v)	For paying taxes (may arise after 2 or 3 years because of set off of past losses), say at 40% [{(ii) + (iii) + (iv)} × {(40%)/(60%)}]	36,400
(vi)	Total profits before interest and taxes [(i)+ (ii) + (iii) + (iv) + (v)]	1,12,600

We shall be glad to furnish any further information that you may require.

Thanking you,

Yours faithfully,

(Signature of the partner with seal)
Chartered Accountants

6.7 Summary

With the compulsion of the compliance of Ind AS-103, significant changes in accounting for mergers and acquisitions were noticed. In order to draft schemes on mergers and acquisitions, valuation of shares including goodwill, exchange ratio of shares, cash payment to avoid fraction, adequate provision for liquidation and formation expenses, etc. are required to be examined seriously.

While drafting schemes on internal reconstruction, it is required to follow the 'steps for internal reconstruction' in which different aspects, viz., losses to be written off, estimation of realizable value of assets in case of forced liquidation, writing off losses, compensation to those who will sacrifice, arrangement of adequate working capital, and estimation of expected future profits and its likely disposal, are to be discussed and demand careful and serious attention.

However, consent of all interested groups of the concerned companies is the primary need in case of merger and acquisition scheme. But in the case of internal reconstruction scheme, approval of the court in addition to the consent of all interested parties of the company being reconstructed is a must. Nevertheless, an in-depth accounting knowledge is exclusively required for drafting any scheme, be it on amalgamation or on internal reconstruction. Schemes on amalgamations and mergers are drafted keeping in view the recommendation of Ind AS-103.

6.8 Exercises

- **Theoretical Questions:**

1. What do you mean by the terms 'mergers' and 'acquisition'? What are the different forms of mergers?
2. What are the various steps for designing the scheme for mergers?
3. What are the prerequisites of internal reconstruction?
4. How can you draw a scheme of internal reconstruction which will be accepted to all the interested groups of the company being reconstructed?

- **Practical Problems**

Problem 1 :

Following are the assets and liabilities of P Ltd. and Q Ltd. as on 31.03.2022

Particulars	P Ltd. Rs.	Q Ltd. Rs.
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment–Plant and Machinery	85,000	1,65,000
- Furniture	34,000	22,000
(2) Current Assets		
Inventories	81,000	45,000
Trade receivables	40,000	46,000
Cash at bank	25,000	22,000
Total	2,65,000	3,00,000

II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital -Equity shares of Rs.10	1,00,000	1,50,000
- 9% Preference shares of Rs. 100	50,000	70,000
(b) Other Equity – General reserve	40,000	22,000
- Profit and Loss (Cr.)	23,000	13,000
(2) Non-current Liabilities	-	-
(3) Current Liabilities (Sundry creditors)	52,000	45,000
Total	2,65,000	3,00,000

On 01.04.2022, P Ltd. decided to absorb Q Ltd. on the following terms:

a) P Ltd. will issue 6 equity shares of Rs.10 each fully paid against 5 equity shares of Q Ltd.

b) Preference shareholders of Q Ltd. are to get Rs.60,000 preference shares of P Ltd.

c) Shares of P Ltd. are to be issued at Rs.14 per share.

d) Plant and Machinery of P Ltd. to be valued at Rs.1,60,000.

Prepare necessary accounts in the books of Q Ltd. to close its books.

Problem 2 :

Following are the Balance Sheets of K Ltd. and D Ltd. as at 31.12.2022.

Particulars	K Ltd. Rs.	D Ltd. Rs.
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment (tangible assets)	9,00,000	5,00,000
(b) Non-current Investment	1,00,000	1,00,000
(2) Current Assets		
Inventories	3,00,000	1,00,000
Trade receivables	3,50,000	1,50,000
Cash at bank	50,000	-
Total	17,00,000	8,50,000
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital -Equity shares of Rs.10	10,00,000	5,00,000
(b) Other Equity – Profit and Loss (Cr.)	2,50,000	1,50,000
(2) Non-current Liabilities	-	-
(3) Current Liabilities (Sundry creditors)	4,50,000	2,00,000
Total	17,00,000	8,50,000

A new company KD Ltd. was formed to take over the business of K Ltd and D Ltd. The purchase consideration were Rs.14,00,000 for K Ltd and Rs.7,00,000 for D Ltd payable in equity shares of Rs.10 each in KD Ltd. Sundry debtors of K Ltd included Rs.50,000 due from D Ltd.

Show the journal entries in the books of K Ltd. Also prepare the opening Balance Sheet of KD Ltd as on 01.01.2022.

Problem 3 :

Azad Ltd, and Hind Ltd. propose to amalgamate. Their Balance Sheets as on March 31, 2022 were as below:

Balance Sheets as on March 31, 2020 (Rs. in crore)

Azad Ltd. and Hind Ltd. propose to merge. Their proposed Balance Sheets as on March 31, 2022 were as below:

Particulars	Azad Ltd. Rs.	Hind Ltd. Rs.
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment	8.00	2.00
(b) Non-current Investments: 4% Tax free bonds (F.V Rs.2.00 Cr)	2.00	-
(2) Current Assets	8.00	4.00
Total	18.00	6.00
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital (Equity shares of Rs.10)	10.00	4.00
(b) Other Equity – General reserve	4.00	0.40
- Profit and Loss (Cr.)	2.00	0.60
(2) Non-current Liabilities	-	-
(3) Current Liabilities (Sundry creditors)	2.00	1.00
Total	18.00	6.00

Net profit after taxation (Rs. In crore):

Particulars	Azad Ltd. Rs.	Hind Ltd. Rs.
I. Assets		
For the year ended 31.3.2020	2.60	0.90
For the year ended 31.3.2021	2.50	0.80
For the year ended 31.3.2022	3.00	1.12

Goodwill may be valued at 4 years' purchase of average super profit from trading on the basis of 15% normal trading profit on closing capital employed. The stock (included in current assets) of Azad Ltd. and Hind Ltd. are to be taken at Rs.4.08 and Rs.2.84 crore respectively. Azad-Hind Ltd. is formed for the purpose of amalgamation of both the companies.

Advise upon capitalization of Azad-Hind Ltd. and suggest a scheme of exchange of shares for that purpose (consider only break-up value). Also draft the Balance Sheet of Azad-Hind Ltd.

Problem 4 :

Two companies A Ltd. and B Ltd. are to be merged. Their Balance Sheets are as follows:

Particulars	A Ltd. Rs.	B Ltd. Rs.
I. Assets		
(1) Non-current Assets		
(a) Property, Plant and Equipment	2,50,000	2,40,000
(2) Current Assets	2,20,000	2,30,000
Total	4,70,000	4,70,000
II. Equity and Liabilities		
(1) Shareholders' Fund		
(a) Share Capital -Equity shares of Rs.10	3,20,000	2,00,000
- 6% Preference shares of Rs. 100	-	80,000
(b) Other Equity – General reserve	32,000	32,000
- Profit and Loss (Cr.)	70,000	70,000
(2) Non-current Liabilities – 8% Debentures	-	40,000
(3) Current Liabilities (Sundry creditors)	48,000	48,000
Total	4,70,000	4,70,000

Profit and Loss Account balances are made up as follows:

Particulars	A Ltd. Rs.	B Ltd. Rs.
Balance as on 01.04.2019	14,000	14,000
Add: Profit before debenture interest during 2019-20	56,000	56,000
	70,000	70,000

Draft a scheme of merger.

Problem 5 :

The following is the abridged balance sheet of Dark Ltd. as on 31.03.2020:

Particulars		(Rs.)
I. Assets (1) Non-current Assets (a) Property, Plant and Equipment (Plant and Machinery) (b) Goodwill (2) Current Assets		 2,00,000 60,000 1,04,000
Total		3,64,000
II. Equity and Liabilities (1) Shareholders' Fund (a) Share Capital - 3,000 Equity shares of Rs.100 - 2,000, 6% Cumulative Preference shares of Rs.100 (b) Other Equity – Profit and Loss (Dr.) (2) Non-current Liabilities (3) Current Liabilities		 3,00,000 2,00,000 (1,36,000) - -
Total		3,64,000

Preference dividend is in arrear for 3 years. Plant and machinery are estimated to worth Rs.1,80,000 and current assets is estimated at Rs.92,000. Annual expected profit will be Rs.30,000.

Draft a scheme for internal reconstruction to be submitted to the Board of Directors.

Problem 6 :

Udayachal Limited which suffered heavy losses in the past considers that the worst is over and that, on a sound reorganization, it will be able to carry on business successfully. Profit in future been expected to be between Rs. 1,00,000 and Rs. 1,36,000 before providing for interest but after charging adequate depreciation.

