CHAPTER **10**

ACCOUNTING STANDARDS FOR CONSOLIDATED FINANCIAL STATEMENTS

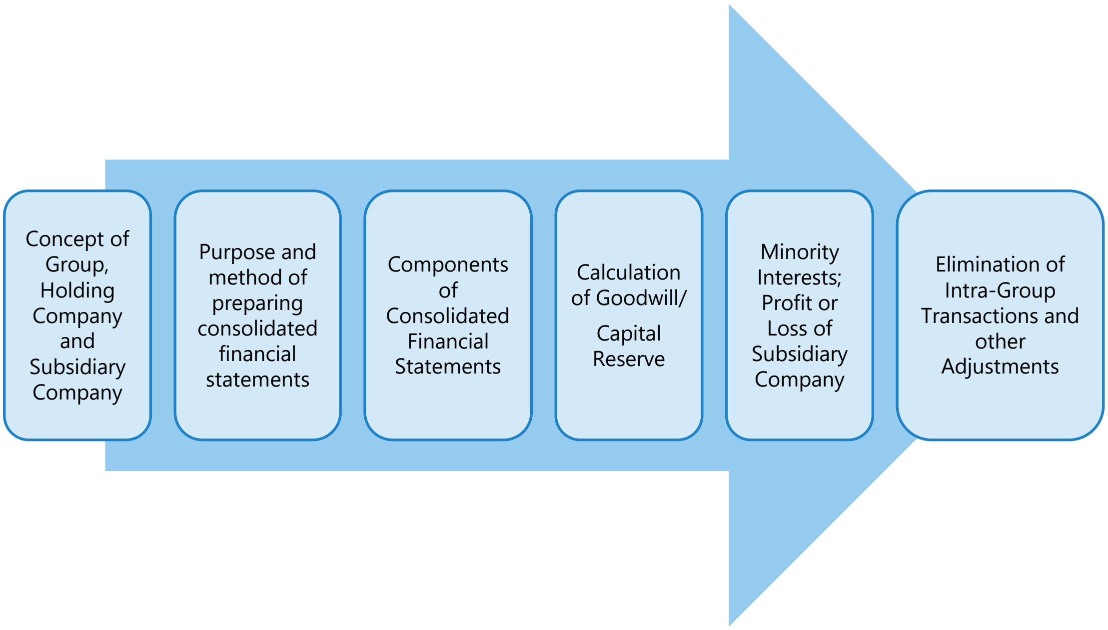
UNIT 1 ACCOUNTING STATDARD 21 CONSOLIDATED FINANCIAL STATEMENTS

LEARNING OUTCOMES

After studying this chapter, you will be able to:

- Understand the concepts of Group, holding company and subsidiary company.
- Apply the consolidation procedures for consolidation of financial statements of subsidiaries with the holding companies.
- Prepare the consolidated financial statements and solve related problems

UNIT OVERVIEW



Note: As per the syllabus, the unit covers simple problems on consolidated financial statements with single subsidiary and excludes problems involving acquisition of Interest in Subsidiary at Different Dates, Cross holding, Disposal of a Subsidiary and Foreign Subsidiaries.

1.1 CONCEPT OF GROUP, HOLDING COMPANY AND SUBSIDIARY COMPANY

In an era of business growth, many organizations are growing into large corporations by the process of acquisition, mergers, gaining control by one company over the other company, restructuring etc. Acquisitions and mergers ultimately lead to either cost reduction or controlling the market or sharing the material supplies or product diversification or availing tax benefits or synergy. Whatever the motto behind these ventures is, the ultimate result is the large-scale corporation. Formation of holding company is the most popular device for achieving these objectives.

Group of Companies

Many a time, a company expands by keeping intact its separate corporate identity. In this situation, a company (i.e. holding company) gains control over the other company (subsidiary company). This control is exercised by one company over the other by-

1. Purchasing specified number of shares i.e. ownership through voting power of that company or
2. Exercising control over the board of directors.

The companies connected in these ways are collectively called as a **Group of Companies.**

Holding Company and Subsidiary Company have also been defined in Section 2 of the Companies Act, 2013.

Holding company

As per Section 2(46) of the Companies Act, 2013,

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

It may be defined as one, which has one or more subsidiary companies and enjoys control over them. Legally a holding company and its subsidiaries are distinct and separate entities. However, in substance holding and subsidiary companies work as a group. Accordingly, users of holding company's accounts need financial information of subsidiaries also to understand the performance and financial position of the group (i.e. holding company and subsidiaries on a consolidated basis).

Subsidiary Company

Section 2(87) of the Companies Act, 2013 defines "subsidiary company" as 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 share capital either at its own or together with one or more of its subsidiary companies:

A company shall be deemed to be a subsidiary company of the holding company even if there is indirect control through the subsidiary company (ies).

The control over the composition of a subsidiary company's Board of Directors means exercise of power to appoint or remove all or a majority of the directors of the subsidiary company.

Section 19 of the Companies Act, 2013 prohibits a subsidiary company from holding shares in the holding company. According to this section, no company shall, either by itself or through its nominees, hold any shares in its holding company and no holding company shall allot or transfer its shares to any of its subsidiary companies and any such allotment or transfer of shares of a company to its subsidiary company shall be void.

However, a subsidiary may continue to be a member of its holding company when

(a) the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or

(b) the subsidiary company holds such shares as a trustee; or

(c) the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.

The subsidiary company shall have a right to vote at a meeting of the holding company only in respect of the shares held by it as a legal representative or as a trustee, as mentioned above in point (a) and (b).

Applicable Accounting Standard

Accounting Standard (AS) 21: Consolidated Financial Statements provides guidance on preparation of Consolidated Financial Statements, the purpose of which is discussed in Para 3 below.

This Standard came into effect in respect of accounting periods commenced on or after 1-4-2001. AS 21 lays down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented by the parent (holding company) to provide financial information about the economic activities of the group as a single economic entity. The parent presenting consolidated financial statements should present such statements in accordance with this standard but in its separate financial statements, investments in subsidiaries would be accounted as per AS 13.

1.2 OBJECTIVES OF AS 21

The objective of this Standard is to lay down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated Financial Statements are prepared by the holding/parent company to provide financial information regarding the economic resources controlled by its group and results achieved with these resources. These consolidated financial statements are prepared by the parent company in addition to the financial statement prepared by the parent company for only its own affairs. Hence parent company prepares two financial statements, one for only its own affairs and one for taking the whole group as one unit in the form of consolidated financial statements. Consolidated financial statements usually comprise the following:

- Consolidated Balance Sheet
- Consolidated Profit & Loss Statement
- Notes to Accounts, other statements and explanatory material
- Consolidated Cash Flow Statement, if parent company presents its own cash flow statement.

While preparing the consolidated financial statement, all other ASs and Accounting Policies will be applicable as they are applied in parent company's own financial statements.

A parent which presents consolidated financial statements should consolidate all subsidiaries, domestic as well as foreign. Where an enterprise does not have a subsidiary but has an associate and/or a joint venture such an enterprise should also prepare consolidated financial statements in accordance with Accounting Standard (AS) 23, Accounting for Associates in Consolidated Financial Statements, and Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures respectively.

Definitions as per Accounting Standard (AS) 21

Parent:

A parent is an enterprise that has one or more subsidiaries.

Subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

Control:

(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

Group:

A group is a parent and all its subsidiaries.

Minority interest is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent.

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

Consolidated financial statements are the financial statements of a group presented as those of a single enterprise.

Circumstances under which Consolidated Financial Statements are prepared

AS 21 should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.

Consolidated financial statements are the financial statements of a group presented as those of a single enterprise.

AS 21 does not mandate which enterprises are required to prepare consolidated financial statements – but specifies the rules to be followed where such financial statements are prepared.

Consolidated Financial Statements will be prepared by the parent company for all the companies that are controlled by the parent company either directly or indirectly, situated in India or abroad except in certain cases.

1.3 WHOLLY OWNED AND PARTLY OWNED SUBSIDIARIES

S. No.	Wholly owned subsidiary company	Partly owned subsidiary company
1.	A wholly owned subsidiary company is one in which all the shares are owned by the holding company.	In a partly owned subsidiary, all the shares of subsidiary company are not acquired by the holding company i.e. only the majority of shares (i.e., more than 50%) are owned by the holding company.
2.	100% voting rights are vested by the holding company.	Voting rights of more than 50% but less than 100% are vested by the holding company.
3.	There is no minority interest because all the shares with voting rights are held by the holding company.	There is a minority interest because less than 50% shares with voting rights are held by outsiders other than the holding company.

1.4 PURPOSE OF PREPARING THE CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements (CFS) are the financial statements of a 'group' presented as those of a single enterprise, where a 'group' refers to a parent and all its subsidiaries. Parent company needs to inform the users about the financial position and results of operations of not only of their enterprise itself but also of the group as a whole. For this purpose, consolidated financial statements are prepared and presented by a parent/holding enterprise to provide financial information about a parent and its subsidiary(ies) as a single economic entity.

CFS are intended to show the financial position of the group as a whole - by showing the economic resources controlled by them, by presenting the obligations of the group and the results the group achieves with its resources.

CFS normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an integral part thereof. Consolidated cash flow statement is presented in case a parent presents its own cash flow statement. The consolidated financial statements are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements.

The logic for presentation of Consolidated Financial Statements can be appreciated with the help of an example below:

Assume that you are holding 10 shares of Reliance Industries Limited, one of the largest conglomerates in India. If you look at Reliance Industries Limited's separate (standalone) balance sheet, you can see investments in subsidiaries like Jio Platforms Limited, Reliance Jio Infocomm Limited, Reliance Retail Limited etc. Now, if we see the standalone financials of Reliance Industries Limited, the revenue is generated from Oil & Gas Business. However, we all know that equally significant for Reliance Industries Limited is the revenue generated from its subsidiary companies. Further, being a holding company, all operational decisions of the subsidiary companies are taken by Reliance Industries Limited. In other words, though the holding company and its subsidiaries are legally different entities, in substance, all the operations of the subsidiaries are merely an extension of the holding company, and the assets and liabilities of the subsidiaries are controlled by the holding company.

Technically, Investments appearing in the balance sheet of Reliance Industries Limited represents proportionate share in the net worth of the respective subsidiary as well as is also a proportionate share in the profits earned by such subsidiaries. Accordingly, consolidating the incomes and expenses, as well as the assets and liabilities of the subsidiary companies with that of the parent company will result in a better presentation of the operations as well as the financial position of Reliance Industries Limited.

Relevant provisions of the Companies Act 2013

Where a company has one or more subsidiaries or associate companies, it shall, in addition to the 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, which shall also be laid before the annual general meeting (AGM) of the company along with the laying of its financial statement.

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 in Form AOC-1 as per Rule 5 of the Companies (Accounts) Rules, 2014.

For the purpose of section 129, 'subsidiary' includes 'associate company' and 'joint venture' which means that the company would be required to prepare consolidated financial statements including associate/ joint venture even if there is no subsidiary of a company.

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Companies Act 2013 and the applicable accounting standards.

In case of a company covered under sub-section (3) of section 129 which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act.

Exemptions from preparation of CFS:

As per Companies (Accounts) Amendment Rules, 2016, preparation of consolidated financial statements by a company is not required if it meets the following conditions:

(i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in or outside India; and

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

AS21 also lays down the accounting principles and procedures for preparation and presentation of consolidated financial statements which have been covered in the later part of this chapter.

It may be pertinent to note that in certain countries outside India, presentation of standalone financial statements is not mandatory. In fact, it is the preparation and presentation of consolidated financial statements that are mandatory, given the reasoning behind Consolidated Financial Statements already discussed in the example of Reliance Industries Limited above.

In India, the statutory framework (such as the Companies Act, 2013 or the Income Tax Act, 1961) mandate presentation of standalone financial statements, thereby making standalone financial statements equally important as consolidated financial statements.

1.5 SCOPE OF AS 21

1. This Standard should be applied in the preparation and presentation of consolidated financial statements for a group of enterprises under the control of a parent.
2. This Standard should also be applied in accounting for investments in subsidiaries in the separate financial statements of a parent.
3. In the preparation of consolidated financial statements, other Accounting Standards also apply in the same manner as they apply to the separate statements.
4. This Standard does not deal with:
    a. methods of accounting for amalgamations and their effects on consolidation, including goodwill arising on amalgamation (see AS 14, Accounting for Amalgamations);
    b. accounting for investments in associates (governed by AS 13, Accounting for Investments); and

c. accounting for investments in joint ventures (governed by AS 13, Accounting for Investments).

Note: AS 21 is mandatory if an enterprise presents consolidated financial statements. In other words, the accounting standard does not mandate an enterprise to present consolidated financial statements but, if the enterprise presents consolidated financial statements for complying with the requirements of any statute or otherwise, it should prepare and present consolidated financial statements in accordance with AS 21.

1.6 CONTROL

The consolidated financial statements are prepared on the basis of financial statements of parent and all enterprises that are controlled by the parent, other than those subsidiaries excluded for the reasons set out in paragraph 11 of AS 21.

Control exists when the parent owns, directly or indirectly through subsidiary(ies), more than one-half of the voting power of an enterprise. Control also exists when an enterprise controls the composition of the board of directors (in the case of a company) or of the corresponding governing body (in case of an enterprise not being a company) so as to obtain economic benefits from its activities.

An enterprise may control the composition of the governing bodies of entities such as gratuity trust, provident fund trust etc. Since the objective of control over such entities is not to obtain economic benefits from their activities, these are not considered for the purpose of preparation of consolidated financial statements.

For the purpose of this Standard, an enterprise is considered to control the composition of

(i) the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. An enterprise is deemed to have the power to appoint a director, if any of the following conditions is satisfied:

a. a person cannot be appointed as director without the exercise in his favour by that enterprise of such a power as aforesaid; or

b. a person's appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or

c. the director is nominated by that enterprise or a subsidiary thereof.

(ii) the governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any other person, to appoint or remove all or a majority of members of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member, if any of the following conditions is satisfied:

a. a person cannot be appointed as member of the governing body without the exercise in his favour by that other enterprise of such a power as aforesaid; or

b. a person's appointment as member of the governing body follows necessarily from his appointment to a position held by him in that other enterprise; or

c. the member of the governing body is nominated by that other enterprise.

Note: It is possible that an enterprise is controlled by two enterprises – one controls by virtue of ownership of majority of the voting power of that enterprise and the other controls, by virtue of an agreement or otherwise, the composition of the board of directors so as to obtain economic benefits from its activities. In such a rare situation, when an enterprise is controlled by two enterprises as per the definition of 'control', the first mentioned enterprise will be considered as subsidiary of both the controlling enterprises within the meaning of AS 21 and, therefore, both the enterprises need to consolidate the financial statements of that enterprise.

1.7 EXCLUSION FROM PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

As per AS 21, a subsidiary should be excluded from consolidation when:

(a) **control is intended to be temporary** because the subsidiary is acquired ***and* held** exclusively **with a view to its subsequent disposal in the near future**; ***or***

(b) it operates under **severe long-term restrictions** which significantly impair its ability to transfer funds to the parent.

In consolidated financial statements, investments in such subsidiaries should be accounted for in accordance with AS 13 'Accounting for Investments'. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares are held as 'stock-in-trade' and are acquired and held exclusively with a view to their subsequent disposal in the near future, the control by the first mentioned enterprise is considered to be temporary. It would be pertinent to note that merely holding all the shares as 'stock-in-trade', is not sufficient to be considered as temporary control. It is only when all the shares held as 'stock-in-trade' are acquired and held exclusively with a view to their subsequent disposal in the near future, that control would be considered to be temporary within the meaning of point (a) above.

The period of time, which is considered as "**near future**" as mentioned above, primarily depends on the facts and circumstances of each case. However, ordinarily, the meaning of the words '**near future**' is considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case. The intention with regard to disposal of the relevant investment is considered at the time of acquisition of the investment. Accordingly if the relevant investment is acquired *without* an intention to its subsequent disposal in near future, and subsequently, it is decided to dispose off the investments, such an investment is not excluded from consolidation, until the investment is actually disposed off.

Conversely, if the relevant investment is acquired with an intention to its subsequent disposal in near future, but, due to some valid reasons, it could not be disposed off within that period, the same will continue to be excluded from consolidation, provided there is no change in the intention.

Exclusion of a subsidiary from consolidation on the ground that its business activities are dissimilar from those of the other enterprises within the group is not justified because better information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries. Extending the above Reliance Industries Limited example, though the parent company is in the Oil and Gas Business, and its subsidiaries operate in industries such as telecom, retail trade, fashion and lifestyle, media etc., all the entities have to be consolidated as such consolidated financial statements will then provide better picture of the business and financial position of Reliance Industries Limited. For example, the disclosures required by AS 17 'Segment Reporting', help to explain the significance of different business activities within the group.

Consolidation of a subsidiary which is a Limited Liability Partnership (LLP) or a Partnership Firm

As per rule 6 of Companies (Accounts) Rules, 2014, under the heading 'Manner of consolidation of accounts' it is provided that consolidation of financial statements of a company shall be done in accordance with the provisions of Schedule III to the Companies Act, 2013 and the applicable Accounting Standards.

It is noted that relevant Indian Accounting Standard i.e., Ind AS 110, Consolidated Financial Statements provides that where an entity has control on one or more other entities, the controlling entity is required to consolidate all the controlled entities. Since, the word 'entity' includes a company as well as any other form of entity, therefore, LLPs and partnership firms are required to be consolidated.

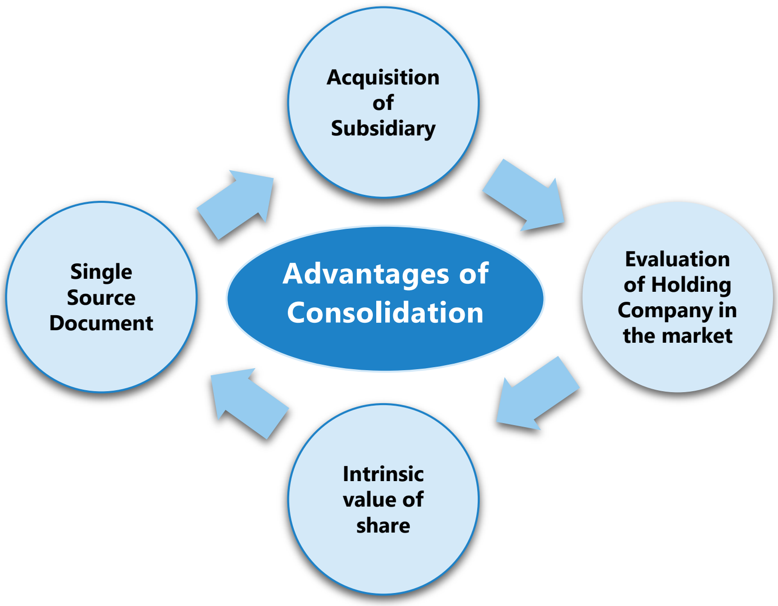
Similarly, under Accounting Standard (AS) 21, as per the definition of subsidiary, an enterprise controlled by the parent is required to be consolidated. The term 'enterprise' includes a company and any enterprise other than a company. Therefore, under AS also, LLPs and partnership firms are required to be consolidated.

Accordingly, in the given case, holding company is required to consolidate its subsidiary which is an LLP or a partnership firm.

Consolidation of Limited Liability Partnership (LLP) which is an Associate or Joint Venture

If LLP or a partnership firm is an associate or joint venture of holding company, even then the LLP and the partnership firm need to be consolidated in accordance with the requirements of applicable Accounting Standards.

1.8 ADVANTAGES OF CONSOLIDATED FINANCIAL STATEMENTS



The main advantages of consolidation are given below:

(i) **Single source document:** From the consolidated financial statements, the users of accounts can get an overall picture of the Group (i.e. holding company and its subsidiaries). Consolidated profit and loss account gives the overall profitability of the group.

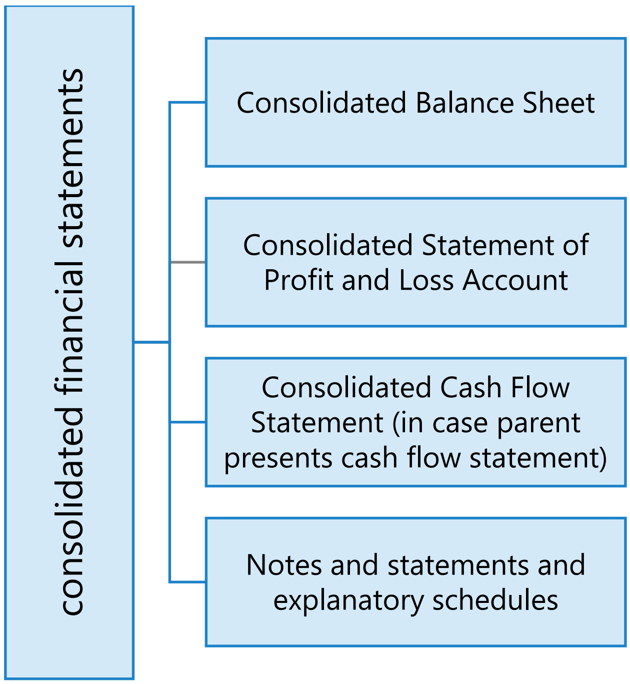
(ii) **Intrinsic value of share:** Intrinsic share value of the holding company can be calculated directly from the Consolidated Balance Sheet.

(iii) **Acquisition of subsidiary:** The minority interest data of the consolidated financial statement indicates that the amount payable to the outside shareholders of the subsidiary company at book value which is used as the starting point of bargaining at the time of acquisition of a subsidiary by the holding company.

(iv) **Evaluation of holding company in the market:** The overall financial health of the holding company can be judged using consolidated financial statements. Those who want to invest in the shares of the holding company or acquire it, need such consolidated statement for evaluation.

1.9 COMPONENTS OF CONSOLIDATED FINANCIAL STATEMENTS

As per AS 21, consolidated financial statements normally include the following:



- The consolidated financial statements are presented to the extent possible in the same format as that adopted by the parent for its separate financial statements.

All the notes appearing in the separate financial statements of the parent enterprise and its subsidiaries need not be included in the notes to the consolidated financial statement. For preparing consolidated financial statements, the following principles may be observed in respect of notes and other explanatory material that form an integral part thereof:

(a) Notes which are necessary for presenting a true and fair view of the consolidated financial statements are included in the consolidated financial statements as an integral part thereof.

(b) Only the notes involving items which are material need to be disclosed. Materiality for this purpose is assessed in relation to the information contained in consolidated financial statements. In view of this, it is possible that certain notes which are disclosed in separate financial statements of a parent or a subsidiary would not be required to be disclosed in the consolidated financial statements when the test of materiality is applied in the context of consolidated financial statements.

(c) Additional statutory information disclosed in separate financial statements of the subsidiary and/or a parent having no bearing on the true and fair view of the consolidated financial statements need not be disclosed in the consolidated financial statements.

In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Accounting Standards including the following as per the requirements of Schedule III to the Companies Act, 2013 which contains the 'General Instructions for Preparation of Consolidated Financial Statements':

(i) Profit or loss attributable to "minority interest" and to owners of the parent in the statement of profit and loss shall be presented as allocation for the period.

(ii) "Minority interests" in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.

Students are also advised to refer the Schedule III to the Companies Act, 2013.

It may be noted that companies do not maintain any separate set of journal entries for 'Consolidated Set of Accounts'. Continuing the example of Reliance Industries Limited, Consolidated Financial Statements of Reliance Industries Limited is not based on "double entry book-keeping in the 'group books of accounts'", as there is no concept of 'group books of accounts'. Practically, Consolidated Financial Statements are prepared from the separate / standalone financial statements of each entity (parent / subsidiary) to which consolidation adjustments are made in accordance with AS 21. Accordingly, the financial statements of each entity are finalized in accordance with the applicable Accounting Standards, and based on such financial statements, consolidation procedures are performed in accordance with AS 21.

1.10 CONSOLIDATION PROCEDURES

Rule 6 of the Companies (Accounts) Rules, 2014 states that the manner of consolidation of financial statements of the company shall be in accordance with the provisions of Schedule III of the Act and the applicable accounting standards. AS 21, lays down the procedure for consolidation of financial statements of the companies within the group.

When preparing consolidated financial statements, the individual balances of the parent and its subsidiaries are combined or consolidated on a line-by-line basis, and then certain consolidation adjustments are made.

For example, the cash, trade receivables and prepayments of the parent and each subsidiary are added together to arrive at the cash, trade receivables and prepayments of the group, before consolidation adjustments are made.

The objective is that the consolidated financial statements should present the information contained in the consolidated financial statements of a parent and its subsidiaries as if they were the financial statements of a single economic entity.

The various steps involved in the consolidation process are as follows:

1. the cost to the parent of its investment (cost of acquisition) in each subsidiary and the parent's portion of equity of each subsidiary (acquirer's interest), at the date on which investment in each subsidiary is made, should be eliminated. In case, cost of acquisition exceeds or is less than the acquirer's interest, at the date on which investment in the subsidiary is made, goodwill or capital reserve should be recognized respectively in the CFS.

2. intragroup transactions, including sales, expenses and dividends, are eliminated, in full;

3. Adjustments in respect of unrealised profits/ losses should be made;

4. minority interest in the net income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent; and

5. minority interests in the net assets of consolidated subsidiaries should be identified and presented in the consolidated balance sheet separately from

liabilities and the equity of the parent's shareholders. Minority interests in the net assets consist of:

(i) the amount of equity attributable to minorities at the date on which investment in a subsidiary is made; and

(ii) the minorities share of movements in equity since the date the parent-subsidiary relationship came in existence.

Note: Where the carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered for the purpose of above computations.

6. The results of operations of a subsidiary are included in the CFS as from the date on which parent-subsidiary relationship came in existence.

   The results of operations of a subsidiary with which parent-subsidiary relationship ceases to exist are included in the consolidated statement of profit and loss until the date of cessation of the relationship.

   The difference between the proceeds from the disposal of investment in a subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognised in the consolidated statement of profit and loss as the profit or loss on the disposal of the investment in the subsidiary.

   In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.

7. An investment in an enterprise should be accounted for in accordance with AS 13, Accounting for Investments, from the date that the enterprise ceases to be a subsidiary and does not become an associate.

8. The carrying amount of the investment at the date that it ceases to be a subsidiary is regarded as cost thereafter.

Thus, Consolidation Adjustments are broadly categorized as under:

Consolidation Adjustments

MAJOR ADJUSTMENTS

Those which 'drive' the double entry:

1. Goodwill / Capital Reserve (i.e., cost of Control)
2. Minority Interests
3. Consolidated Reserves
4. Disposal of Subsidiary*

INTRA-GROUP ADJUSTMENTS

1. Intra-group balances
2. Unrealized profit
3. Inventory
4. Non-Current Asset transfers
5. Minority Interests

* Disposal of Subsidiary is not examined at the Intermediate Level.

1.11.CALCULATION OF GOODWILL/CAPITAL RESERVE (COST OF CONTROL)

As on the date of investment, the cost of investment and the equity in the subsidiary needs to be calculated.

Equity is defined as the 'residual interest in the assets of an enterprise after deducting all its liabilities.' In other words, it is equal to the net worth of the enterprise.

Once the above is calculated, goodwill or capital reserve is calculated as under:

Goodwill = Cost of Investment - Parent's share in the equity of the subsidiary on date of investment

Capital Reserve = Parent's share in the equity of the subsidiary on date of investment – Cost of investment

The parent's portion of equity in a subsidiary, at the date on which investment is made, is determined on the basis of information contained in the financial statements of the subsidiary as on the date of investment.

However, if the financial statements of a subsidiary as on the date of investment are not available and if it is impracticable to draw the financial statements of the subsidiary as on that date, financial statements of the subsidiary for the immediately preceding period are used as a basis for consolidation.

Adjustments are made to these financial statements for the effects of significant transactions or other events that occur between the date of such financial statements and the date of investment in the subsidiary.

It may be mentioned that positive or negative differential is separately recognised only in purchase method. This differential calculated as cost of control is shown in the consolidated balance sheet.

A detailed illustration below will help in understanding the concept of goodwill / capital reserve.

Example 1

The following information is given as at 31 March 20X1

	P Ltd.	**S Ltd.**
Non-current Assets:		
PPE	*2,000*	*500*
Investment in Subsidiary	*1,000*	
Net Current Assets	*2,000*	*500*
	5,000	***1,000***
Issued Capital	*500*	*1,000*
Reserves and Surplus	*4,500*	
	5,000	***1,000***

P Ltd. acquired 100% of shares of S Ltd. on 31 March 20X1 for ₹ 1,000.

Since P Ltd. has acquired S Ltd., we will have to determine goodwill / capital reserve. Let us understand why goodwill / capital reserve arises in case of consolidation, and what would be the interpretation of the same.

In the given case, P Ltd. acquired all the shares of S Ltd. by paying ₹ 1,000. This payment (i.e., purchase consideration) would be made by P Ltd. to the shareholder(s) of S Ltd. (hence the transfer of this amount would not appear in the books of S Ltd.).

By paying ₹ 1,000, P Ltd. has acquired 'control' over S Ltd. This acquisition is quite different from the concept of amalgamation done in accordance with AS 14, though the concept of goodwill / capital reserve is similar. Under AS 14, the target company would generally liquidate, and all assets and liabilities would be transferred from the Selling Company to the Purchasing Company. In case of consolidation, P Ltd. is acquiring 'control' i.e., by way of acquiring equity shares in S Ltd.. Thus, S Ltd. continues to exist, and the assets and liabilities of S Ltd. are not transferred to P Ltd., but instead continue to remain with S Ltd. only. However, since in substance, acquisition has taken place (albeit through transfer of control), the purchase consideration of ₹ 1,000 will be compared with the net worth of S Ltd., which is ₹ 1,000. Since amount paid (i.e., purchase consideration) equals the net worth, no goodwill / capital reserve is recognized. In case the amount paid (i.e., purchase consideration) would be higher / lower than the net worth of S Ltd., such difference would be recognized in Goodwill / Capital Reserve respectively.

The calculation of goodwill is presented below:

Tangible Assets	***500***
Net Current Assets	*500*
	1,000
Less: Liabilities	*NIL*
Net Worth of S Ltd.	*1,000*
Investment in S Ltd. (purchase consideration)	*1,000*
Goodwill / (Capital Reserve)	***NIL***

Example 2

Modifying example 1, the following information is given as at 31 March 20X1

	P Ltd.	***S Ltd.***
Non-current Assets:		
PPE	*2,000*	*500*
Investment in Subsidiary	*1,000*	
Net Current Assets	*2,000*	*500*
	5,000	***1,000***

Issued Capital	*500*	*700#*
Reserves and Surplus	*4,500*	*300#*
	5,000	***1,000***

 # As compared to Example 1 – There is a difference in the break-up of net worth of S Ltd. (Example 1 – Issued capital was 1,000 and Reserves and Surplus was Nil; The Net worth is 1,000).