The balance sheet of the company as on 31st March 2020 is as follows:

Particulars	(Rs.)
I. Assets (1) Non-current Assets (a) Property, Plant and Equipment – Sundry fixed assets (2) Current Assets Stock Cash at bank	 16,00,000 8,16,000 96,000
Total	25,12,000

II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital – 8,000 Equity shares of Rs.100 each	8,00,000
- 6% Cumulative preference shares of Rs.100 each	4,80,000
(b) Other Equity – Profit and Loss (Dr.)	(17,12,000)
(2) Non-current Liabilities – 5% Debentures (Secured by floating charges)	21,44,000
- Outstanding interest on debentures	64,000
(3) Current Liabilities – Sundry creditors	7,20,000
-Tax liability	16,000
Total	25,12,000

Preference dividend is an arrear for two years. Debentures carry a floating charge on all assets of the company. Sundry fixed assets are worth Rs. 8,00,000 and stock is worth Rs. 6,40,000.

The board of directors of the company request you to draft scheme of the internal structure which would be acceptable to all the interested groups.

Problem 7 :

North-East India Ltd. has experienced difficulties. It is decided to reconstruct the company internally. The following id the Balance Sheet as on 31.03.2020:

Particulars	(Rs.)
I. Assets	
(1) Non-current Assets	
(a) Property, Plant and Equipment – Land and building	2,25,000
- Plant and Machinery	4,50,000
(b) Patent	60,000
(2) Current Assets:	
Stock	2,25,000
Debtors	90,000
Cash at bank	7,500
Total	10,57,500
II. Equity and Liabilities	
(1) Shareholders' Fund	
(a) Share Capital – 4,500 Equity shares of Rs.100 each	4,50,000
- 7.5% Cumulative preference shares of Rs.100 each	6,00,000
(b) Other Equity – Profit and Loss (Dr.)	(8,17,500)
(2) Non-current Liabilities – 6% Debentures (Secured by floating charges)	3,00,000
(3) Current Liabilities – Sundry creditors	5,25,000
Total	25,12,000

An analysis of causes leading to losses in the past reveals that processes are outdated and that sufficient credit is not allowed. Modernization of plant will cost Rs. 300000; Rs.150000 worth of present plant being retired and sold for Rs. 30000.

Two months' credit has to be allowed for sales to be maintained at their proper level of Rs.1800000 leading to a profit before interest Rs. 90,000.

Trade creditors include Rs.30000 payable to preferential creditors. Land and building are valued at Rs. 270000 and Patents are worth only Rs.15000. Preference dividend is in arrear for four years. You may assume that the company has to pay nothing for income tax for coming few years.

Submit your proposal for the reconstruction of the company.

Unit 7 □ Segment Reporting

Structure

7.1 Objective

7.2 Introduction

7.3 General Meaning of Segment

7.4 Meaning of Segment Reporting

7.5 Need for Segment Reporting

7.6 Benefits of Segment Reporting

- **7.6.1 Benefits of Segment Reporting from the point of view of Users**
- **7.6.2 Benefits of Segment Reporting from the point of view of Companies**

7.7 Segment Reporting as per Ind AS 108 'Operating Segment'

- **7.7.1 Definition of Segment Information**
- **7.7.2 Scope of the Standard**
- **7.7.3 Concept of Operating Segments**
- **7.7.4 Aggregation Criteria**
- **7.7.5 Identification of Reportable Segments**
- **7.7.6 Disclosure Requirements of Segment Reporting as per Ind AS 108**

7.8 Summary

7.9 Exercises

7.1 Objective

After going through this unit, you will be able to:

- know the meaning of segments
- know the classification and process of identification of segments;
- know the benefits of segment reporting;
- know the segment accounting policies; and
- know the disclosure requirements of segment reporting as per Ind AS 108.

7.2 Introduction

Presently, we are passing through the age of change where everything tends to change. Those who cannot adapt to the change loses their position and eventually gets wiped out. Keeping pace with the changes, different professional accounting bodies, viz., Institute of Chartered Accountants of India, Institute of Cost Accountants of India, etc. and other educational institutions like universities and IIMs have been changing their course curricula on a regular basis. Financial reporting, a part of accounting, is not an exception to this change. Users of financial information are not satisfied with the consolidated form of information. In addition, they require specific information for individual parts of the business. Considering this information need, ICAI issued *'AS-17: Segment Reporting'* for compliance in maintaining accounts and reporting thereof by Indian companies which was mandatory for selected class of companies from accounting year 2001 onwards. With the recent introduction of the converged set of accounting standards namely Ind AS (Indian Accounting Standards), AS-17 has been replaced by *Ind AS 108: Operating Segment*.

7.3 General Meaning of Segment

Generally, the term, 'segment' refers to a part cut off or a portion or a section of the totality. Likewise, in business, it means sectionalisation or categorisation of products or services and business zones of the company on the basis of dominance. In other words, dominating products or services and business zones of an enterprise are known as segments. Identification of various segments is needed for providing useful information to the users.

7.4 Meaning of Segment Reporting

Segment reporting refers to the process of providing the relevant information about the dominant segments of the organization to the users of information in a formal well organised structure. The structure is uniform to all organizations to which the regulation applies, however, the segments to be identified is decided by certain rules.

7.5 Need for Segment Reporting

Many large companies are engaged in the production and distribution of different products or services not only to serve the home market but also to serve the global market. Moreover, currently there has been a trend toward diversification by the line of business also. Keeping this in view, large companies operate either in a number of industries or in a number of locations within the country, or both. Again,

many companies are so diversified that domestic operations account for a minority of total revenues and no single business sector predominates. Thus, business locations of companies are not confined to any country's territory; even it extends to any place of the world. This phenomenon has gained importance with the emergence of globalization and liberalization all over the world.

A business enterprise has to perform many functions including financial reporting for the users. In order to discharge financial reporting function, usually consolidated financial information is provided without disaggregating information on the basis of products or services and business locations. Providing this type of information will serve only the purpose of general assessment of the business while users may be directly affected by only one part of the company's business. Hence, the information need of the users is more than general information. They are rather interested in getting segment information with a view to measuring the efficacy or otherwise of the segments so that they can evaluate the overall performance of a business enterprise in a better manner.

7.6 Benefits of Segment Reporting

As mentioned earlier, the area of financial reporting where segment-wise financial reporting practices are followed may be considered as Segment Reporting. Many large companies may have diversified product lines or plant and customer locations and these segments may differ from each other in respect of profitability, growth potential and risk. In this context, they essentially make segment reporting for highlighting different issues which are of immense help to the users of segment information in particular and consolidated information in general for measuring overall performance of companies. Segment reporting is surely beneficial to the users of financial information but it is also beneficial to the companies themselves in many respects. The benefits of segment reporting may be discussed from the point of view of companies and users as well, in the sub-heads that follow.

7.6.1 Benefits of Segment Reporting from the point of view of users

Users of information are benefited in a number of ways as below:

(1) It helps in providing a complete picture of information as required by the users,

(2) It helps the users in evaluating the efficiency or otherwise of each segment.

(3) It helps to assess the safety and security of the funds invested by the investors,

(4) It helps to create confidence or otherwise in the minds of the existing and prospective investors. As a result, they may invest their funds accordingly.

(5) It helps in feeling good or otherwise in the matter of social security of the employees.

(6) It helps the existing and prospective investors to understand the stock market reaction.

7.6.2 Benefits of Segment Reporting from the point of view of companies

Every company derives the following benefits from segment reporting:

(1) The main benefit of segment reporting is that it enables prediction of future cash flows and the risk thereof.

(2) It provides a complete picture of the affairs of each segment. The result of each segment may be suitably compared with those of similar other segment over a number of years. This will facilitate management control over the working of each segment.

(3) It not only helps in explaining segment-wise performance but it also helps in exhibiting financial position which are required in framing policy-making exer-cise. Based on it, the management can take decision for business expansion or otherwise.

7.7 Segment Reporting as per Ind AS 108 'Operating Segment'

7.7.1 Definition of Segment Information

An entity shall disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates. Such information may be termed as 'Segment Information'.

7.7.2 Scope of the Standard

(i) This Accounting Standard applies to companies to which Indian Accounting Standards (Ind ASs), notified under the Companies Act, apply.

(ii) If any entity, which is not required to apply this Ind AS, chooses to disclose information about segments that does not comply with this Ind AS, it shall not describe the information as segment information.

(iii) If any financial report contains both the consolidated financial statements of a parent that is within the scope of this Ind AS as well as the parent's separate financial statements, segment information is required only in the consolidated financial statements.

7.7.3 Concept of Operating Segments

An operating segment is a component of an entity:

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

(b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available.

An operating segment may engage in business activities for which it is yet to earn revenues. For example, a start-up operation initiated by an organization may be treated as an operating segment before earning revenues.