P Ltd. acquired 100% of shares of S Ltd. on 31 March 20X1 for ₹ 1,000.

Like Example 1 above P Ltd. has acquired 'control' over S Ltd. by paying ₹ 1,000. Accordingly, the purchase consideration of ₹ 1,000 will be compared with the net worth of S Ltd. which is ₹ 1,000. Since amount paid (i.e., purchase consideration) equals the net worth, no goodwill / capital reserve is recognized. In case the amount paid (i.e., purchase consideration) would be higher / lower than the net worth of S Ltd., such difference would be recognized in Goodwill / Capital Reserve respectively.

The calculation of goodwill is presented below:

Tangible Assets	***500***
Net Current Assets	*500*
	1,000
Less: Liabilities	*NIL*
Net Worth of S Ltd.	*1,000*
Investment in S Ltd. (purchase consideration)	*1,000*
Goodwill / (Capital Reserve)	***NIL***

Example 3

Modifying example 2, the following information is given as at 31 March 20X1

	P Ltd.	***S Ltd.***
Non-current Assets:		
PPE	*2,000*	*500*
Investment in Subsidiary	*1,200*	

Net Current Assets	*2,000*	*500*
	5,200	***1,000***
Issued Capital	*700*	*700*
Reserves and Surplus	*4,500*	*300*
	5,200	***1,000***

P Ltd. acquired 100% of shares of S Ltd. on 31 March 20X1 for ₹ 1,200.

Like Examples 1 and 2 above P Ltd. has acquired 'control' over S Ltd. by paying ₹ 1,200. Accordingly, the purchase consideration of ₹ 1,200 will be compared with the net worth of S Ltd. which is ₹ 1,000. Since amount paid (i.e., purchase consideration) exceeds the net worth, such excess of is recognized as goodwill. In case the amount paid (i.e., purchase consideration) would be lower than the net worth of S Ltd., such difference would be credited to Capital Reserve.

The calculation of goodwill is presented below:

Tangible Assets	***500***
Net Current Assets	*500*
	1,000
Less: Liabilities	*NIL*
Net Worth of S Ltd.	*1,000*
Investment in S Ltd. (purchase consideration)	*1,200*
Goodwill / (Capital Reserve)	***200***

1.12 MINORITY INTERESTS

Minority interest is that part of the net assets of a subsidiary attributable to interest which is held by outsiders.

Minority interests in the net income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group in order to arrive at the net income attributable to the shareholders of the holding company.

Minority interests should be presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders.

Minority interest in the income of the group should be separately presented in the consolidated income statement.

Minority interests in the net assets consist of:

(i) The amount of equity attributable to minorities at the date on which investment in a subsidiary is made and

(ii) The minorities' share of movements in equity since the date the parent-subsidiary relationship came in existence.

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. The excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to and is able to make good the losses. If the subsidiary subsequently reports profit, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Example 4

Modifying Example 2, the following information is given as at 31 March 20X1:

	P Ltd.	***S Ltd.***
Non-current Assets:		
Tangible Assets	*2,000*	*500*
Investment in Subsidiary	*1,000*	
Net Current Assets	*2,000*	*500*
	5,000	***1,000***
Issued Capital	*500*	*700*
Reserves and Surplus	*4,500*	*300*
	5,000	***1,000***

P Ltd. acquired 80% of shares of S Ltd. on 31 March 20X1 for ₹ 1,000.

In the given case, P Ltd. acquired 80% of the shares of S Ltd. by paying ₹ 1,000. This payment (i.e., purchase consideration) would be made by P Ltd. to the shareholder(s) of S Ltd.

By paying ₹ 1,000, P Ltd. has acquired 'control' over S Ltd. We cannot say that P Ltd. has acquired only '80% control', since its shareholding in S Ltd. will enable it to take all the decisions regarding S Ltd.'s operations and usage of assets and repayment of liabilities. However, the fact remains that 20% stake does NOT belong to S Ltd. It belongs to outsiders, who are called 'Minority Interest' in accordance with AS 21. Accordingly, in this case, the purchase consideration of ₹ 1,000 will be compared with 80% of the net worth of S Ltd. Any excess or deficit would be recorded as goodwill / capital reserve respectively. 20% of the net worth on the date of acquisition would be recorded separately as Minority Interest.

AS 21 defines Minority Interest as that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiary(ies), by the parent. As per Schedule III to the Companies Act, 2013, "Minority Interests" in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.

In the given case, the calculation of goodwill is presented below:

Tangible Assets: 80% being share of parent	***400***
Net Current Assets: 80% being share of parent	*400*
	800
Less: Liabilities	*NIL*
Net Worth of S Ltd.: attributable to the parent's shareholding	*800*
Investment in S Ltd. (purchase consideration)	*1,000*
Goodwill / (Capital Reserve)	***200***

1.13. PROFIT OR LOSS OF SUBSIDIARY COMPANY

For the purpose of consolidated balance sheet preparation, all reserves and profits (or losses) of subsidiary company should be classified into **pre and post-acquisition reserves and profits (or losses).**

Profits (or losses) earned (or incurred) by subsidiary company up to the date of acquisition of the shares by the holding company are pre acquisition or capital profits (or loss).

Similarly, all reserves of subsidiary company up to the date of acquisition are capital reserves from the view point of holding company. If the holding interest in subsidiary is acquired during the middle or some other period of the current year, pre-acquisition profit should be calculated accordingly.

The minority interest in the reserves and profits (or losses) of subsidiary company should be transferred to minority interest account which will also include share capital of subsidiary company held by outsiders / minority shareholders.

Minority Interest = Share Capital of subsidiary belonging to outsiders + Minority interest in reserves and profits of subsidiary company

The holding company's interest in the pre-acquisition reserves and profits (or losses) should be adjusted against cost of control to find out goodwill or capital reserve on consolidation. The reserves and profits (or loss) of subsidiary company, representing holding company's interest in post-acquisition or revenue reserves and profits (or losses), should be added to the reserves and profits (or losses) of holding company.

1.14 CONSOLIDATION ADJUSTMENTS

A. Revaluation of Assets of Subsidiary Company

It may be possible that the fair value of the assets of the subsidiary may be different from the book value. Hence, the parent may choose to perform a revaluation of the assets of the subsidiary for the purposes of consolidation. It may be noted that such revaluation is not performed in the standalone / separate financial statements of the subsidiary. The profit or loss on revaluation of fixed assets of subsidiary should also be treated as capital profit or loss. But if the fall in the value of the asset occurs after the date of acquisition, the loss should be treated as revenue loss. Adjustment for depreciation would be made in the profit and loss account of the subsidiary.

Depreciation on changed value of the assets shall be given effect to. Depreciation on revalued assets will be taken as capital or revenue depending on the period for which the depreciation belongs to. Hence the period for depreciation is important to be considered.

Property, Plant and Equipment (PPE)

Initial Recognition	Subsequent Measurement
Fair Value (-) Carrying Amount (As on the date of acquisition)	Additional Depreciation would arise in case of initial upward or Reversal of excess depreciation would arise in case of initial downward valuation.
PPE A/c Dr. xxx To **Pre**- P/L xxx (In case of upward revaluation)	**Post** P/L Dr. xxx To PPE xxx (Additional depreciation)
Pre- P/L Dr. xxx To PPE xxx (In case of downward revaluation)	PPE Dr. xxx To **Post** P/L xxx (Reversal of excess depreciation)

1. The above entries are not recorded in the standalone books of either the subsidiary or the parent. These entries are only for understanding the impact in the consolidated financial statements and as such, only the effect of such entries will appear in the consolidated financial statements (and not the standalone / separate financial statements).

2. It is presumed that the subsidiary does not follow the revaluation model for accounting of fixed assets. If it had to follow, then the standalone balance sheet of the subsidiary would already contain the impact of the revaluation.

The debit /credit on account of revaluation could alternatively be taken to the Revaluation Reserve or the P/L depending on whether it is a first-time upward / downward revaluation. However, as ultimately the reserves have to be analyzed between pre- and post-acquisition for the purposes of consolidation, the nature of reserves is irrelevant.

Example 5

H Ltd. acquires 70% of the equity shares of S Ltd. on 1.1.20X1. On that date, paid up capital of S Ltd. was 10,000 equity shares of ₹ 10 each; accumulated reserve balance was ₹ 1,00,000. H Ltd. paid ₹ 1,60,000 to acquire 70% interest in the S Ltd. Assets of S Ltd. were revalued on 1.1.20X1 and a revaluation loss of ₹ 20,000 was ascertained. The book value of shares of S Ltd. is calculated as shown below:

	₹
70% of the Equity Share Capital ₹ 1,00,000	*70,000*
70% of Accumulated Reserve ₹ 1,00,000	*70,000*
70% of Revaluation Loss ₹ 20,000	*(14,000)*
	1,26,000

So, H Ltd. paid a positive differential of ₹ 34,000 i.e. ₹ (1,60,000 – 1,26,000). This differential is called goodwill and is shown in the balance sheet under the head intangibles.

Example 6

A Ltd. acquired 70% interest in B Ltd. on 1.1.20X1. On that date, B Ltd. had paid-up capital of ₹ 1,00,000 consisting of 10,000 equity shares of ₹ 10 each and accumulated balance in reserve and surplus of ₹1,00,000. On that date, assets and liabilities of B Ltd. were also revalued and revaluation profit of ₹ 20,000 was calculated. A Ltd. paid ₹ 1,30,000 to purchase the said interest.

In this case, the book value of Shares of B Ltd. is calculated as shown below:

	₹
70% of the Equity Share Capital ₹1,00,000	*70,000*
70% of Reserves and Surplus ₹ 1,00,000	*70,000*
70% of Revaluation Profit ₹ 20,000	*14,000*
	1,54,000

In this case, a negative differential of ₹ 24,000 arises i.e. (1,54,000 – 1,30,000) which is called and presented as capital reserve.

Example 7

H Ltd. acquired 16,000 equity shares of ₹ 10 each, in S Ltd. on October 1, 20X1 for ₹ 3,06,800. The profit and loss account of S Ltd. showed a balance of ₹10,000 on April 1,20X1. The plant and machinery of S Ltd. which stood in the books at ₹ 1,50,000 on April 1,20X1 was considered worth ₹ 1,80,000 on the date of acquisition.

The information of the two companies as at 31-3-20X2 was as follows:

	H Ltd.(₹)	**S Ltd. (₹)**
Shares capital (fully paid equity shares of ₹ 10 each)	5,00,000	2,00,000
General reserve	2,40,000	1,00,000
Profit and loss account	57,200	82,000
Current Liabilities	1,69,800	33,000
Land and building	1,80,000	1,90,000
Plant and machinery	2,40,000	1,35,000
Investments	3,06,800	
Current assets	2,40,200	90,000

In this case,

Percentage of holding:

		No. of Shares	Percentage
Holding Co.	:	16,000	(80%)
Minority shareholders	:	4,000	(20%)
TOTAL SHARES	:	20,000	

Impact of Revaluation of Plant and Machinery will be as -

	₹
Book value of Plant and Machinery as on 01-04-20X1	*1,50,000*
Depreciation Rate $\frac{(1,50,000-1,35,000)}{1,50,000}$ *= 15,000/1,50,000 X100*	*10%*
Book value of Plant and Machinery as on 01-10-20X1 after six months depreciation @10% (1,50,000-7,500)	*1,42,500*
Revalued at	*1,80,000*
Revaluation profit (1,80,000-1,42,500)	*37,500*
Share of H Limited in Revaluation Profit (80%)	*30,000*
Share of Minority in Revaluation profit (20%)	*7,500*
Additional Depreciation on appreciated value to be charged from post-acquisition profits	
(10% of ₹ 1,50,000 for 6 months) + (10% of ₹ 1,80,000 for 6 months) less ₹ 15,000 (as already charged)	*1500*
Share of H Limited in additional depreciation that will reduce its share (80%) in post-acquisition profit by	*1,200*
Share of Minority Interest in additional depreciation	*300*

B. Dividend Received From SubsidiarY(IES)

As per AS 13, 'Accounting for Investments', Interest, dividends and rentals receivables in connection with an investment are generally regarded as income, being the return on the investment.

However, in some circumstances, such inflows represent a recovery of cost and do not form part of income.

Example: When unpaid interest has accrued before the acquisition of an interest-bearing investment and is therefore included in the price paid for the investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; the pre-acquisition portion is deducted from cost.

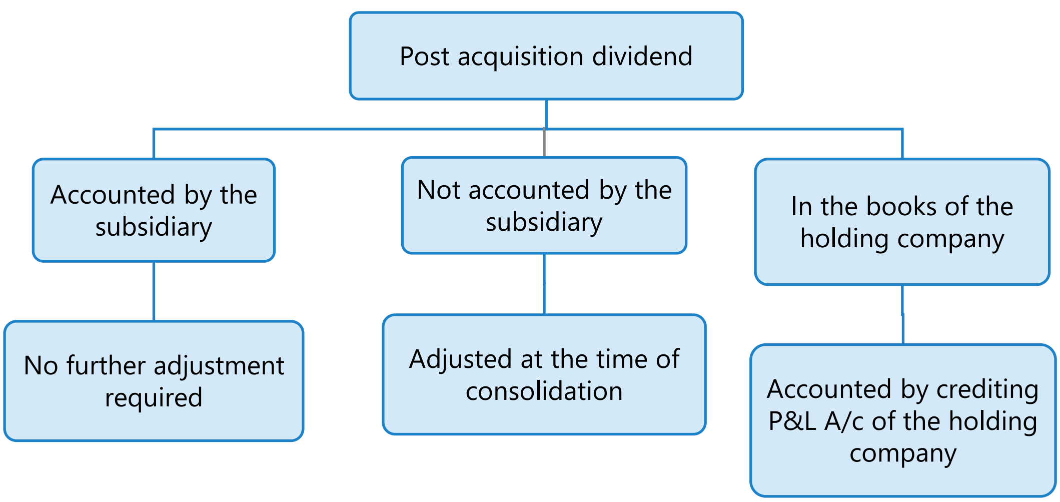
When dividends on equity are declared from pre-acquisition profits, a similar treatment (i.e. as mentioned above) may apply. If it is difficult to make such an allocation except on an arbitrary basis, the cost of investment is normally reduced by dividends receivable only if they clearly represent a recovery of a part of the cost.

When holding company receives dividend from a subsidiary company, it must distinguish between the part received out of capital profits (i.e. pre-acquisition profits) and revenue profits (i.e. post-acquisition profits); capital profits are credited to Investment account (being capital receipts) and revenue profits are credited to the Profit & Loss Account.

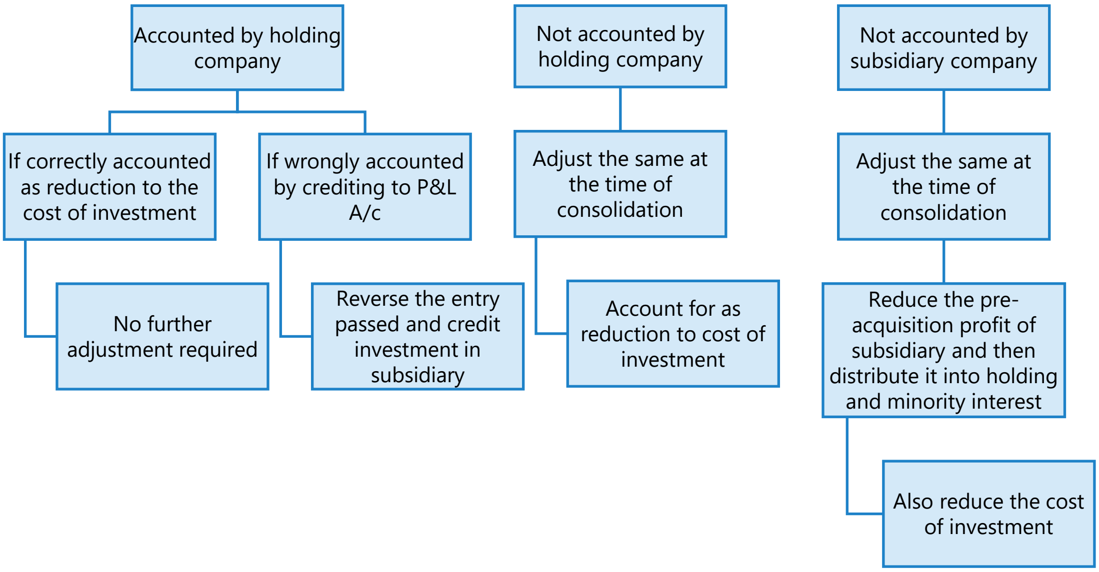
If the controlling interest was acquired during the course of a year, profit for that year must be apportioned into the pre-acquisition and post-acquisition portions, on the basis of time in the absence of information on the point.

It must be understood that the term 'capital profit', in this context, apart from the generic meaning of the term, connotes profit earned by the subsidiary company till the date of acquisition. As a result, profits which may be of revenue nature for the subsidiary company may be capital profits so far as the holding company is concerned.

Treatment in case of post-acquisition dividend



Treatment in case of pre-acquisition dividend



Dividends received out of profits earned before purchase of investments normally also are credited to the Investment Account.

Example 8

If shares in X Ltd., are purchased in January 20X2 and in April 20X2, X Ltd., declares a dividend in respect of 20X1, the dividend received by the holder of the shares correctly should not be treated as income but as capital receipt and credited to Investment Account.

Note: In case of issue of bonus shares by the subsidiary company, the holding company, like other holders, record no entry; only the number of shares held is increased.

Illustration 1

From the following data, determine in each case:

(1) Minority interest at the date of acquisition and at the date of consolidation.

(2) Goodwill or Capital Reserve.

(3) *Amount of holding company's profit in the consolidated Balance Sheet assuming holding company's own Profit & Loss Account to be ₹ 2,00,000 in each case:*

Case	***Subsidiary Company***	***% shares owned***	***Cost***	***Date of acquisition***		***Consolidation Date***	
				1.1.20X1		***31.12.20X1***	
				Share Capital	***Profit & Loss Account***	***Share Capital***	***Profit & Loss Account***
			₹	***₹***	***₹***	***₹***	***₹***
Case 1	*A*	*90%*	*1,40,000*	*1,00,000*	*50,000*	*1,00,000*	*70,000*
Case 2	*B*	*85%*	*1,04,000*	*1,00,000*	*30,000*	*1,00,000*	*20,000*
Case 3	*C*	*80%*	*56,000*	*50,000*	*20,000*	*50,000*	*20,000*
Case 4	*D*	*100%*	*1,00,000*	*50,000*	*40,000*	*50,000*	*55,000*

Solution

(1) Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case it should be equal to Share Capital + Profit & Loss A/c

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

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

(2) Calculation of Goodwill or Capital Reserve

	Shareholding % [F]	Cost [G]	Total Equity [A] + [B] = [C]	Parent's Portion of equity [F] x [C] =H	Goodwill ₹ [G] – [H]	Capital Reserve ₹ [H] – [G]
Case 1	90 %	1,40,000	1,50,000	1,35,000	5,000	—
Case 2	85 %	1,04,000	1,30,000	1,10,500	—	6,500
Case 3	80 %	56,000	70,000	56,000	Nil	Nil
Case 4	100 %	1,00,000	90,000	90,000	10,000	—

(3) The balance in the Profit & Loss Account on the date of acquisition (1.1.20X1) is Capital profit, as such the balance of Consolidated Profit & Loss Account shall be equal to Holding Co.'s profit.

On 31.12.20X1 in each case the following amount shall be added or deducted from the balance of holding Co.'s Profit & Loss account.

	% Share holding [K]	P & L as on 1.1.20X1 [L]	P & L as on consolidation date [M]	P & L post acquisition [N] = [M]-[L]	Amount to be added / (deducted) from holding's P & L [O] = [K] x [N]
1	90 %	50,000	70,000	20,000	18,000
2	85 %	30,000	20,000	(10,000)	(8,500)
3	80 %	20,000	20,000	NIL	NIL
4	100 %	40,000	55,000	15,000	15,000

Illustration 2

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

During the year ended 31st December, 20X1, ABC Ltd. earned a profit of ₹ 20,000 and at year end, declared and paid a dividend of ₹ 15,000.

Show by an entry how the dividend should be recorded in the books of XYZ Ltd.

What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also please check whether there should be any goodwill/ capital reserve at the date of acquisition.

Solution

Total dividend paid is ₹ 15,000 (assumed to be out of post-acquisition profits), hence dividend received by XYZ will be credited to P & L.

XYZ Ltd.'s share of dividend = ₹ 15,000 X 80% = ₹ 12,000

In the books of XYZ Ltd.

		₹	₹
Bank A/c	Dr.	12,000	
To Profit & Loss A/c			12,000
(Dividend received from ABC Ltd credited to P&L A/c being out of post-acquisition profits – as explained above)			
Goodwill on consolidation (at the date of acquisition):		₹	₹
Cost of shares			1,40,000
Less: Face value of capital i.e. 80% of capital		80,000	
Add: Share of capital profits [60,000X 80 %]		48,000	(1,28,000)
Goodwill			12,000

Minority interest on:		
- **1st January, 20X1:**		
20% of ₹ 1,60,000 [1,00,000 + 60,000]		32,000
- **31st December, 20X1:**		33,000
20% of ₹ 1,65,000 [1,00,000 + 60,000 + 20,000 – 15,000]		

Illustration 3

Exe Ltd. acquires 70% of equity shares of Zed Ltd. as on 31st March, 20X1 at a cost of ₹ 70 lakhs. The following information is available from the balance sheet of Zed Ltd. as on 31st March, 20X1:

	₹ in lakhs
Property, plant and equipment	*120*
Investments	*55*
Current Assets	*70*
Loans & Advances	*15*
15% Debentures	*90*
Current Liabilities	*50*

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment	*Up by 20%*
Investments	*Down by 10%*

Zed Ltd. declared and paid dividend @ 20% on its equity shares as on 31st March, 20X1 (Face value - ₹ 10 per share). Exe Ltd. purchased the shares of Zed Ltd. @ ₹ 20 per share.

Calculate the amount of goodwill/capital reserve on acquisition of shares of Zed Ltd.

Solution

Revalued net assets of Zed Ltd. as on 31st March, 20X1

	₹ in lakhs	₹ in lakhs
Property, plant and equipment [120 X 120%]		144.0
Investments [55 X 90%]		49.5
Current Assets		70.0
Loans and Advances		15.0
Total Assets after revaluation		278.5
Less: 15% Debentures	90.0	
Current Liabilities	50.0	(140.0)
Equity / Net Worth		138.5
Exe Ltd.'s share of net assets (70% of 138.5)		96.95
Exe Ltd.'s cost of acquisition of shares of Zed Ltd.		
(₹ 70 lakhs – ₹ 7 lakhs*)		63.00
Capital reserve		33.95

* Total Cost of 70 % Equity of Zed Ltd	₹ 70 lakhs
Purchase Price of each share	₹ 20
Number of shares purchased [70 lakhs /₹ 20]	3.5 lakhs
Dividend @ 20 % i.e. ₹ 2 per share	₹ 7 lakhs

Since dividend received is for pre-acquisition period, it has been reduced from the cost of investment in the subsidiary company.

Illustration 4

A Ltd. acquired 70% of equity shares of B Ltd. on 1.4.20X1 at cost of ₹ 10,00,000 when B Ltd. had an equity share capital of ₹ 10,00,000 and reserves and surplus of ₹ 80,000. In the four consecutive years, B Ltd. fared badly and suffered losses of ₹ 2,50,000, ₹ 4,00,000, ₹ 5,00,000 and ₹ 1,20,000 respectively. Thereafter in 20X5-X6, B Ltd. experienced turnaround and registered an annual profit of ₹ 50,000. In the *next two years i.e. 20X6-X7 and 20X7-X8, B Ltd. recorded annual profits of ₹ 1,00,000 and ₹ 1,50,000 respectively. Show the minority interests and cost of control at the end of each year for the purpose of consolidation.*

Solution

The losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the equity of the subsidiary. In such cases, AS 21 prescribes that the excess, and any further losses applicable to the minority, are adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. If the subsidiary subsequently reports profits, all such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Where the minority interest has a binding obligation (say by way of a shareholders' agreement), then the share of losses will be attributed to the minority interest even if it exceeds the minority interest in the equity (i.e., debit balance in minority interest). Since information on the existence of a binding obligation is not given in the question, we solve as if such obligation does not exist, and hence the minority interests will be computed as follows:

Year	***Profit/(Loss)***	***Minority Interest (30%)***	***Additional Consolidated P & L (Dr.) Cr. (for the year ended balance)***	***Minority's Share of losses borne by A Ltd.***		***Cost of Control***
				₹	***Balance***	
At the time of acquisition in 20X1		3,24,000 - (W.N.)	-			

20X1-X2	(2,50,000)	(75,000)	(1,75,000)			2,44,000 (W.N.)
Balance		2,49,000				
20X2-X3	(4,00,000)	(1,20,000)	(2,80,000)			2,44,000
Balance		1,29,000				
20X3-X4	(5,00,000)	(1,50,000)	(3,50,000)			2,44,000
		(21,000)				
	Loss of minority borne by Holding Co.	21,000	(21,000)	21,000	21,000	
Balance		Nil	(3,71,000)			
20X4-X5	(1,20,000)	(36,000)	(84,000)			2,44,000
	Loss of minority borne by Holding Co.	36,000	(36,000)	36,000	57,000	
Balance		Nil	(1,20,000)			
20X5-X6	50,000	15,000	35,000			2,44,000
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(15,000)	15,000	(15,000)	42,000	
Balance		Nil	50,000			

20X6-X7	1,00,000	30,000	70,000			
	Profit share of minority adjusted against losses of minority absorbed by Holding Co.	(30,000)	30,000	(30,000)	12,000	2,44,000
Balance		Nil	100,000			
20X7-X8	1,50,000	45,000	1,05,000	(12,000)	Nil	2,44,000
		(12,000)	12,000			
Balance		33,000	1,17,000			

Working Note:

Calculation of Minority interest and Cost of control on 1.4.20X1

		Share of Holding Co.	Minority Interest
	100%	70%	30%
	(₹)	(₹)	(₹)
Share Capital	10,00,000	7,00,000	3,00,000
Reserve	80,000	56,000	24,000
		7,56,000	3,24,000
Less: Cost of investment		(10,00,000)	
Goodwill		2,44,000	

Illustration 5

Variety Ltd. holds 46% of the paid-up share capital of VR Ltd. The shares were acquired at a market price of ₹ 17 per share. The balance of shares of VR Ltd. are *held by a foreign collaborating company. A memorandum of understanding has been entered into with the foreign company providing for the following:*

(a) The shares held by the foreign company will be sold to Variety Ltd. The price per share will be calculated by capitalising the yield at 15%. Yield, for this purpose, would mean 40% of the average of pre-tax profits for the last 3 years, which were ₹ 30 lakhs, ₹ 40 lakhs and ₹ 65 lakhs.

(b) The actual cost of the shares to the foreign company was ₹ 5,40,000 only. The profit that would accrue to them would be taxable at an average rate of 30%. The tax payable will be deducted from the proceeds and Variety Ltd. will pay it to the Government.

(c) Out of the net consideration, 50% would be remitted to the foreign company immediately and the balance will be an unsecured loan repayable after two years.

The above agreement was approved by all concerned for being given effect to on 1.4.20X1. The total assets of VR Ltd. as on 31st March, 20X1 was ₹ 1,00,00,000. It was decided to write down Property, Plant and Equipment by ₹ 1,75,000. Current liabilities of VR Ltd. as on the same date were ₹ 20,00,000. The paid-up share capital of VR Ltd. was ₹ 20,00,000 divided into 2,00,000 equity shares of ₹ 10 each.

Find out goodwill/capital reserve to Variety Ltd. on acquiring wholly the shares of VR Ltd.

Solution

1. Computation of Purchase Consideration

(a) Yield of VR Ltd.: $\left[\frac{40}{100} \times \frac{30+40+65}{3}\right]$ ₹ 18 lakhs

(b) <u>Price per share of VR Ltd.:</u>

Capitalized Yield: $\left[\frac{18 \text{ lakhs}}{0.15}\right]$ ₹ 120 lakhs

No. of shares 2 lakhs

Therefore, price per share ₹ 60

(c) Purchase Consideration for 54% shares in VR Ltd.

2 lakh shares x 54% x ₹ 60 per shares ₹ 64.80 lakhs

(d) Discharge of Purchase Consideration:

Tax at source (₹ 64.80 lakhs – ₹ 5.40 lakhs) × $\frac{30}{100}$	₹ 17.82 lakhs
50% of purchase consideration (net of tax) in cash [₹ (64.80 – 17.82) x 50%]	₹ 23.49 lakhs
Balance – Unsecured Loan	₹ 23.49 lakhs

2. Goodwill / Capital Reserve to Variety Ltd.

	₹ in lakhs	
Total Assets	100.00	
Less: Reduction in Value of Property, Plant and Equipment	(1.75)	
	98.25	
Less: Current Liabilities	(20.00)	
Net Assets of VR Ltd. on Date of Acquisition		78.25
Purchase Consideration: 54% purchased from Foreign Co.	64.80	
Investment: 46% existing stake	15.64	(80.44)
Goodwill on Date of Acquisition		**2.19**

Illustration 6

A Ltd. acquired 60% shares of B Ltd. @ ₹ 20 per share. Following is the extract of Balance Sheet of B Ltd.:

	₹
10,00,000 Equity Shares of ₹ 10 each	*1,00,00,000*
10% Debentures	*10,00,000*
Trade Payables	*55,00,000*
Property, Plant and Equipment	*70,00,000*
Investments	*45,00,000*
Current Assets	*68,00,000*
Loans and Advances	*22,00,000*

On the same day B Ltd. declared dividend at 20% and as agreed between both the companies Property, Plant and Equipment were to be depreciated @ 10% and investment to be taken at market value of ₹ 60,00,000. Calculate the Goodwill or Capital Reserve to be recorded in Consolidated Financial Statements.

Solution

Since dividend is declared by B Ltd. on the date of acquisition itself, it would be out of the divisible profits of B Ltd. existing on the date of acquisition i.e., pre-acquisition profits from the perspective of A Ltd. Accordingly, as per AS 13, such pre-acquisition dividend would be reduced from the cost of investment, as seen below in the determination of Goodwill on the date of acquisition.

	₹	₹
Assets		
Property, Plant and Equipment	70,00,000	
Less: Value written off (₹ 70 lakhs x 10%)	(7,00,000)	
	63,00,000	
Investments at Market Value	60,00,000	
Current Assets	68,00,000	
Loans and Advances	22,00,000	2,13,00,000
Less: Liabilities		
Trade Payables	55,00,000	
10% Debentures	10,00,000	(65,00,000)
Net Assets of B Ltd.		1,48,00,000
Share of A Ltd. in Net Assets of B Ltd.: 60%		88,80,000
Less: Cost of Investment in B Ltd. (60% stake):		
10,00,000 Equity Shares x 60% x ₹ 20 per share	1,20,00,000	
Less: Pre-acquisition dividend: 6,00,000 shares x ₹ 2	(12,00,000)	(1,08,00,000)
Goodwill on Date of Acquisition		**19,20,000**

Illustration 7

H Ltd. acquired 3,000 shares in S Ltd., at a cost of ₹4,80,000 on 31.7.20X1. The capital of S Ltd. consisted of 5,000 shares of ₹ 100 each fully paid. The Profit & Loss Account of this company for 20X1 showed an opening balance of ₹ 1,25,000 and profit for the year was ₹ 3,00,000. At the end of the year, it declared a dividend of 40%. Record the entry in the books of H Ltd., in respect of the dividend. Assume the profit is accruing evenly and calendar year as financial year.