7.7.4 Aggregation Criteria

An organization may have two or more operating segments that exhibit similar long-term financial performance as they have similar economic characteristics. For example, if segments have similar economic characteristics, their long-term average gross margins would be expected to be similar. In such cases, two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this Ind AS, i.e., the segments have similar economic characteristics, and the segments are similar in each of the following respects:

(a) the nature of the products and services;

(b) the nature of the production processes;

(c) the type or class of customer for their products and services.

Such aggregation naturally reduces the number of segments within a practical limit.

7.7.5 Identification of Reportable Segments

Once the operating segments are identified, the management needs to identify the segments for which segment information will be disclosed. Such segments are called the reportable segments.

An entity shall report separately information about an operating segment that meets any of the following quantitative thresholds:

(a) Its reported revenue, including both sales to external customers and

intersegment sales or transfers, is 10 per cent or more of the combined revenue, internal and external, of all operating segments.

(b) The absolute amount of its reported profit or loss is 10 per cent or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.

(c) Its assets are 10 per cent or more of the combined assets of all operating segments.

In addition to above, additional operating segments that do not meet any of the quantitative thresholds may still be considered reportable, if the management believes that information about the segment would be useful to users of the financial statements.

If the total external revenue reported by operating segments identified based on the quantitative thresholds plus those selected by the management voluntarily constitutes less than 75 per cent of the entity's total external revenue, then, additional operating segments shall be identified as reportable segments (even if they do not meet the criteria stated above) until at least 75 per cent of the entity's total external revenue is included in reportable segments.

Information about other business activities and operating segments that are not reportable shall be combined and disclosed in an 'all other segments' category.

Note 1: An entity may combine information about two or more operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments have similar economic characteristics and share a majority of the aggregation criteria stated in section 8.6.4.

Note 2: If management judges that an operating segment identified as a reportable segment in the immediately preceding period is of continuing significance, it may continue to report the information about that segment even if it no longer meets the criteria for reportability.

Note 3: If an operating segment is identified as a reportable segment in the current period in accordance with the quantitative thresholds, segment data for the prior period shall also be disclosed even if that segment did not satisfy the criteria for reportability in that prior period, unless the necessary information is not available and the cost to develop it would be excessive.

Note 4: There should always be a practical limit to the number of reportable segments that an entity separately discloses as beyond that segment information will be too detailed to comprehend. Thus, the Standard provides that in case the number exceeds ten, the entity should consider whether a practical limit has been reached.

● **A Practical Problem on Identification of Reportable Segments:**

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in Rs.'000):

	A	B	C	D	E	F	G	H	Total (segment)
1. Segment Revenue (a) External Sales (b) Inter Segment Sales	 - 100	 255 60	 15 30	 10 5	 15 -	 50 -	 20 5	 35 -	 400 200
2. Segment Results Profit/ (Loss)	5	-90	15	-5	8	-5	5	7	
3. Segment Assets	15	47	5	11	3	5	5	9	100

Identify the reportable segments as per Ind AS 108.

Solution :

Calculation for identification of reportable segments as per Ind AS 108 (Operating Segments)

The reportable segments are identified as follows –

Particulars	A	B	C	D	E	F	G	H	Total
1. **Segment Revenue** (a) External Sales (b) Inter Segment Sales	 - 100	 255 60	 15 30	 10 5	 15 -	 50 -	 20 5	 35 -	 400 200
Total Revenue	100	315	45	15	15	50	25	35	600
% of segment revenue to the total revenue of all segments taken together	**16.7**	**52.5**	7.5	2.5	2.5	8.3	4.17	5.83	100
2. **Segment Results** Profit (Loss)	 5 	 -90	 15 	 -5	 8 	 -5	 5 	 7 	 40 -100
% of segment profit/loss to the higher of total profit or total loss in absolute figure	5	**90**	**15**	5	8	5	5	7	
3. **Segment Assets**	15	47	5	11	3	5	5	9	100
% of segment assets to the total assets of all segments taken together	**15**	**47**	5	**11**	3	5	5	9	100

1. As per the Segment Revenue criterion Segments A and B with segment revenue of more than 10% of the total revenue of all segments taken together, are identified as Reportable Segments.
2. As per the Segment Result criterion Segments B and C with segment profit or loss of more than 10% of the higher of total profit of all profit-making segments and total loss of all loss-making segments -in absolute figure- are identified as Reportable Segments.
3. As per the Segment Asset criterion Segments A, B and D with segment assets of more than 10% of the total assets of all segments taken together, are identified as Reportable Segments.

Further, we assume that the management has not identified any other segments voluntarily at their discretion for reporting purpose.

So primarily the reportable segments are A, B, C and D.

Now total external sales of the above four segments = Nil +255+15+10 = 280

However, the threshold external sales = 75% of total external sales = 75% of 400 = 300.

Thus, in order to achieve the threshold one or more segments are to be identified as reportable. Let us consider segment F with highest external sales for this purpose.

So, finally, the reportable segments are – A, B, C, D, F and all other segments are to be reported on a consolidated basis under the head 'All Other Segments'.

7.7.6 Disclosure Requirements of Segment reporting as per Ind AS 108

● General information

An entity shall disclose the following general information:

(i) factors used to identify the entity's reportable segments.

(ii) the judgements made by management in applying the aggregation criteria.

(iii) types of products and services from which each reportable segment derives its revenues.

● **Information about profit or loss, assets and liabilities**

For each reportable segment the entity shall have to disclose the following main points:

(a) revenues from external customers;

(b) revenues from transactions with other operating segments of the same entity;

(c) interest revenue;

(d) interest expense;

(e) depreciation and amortization;

(f) material items of income and expense disclosed in accordance with Ind AS 1, *Presentation of Financial Statements*;

(g) the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method;

(h) income tax expense or income; and

(i) material non-cash items other than depreciation and amortization.

- **Measurement**

An entity shall provide an explanation of the measurements of segment profit or loss, segment assets and segment liabilities for each reportable segment.

- **Reconciliations**

An entity shall provide reconciliations of all of the following:

(a) the total of the reportable segments' revenues to the entity's revenue.

(b) the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense (tax income) and discontinued operations.

(c) the total of the reportable segments' assets to the entity's assets.

(d) the total of the reportable segments' liabilities to the entity's liabilities.

(e) the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity.

- **Restatement of previously reported information**

If an entity changes its internal organizational structure in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, should be restated unless the information is not available and the cost to develop would be excessive.

- **Entity-wide disclosures**

The following information shall be provided only if it is not provided as part of the reportable segment information required by this Ind AS.

I. Information about products and services

An entity shall report the revenues from external customers for each product and service, or each group of similar products and services. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements.

II. Information about geographical areas

An entity shall report the following geographical information:

(a) revenues from external customers (i) attributed to the entity's country of domicile, and (ii) attributed to all foreign countries in total from which the entity derives revenues.

(b) non-current assets other than financial instruments, deferred tax assets, post-employment benefit assets, and rights arising under insurance contracts (i) located in the entity's country of domicile, and (ii) located in all foreign countries in total in which the entity holds assets.

III. Information about major customers

An entity shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount to 10 per cent or more of an entity's revenues, the entity shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues.

7.8 Summary

Segment reporting is made for both the internal and external purposes. It plays an important role in disseminating disaggregated information to the users. Users of information may feel good in evaluating segment performance and overall perfor-mance of the company. This might encourage them. Stock market might show its reaction. Segment reporting also helps the management in framing policy decisions and in measuring growth potential, risks and returns. When segment reporting is used for internal purposes, it provides an opportunity to the management to keep constant watch over the bad and good performing segments. As a result, they can take corrective measures for the badly performing segment. They can also think about expansion for segment performing better than others with a view to enhancing overall profitability of the company.

7.9 Exercises

● **Theoretical Questions:**

1. What do you mean by the term 'segment' as used in business?
2. What is segment reporting? Why is segment reporting needed? What are the benefits of segment reporting?
3. State the conditions for identifying the reportable segments as per Ind AS 108.
4. State the disclosures that are to be made for each reportable segment.

- **Practical Problems:**

Problem 1 :

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in Rs.'000):

Particulars	A	B	C	D	E	F	G	H
1. Segment Revenue								
(a) External Sales	-	5035	285	190	95	950	380	722
(b) Inter Segment Sales	190	1140	570	95	-	-	95	-
2. Segment Results Profit/ (Loss)	95	-1710	285	-95	152	-95	95	133
3. Segment Assets	285	95	95	1140	57	95	95	38

Identify the reportable segments as per Ind AS 108.