Solution

The profits of S Ltd., have to be divided between capital and revenue profits from the point of view of the holding company:

	Capital Profit (Pre-acquisition) ***₹***		***Revenue Profit (Post-acquisition)*** ***₹***
Balance on 1.1.20X1	1,25,000	—	
Profit for 20X1 (3,00,000 × 7/12)	1,75,000	(3,00,000×5/12)	1,25,000
Total	3,00,000		1,25,000
Proportionate share of H Ltd. (3/5)	1,80,000		75,000

Total dividend declared = ₹ 5,00,000 X 40 % = ₹ 2,00,000

H Ltd.'s share in the dividend = ₹ 2,00,000 X 3/5 = ₹ 1,20,000

There can be two situations as regards the treatment of dividend of ₹ 1,20,000:

(1) The profit for 20X1 has been utilised to pay the dividend.

The share of H Ltd in profit for the first seven months of S Ltd = ₹ 1,05,000 (i.e. ₹ 1,75,000 × 3/5)

Profit for the remaining five months = ₹ 75,000

(i.e.₹ 1,25,000 × 3/5).

The dividend of ₹ 1,20,000 will be adjusted in this ratio of 1,05,000: 75,000 = ₹ 70,000 out of profits up to 31.7.20X1 and ₹ 50,000 out of profits after that date.

The dividend out of profits subsequent to 31.7.20X1 will be revenue income and that out of earlier profits will be capital receipt. Hence the entry will be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			70,000
To Profit and Loss Account			50,000

(2) <u>Later profits have been utilised first and then pre- acquisition profits.</u>

In such a case, the whole of ₹ 75,000 (share of H Ltd. in profits of S Ltd., after 31.7.20X1) would be received and treated as revenue income; the remaining dividend, ₹45,000 (₹1,20,000 less ₹ 75,000) would be capital receipt. The entry would be:

		₹	₹
Bank	Dr.	1,20,000	
To Investment Account			45,000
To Profit & Loss Account			75,000

Note: Point (2) discussed above can arise only if there is definite information about the profits utilized. In practice, such treatment is rare.

Illustration 8

A Ltd. and B Ltd. provide the following information:

	₹ '000s	
	A Ltd.	**B Ltd.**
Equity Shares	*6,000*	*5,000*
6% Preference Shares	*NIL*	*1,000*
General Reserve	*1,200*	*800*

Profit and Loss Account	*1,020*	*1,790*
Trade Payables	*3,850*	*3,410*
Dividend Payable	*600*	*500*
Goodwill	*100*	*20*
Property, Plant and Equipment	*3,850*	*2,750*
Investment	*1,620*	*1,100*
Inventory	*1,900*	*4,150*
Trade Receivables	*4,600*	*4,080*
Cash & Bank	*600*	*400*

A Ltd. purchased 3/4th interest in B Ltd. at the beginning of the year at the premium of 25%. Following other information is available:

a. Profit & Loss Account of B Ltd. includes ₹ 1,000 thousands bought forward from the previous year.

b. The General Reserve balance is brought forward from the previous year.

c. The directors of both the companies have declared a dividend of 10% on equity share capital for the previous and current year.

From the above information calculate Pre- and Post-acquisition Profits, Minority Interest and Cost of Control.

Solution

Calculation of Pre- and Post-Acquisition Profits:

	Pre-Acquisition Profits (₹)	**Post-Acquisition Profits (₹)**
Profit & Loss Account	10,00,000	7,90,000
General Reserve	8,00,000	NIL
	18,00,000	7,90,000
Less: Share of Minority Interest: (¼)	(4,50,000)	(1,97,500)
Attributable to Parent	13,50,000	5,92,500
	(Cost of Control)	(Post-acquisition Profits)

Calculation of Minority Interest:

Particulars	**₹**
Paid-up Equity Share Capital (₹ 50,00,000 x ¼)	12,50,000
Paid-up Preference Share Capital	10,00,000
Share in Reserves:	
Profit & Loss Account: ₹ 17,90,000 x ¼	4,47,500
General Reserve: ₹ 8,00,000 x ¼	2,00,000
Minority Interest	**28,97,500**

Calculation of Goodwill/Capital Reserve

	₹	**₹**
Cost of Investment in Subsidiary:	46,87,500	
₹ 50,00,000 x 75% x 125% (cost + 25% premium)		
Less: Pre-acquisition dividend	(3,75,000)	43,12,500
Less: Net Worth of B Ltd. on Date of Acquisition (attributable to A Ltd.):		
Paid-up Capital	37,50,000	
Pre-acquisition Reserves	13,50,000	(51,00,000)
Capital Reserve		7,87,500

Illustration 9

On 31st March, 20X1, P Ltd. acquired 1,05,000 shares of Q Ltd. for ₹ 12,00,000. The position of Q Ltd. on that date was as under:

	₹
Property, plant and equipment	*10,50,000*
Current Assets	*6,45,000*
1,50,000 equity shares of ₹ 10 each fully paid	*15,00,000*

Pre-incorporation profits	*30,000*
Profit and Loss Account	*60,000*
Trade payables	*1,05,000*

P Ltd. and Q Ltd. give the following information on 31st March, 20X3:

	P Ltd. ₹	Q Ltd. ₹
Equity shares of ₹ 10 each fully paid (before bonus issue)	*45,00,000*	*15,00,000*
Securities Premium	*9,00,000*	*–*
Pre-incorporation profits	*–*	*30,000*
General Reserve	*60,00,000*	*19,05,000*
Profit and Loss Account	*15,75,000*	*4,20,000*
Trade payables	*5,55,000*	*2,10,000*
Property, plant and equipment	*79,20,000*	*23,10,000*
Investment: 1,05,000 Equity shares in Q Ltd. at cost	*12,00,000*	*–*
Current Assets	*44,10,000*	*17,55,000*

Directors of Q Ltd. made bonus issue on 31.3.20X3 in the ratio of one equity share of ₹ 10 each fully paid for every two equity shares held on that date. Bonus shares were issued out of post-acquisition profits by using General Reserve.

Calculate as on 31st March, 20X3 (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account in each of the following cases:

(a) Before issue of bonus shares;

(b) Immediately After issue of bonus shares.

Solution

Shareholding pattern

Particulars	Number of Shares	% of holding
a. P Ltd.		
(i) Purchased on 31.03.20X1	1,05,000	
(ii) Bonus Issue (1,05,000/2)	52,500	

	Total	1,57,500	70%
b.	Minority Interest	67,500	30%

Calculations of (i) Cost of Control/Capital Reserve; (ii) Minority Interest; (iii) Consolidated Profit and Loss Account as on 31st March, 20X3:

(a) Before issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Investment in Q Ltd.		12,00,000
	Less: Face value of investments (Share Capital)	10,50,000	
	Capital profits (W.N.)	63,000	(11,13,000)
	Cost of control (i.e., Goodwill)		87,000
(ii)	**Minority Interest**		₹
	Share Capital		4,50,000
	Capital profits (W.N.)		27,000
	Revenue profits (W.N.)		6,79,500
			11,56,500
(iii)	**Consolidated profit and loss account – P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		15,85,500
			31,60,500

(b) Immediately after issue of bonus shares

(i)	**Cost of control/capital reserve**	₹	₹
	Face value of investments (₹ 10,50,000 + ₹ 5,25,000)	15,75,000	
	Capital Profits (W.N.)	63,000	16,38,000
	Less: Investment in Q Ltd.		(12,00,000)
	Capital reserve		4,38,000

(ii)	**Minority Interest**		₹
	Share Capital (₹ 4,50,000 + ₹ 2,25,000)		6,75,000
	Capital Profits (W.N.)		27,000
	Revenue Profits (W.N.)		4,54,500
			11,56,500
(iii)	**Consolidated Profit and Loss Account – P Ltd.**		₹
	Balance		15,75,000
	Add: Share in revenue profits of Q Ltd. (W.N.)		10,60,500
			26,35,500

Working Note:

Analysis of Profits of Q Ltd.

	Capital Profits (Pre-acquisition)	**Revenue Profits (Post-acquisition)**	
	(Before and after issue of bonus shares) ₹	**Before Bonus Issue** ₹	**After Bonus Issue** ₹
Pre-incorporation profits	30,000		
Profit and loss account on 31.3.20X1	60,000		
	90,000		
General reserve*		19,05,000	19,05,000
Less: Bonus shares			(7,50,000)
			11,55,000
Profit for period of 1st April, 20X1 to 31st March,		3,60,000	3,60,000

20X3 (₹ 4,20,000 – ₹ 60,000)			
		22,65,000	15,15,000
P Ltd.'s share (70%)	63,000	15,85,500	10,60,500
Minority's share (30%)	27,000	6,79,500	4,54,500

*Share of P Ltd. in General reserve has been adjusted in Consolidated Profit and Loss Account.

Illustration 10

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31 March, 20X1 from the following information:

	H Ltd.	*S Ltd.*
	₹	₹
PPE	*5,00,000*	*3,00,000*
Investments		
(20,000 equity shares of S Ltd.)	*2,20,000*	
Current Assets	*1,55,000*	*1,00,000*
Share capital (Fully paid equity shares of ₹ 10 each)	*5,00,000*	*2,50,000*
Profit and loss account	*2,00,000*	*1,00,000*
Trade Payables	*1,75,000*	*50,000*

H Ltd. acquired the shares of S Ltd. on 31st March, 20X1.

Solution

Percentage of holding:

		No. of Shares	**Percentage**
Holding Co	:	20,000	(80%)
Minority shareholders	:	5,000	(20%)
TOTAL SHARES	:	25,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd.

as at 31st March,20X1

		Note No	Amount (₹)
	I EQUITY AND LIABILITIES		
1	**Shareholder's Fund**		
	(a) Share Capital	1	5,00,000
	(b) Reserve and Surplus	2	2,60,000
2	**Minority interest**	3	
3	**Current Liabilities**		70,000
	(a) Trade payables	4	2,25,000
	Total		10,55,000
	II ASSETS		
1.	**Non-Current Assets**		
	PPE	5	8,00,000
2.	**Current Assets**	6	2,55,000
	Total		10,55,000

Notes to Accounts

			Amounts (₹)
1	**Share capital**		
	50,000 Equity Shares @ ₹10 each		5,00,000
2	**Reserve and Surplus**		
	Capital Reserve (W.N.)		60,000
	Profit and loss account		2,00,000
			2,60,000
3	**Minority Interest**		
	Paid up value of shares	50,000	
	Add: Share in Profit and loss account	20,000	70,000
4	**Trade payables**		
	H Ltd.		1,75,000
	S Ltd.		50,000
			2,25,000

5	**PPE**	
	H Ltd.	5,00,000
	S Ltd.	3,00,000
		8,00,000
6	**Current Assets**	
	H Ltd.	1,55,000
	S Ltd.	1,00,000
		2,55,000

Working Note:

Determination of Goodwill/(*Capital Reserve*)		**(₹)**
Cost of investment		2,20,000
Less: Paid up value of shares (80% of 2,50,000)	2,00,000	
Share in pre-acquisition profits (80% of 1,00,000)	80,000	
		(2,80,000)
Capital Reserve		(60,000)

Illustration 11

H Ltd. and S Ltd. provide the following information as at 31st March,20X2:

	H Ltd.	***S Ltd.***
	₹	***₹***
PPE	*1,00,000*	*1,30,000*
Investments (8,000 equity shares of S Ltd.)	*1,26,000*	
Current Assets	*74,000*	*70,000*
Share capital (Fully paid equity shares of ₹10 each)	*1,50,000*	*1,00,000*
Profit and loss account	*50,000*	*40,000*
Trade Payables	*1,00,000*	*60,000*

Additional information:

H Ltd. acquired the shares of S Ltd. on 1-7-20X1 and Balance of profit and loss account of S Ltd. on 1-4-20X1 was 30,000.

Prepare consolidated balance sheet of H Ltd. and its subsidiary as at 31st March, 20X2.

Solution

Percentage of holding:

		No. of Shares	Percentage
Holding Co.	:	8,000	(80%)
Minority shareholders	:	2,000	(20%)
TOTAL SHARES	:	10,000	

Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X2

		Note No	Amount (₹)
	I EQUITY AND LIABILITYES		
1	Shareholder's Fund		
	(a) Share Capital	1	1,50,000
	(b) Reserve and Surplus	2	56,000
2	Minority interest	3	28,000
3	Current Liabilities		
	(a) Trade payables	4	1,60,000
	Total		**3,94,000**
	II ASSETS		
1	Non-Current Assets:		
	PPE	5	2,30,000
	Intangible Asset	6	20,000
2	Current Assets	7	1,44,000
	Total		**3,94,000**

Notes to Accounts

			Amount (₹)
1	**Share capital**		1,50,000
	15,000 Equity Shares @ ₹10 each		
2	**Reserve and Surplus**		
	Profit and loss account (₹ 50,000+ 80% of 9/12 x 10,000)		56,000
3	**Minority Interest**		
	Share capital (20% of ₹ 1,00,000)	20,000	
	Share in Profit and loss account (₹ 40,000 X 20%)	8,000	28,000
4	**Trade payables**		
	H Ltd.		1,00,000
	S Ltd.		60,000
			1,60,000
5	**PPE**		
	H Ltd.		1,00,000
	S Ltd.		1,30,000
			2,30,000
6	Intangible Asset		
	Cost of Investment		1,26,000
	Less: Paid up value of shares (80% of ₹ 1,00,000)		
	Share in pre-acquisition profits		(80,000)
	80% of [30,000+3/12(40,000-30,000)]		(26,000)
	Goodwill		20,000
7	**Current Assets**		
	H Ltd.		74,000
	S Ltd.		70,000
			1,44,000

Illustration 12

From the Balance Sheets and information given below, prepare Consolidated Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March. Virat Ltd. holds 80% of Equity Shares in Anushka Ltd. since its (Anushka Ltd.'s) incorporation.