[Ans. Reportable Segments are A, B, C, D, F and other segments]

Problem 2 :

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in Rs.'000) :

	A	B	C	D	E	F	G	H	Total (segment)
1. Segment Revenue									
(a) External Sales	-	663	37	25	13	125	50	87	1000
(d) Inter Segment Sales	250	150	75	13	-	-	12	-	500
2. Segment Results Profit/ (Loss)	15	(270)	45	(15)	24	(15)	15	21	
3. Segment Assets	15	5	5	60	3	5	5	2	100

Identify the reportable segments as per Ind AS108.

[Ans. Reportable Segments are A, B, C, D, F and other segments]

Problem 3 :

An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information about these segments is given in the following table (amounts in Rs.'000):

Particulars	A	B	C	D	E	F	G	H
1. Segment Revenue								
(a) External Sales	6600	-	250	400	1200	500	180	870
(e) Inter Segment Sales	500	2000	1130	800	-	570	-	-
2. Segment Results Profit/ (Loss)	2700	150	(150)	(450)	150	(550)	(210)	(240)
3. Segment Assets	800	250	500	80	100	50	50	170

Identify the reportable segments as per Ind AS 108.

[Ans. Reportable Segments are A, B, C, D, F and other segments]

Problem 4 :

Determine the reportable segments from the following information of X Ltd for 2020:

	India	Brazil	Canada	Russia	USA	UK	Total (segment)
1. Segment Revenue							
(a) External Sales	750	20	250	400	160	100	1680
(f) Inter Segment Sales	150	60	80	220	390	10	910
2. Segment Results Profit/(Loss)	170	(20)	(30)	270	150	(50)	
3. Segment Assets	810	510	160	160	270	50	1960

Identify the reportable segments as per Ind AS108.

[Ans. Reportable Segments are India, Brazil, Canada, Russia, USA and other segments]

Unit 8 □ Contemporary Issues in Corporate Reporting

Structure

8.1 Objective
8.2 Introduction
8.3 Business Responsibility Report
    8.3.1 Applicability of BRR
    8.3.2 Format for Business Responsibility Report
    8.3.3 Availability of BRR
8.4 Corporate Social Responsibility Reporting
    8.4.1 Concept of Corporate Social Responsibility
    8.4.2 Benefits of CSR
    8.4.3 Justification of CSR Policy
    8.4.4 Present Legislation on CSR in India
    8.4.5 Format for the Annual Report on CSR Activities to be Included in the Board's Report
    8.4.6 Availability of CSR Report
8.5 Sustainability Reporting and Global Reporting Initiatives
    8.5.1 Sustainability Reporting
    8.5.2 Global Reporting Initiatives
8.6 Integrated Report
    8.6.1 History of Integrated Reporting
    8.6.2 Concept and Definition of Integrated Reporting (IR)
    8.6.3 Objectives of Integrated Reporting
    8.6.4 Integrated Reporting (IR) Framework
    8.6.5 Integrated Report: Guiding Principles
    8.6.6 Integrated Reporting: the International Scenario
    8.6.7 Integrating Reporting in India
8.7 Summary
8.8 Exercises

8.1 Objective

After going through this unit, you will be able to:

- Understand the importance of recent developments in corporate financial accounting and reporting
- Know the importance and contents of Business Responsibility Report (BRR)
- Know the regulatory framework of CSR in India
- Know the importance of Integrated Reporting and contents of <IR> Framework

8.2 Introduction

Accounting and reporting are dynamic in nature. While the changes in accounting are driven by the need to exhibit a true and fair view of the financial performance and financial state of affairs through financial statements, the same in reporting are driven by the ever-increasing need for information by the shareholders in particular and the stakeholders at large.

In the past one decade or so, accounting and reporting across the world have seen many pertinent developments. Along with a fundamental knowledge of various accounting techniques, an accounting practitioner need to have a clear understanding of all these developments.

8.3 Business Responsibility Report

Adoption of responsible business practices in the interest of the social set-up and the environment are as vital as their financial and operational performance. This is all the more relevant for listed entities which, considering the fact that they have accessed funds from the public, have an element of public interest involved, and are obligated to make exhaustive continuous disclosures on a regular basis.

Keeping this in mind, in July 2011, the Ministry of Corporate Affairs, Government of India, came out with the 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business'. These guidelines contained comprehensive principles to be adopted by companies as part of their business practices and a structured business responsibility reporting format requiring certain specified disclosures, demonstrating the steps taken by companies to implement the said principles.

In line with the above Guidelines and considering the larger interest of public disclosure regarding steps taken by listed entities from Environmental, Social and Governance ("ESG") perspective, it was decided by SEBI to mandate inclusion of Business Responsibility Reports ("BR reports") as part of the Annual Reports for listed entities. Consequently, certain listing conditions are specified by way of inserting Clause 55 in the equity Listing Agreement. (Reference: SEBI Circular CIR/CFD/DIL/8/2012 dated August 13, 2012). As per the latest amendment of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, preparation of BRR is mandatory for top 1000 market capitalization companies.

8.3.1 Applicability of BRR

a. The requirement to include BR Reports as part of the Annual Reports shall be mandatory for top 1000 listed entities based on market capitalization at BSE and NSE. BSE and NSE shall independently draw up a list of listed entities who are required to prepare BR Report based on the said criteria and disseminate the same in their websites respectively. Other listed entities may voluntarily disclose BR Reports as part of their Annual Reports.

Those listed entities which have been submitting sustainability reports to overseas regulatory agencies/stakeholders based on internationally accepted reporting frameworks need not prepare a separate report for the purpose of these guidelines but only furnish the same to their stakeholders along with the details of the framework under which their BR Report has been prepared and a mapping of the principles contained in these guidelines to the disclosures made in their sustainability reports.

8.3.2 Format for Business Responsibility Report *[Regulation 34(2) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015]*

The general format of BRR is composed of five segments as follows:

Section A : General information about the Company

1. Corporate Identity Number (CIN) of the Company
2. Name of the Company
3. Registered address
4. Website
5. E-mail id

6. Financial Year reported
7. Sector(s) that the Company is engaged in (industrial activity code-wise)
8. List three key products/services that the Company manufactures/provides (as in balance sheet)
9. Total number of locations where business activity is undertaken by the Company
   (a) Number of International Locations (Provide details of major 5)
   (b) Number of National Locations
10. Markets served by the Company – Local/State/National/International

Section B : Financial Details of the Company

1. Paid up Capital (INR)
2. Total Turnover (INR)
3. Total profit after taxes (INR)
4. Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%)
5. List of activities in which expenditure in 4 above has been incurred.

Section C : Other Details

1. Does the Company have any Subsidiary Company/ Companies?
2. Do the Subsidiary Company/Companies participate in the BR Initiatives of the parent company? If yes, then indicate the number of such subsidiary company(s)
3. Do any other entity/entities (e.g., suppliers, distributors etc.) that the Company does business with participate in the BR initiatives of the Company? If yes, then indicate the percentage of such entity/entities? [Less than 30%, 30-60%, More than 60%]

Section D : BR Information

1. Details of Director/Directors responsible for BR

a) Details of the Director/Director responsible for implementation of the BR policy/policies

- DIN Number
- Name
- Designation

b) Details of the BR head

Serial No.	Particulars	Details
1.	DIN Number (if applicable)	
2.	Name	
3.	Designation	
4.	Telephone no.	
5.	Email Id	

2. Principle-wise (as per NVGs) BR Policy/policies (Reply in Y/N)

Sl. No.	Questions	P 1	P 2	P 3	P 4	P 5	P 6	P 7	P 8	P 9
1.	Do you have policy/policies for....									
2.	Has the policy being formulated in consultation with the relevant stakeholders?									
3.	Does the policy conform to any national / international standards? If yes, specify? (50 words)									
4.	Has the policy being approved by the Board? Is yes, has it been signed by MD/owner/CEO/ appropriate Board Director?									
5.	Does the company have a specified committee of the Board/ Director/Offcial to oversee the implementation of the policy?									
6.	Indicate the link for the policy to be viewed online?									
7.	Has the policy been formally communicated to all relevant internal and external stakeholders?									
8.	Does the company have in-house structure to implement the policy/policies?									
9.	Does the Company have a grievance redressal mechanism related to the policy/policies to address stakeholders' grievances related to the policy/policies?									
10.	Has the company carried out independent audit/evaluation of the working of this policy by an internal or external agency?									

2a. If answer to S. No. 1 against any principle, is 'No', please explain why: (Tick up to 2 options)

Sl. No.	Questions	P 1	P 2	P 3	P 4	P 5	P 6	P 7	P 8	P 9
1.	The company has not understood the Principles									
2.	The company is not at a stage where it finds itself in a position to formulate and implement the policies on specified principles									
3.	The company does not have financial or manpower resources available for the task									
4.	It is planned to be done within next 6 months									
5.	It is planned to be done within the next 1 year									
6.	Any other reason (please specify)									

3. Governance related to BR

● Indicate the frequency with which the Board of Directors, Committee of the Board or CEO to assess the BR performance of the Company (Within 3 months, 3-6 months, Annually, More than 1 year).