Balance Sheet of Virat Ltd. and Anushka Ltd. as at 31st March, 20X1

Particulars	Note No.	Virat Ltd. (₹)	Anushka Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	6,00,000	4,00,000
(b) Reserves and Surplus	2	1,00,000	1,00,000
(2) Non-current Liabilities			
Long Term Borrowings		2,00,000	1,00,000
(3) Current Liabilities			
(a) Trade Payables		1,00,000	1,00,000
Total		10,00,000	7,00,000
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment		4,00,000	3,00,000
(b) Non-current investments	3	3,20,000	-
(2) Current Assets			
(a) Inventories		1,60,000	2,00,000
(b) Trade Receivables		80,000	1,40,000
(c) Cash & Cash Equivalents		40,000	60,000
Total		10,00,000	7,00,000

Notes to Accounts

	Particulars	(₹)	Virat Ltd. (₹)	Anushka Ltd. (₹)
1.	**Share capital**			
	60,000 equity shares of ₹ 10 each fully paid up		6,00,000	--
	40,000 equity shares of ₹ 10 each fully paid up		--	4,00,000
	Total		6,00,000	4,00,000
2.	**Reserves and Surplus**			
	General Reserve		1,00,000	1,00,000
	Total		1,00,000	1,00,000
3.	**Non-current investments**			
	Shares in Anushka Ltd		3,20,000	--

Solution

Consolidated balance Sheet of Virat Ltd. and its Subsidiary Anushka Ltd. as at 31st March, 20X1

	Particulars	Note	Amount (₹)
I	**EQUITY AND LIABILITIES:**		
(1)	**Shareholders' Funds:**		
	(a) Share Capital	1	6,00,000
	(b) Reserve and Surplus	2	1,80,000
(2)	**Minority Interest**	3	1,00,000
(3)	**Non-Current Liabilities:**		
	Long Term Borrowings	4	3,00,000

(4)	**Current Liabilities:**		
	Trade Payables	5	2,00,000
	Total		**13,80,000**
II	**ASSETS:**		
(1)	**Non-Current Assets**		
	Property, Plant & Equipment	6	7,00,000
(2)	**Current Assets:**		
	(a) Inventories		
	(b) Trade receivables	7	3,60,000
	(c) Cash and Cash Equivalents	8	2,20,000
		9	1,00,000
	Total		**13,80,000**

Notes to Accounts

	Particulars	**₹**	**₹**
1.	**Share capital**		
	60,000 equity shares of ₹10 each fully paid up		6,00,000
2.	**Reserves and Surplus**		
	General Reserve	1,00,000	
	Add: General reserve of Anushka Ltd (80%)	80,000	
	Total		1,80,000
3.	**Minority interest**		
	20% share in Anushka Ltd (WN 3)		1,00,000
4	**Long term borrowings**		
	Long term borrowings of Virat	2,00,000	
	Add: Long term borrowings of Anushka	1,00,000	
	Total		3,00,000

5.	**Trade payables**		
	Trade payables of Virat	1,00,000	
	Add: Trade payables of Anushka	1,00,000	
	Total		2,00,000
6.	**Property, Plant and Equipment (PPE)**		
	PPE of Virat Ltd	4,00,000	
	Add: PPE of Anushka Ltd	3,00,000	
	Total		7,00,000
7.	**Inventories**		
	Inventories of Virat Ltd	1,60,000	
	Add: Inventories of Anushka Ltd	2,00,000	
	Total		3,60,000
8.	**Trade receivables**		
	Trade receivables of Virat Ltd	80,000	
	Add: Trade receivables of Anushka Ltd	1,40,000	
	Total		2,20,000
9	**Cash and cash equivalents**		
	Cash and cash equivalents of Virat Ltd	40,000	
	Add: Cash and cash equivalents of Anushka Ltd	60,000	
	Total		1,00,000

Working Notes:

1. Basic Information

Company Status	Dates	Holding Status
Holding Co. = Virat Ltd. Subsidiary = Anushka Ltd.	Acquisition: Anushka's Incorporation Consolidation: 31st March, 20X1	Holding Company = 80% Minority Interest = 20%

2. Analysis of General Reserves of Anushka Ltd

Since Virat holds shares in Anushka since its incorporation, the entire Reserve balance of ₹1,00,000 will be Revenue.

3. Consolidation of Balances

Holding- 80%, Minority - 20%	Total	Minority Interest	Holding Company	
Equity Capital	4,00,000	80,000	3,20,000	-
General Reserves	1,00,000	20,000	Nil (pre-acq)	80,000 (post-acq)
Total		1,00,000	3,20,000	80,000
Cost of Investment			(3,20,000)	-
Goodwill/capital reserve			NIL	
Parent's Balance				1,00,000
Amount for Consolidated Balance Sheet				1,80,000

Illustration 13

From the following balance sheets of H Ltd. And its subsidiary S Ltd. drawn up at 31st March, 20X1, prepare a consolidated balance sheet as at that date, having regard to the following:

(i) Reserves and Profit and Loss Account of S Ltd. stood at ₹ 25,000 and ₹ 15,000 respectively on the date of acquisition of its 80% shares by H Ltd. on 1st April, 20X0.

(ii) Machinery (Book-value ₹ 1,00,000) and Furniture (Book value ₹ 20,000) of S Ltd. were revalued at ₹ 1,50,000 and ₹ 15,000 respectively on 1st April, 20X0 for the purpose of fixing the price of its shares. [Rates of depreciation computed on the basis of useful lives: Machinery 10%, Furniture 15%.]

Balance Sheet of H Ltd. and S Ltd. as at 31st March, 20X1

Particulars	Note No.	H Ltd. (₹)	S Ltd. (₹)
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	1	6,00,000	1,00,000
(b) Reserves and Surplus	2	3,00,000	1,00,000
(2) Current Liabilities			
(a) Trade Payables		1,50,000	57,000
Total		10,50,000	2,57,000
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	3	4,50,000	1,07,000
(b) Other non-current investments	4	6,00,000	1,50,000
Total		10,50,000	2,57,000

Notes to Accounts

		₹	H Ltd. (₹)	S Ltd. (₹)
1.	**Share capital**			
	6,000 equity shares of ₹ 100 each, fully paid up		6,00,000	--
	1,000 equity shares of ₹ 100 each, fully paid up			
	Total		- -	1,00,000
			6,00,000	1,00,000
2.	**Reserves and Surplus**			
	General reserves		2,00,000	75,000
	Profit and loss account		1,00,000	25,000
	Total		3,00,000	1,00,000
3.	**Property, Plant and Equipment**			
	Machinery		3,00,000	90,000
	Furniture		1,50,000	17,000
	Total		4,50,000	1,07,000
4.	**Other Non-current investments**			
	Non-current Investments		4,40,000	1,50,000
	Shares in S Ltd.			
	(800 shares at ₹200 each)		1,60,000	--
	Total		6,00,000	1,50,000

Solution

Consolidated Balance Sheet of H Ltd. and its Subsidiary S Ltd. as at 31st March, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	6,00,000
(b) Reserves and Surplus	2	3,44,600
(2) Minority Interest	3	48,150
(3) Current Liabilities		
(a) Trade Payables		2,07,000
Total		**11,99,750**
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	4	5,97,750
(b) Intangible assets	5	12,000
(c) Other non-current investments	6	5,90,000
Total		**11,99,750**

Notes to Accounts

				₹
1.	**Share capital**			
	6,000 equity shares of ₹ 100 each, fully paid up			6,00,000
	Total			6,00,000

2.	**Reserves and Surplus**			
	Reserves		2,00,000	
	Add: 4/5th share of S Ltd.'s post-acquisition reserves (W.N.3)		40,000	2,40,000
	Profit and Loss Account		1,00,000	
	Add: 4/5th share of S Ltd.'s post-acquisition profits (W.N.4)		4,600	1,04,600
	Total			3,44,600
3.	**Minority interest in S Ltd.** (WN 5)			48,150
4.	**Property, plant and equipment**			
	Machinery			
	H. Ltd.		3,00,000	
	S Ltd.	1,00,000		
	Add: Appreciation	50,000		
		1,50,000		
	Less: Depreciation (1,50,000 X 10%)*	(15,000)	1,35,000	
	Furniture			
	H. Ltd.		1,50,000	
	S Ltd.	20,000		
	Less: Decrease in value	(5,000)		
		15,000		
	Less: Depreciation (15,000 X 15%)*	(2,250)	12,750	5,97,750
5.	**Intangible assets**			
	Goodwill [WN 6]			12,000
6.	Other non-current investments			
	H Ltd.		4,40,000	
	S Ltd.		1,50,000	
	Total			5,90,000

* As an alternative manner of presentation, the solution contains only the 'additional depreciation'.

Working Notes:

1. Pre-acquisition profits and reserves of S Ltd.	₹
Reserves	25,000
Profit and Loss Account	15,000
	40,000
H Ltd.'s = 4/5 (or 80%) × 40,000	32,000
Minority Interest= 1/5 (or 20%) × 40,000	8,000
2. Profit on revaluation of assets of S Ltd.	
Profit on Machinery ₹ (1,50,000 – 1,00,000)	50,000
Less: Loss on Furniture ₹ (20,000 – 15,000)	5,000
Net Profit on revaluation	45,000
H Ltd.'s share 4/5 × 45,000	36,000
Minority Interest 1/5 × 45,000	9,000
3. Post-acquisition reserves of S Ltd.	
Post-acquisition reserves (Total reserves less pre-acquisition reserves = ₹ 75,000 – 25,000)	50,000
H Ltd.'s share 4/5 × 50,000	40,000
Minority interest 1/5 × 50,000	10,000
4. Post -acquisition profits of S Ltd.	
Post-acquisition profits (Profit & loss account balance less pre-acquisition profits = ₹ 25,000 – 15,000)	10,000
Add: Excess depreciation charged on furniture @ 15%	
on ₹ 5,000 i.e. (20,000 – 15,000)	750
	10,750

Less: Under depreciation on machinery @ 10%	
on ₹ 50,000 i.e. (1,50,000 – 1,00,000)	(5,000)
Adjusted post-acquisition profits	5,750
H Ltd.'s share 4/5 × 5,750	4,600
Minority Interest 1/5 × 5,750	1,150
5. Minority Interest	
Paid-up value of (1,000 – 800) = 200 shares	
held by outsiders i.e. 200 × ₹ 100 (or 1,00,000 X 20%)	20,000
Add: 1/5th share of pre-acquisition profits and reserves	8,000
1/5th share of profit on revaluation	9,000
1/5th share of post-acquisition reserves	10,000
1/5th share of post-acquisition profit	1,150
	48,150
6. Cost of Control or Goodwill	
Price paid by H Ltd. for 800 shares(A)	1,60,000
Intrinsic value of the shares-	
Paid-up value of 800 shares held by H Ltd. i.e. 800 × ₹ 100	80,000
(or 1,00,000 X 80%)	
Add: 4/5th share of pre-acquisition profits and reserves	32,000
4/5th share of profit on the revaluation	36,000
Intrinsic value of shares on the date of acquisition (B)	1,48,000
Cost of control or Goodwill (A – B)	12,000

C. Elimination of Intra-Group Transactions

Consolidated Financial Statements reflect the financial position and operations of the group as a single entity. Accordingly, the statements must contain only those transactions and balances with entities 'external' to the group, thereby requiring elimination of intra-group transactions.

In order to present financial statements for the group in a consolidated format, the effect of transactions between group enterprises should be eliminated. Para 16 of AS 21 states that intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

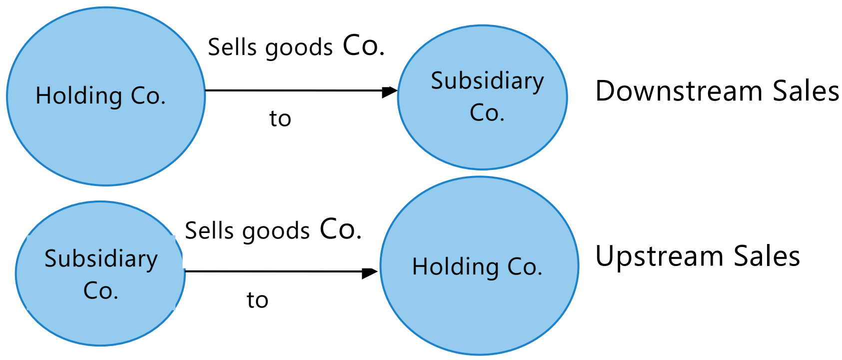
Liabilities due to one group enterprise by another will be set off against the corresponding asset in the other group enterprise's financial statements; sales made by one group enterprise to another should be excluded both from turnover and from cost of sales or the appropriate expense heading in the consolidated statement of profit and loss.

To the extent that the buying enterprise has further sold the goods in question to a third party, the eliminations to sales and cost of sales are all that is required, and no adjustments to consolidated profit or loss for the period, or to net assets, are needed. However, to the extent that the goods in question are still on hand at year end, they may be carried at an amount that is in excess of cost to the group and the amount of the intra-group profit must be eliminated, and assets are reduced to cost to the group.

For transactions between group enterprises, unrealized profits resulting from intra-group transactions that are included in the carrying amount of assets, such as inventories and tangible fixed assets, are eliminated in full. The requirement to eliminate such profits in full applies to the transactions of all subsidiaries that are consolidated – even those in which the group's interest is less than 100%.

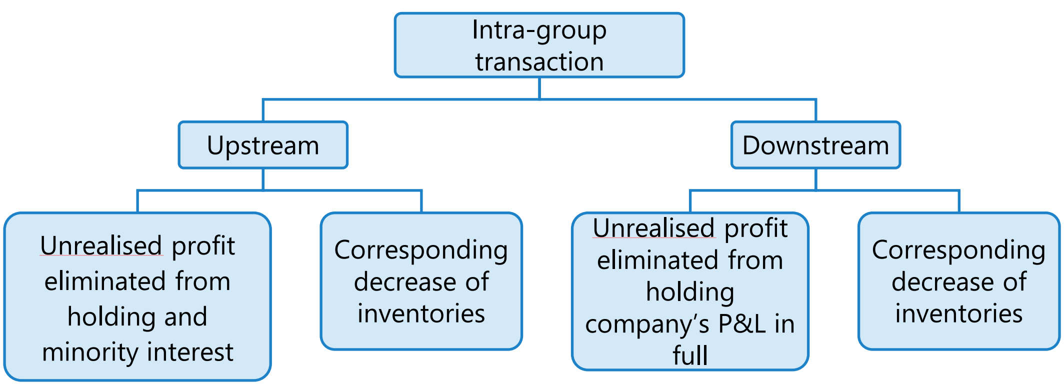
Unrealized profit in inventories: Where a group enterprise sells goods to another, the selling enterprise, as a separate legal enterprise, records profits made on those sales. If these goods are still held in inventory by the buying enterprise at the year end, the profit recorded by the selling enterprise, when viewed from the standpoint of the group as a whole, has not yet been earned, and will not be earned until the goods are eventually sold outside the group. On consolidation, the unrealized profit on closing inventories will be eliminated from the group's profit, and the closing inventories of the group will be recorded at cost to the group.

Here, the point to be noted is that one has to see whether the intragroup transaction is "upstream" or "down-stream". **Upstream transaction** is a transaction in which the subsidiary company sells goods to holding company. While in the **downstream transaction** holding company is the seller and subsidiary company is the buyer.



In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.



Unrealized profit on transfer of non-current asset: Similar to the treatment described above for unrealized profits in inventories, unrealized inter-company profits arising from intra-group transfers of fixed assets are also eliminated from the consolidated financial statements.

Unrealized losses: Unrealized losses resulting from intra-group transactions that are deducted in arriving at the carrying amount of assets are also eliminated **unless cost cannot be recovered.**

Example:

If net realizable value (NRV) expected from sale of such goods is more than the actual cost of the goods, then unrealized loss should be reversed during consolidation process. However, if it is expected that NRV would not be sufficient to recover the loss incurred on transfer of goods from one entity to another, the unrealized loss should not be reversed.

Illustration 14

a. *A Ltd. holds 80% of the equity capital and voting power in B Ltd. A Ltd. sells inventories costing ₹ 180 lacs to B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with B Ltd. at the financial year end i.e. 31 March 20X1.*

b. *A Ltd. holds 75% of the equity capital and voting power in B Ltd. A Ltd. purchases inventories costing ₹ 150 lacs from B Ltd at a price of ₹ 200 lacs. The entire inventories remain unsold with A Ltd. at the financial year end i.e. 31 March 20X1.*

Suggest the accounting treatment for the above mentioned transactions in the consolidated financial statements of A Ltd. giving reference of the relevant guidance/standard.