● Does the Company publish a BR or a Sustainability Report? What is the hyperlink for viewing this report? How frequently it is published?

Section E: Principle-wise performance

Principle 1 - Business should conduct and govern themselves with ethics, transparency and accountability.

1. Does the policy relating to ethics, bribery and corruption cover only the company? Yes/ No. Does it extend to the Group/Joint Ventures/ Suppliers/ Contractors/NGOs /Others?
2. How many stakeholder complaints have been received in the past financial year and what percentage was satisfactorily resolved by the management?

(*If so, provide details thereof, in about 50 words or so).*

Principle 2 - Business should provide goods and services that are safe and contribute to the sustainability throughout their life cycle.

1. List up to 3 of your products or services whose design has incorporated social or environmental concerns, risks and/or opportunities.

i.

ii.

iii.

2. For each such product, provide the following details in respect of resource use (energy, water, raw material etc.) per unit of product(optional):

i. Reduction during sourcing/production/ distribution achieved since the previous year throughout the value chain?

ii. Reduction during usage by consumers (energy, water) has been achieved since the previous year?

3. Does the company have procedures in place for sustainable sourcing (including transportation)?

i. If yes, what percentage of your inputs was sourced sustainably? *Also, provide details thereof, in about 50 words or so.*

4. Has the company taken any steps to procure goods and services from local & small producers, including communities surrounding their place of work?

If yes, what steps have been taken to improve their capacity and capability of local and small vendors?

5. Does the company have a mechanism to recycle products and waste? If yes, what is the percentage of recycling of products and waste (separately as <5%, 5-10%, >10%). Also, provide details thereof, in about 50 words or so.

Principle 3 - Business should promote the wellbeing of all employees.

1. Please indicate the Total number of employees.
2. Please indicate the Total number of employees hired on temporary/ contractual/casual basis.
3. Please indicate the Number of permanent women employees.
4. Please indicate the Number of permanent employees with disabilities
5. Do you have an employee association that is recognized by management?
6. What percentage of your permanent employees is members of this recognized employee association?
7. Please indicate the Number of complaints relating to child labour, forced labour, involuntary labour, sexual harassment in the last financial year and pending, as on the end of the financial year.

8. What percentage of your under mentioned employees were given safety & skill up-gradation training in the last year?
    - Permanent Employees
    - Permanent Women Employees
    - Casual/Temporary/Contractual Employees
    - Employees with Disabilities

Principle 4 - Business should respect the interest of and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.

1. Has the company mapped its internal and external stakeholders? Yes/No
2. Out of the above, has the company identified the disadvantaged, vulnerable & marginalized stakeholders?
3. Are there any special initiatives taken by the company to engage with the disadvantaged, vulnerable and marginalized stakeholders? If so, provide details thereof, in about 50 words or so.

Principle 5 - Business should respect and promote human rights.

1. Does the policy of the company on human rights cover only the company or extend to the Group/Joint Ventures/Suppliers/Contractors/NGOs/Others?
2. How many stakeholder complaints have been received in the past financial year and what percent was satisfactorily resolved by the management?

Principle 6 - Business should respect, protect and make efforts to restore the environment.

1. Does the policy related to Principle 6 cover only the company or extends to the Group/Joint Ventures/Suppliers/Contractors/NGOs/others.
2. Does the company have strategies/ initiatives to address global environmental issues such as climate change, global warming, etc? Y/N. If yes, please give hyperlink for webpage etc.
3. Does the company identify and assess potential environmental risks? Y/N
4. Does the company have any project related to Clean Development Mechanism? If so, provide details thereof, in about 50 words or so. Also, if Yes, whether any environmental compliance report is filed?

5. Has the company undertaken any other initiatives on – clean technology, energy efficiency, renewable energy, etc? Y/N. If yes, please give hyperlink for web page etc.
6. Are the Emissions/Waste generated by the company within the permissible limits given by CPCB/SPCB for the financial year being reported?
7. Number of show cause/ legal notices received from CPCB/SPCB which are pending (i.e. not resolved to satisfaction) as on end of Financial Year.

Principle 7 - Business, when engaged in influencing public and regulatory policy, should do so in a responsible manner.

1. Is your company a member of any trade and chamber or association? If Yes, Name only those major ones that your business deals with:

a.

b.

c.

d.

2. Have you advocated/lobbied through above associations for the advancement or improvement of public good? Yes/No; if yes specify the broad areas (drop box: Governance and Administration, Economic Reforms, Inclusive Development Policies, Energy security, Water, Food Security, Sustainable Business Principles, Others).

Principle 8 - Business should support inclusive growth and equitable development.

1. Does the company have specified programmes/initiatives/projects in pursuit of the policy related to Principle 8? If yes details thereof.
2. Are the programmes/projects undertaken through in-house team/own foundation/external NGO/government structures/any other organization?
3. Have you done any impact assessment of your initiative?
4. What is your company's direct contribution to community development projects- Amount in INR and the details of the projects undertaken?
5. Have you taken steps to ensure that this community development initiative is successfully adopted by the community? Please explain in 50 words, or so.

Principle 9 Business should engage with and provide value to their customers in a responsible manner.

1. What percentage of customer complaints/consumer cases are pending as on the end of financial year.
2. Does the company display product information on the product label, over and above what is mandated as per local laws? Yes/No/N.A. /Remarks (additional information)
3. Is there any case filed by any stakeholder against the company regarding unfair trade practices, irresponsible advertising and/or anti-competitive behaviour during the last five years and pending as on end of financial year. If so, provide details thereof, in about 50 words or so.
4. Did your company carry out any consumer survey/ consumer satisfaction trends?

8.3.3 Availability of BRR

BRR of an eligible company can be found as a part of the Annual Report of the company. Most of the companies also post a separate link in their Annual Report to access the soft copy of the report.

8.4 Corporate Social Responsibility Reporting

8.4.1 Concept of Corporate Social Responsibility

A business cannot exist in isolation. In the process of its existence and growth it consumes various resources of the society and hence, in turn, must have an obligation towards the society. In the context of corporate organisations, recognising and discharging this obligation may be interpreted as Corporate Social Responsibility (CSR).

The term 'corporate social responsibility' has hardly been defined in any legislation. Philip Kotler and Nancy Lee (2005) defined CSR as a "commitment to improve community well-being through discretionary business practices and contributions of corporate resources".

Thus, CSR may be understood to be a philosophy imposing an obligation on the corporates to contribute to the society (whether towards any economic, social or ecological cause) along with the reinforced duty to conduct the business operations in an ethical manner.

It should be viewed as a form of self-regulation, rather than merely a compliance towards a given regulation, that should be integrated into the business model.

8.4.2 Benefits of CSR

CSR practises bring in many benefits for society, the people within and the corporate itself.

- CSR enhanced corporate image and builds reputational capital.
- It often strengthens brand positioning.
- It gives the company a sense of satisfaction of economic and social contribution.
- CSR increases the acceptability of the company among the investors.
- Local economy as well as selective external stakeholders are directly benefited

8.4.3 Justification of CSR Policy

CSR should not be viewed as a mere compliance requirement to any given legislation. Existence of a well-defined CSR policy is a must in today's business context.

- A well-defined CSR policy may help in building reputational capital which may help a company to maintain the investor confidence in turbulent times. It may even be helpful in bringing down the cost of capital.
- Good CSR policies shift the orientation of the company from short term profit generation to long term value addition.
- CSR policies towards maintaining ecological balances may contribute to conserve the continually depleting non-renewable resources.
- With growing globalization, when businesses are being viewed as expositors rather than saviours in the society, good CSR policy and execution of the same may work to counter this perception.

8.4.4 Present Legislation on CSR in India

Keeping the immense importance of CSR in the society, regulators in different countries initiate well-defined regulatory mechanism to guide and monitor the corporate social responsibility (CSR) activities undertaken by corporate firms. Unfortunately, Indian regulators had largely overlooked such a requirement. There was no corresponding provision in the Companies Act 1956 on CSR. The Ministry of Corporate Affairs, Govt. of India had only issued a guideline namely 'Corporate Social Responsibility Voluntary Guidelines, 2009' which required companies to formulate a CSR policy to guide its strategic planning and provide a roadmap for its

CSR initiatives. Quite understandably, the effort was never taken seriously by the Indian corporate sector. However, with the introduction of the new Companies Act 2013, which has introduced a well-defined framework in this respect, the situation seems changing significantly and in a positive direction.