Solution

As per para 16 and 17 of AS 21, intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full. Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Intragroup balances and intragroup transactions, including sales, expenses and dividends, are eliminated in full. Unrealized profits resulting from intragroup transactions that are included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Unrealized losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.

One also needs to see whether the intragroup transaction is "upstream" or "down-stream". Upstream transaction is a transaction in which the subsidiary company sells goods to holding company. While in the downstream transaction, holding company is the seller and subsidiary company is the buyer.

In the case of upstream transaction, since the goods are sold by the subsidiary to holding company; profit is made by the subsidiary company, which is ultimately shared by the holding company and the minority shareholders. In such a transaction, if some goods remain unsold at the balance sheet date, the unrealized profit on such goods should be eliminated from minority interest as well as from consolidated profit on the basis of their share-holding besides deducting the same from unsold inventory.

But in the case of downstream transaction, the whole profit is earned by the holding company, therefore, whole unrealized profit should be adjusted from unsold inventory and consolidated profit and loss account only irrespective of the percentage of the shares held by the parent.

Using above mentioned guidance, following adjustments would be required:

a. This would be the case of downstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

   Further, the unrealized profits of ₹ 20 lacs (i.e. ₹ 200 lacs – ₹ 180 lacs), would be eliminated from the consolidated financial statements for financial year ended 31 March 20X1, by reducing the consolidated profits/ increasing the consolidated losses, and reducing the value of closing inventories as of 31 March 20X1.

b. This would be the case of upstream transaction. In the consolidated profit and loss account for the year ended 31 March 20X1, entire transaction of sale and purchase of ₹ 200 lacs each, would be eliminated by reducing both sales and purchases (cost of sales).

Further, the unrealized profits of ₹ 50 lacs (i.e. ₹ 200 lacs – ₹ 150 lacs), would be eliminated in the consolidated financial statements for financial year ended 31 March 20X1, by reducing the value of closing inventories by ₹ 50 lacs as of 31 March 20X1. In the consolidated balance sheet as of 31 March 20X1, A Ltd.'s share of profit from B Ltd will be reduced by ₹ 37.50 lacs (being 75% of ₹ 50 lacs) and the minority's share of the profits of B Ltd would be reduced by ₹ 12.50 lacs (being 25% of ₹ 50 lacs).

D. ALIGNMENT OF REPORTING DATES

The financial statements used in the consolidation should be drawn up to the same reporting date. If it is not practicable to draw up the financial statements of one or more subsidiaries to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements.

In any case, the difference between reporting dates should not be more than six months.

The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are usually drawn up to the same date. When the reporting dates are different, the subsidiary often prepares, for consolidation purposes, statements as at the same date as that of the parent.

When it is impracticable to do this, financial statements drawn up to different reporting dates may be used provided the difference in reporting dates is not more than six months.

The consistency principle requires that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.

1.15 PREPARATION OF CONSOLIDATED STATEMENT OF PROFIT AND LOSS

All the items of profit and loss account are to be added on line by line basis and inter-company transactions should be eliminated from the consolidated figures.

For example, a holding company may sell goods or services to its subsidiary, receive consultancy fees, commission, royalty etc. These items are included in sales and other income of the holding company and in the expense items of the subsidiary. Alternatively, the subsidiary may also sell goods or services to the holding company. These inter-company transactions are to be eliminated in full.

If there remains any unrealized profit in the inventory, of any of the Group Company, such unrealized profit is to be eliminated from the value of inventory to arrive at the consolidated profit.

Illustration 15

H Ltd and its subsidiary S Ltd provide the following information for the year ended 31st March, 20X3:

	H Ltd. ***(₹ in lacs)***	***S Ltd.*** ***(₹ in lacs)***
Sales and other income	*5,000*	*1,000*
Increase in Inventory (closing less opening)	*1,000*	*200*
Raw material consumed	*800*	*200*
Wages and Salaries	*800*	*150*
Production expenses	*200*	*100*
Administrative Expenses	*200*	*100*
Selling and Distribution Expenses	*200*	*50*
Interest	*100*	*50*
Depreciation	*100*	*50*

Other Information:

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

H Ltd. holds 80% of equity share capital of ₹ 1,000 lacs in S Ltd. prior to 20X1-20X2. H Ltd. took credit to its Profit and Loss Account, the proportionate amount of dividend declared and paid by S Ltd. for the year 20X1-20X2.

Prepare a consolidated statement of profit and loss..

Solution

Consolidated statement of profit and loss of H Ltd. and its subsidiary S Ltd. for the year ended on 31st March, 20X3

Particulars	Note No.	₹ in Lacs
I. Revenue from operations	1	5,865
II. Total Income		**5,865**
III. Expenses		
Cost of material purchased/consumed	2	1,180
Changes of inventories of finished goods	3	(1,196)
Employee benefit expense	4	950
Finance cost	5	150
Depreciation and amortization expense	6	150
Other expenses	7	535
Total expenses		**1,769**
IV. Profit before tax (II-III)		**4,096**

Notes to Accounts

		₹ in Lacs	₹ in Lacs
1.	Revenue from operations		
	Sales and other income		
	H Ltd.	5,000	
	S Ltd.	1,000	
		6,000	
	Less: Inter-company sales	(120)	
	Consultancy fees received by H Ltd. from S Ltd.	(5)	
	Commission received by S Ltd. from H Ltd.	(10)	5,865
2.	Cost of material purchased/consumed		
	H Ltd.	800	
	S Ltd.	200	
		1,000	
	Less: Purchases by S Ltd. from H Ltd.	(120)	880
	Direct expenses (Production)		
	H Ltd.	200	
	S Ltd.	100	300
			1,180
3.	Changes of inventories of finished goods		
	H Ltd.	1,000	
	S Ltd.	200	
	Less: Unrealized profits ₹ 24 lacs × $\frac{20}{120}$	(4)	1,196

4.	Employee benefits and expenses		
	Wages and salaries:		
	H Ltd.	800	
	S Ltd.	150	950
5.	Finance cost		
	Interest:		
	H Ltd.	100	
	S Ltd.	50	150
6.	Depreciation		
	H Ltd.	100	
	S Ltd.	50	150
7.	Other expenses		
	Administrative expenses		
	H Ltd.	200	
	S Ltd.	100	
	Less: Consultancy fees received by H Ltd. from S Ltd.	(5)	295
	Selling and distribution Expenses:		
	H Ltd.	200	
	S Ltd.	50	
	Less: Commission received by S Ltd. from H Ltd.	(10)	240
			535

1.16 PREPARATION OF CONSOLIDATED CASH FLOW STATEMENT

As per AS 21, Consolidated cash flow statement is presented in case a parent presents its own cash flow statement.

For the purpose of preparation of consolidated cash flow statement, all the items of cash flow from operating activities, investing activities and financing activities are to be added on line by line basis and from the consolidated items, inter-company transactions should be eliminated. Below given is an illustrative consolidated cash flow statement with hypothetical figures:

Consolidated Cash Flow Statement (Illustrative only)

			(₹ in million)
	A Company	B Company	Total
Cash Flows from Operating Activities			
Change in Reserve	8	2	10
Change in P & L A/c	-	1	1
Dividend Paid	22	-	22
Tax Provision	20	1	21
Depreciation	10	5	15
Interest	(10)	10	-
	50	19	69
Less: Tax payment	(20)	(1)	(21)
	30	18	48
Working capital adjustment	(13)	12	(1)
(A)	17	30	47
Cash Flows from Investment Activities			
Sale of fixed assets	30	-	30
Purchase of fixed assets	(30)	(20)	(50)
(B)	-	(20)	(20)
Cash Flows from Financing Activities	(5)	(10)	(15)
(C)			
Net cash flows (A+B+C)	**12**	-	**12**

1.17 UNIFORM ACCOUNTING POLICIES

Para 20 of AS 21 states that consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances.

If any company in the same group uses accounting policies other than those adopted in consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, the fact should be disclosed together with the proportions of items to which different accounting policies have been applied.

For example, if the subsidiary company follows weighted average method for valuation of inventories and the holding company follows FIFO method, the financial statements of subsidiary company should be restated by adjusting the value of inventories to bring the same in line with the valuation procedure adopted by the holding company. After that consolidation should be done.

Illustration 16

Subsidiary B Ltd. provides the following balance sheet:

Particulars	***Note No.***	***20X0 (₹)***	***20X1 (₹)***
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*5,00,000*	*5,00,000*
(b) Reserves and Surplus	*2*	*2,86,000*	*7,14,000*
(2) Current Liabilities			
(a) Short term borrowings	*3*	*--*	*1,70,000*
(b) Trade Payables		*4,90,000*	*4,94,000*
(c) Short-term provisions	*4*	*3,10,000*	*4,30,000*
Total		*15,86,000*	*23,08,000*

II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	*5*	*2,72,000*	*2,24,000*
(b) Non-current Investment			*4,00,000*
(2) Current assets			
(a) Inventories		*5,97,000*	*7,42,000*
(b) Trade Receivables		*5,94,000*	*8,91,000*
(c) Cash & Cash Equivalents		*51,000*	*3,000*
(d) Other current assets	*6*	*72,000*	*48,000*
Total		*15,86,000*	*23,08,000*

		20X0 (₹)	***20X1 (₹)***
1.	***Share capital***		
	5,000 equity shares of ₹10 each, fully paid up	*5,00,000*	*5,00,000*
2.	***Reserves and Surplus***		
	General Reserves	*2,86,000*	*7,14,000*
3.	***Short term borrowings***		
	Bank overdraft	*--*	*1,70,000*
4.	***Short term provisions***		
	Provision for taxation	*3,10,000*	*4,30,000*
5.	***Property, plant and equipment***		
	Cost	*3,20,000*	*3,20,000*
	Less: Depreciation	*(48,000)*	*(96,000)*
	Total	*2,72,000*	*2,24,000*
6.	***Other current Assets***		
	Prepaid expenses	*72,000*	*48,000*

Also consider the following information:

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

(b) A Ltd. values inventory on weighted average basis while B Ltd. used FIFO basis. To bring B Ltd.'s values in line with those of A Ltd, its value of inventory is required to be reduced by ₹12,000 at the end of 20X0 and ₹ 34,000 at the end of 20X1.

(c) B Ltd. deducts 1% from Trade Receivables as a general provision against doubtful debts.

(d) Prepaid expenses in B Ltd. include advertising expenditure carried forward of ₹ 60,000 in 20X0 and₹ 30,000 in 20X1, being part of initial advertising expenditure of ₹ 90,000 in 20X0 which is being written off over three years. Similar amount of advertising expenditure of A Ltd. has been fully written off in 20X0.

Restate the balance sheet of B Ltd. as at 31st December, 20X1 after considering the above information, for the purpose of consolidation. Would restatement be necessary to make the accounting policies adopted by A Ltd. and B Ltd. uniform.

Solution

As per para 20 and 21 of AS 21, Consolidated financial statements:

Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements when they are used in preparing the consolidated financial statements.

Accordingly in the given case, restatement would be required to make the accounting policies of A Ltd and B Ltd uniform.

Adjusted reserves of B Ltd.:

	₹	₹
Reserves as given		7,14,000
Add: Provision for doubtful debts		
{[8,91,000 / 99 X 100]-8,91,000}		9,000
		7,23,000
Less: Reduction in value of Inventory	34,000	
Advertising expenditure to be written off	30,000	(64,000)
Adjusted reserves		6,59,000

Note: No adjustment would be required in respect of opening inventory of B Ltd as that will not have any impact on P&L.

Restated Balance Sheet of B Ltd.
as at 31st December, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	6,59,000
(2) Current Liabilities		
(a) Short term borrowings	3	1,70,000
(b) Trade Payables		4,94,000
(c) Short-term provision	4	4,30,000
Total		22,53,000
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	2,24,000
(b) Non-current Investment		4,00,000
(2) Current assets		
(a) Inventories	6	7,08,000

(b)	Trade Receivables	7	9,00,000
(c)	Cash & Cash Equivalents		3,000
(d)	Other current assets	8	18,000
	Total		22,53,000

Notes to Accounts

			20X1 (₹)
1.	**Share capital**		
	5,000 equity shares of Rs 10 each, fully paid up		5,00,000
2.	**Reserves and Surplus**		
	General Reserves (refer to WN)		6,59,000
3.	**Short term borrowings**		
	Bank overdraft		1,70,000
4.	**Short term provisions**		
	Provision for taxation		4,30,000
5.	**Property, plant and equipment**		
	Cost		3,20,000
	Less: Depreciation		(96,000)
	Total		2,24,000
6.	**Inventory**		
	Actual inventory		7,42,000
	Less: Change in method of valuation		(34,000)
	Total		7,08,000
7.	**Trade receivables**		
	Actual trade receivables		8,91,000
	Add: Adjustment for provision		9,000
	Total		9,00,000
8.	**Other current Assets**		
	Prepaid expenses		48,000

1.18 TREATMENT OF SUBSIDIARY COMPANY HAVING PREFERENCE SHARE CAPITAL

While preparing CFS, outstanding cumulative preference shares issued by a subsidiary are considered in the same manner as any other liability, such as debentures etc. Accordingly, the cost associated with such cumulative preference shares needs to be adjusted for.

Therefore, while computing its share of profits or losses of the subsidiary, the parent should make adjustments in respect of preference dividends on outstanding cumulative preference shares issued by a subsidiary and held outside the group since, for the group, such preference shares represent external liabilities. It would be appropriate for the parent to compute its share of profits or losses after adjusting for subsidiary's cumulative preference dividends, whether or not profits are available or dividends have been declared.

However, in case of non-cumulative preference shares, no such adjustment is required unless the dividend is actually received.

SUMMARY

- "Holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies; "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—
    - controls the composition of the Board of Directors; or
    - exercises or controls more than one-half of the total share capital 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.
- 'Total share capital', as defined in section 2(87) (ii) above, has been further clarified by the Rule 2(1)(r) of the Companies (Specification of Definitions Details) Rules, 2014. As per the Rule, total share capital includes
    - paid up equity share capital
    - convertible preference share capital.

- Consolidated financial statements are prepared and presented by a parent/holding enterprise to provide financial information about a parent and its subsidiary (ies) as a single economic entity.
- Distinction must be made from the point of view of the holding company, between revenue and capital profit of the subsidiary. In the absence of information, profits of a year may be treated as accruing from day to day.

Preparation of Consolidated Statement of Profit and Loss

- All the revenue items are to be added on line by line basis and from the consolidated revenue items, inter-company transactions should be eliminated.
- If there remains any unrealized profit in the inventory of goods, of any of the Group Company, such unrealized profit should be eliminated from the value of inventory to arrive at the consolidated profit.

Preparation of Consolidated Cash Flow Statement

All the items of Cash flow from operating activities, investing activities and financing activities are to be added on line by line basis and from the consolidated items, inter-company transactions should be eliminated.

The financial statements used in the consolidation should be drawn up to the same reporting date. If it is not practicable to draw up the financial statements of one or more subsidiaries to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements.

In any case, the difference between reporting dates should not be more than six months.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Minority interest should be presented in the consolidated balance sheet*

   (a) As a part of liabilities.

   (b) As a part of equity of the parent's shareholders.

   (c) Separately from liabilities and the equity of the parent's shareholders.

   (d) As a part of assets.

2. *Minority of the subsidiary is entitled to*

   (a) Capital profits of the subsidiary company.

   (b) Revenue profits of the subsidiary company.

   (c) Both capital and revenue profits of the subsidiary company.

   (d) Neither capital nor revenue profits of the subsidiary..

3. *In consolidation of accounts of holding and subsidiary company ________ is eliminated in full.*

   (a) Current liabilities of subsidiary company.