The present legal framework on CSR in India comprises of –

(a) Section 135 of Companies Act 2013 [Notified on 01.04.2014];

(b) Schedule VII of Companies Act 2013; and

(c) Companies (Corporate Social Responsibility Policy) Rules 2014 [Notified on 01.04.2014].

The salient features of these regulations are given below.

1. **Formation and Composition of CSR Committee :** Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year (amendment effective from 19.09.2018) shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

   However, companies, which are not required to appoint an independent director u/s 149(4), shall have in its Corporate Social Responsibility Committee two or more directors [Section 135(1)].

2. **Board's Report and CSR Committee :** The Board's report u/s 134(3) shall disclose the composition of the Corporate Social Responsibility Committee. [Section 135(2)].

3. **Functions of CSR Committee :** The Corporate Social Responsibility Committee shall —

   (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII.

   (b) recommend the amount of expenditure to be incurred on the above activities; and

   (c) monitor the Corporate Social Responsibility Policy of the company from time to time.

[Section 135(3)]

4. **Board's Responsibility :** The Board shall—

(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and

(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company. [Section 135(4)]

5. **CSR Spending :**

The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

If the company fails to spend such amount, the Board shall specify the reasons for not spending the amount and unless the unspent amount relates to any ongoing project referred to in sub-section (6), transfer such unspent amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

If the company spends an amount in excess of the requirements provided under this sub-section, such company may set off such excess amount against the requirement to spend under this sub-section for such number of succeeding financial years and in such manner, as may be prescribed.

Any amount remaining unspent under sub-section (5), pursuant to any ongoing project, fulfilling such conditions as may be prescribed, undertaken by a company in persuance 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, and 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 is in default in complying with the provisions of sub-section (5) or sub-section (6), the company shall be liable to a penalty of twice the amount

required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or one crore rupees, whichever is less, and every officer of the company who is in default shall be liable to a penalty of one-tenth of the amount required to be transferred by the company to such Fund specified in Schedule VII, or the Unspent Corporate Social Responsibility Account, as the case may be, or two lakh rupees, whichever is less. [Section 135(5)]

6. **Modalities of Undertaking CSR Activities [Rule 4] :**

a) The CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business.

b) The Board of a company may decide to undertake its CSR activities approved by the CSR Committee, through

- a company established under section 8 of the Act or a registered trust or a registered society, established by the company, either singly or along with any other company; or
- a company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of Parliament or a State legislature.

c) A company may also collaborate with other companies for undertaking projects or programs or CSR activities.

d) The CSR projects or programs or activities that benefit only the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

e) Companies may build CSR capacities of their own personnel as well as those of their Implementing agencies through Institutions with established track records of at least three financial years but such expenditure shall not exceed five percent of total CSR expenditure of the company in one financial year.

f) Contribution of any amount directly or indirectly to any political party shall not be considered as CSR activity.

7. **CSR Policy [Rule 6]**

The CSR Policy of the company shall, inter-alia, include the following namely:

(a) a list of CSR projects or programs which a company plans to undertake in areas or subjects specified in of the Schedule VII of the Act, specifying modalities of execution of such project or programs and implementation schedules for the same; and

(b) monitoring process of such projects or programs.

The CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

8. **CSR Report [Rule 8]**

The Board's Report shall include an annual report on CSR containing particulars specified in Annexure.

9. **Areas of CSR Activities [Schedule VII] :** The broad areas are:

(i) Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water.

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects.

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups.

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga.

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional art and handicrafts;

(vi) measures for the benefit of armed forces veterans, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows

(vii) training to promote rural sports, nationally recognised sports, paralympic sports and olympic sports

(viii) contribution to the Prime Minister's National Relief Fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM CARES Fund) or any other fund set up by the central govt. for socio economic development and relief and welfare of the schedule caste, tribes, other backward classes, minorities and women;

(ix) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organization (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs).

(x) rural development projects

(xi) slum area development

(xii) Disaster management, including relief, rehabilitation and reconstruction activities.

8.4.5 Format for the Annual Report on CSR Activities to be Included in the Board's Report

A CSR report shall include -

1. A brief outline of the company's CSR policy, including overview of projects or programs proposed to be undertaken and a reference to the web-link to the CSR policy and projects or programs.
2. The composition of the CSR Committee.
3. Average net profit of the company for last three financial years
4. Prescribed CSR Expenditure (two percent of the amount as in the Item 3 above)

5. Details of CSR spent during the financial year.
   (a) Total amount to be spent for the financial year;
   (b) Amount unspent, if any;
   (c) Manner in which the amount spent during the financial year is detailed below.

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
S. No.	CSR Project or Activity Identified	Sector in which the project is covered	Project or Programs (1) Local area or other (2) Specify the state and district where projects or programs was undertaken	Amount outlay (budget) project or programs wise	Amount spent on the project or programs Sub-heads: (1) Direct expenditure on projects or programs (2) Overheads:	Cumulative expenditure up to the reporting period	Amount spent: Direct or through implementing agency

6. In case the company has failed to spend the two percent of the average net profit of the last three financial years or any part thereof, the company shall provide the reasons for not spending the amount in its Board report.
7. A responsibility statement of the CSR Committee that the implementation and monitoring of CSR Policy, is in compliance with CSR objectives and Policy of the company.

Sd/-	Sd/-	Sd/-
(Chief Executive Officer or Managing Director or Director)	(Chairman CSR Committee)	(Person specified under clause (d) of sub-section (1) of section 380 of the Act) (wherever applicable)

8.4.6 Availability of CSR Report

In India, CSR report of an eligible company may be found as an annexure to the Board's Report included in the Annual Report of the company.

8.5 Sustainability Reporting and Global Reporting Initiatives

8.5.1 Sustainability Reporting

Today's business organisation is often found to be committed towards sustainable business practices to ensure its participation in sustainable economic development. A sustainability report is a report published by a company or organization about the economic, environmental and social impacts caused by its everyday activities. It also presents the organization's values and governance model, and demonstrates the link between its strategy and its commitment to a sustainable global economy.

Sustainability reporting can help organizations to measure, understand and communicate their economic, environmental, social and governance performance, and accordingly set goals, and manage change more effectively. It is the key platform for communicating sustainability performance and impacts – whether positive or negative. It is often considered as synonymous with other terms for non-financial reporting like triple bottom line reporting, corporate social responsibility (CSR) reporting, and more. It is also an intrinsic element of **integrated reporting**; a more recent development that combines the analysis of financial and non-financial performance.

- **Benefits of Sustainability Reporting**

Sustainability reporting can have a wide range of business benefits.

(a) Driver of innovation and learning

Sustainability reporting often highlights inefficiencies and risk. It helps to identify opportunities for the business arising out of the changes in the business environment.

(b) Building reputational capital

Sustainability reporting increases the reputational capital of the business. It is highly accepted by the investors and other stakeholders. Higher acceptability many a times reduces the cost of capital in the long run. It also improves employee retention as employees are more inclined to be associated with a responsible company.

(d) Raising corporate transparency

Sustainability reporting raises corporate transparency. This improves the brand value of the company. It also helps stakeholders to assess the management quality.

(e) Balanced assessment by stakeholders

Sustainability reporting requires disclosure of both positive and negative impact of business operations. As a result, stakeholders can have a balanced assessment of an organisation's activities.

(f) Holistic assessment of emerging risks and opportunities

Today, success of a business largely depends on how well it can manage the non-financial risks. Sustainability reporting provides adequate information in this respect and in the process highlights emerging markets and opportunities. It also improves business resilience and reassures investors that company is managing non-financial risk well.

(g) Promotes stakeholder engagement and communications

Sustainability reporting is stakeholder oriented rather than being merely shareholder oriented. This eventually ensure better stakeholder engagement and communications.

(h) Aligned with objectives of annual reporting of financial information.

Sustainability reporting is not totally separated from financial reporting rather it is aligned with objectives of annual reporting and discloses a holistic picture of the company.

(h) Important source of information to the regulators and others

Sustainability reporting is often an important source of information to the regulators and social activists.

- **Contents of Sustainability Report**

As mentioned at the outset, sustainability reporting enables organizations to report on environmental and social performance. Accordingly, sustainability report includes all such information that depicts the impact, both positive and negative, of an organisation's business practices. It includes organisation's economic performance, impact of its activities on ecology (such as carbon footprint, waste management, conservation of non-renewable resources), its efforts to ensure occupational health and safety, upholding human rights, safe and sustainable product delivery and last but not the least organisation's efforts towards community development.

- **Providers of Sustainability Reporting Guidelines**

Major providers of sustainability reporting guidance include:

- GRI (GRI's Sustainability Reporting Standards)
- The Organisation for Economic Co-operation and Development (OECD Guidelines for Multinational Enterprises)
- The United Nations Global Compact (the Communication on Progress)
- The International Organization for Standardization (ISO 26000, International Standard for social responsibility)

8.5.2 Global Reporting Initiatives

- **The History of GRI**

The Global Reporting Initiative (known as GRI) is an international independent standards organization that helps businesses, governments and other organizations understand and communicate their impacts on issues such as climate change, human rights and corruption.

GRI was founded in Boston in 1997 following the public outcry over the environmental damage of the Exxon Valdez oil spill. It was formed by the United States-based non-profits CERES (formerly the Coalition for Environmentally Responsible Economies) and Tellus Institute, with the support of the United Nations Environment Programme (UNEP). The objective was to introduce an accountability mechanism to ensure companies adhere to responsible environmental conduct which later on widened further to include social, economic and governance issues. In 2000, the organisation issued its first guidelines (G1) on sustainability reporting. In 2001, GRI was established as an international independent organisation. In 2002 GRI moved its secretariat to Amsterdam, Netherlands and also issued the first update of its guidelines (G2) which was further modified in 2006 (G3) and 2013 (G4). Although the GRI is independent, it remains a collaborating centre of UNEP and works in cooperation with the United Nations Global Compact.

- **Standards Issued by GRI**

The following is the list of standards issued by GRI:

Universal Standards	**Effective date**
GRI 101: Foundation 2016	1 July 2018
GRI 102: General Disclosures 2016	1 July 2018
GRI 103: Management Approach 2016	1 July 2018
Topic-specific Standards	

Universal Standards	**Effective date**
GRI 200: Economic	
GRI 201: Economic Performance 2016	1 July 2018
GRI 202: Market Presence 2016	1 July 2018
GRI 203: Indirect Economic Impacts 2016	1 July 2018
GRI 204: Procurement Practices 2016	1 July 2018
GRI 205: Anti-corruption 2016	1 July 2018
GRI 206: Anti-competitive Behavior 2016	1 July 2018
GRI 207: Tax 2019	1 January 2021
GRI 300: Environmental	
GRI 301: Materials 2016	1 July 2018
GRI 302: Energy 2016	1 July 2018
GRI 303: Water and Effluents 2018	1 January 2021
GRI 304: Biodiversity 2016	1 July 2018
GRI 305: Emissions 2016	1 July 2018
GRI 306: Waste 2020	1 January 2022
GRI 307: Environmental Compliance 2016	1 July 2018
GRI 308: Supplier Environmental Assessment 2016	1 July 2018
GRI 400: Social	
GRI 401: Employment 2016	1 July 2018
GRI 402: Labor/Management Relations 2016	1 July 2018
GRI 403: Occupational Health and Safety 2018	1 January 2021
GRI 404: Training and Education 2016	1 July 2018
GRI 405: Diversity and Equal Opportunity 2016	1 July 2018
GRI 406: Non-discrimination 2016	1 July 2018
GRI 407: Freedom of Association and Collective Bargaining 2016	1 July 2018
GRI 408: Child Labor 2016	1 July 2018
GRI 409: Forced or Compulsory Labor 2016	1 July 2018
GRI 410: Security Practices 2016	1 July 2018
GRI 411: Rights of Indigenous Peoples 2016	1 July 2018

Universal Standards	Effective date
GRI 412: Human Rights Assessment 2016	1 July 2018
GRI 413: Local Communities 2016	1 July 2018
GRI 414: Supplier Social Assessment 2016	1 July 2018
GRI 415: Public Policy 2016	1 July 2018
GRI 416: Customer Health and Safety 2016	1 July 2018
GRI 417: Marketing and Labeling 2016	1 July 2018
GRI 418: Customer Privacy 2016	1 July 2018
GRI 419: Socioeconomic Compliance 2016	1 July 2018

- **Acceptability of GRI Sustainability Reporting Standards**

Though sustainability reporting standards are provided by many organisations, GRI Sustainability Reporting Standards are the most widely accepted. Like all other standards, GRI Sustainability Reporting Standards (GRI Standards) also help businesses, governments and other organizations understand and communicate the impact of business on critical sustainability issues. Some of the distinctive elements of the GRI Standards that have increased its wide acceptance, include:

a) **Multi-stakeholder input :** GRI's approach is based on multi-stakeholder engagement, representing the best combination of technical expertise and diversity of experience to address the needs of all report makers and users. This approach enables to produce universally-applicable reporting guidance. All elements of the Reporting Framework are created and improved using a consensus-seeking approach, and considering the widest possible range of stakeholder interests which includes business, civil society, labour, accounting, investors, academics, governments and sustainability reporting practitioners.

b) **A record of use and endorsement :** Of the world's largest 250 corporations, 92% report on their sustainability performance and 74% of these use GRI's Standards to do so. With over 23,000 GRI Reports recorded in GRI database, sustainability reporting using the GRI Standards is significant.

c) **Governmental references and activities :** Enabling policy is a key aspect of GRI's overall strategy and they work with governments, international organizations and capital markets to further this agenda. As a result, 35 countries use GRI in their sustainability policies. In addition, GRI has long-standing collaborations with over 20 international organizations such as the UNGC, OECD and the UN Working Group on Business & Human Rights.

d) **Independence :** The creation of the Global Sustainability Standards Board in 2014, and related governance structure changes, have strengthened the independence of the standards aspect of our work. Its funding approach also ensures independence. GRI is a non-profit foundation with a business model that aims for a degree of self-sufficiency. Funding is secured from diverse sources; governments, companies, foundations, partner organizations and supporters.

e) **Shared development costs :** The expense of developing GRI's reporting guidance is shared among many users and contributors. For companies and organizations, this negates the cost of developing in-house or sector-based reporting frameworks.

8.6 Integrated Report

The present corporate reporting framework across many nations requires companies to prepare multiple reports to meet the growing information needs of corporate stakeholders such as management discussion and analysis, auditor's report, directors' report etc. As a result, the information set appears to be disintegrated and fails to explain how an organisation, through a coordinated effort, has been able to create value. In this context, Integrated Reporting<IR> is increasingly gaining popularity by explaining how the interaction among organization's varied efforts to meet stakeholders' expectations can create value for the organization.

8.6.1 History of Integrated Reporting

In 2009, the Prince of Wales convened a high-level meeting of investors, standard setters, companies, accounting bodies and UN representatives including The Prince's Accounting for Sustainability Project, International Federation of Accountants (IFAC), and the Global Reporting Initiative (GRI), to establish the International Integrated Reporting Committee (IIRC), a body to oversee the creation of a globally accepted Integrated Reporting framework. In November 2011, the Committee was renamed the International Integrated Reporting Council. On 17 and 18 October 2011, the first Integrated Reporting Pilot Programme conference was convened in Rotterdam. The Pilot Programme is made up of a Business Network and Investor Network that are both feeding back to the IIRC with their progression towards Integrated Reporting. There are over 80 Businesses and over 25 Investors participating in the Pilot Programme. The Discussion Paper Towards Integrated Reporting – Communicating Value in the 21st Century was launched Monday 12 September 2011. It considered the rationale for Integrated Reporting, offering initial proposals for the development of an International Integrated Reporting Framework

and outlining the next steps towards its creation and adoption. Its purpose was to prompt input from all those with a stake in improved reporting, including producers and users of reports. On 26 November 2012 the IIRC released a Prototype of the International IR Framework, a significant further step towards publication of the Framework in 2013. This was an interim step intended to demonstrate progress towards defining key concepts and principles that underpin IR, and support organizations' ability to produce an integrated report. Finally, on 16 April 2013 the IIRC released the Consultation Draft of the International IR Framework.

8.6.2 Concept and Definition of Integrated Reporting<IR>

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. 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.

According to IIRC, *an integrated report is a concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term*.

8.6.3 Objectives of Integrated Reporting

The objectives of Integrated Reporting <IR> are:

- To improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital
- To promote a more cohesive and efficient approach to corporate reporting that can explain how an organisation creates value through a coordinated approach.
- To enhance accountability and stewardship for the broad base of capitals (financial, manufactured, intellectual, human, social and relationship, and natural) and promote understanding of their interdependencies
- Support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

8.6.4 Integrated Reporting <IR> Framework

Integrated Reporting <IR> Framework is a detailed suggestive guidance on preparation of an integrated report. The framework has been issued by the International Integrated Reporting Council (IIRC). The objective of this framework is to provide the guidelines and the content element that will be the basis for preparation of an integrated report. Though the framework is primarily meant for private corporates, the same may be suitably adapted by public sector organizations and even not for profit undertakings. The framework only identifies the information to be included in an integrated report to enable the users to appropriately assess the organization's ability to create value. It does not provide any benchmark. Moreover, the framework is principles-based in order to strike an appropriate balance between flexibility and prescription that recognizes the wide variation in individual circumstances of different organizations and yet provide a decent degree of comparability.

The framework details the value creation process as follows:

A. Value Creation; Meaning: An organisation creates value over time which gets manifested in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs. The value is created by the organisation for itself, which enables financial returns to the providers of financial capital and also for others (i.e., stakeholders and society at large).

B. The Components of Value Creation Process:

1. Different Forms of Capital: All organizations depend on various forms of capital for their success. In this Framework, the capitals comprise financial (fund available from shareholders, loan providers), manufactured (building, plant etc.), intellectual (i.e., knowledge-based intangibles), human (people's competencies, capabilities and experience, and their motivations to innovate), social and relationship (the institutions and the relationships within and between communities, groups of stakeholders and other networks), and natural (All renewable and non-renewable environmental resources and processes that provide goods or services). All these forms of capital may not be equally relevant or applicable to all organisations. While most of the organisation do interact with all forms of capital, at times the interactions may be so minor to report some capitals in the integrated report.

2. External Environment: This includes economic conditions, technological change, societal issues and environmental challenges, sets the context within which the organization operates.

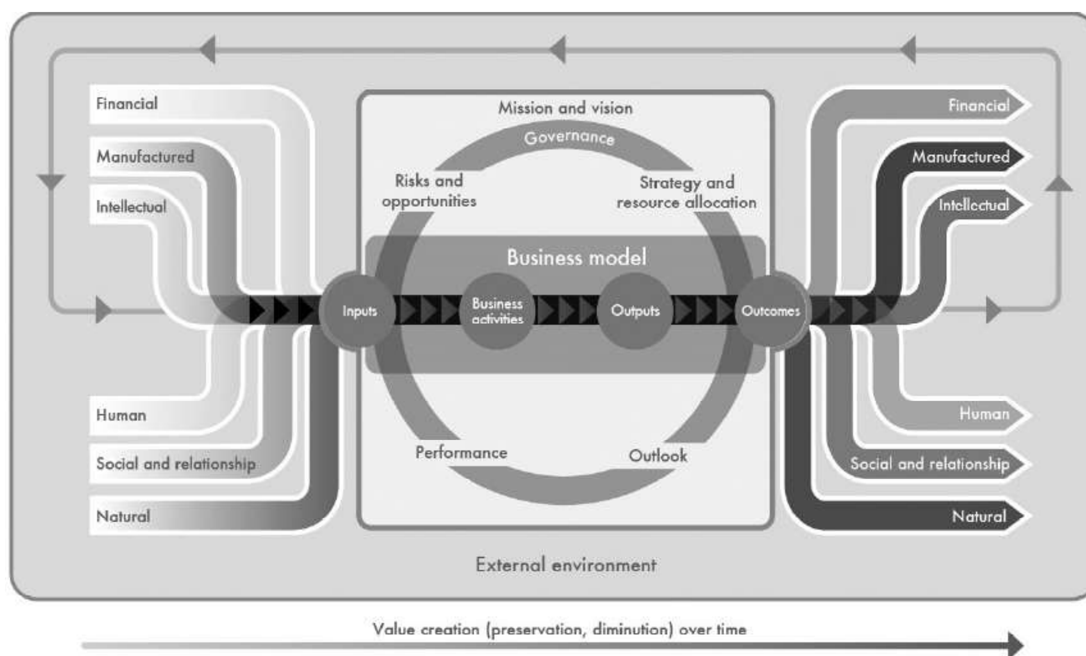
3. **Mission and Vision :** It encompass the whole organization, identifying its purpose and intention in clear, concise terms.
4. **Governance :** Those charged with governance are responsible for creating an appropriate oversight structure to support the ability of the organization to create value.
5. **Risk and opportunities :** Continuous monitoring and analysis of the external environment in the context of the organization's mission and vision identifies risks and opportunities relevant to the organization, its strategy and its business model.
6. **Strategy and Resource Allocation :** The organization's strategy identifies how it intends to mitigate or manage risks and maximize opportunities. It sets out strategic objectives and strategies to achieve them, which are implemented through resource allocation plans.
7. **Performance :** The organization needs information about its performance, which involves setting up measurement and monitoring systems to provide information for decision-making.
8. **Outlook :** The value creation process is not static; regular review of each component and its interactions with other components, and a focus on the organization's outlook, lead to revision and refinement to improve all the components.
9. **Business Model :** At the core of the organization is its business model, which draws on various capitals as inputs and, through its business activities, converts them to outputs (products, services, by-products and waste). The organization's activities and its outputs lead to outcomes in terms of effects on the capitals. The capacity of the business model to adapt to changes (e.g., in the availability, quality and affordability of inputs) can affect the organization's longer-term viability.

C. The Value Creation Process :

In its attempt to create value for internal and external stakeholders, an organisation selects an appropriate business model based on its assessment of external environmental forces, its own vision and mission, assessment of risk and opportunities due to external changes and its attitude towards handing risks (or strategies). Then, based on a minutely designed resource allocation plan the organisation employs various capitals as inputs and converts them into output through a number of business activities. This results in augmentation in the capitals introduced in both quantitative and qualitative terms (like profits improves financial capital, remuneration, career advancement programmes and training improve human capital etc.) and thus value

is created. This process, is however, not static. Thus, through a constant monitoring based on performance related information, the organisation assesses the changes required in all the components and relationships and accordingly brings in necessary and timely changes to further improve the value creation process.

The following figure describes vividly this value creation process.



8.6.5 Integrated Report: Guiding Principles

As proposed in the Integrated Reporting <IR> framework, the guiding principles while preparing an integrated report are the following:

- *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 in the short, medium and long term, and to its use of and effects on the capitals
- *Connectivity of information*: An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organization's ability to create value over time
- *Stakeholder relationships*: An integrated report should provide insight into the 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 the short, medium and long term
- *Conciseness*: An integrated report should be concise
- *Reliability and completeness*: An integrated report should include all material matters, both positive and negative, in a balanced way and without material error
- *Consistency and comparability*: The information in an integrated report should be presented: (a) on a basis that is consistent over time; and (b) 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.

8.6.6 Integrated Reporting: the International Scenario

There is an increasing interest over Integrated Reporting worldwide. IIRC, the parent body of <IR> movement, with its council members and ambassadors, is constantly working for its global acceptance. So far 750 organisations have participated in the <IR> Network worldwide. 150 companies are practicing <IR> in Japan alone. Worldwide more than 1000 companies are using <IR> to communicate with their stakeholders. International bodies like B20 and IOSCO are taking serious interest in <IR> to use it as a tool to combat market challenges worldwide. Regulators in countries like Japan and UK are also in the process to recommend it as a route towards achieving a comprehensive reporting and financial stability with European Commission labelling it as 'a step ahead'.

8.6.7 Integrating Reporting in India

In India, integrated reporting is still at its nascent stage. In 2017 the Securities and Exchange Board of India (SEBI) endorsed the voluntary adoption of integrated reporting. The Regulator's circular invited top 500 companies which prepare Business Responsibility Report (BRR) to voluntarily adopt integrated reporting with effect from 2017-18 financial year. The increased awareness, investor expectations and perceived benefits have resulted in more than 30 companies adopting integrated reporting in India through the last financial year. The list includes Tata Steel, Infosys, Mahindra and Mahindra, Wipro, Yes Bank and Reliance Industries. However, the regulators are still examining its mandatory adoption in India and any promulgation is yet to be confirmed.

8.7 Summary

During last few years corporate reporting in India and worldwide has changed a lot. Increased pressure of stakeholders including regulators has forced large companies to disclose information about the impact of their activities on economy, ecology and the society and also on their ethical conduct. In many cases corporates themselves are resorting to various innovative reporting means to make them more visible. Reporting such as BRR and CSR have been disclosing valuable information in this respect. Globally, GRI are issuing standards to be followed to prepare sustainability reporting. Multiple reporting practices will soon be merged into a single reporting exercise known as Integrated Report. All these reporting has become a integral part of a company's regular exercises.

8.8 Exercises

1. Discuss the applicability of BRR in India. What are the components of a BRR?
.2. Mention the nine principles of BRR.
3. What do you mean by corporate social responsibility? What are its benefits?
4. How will you justify preparation of a CSR policy?
5. Discuss the present regulation relating to CSR in India with respect to the following points: (a) applicability or eligible companies, (b) CSR spending (c) CSR committee (d) CSR policy (e) Areas of CSR activities.
6. What do you mean by Sustainability Report? What are its benefits?
7. Name a few organizations that provide sustainability standards.
8. Why and How was GRI formed? What is its major aim? Name the four broad areas where GRI standards have been issued.
9. What is Integrated Report? Which organization provides the Integrated Reporting Framework?
10. What is the aim of Integrated Report?
11. What are the different forms of capital as per the Integrated Reporting Framework? How is value created in an organization?
12. What is the present status of integrated reporting in India?

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