   (b) Reserves and surplus of both holding and subsidiary company.

   (c) Mutual indebtedness.

   (d) Nothing.

4. *In consolidated balance sheet, the share of the outsiders in the net assets of the subsidiary must be shown as*

   (a) Minority interest.

   (b) Capital reserve.

   (c) Current liability.

   (d) Current assets.

5. *Provision for Tax made by the subsidiary company will appear in the consolidated balance sheet as an item of*

   (a) Current liability.

   (b) Revenue profit.

   (c) Capital profit.

   (d) Current assets.

Scenario-based Questions

6. *Hemant Ltd. purchased 80% shares of Power Ltd. on 1st January, 20X1 for ₹2,10,000. The issued capital of Power Ltd., on 1st January, 20X1 was ` 1,50,000 and the balance in the Profit & Loss Account was ₹ 90,000. During the year ended 31st December, 20X1, Power Ltd. earned a profit of ` 30,000 and at year end, declared and paid a dividend of ₹ 22,500. What is the amount of minority interest as on 1st January, 20X1 and 31st December, 20X1? Also compute goodwill/ capital reserve at the date of acquisition.*

7. *King Ltd. acquires 70% of equity shares of Queen Ltd. as on 31st March, 20X1 at a cost of ₹ 140 lakhs. The following information is available from the balance sheet of Queen Ltd. as on 31st March, 20X1:*

	₹ in lakhs
Property, plant and equipment	*240*
Investments	*110*
Current Assets	*140*
Loans & Advances	*30*
15% Debentures	*180*
Current Liabilities	*100*

The following revaluations have been agreed upon (not included in the above figures):

Property, plant and equipment- up by 20% and Investments- down by 10%.

King Ltd. purchased the shares of Queen Ltd. @ ₹20 per share (Face value - ₹10).

Calculate the amount of goodwill/capital reserve on acquisition of shares of Queen Ltd.

8. *From the following information, determine Minority Interest on the date of acquisition and on the date of consolidation in each case:*

Case	***Subsidiary Company***	***% of Share owned***	***Cost***	***Date of Acquisition 01-01-20X1***		***Consolidation date 31-12-20X1***	
				Share Capital	***Profit and Loss A/c***	***Share Capital***	***Profit and Loss A/c***
				₹	***₹***	***₹***	***₹***
Case-A	*X*	*90%*	*2,00,000*	*1,50,000*	*75,000*	*1,50,000*	*85,000*
Case-B	*Y*	*75%*	*1,75,000*	*1,40,000*	*60,000*	*1,40,000*	*20,000*
Case-C	*Z*	*70%*	*98,000*	*40,000*	*20,000*	*40,000*	*20,000*
Case-D	*M*	*95%*	*75,000*	*60,000*	*35,000*	*60,000*	*55,000*

9. *A Ltd acquired 1,600 ordinary shares of ₹100 each of B Ltd on 1st July, 20X1. On 31st December, 20X1, the balance sheets of the two companies were as given below:*

Balance Sheet of A Ltd. and its subsidiary, B Ltd. as at 31st December, 20X1

Particulars	***Note No.***	***A Ltd. (₹)***	***B Ltd. (₹)***
I. Equity and Liabilities			
(1) Shareholder's Funds			
(a) Share Capital	*1*	*5,00,000*	*2,00,000*
(b) Reserves and Surplus	*2*	*2,97,200*	*1,82,000*
(2) Current Liabilities			
(a) Trade Payables		*47,100*	*17,400*

(b) Short term borrowings	3	80,000	
Total		9,24,300	3,99,400
II. Assets			
(1) Non-current assets			
(a) Property, Plant and Equipment	4	3,90,000	3,15,000
(b) Non-current Investments	5	3,40,000	--
(2) Current assets			
(a) Inventories		1,20,000	36,400
(b) Trade receivables		59,800	40,000
(c) Cash & Cash equivalents	6	14,500	8,000
Total		9,24,300	3,99,400

Notes to Accounts

		A Ltd. ₹	**B Ltd.** ₹
1.	**Share Capital**		
	5,000 shares of ₹ 100 each, fully paid up	5,00,000	-
	2,000 shares of ₹ 100 each, fully paid up	-	2,00,000
	Total	5,00,000	2,00,000
2.	**Reserves and Surplus**		
	General Reserves	2,40,000	1,00,000
	Profit & loss	57,200	82,000
	Total	2,97,200	1,82,000
3.	**Short term borrowings**		
	Bank overdraft	80,000	--

4.	***Property plant and equipment***		
	Land and building	*1,50,000*	*1,80,000*
	Plant & Machinery	*2,40,000*	*1,35,000*
	Total	*3,90,000*	*3,15,000*
5.	***Non-current Investments***		
	Investment in B Ltd (at cost)	*3,40,000*	*--*
6.	***Cash & Cash equivalents***		
	Cash	*14,500*	*8,000*

The Profit & Loss Account of B Ltd. showed a credit balance of ₹30,000 on 1st January, 20X1 out of which a dividend of 10% was paid on 1st August, 20X1; A Ltd. credited the dividend received to its Profit & Loss Account. The Plant & Machinery which stood at ₹ 1,50,000 on 1st January, 20X1 was considered as worth ₹ 1,80,000 on 1st July, 20X1; this figure is to be considered while consolidating the Balance Sheets. The rate of depreciation on plant & machinery is 10% (computed on the basis of useful lives).

Prepare consolidated Balance Sheet as at 31st December, 20X1.

10. *On 31st March, 20X1, the Balance Sheets of H Ltd. and its subsidiary S Ltd. stood as follows:*

Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1

Particulars	***Note No.***	***H Ltd. (₹ in Lacs)***	***S Ltd. (₹ in Lacs)***
I. Equity and Liabilities			
(1) ***Shareholder's Funds***			
(a) Share Capital	*1*	*12,000*	*4,800*
(b) Reserves and Surplus	*2*	*5,499*	*3,000*
(2) ***Current Liabilities***			
(a) Trade payables	*3*	*1,833*	*1,014*
(b) Short term provisions	*4*	*855*	*394*

		(c)	Other current liabilities (Dividend payable)		1,200	-
			Total		21,387	9,208
II.	**Assets**					
	(1)	**Non-current assets**				
		(a)	Property, Plant and Equipment	5	9,468	5,486
		(b)	Non-current Investments (Shares in S Ltd.)		3,000	
	(2)	**Current assets**				
		(a)	Inventories		3,949	1,956
		(b)	Trade receivables	6	2,960	1,562
		(c)	Cash and cash equivalents		1,490	204
		(d)	Short term loans and advances	7	520	
			Total		21,387	9,208

Notes to Accounts

		H Ltd. (₹ in lacs)	S Ltd. (₹ in lacs)
1.	***Share Capital***		
	Authorized share capital	15,000	6,000
	Equity shares of ₹ 10 each, fully paid up		
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up	12,000	4,800

2.	***Reserves and surplus***		
	General Reserve	*2,784*	*1,380*
	Profit and Loss Account:	*2,715*	*1,620*
	Total	*5,499*	*3,000*
3.	***Trade Payables***		
	Creditors	*1,461*	*854*
	Bills Payable	*372*	*160*
		1,833	*1,014*
4.	***Short term provisions***		
	Provision for Taxation	*855*	*394*
5.	***Property, plant and equipment***		
	Land and Buildings	*2,718*	-
	Plant and Machinery	*4,905*	*4,900*
	Furniture and Fittings	*1,845*	*586*
	Total	*9,468*	*5,486*
6.	***Trade receivables***		
	Debtors	*2,600*	*1,363*
	Bills Receivable	*360*	*199*
	Total	*2,960*	*1,562*
7.	***Short term loans and advances***		
	Sundry Advances	*520*	--

The following information is also provided to you:

(a) H Ltd. purchased 180 lakh shares in S Ltd. on 31st March, 20X0 when the balances of General Reserve and Profit and Loss Account of S Ltd. stood at ₹ 3,000 lakh and ₹ 1,200 lakh respectively.

(b) *On 1st April, 20X0, S Ltd. declared a dividend @ 20% for the year ended 31st March, 20X0. H Ltd. credited the dividend received by it to its Profit and Loss Account.*

(c) *On 1st January, 20X1, S Ltd. issued 3 fully paid-up bonus shares for every 5 shares held out of balances of its general reserve as on 31st March, 20X0.*

(d) *On 31st March, 20X1, all the bills payable in S Ltd.'s balance sheet were acceptances in favour of H Ltd. But on that date, H Ltd. held only ₹ 45 lakh of these acceptances in hand, the rest having been endorsed in favour of its trade payables.*

(e) *On 31st March, 20X1, S Ltd.'s inventory included goods which it had purchased for ₹ 100 lakh from H Ltd. which made a profit @ 25% on cost.*

Prepare a Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1.

11. *Chand Ltd. and its subsidiary Sitara Ltd. provided the following information for the year ended 31st March, 20X4:*

Particulars	**Chand Ltd (₹)**	**Sitara Ltd. (₹)**
Equity Share Capital	*20,00,000*	*6,00,000*
Finished Goods Inventory as on 01.04.2022	*4,20,000*	*3,01,000*
Finished Goods Inventory as on 31.03.2023	*8,57,500*	*3,76,250*
Dividend Income	*1,68,000*	*43,750*
Other non-operating Income	*35,000*	*10,500*
Raw material consumed	*13,93,000*	*4,72,500*
Selling and Distribution Expenses	*3,32,500*	*1,57,500*
Production Expenses	*3,15,000*	*1,40,000*
Loss on sale of investments	*26,250*	*Nil*
Sales and other operating income	*33,25,000*	*19,07,500*

Wages and Salaries	*13,30,000*	*2,45,000*
General and Administrative Expenses	*2,80,000*	*1,22,500*
Royalty paid	*Nil*	*5,000*
Depreciation	*31,500*	*14,000*
Interest expense	*17,500*	*5,250*

Other information

- *On 1st September 20X1 Chand Ltd., acquired 5,000 equity shares of ₹ 100 each fully paid up in Sitara Ltd.*
- *Sitara Ltd. paid a dividend of 10% for the year ended 31st March 20X3. The dividend was correctly accounted for by Chand Ltd.*
- *Chand Ltd. sold goods of ₹ 1,75,000 to Sitara Ltd. at a profit of 20% on selling price. Inventory of Sitara Ltd. includes goods of ₹ 70,000 received from Chand Ltd.*
- *Selling and Distribution expenses of Sitara Ltd. include ₹ 21,250 paid to Chand Ltd. as brokerage fees.*
- *General and Administrative expenses of Chand Ltd. include ₹ 28,000 paid to Sitara Ltd. as consultancy fees.*
- *Sitara Ltd. used some resources of Chand Ltd., and Sitara Ltd. paid ₹ 5,000 to Chand Ltd. as royalty.*

Consultancy fees, Royalty and brokerage received is to be considered as operating revenues.

Prepare Consolidated Statement of Profit and Loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended 31st March, 20X4 as per Schedule III to the Companies Act, 2013.

ANSWERS/SOLUTION

Answer to the Multiple Choice Questions

1.	(c)	**2.**	(c)	**3.**	(c)	**4.**	(a)	**5.**	(a)

Answer to the Scenario-based Questions

6. Total dividend paid is ₹ 22,500 (out of post-acquisition profits), hence dividend received by Hemant will be credited to P & L account. Hemant Ltd.'s share of dividend = ₹ 22,500 X 80% = ₹ 18,000

Goodwill on consolidation (at the date of acquisition):	₹	₹
Cost of shares		2,10,000
Less: Face value of capital i.e. 80% of capital	1,20,000	
Add: Share of capital profits [90,000 X 80 %]	72,000	(1,92,000)
Goodwill		18,000
Minority interest on:		
- **1st January, 20X1:**		
20% of ₹ 2,40,000 [1,50,000 + 90,000]		48,000
- **31st December, 20X1:**		
20% of ₹ 2,47,500 [1,50,000 + 90,000 + 30,000 – 22,500]		49,500

7. Revalued net assets of Queen Ltd. as on 31st March, 20X1

	₹ in lakhs	***₹ in lakhs***
PPE [240 X 120%]		288
Investments [110 X 90%]		99
Current Assets		140
Loans and Advances		30

Total Assets after revaluation		557
Less: 15% Debentures	180.0	
Current Liabilities	100.0	(280)
Equity / Net Worth		277
King Ltd.'s share of net assets (70% of 277)		193.9
King Ltd.'s cost of acquisition of shares of Queen Ltd.		
(₹140 lakhs)		(140)
Capital reserve		53.9

8. Minority Interest = Equity attributable to minorities

Equity is the residual interest in the assets of an enterprise after deducting all its liabilities i.e. in this case, it should be equal to Share Capital + Profit & Loss A/c

A = Share capital on 1.1.20X1

B = Profit & loss account balance on 1.1.20X1

C = Share capital on 31.12.20X1

D = Profit & loss account balance on 31.12.20X1

	Minority % Shares Owned [E]	**Minority interest as at the date of acquisition [E] x [A + B] ₹**	**Minority interest as at the date of consolidation [E] X [C + D] ₹**
Case A [100-90]	10 %	22,500	23,500
Case B [100-75]	25 %	50,000	40,000
Case C [100-70]	30 %	18,000	18,000
Case D [100-95]	5%	4,750	5,750

9. **Consolidated Balance Sheet of A Ltd. and its subsidiary, B Ltd.**

as at 31st December, 20X1

Particulars	Note No.	(₹)
I. Equity and Liabilities		
(1) Shareholder's Funds		
(a) Share Capital	1	5,00,000
(b) Reserves and Surplus	2	3,08,800
(2) Minority Interest		83,600
(3) Current Liabilities		
(a) Trade Payables	3	64,500
(b) Short term borrowings	4	80,000
Total		10,36,900
II. Assets		
(1) Non-current assets		
(a) Property, Plant and Equipment	5	7,41,000
(b) Intangible assets	6	17,200
(2) Current assets		
(a) Inventories	7	1,56,400
(b) Trade receivables	8	99,800
(c) Cash & Cash equivalents	9	22,500
Total		10,36,900

Notes to Accounts

			₹
1.	**Share Capital**		
	5,000 shares of ₹ 100 each		5,00,000

2.	**Reserves and Surplus**			
	Reserves		2,40,000	
	Profit & loss (Refer to W.N 8)		68,800	
	Total			3,08,800
3.	**Trade Payables**			
	A Ltd.	47,100		
	Add: B Ltd	17,400		
	Total			64,500
4.	**Short term borrowings**			
	Bank overdraft			80,000
5.	**Property, plant and equipment**			
	Land and building- A Ltd	1,50,000		
	Add: Land and building- B Ltd	1,80,000	3,30,000	
	Plant & Machinery (Refer to W.N 7)		4,11,000	
	Total			7,41,000
6.	**Intangible assets**			
	Goodwill (refer to W.N 6)			17,200
7.	**Inventories**			
	A Ltd.		1,20,000	
	B Ltd.		36,400	
	Total			1,56,400
8	**Trade Receivables**			
	A Ltd.	59,800		
	B Ltd.	40,000		
	Total			99,800

9	**Cash & Cash equivalents**		
	Cash of A Ltd	14,500	
	Add: cash of B Ltd.	8,000	
	Total		22,500

Share holding Pattern

Total Shares of B Ltd	2,000 shares
Shares held by A Ltd	1,600 shares i.e. 80 %
Minority Shareholding	400 shares i.e. 20 %

Working Notes:

1. The dividend @ 10% on 1,600 shares - ₹ 16,000 received by A Ltd. should have been credited to the investment A/c, being out of pre-acquisition profits. A Ltd., must pass a rectification entry, viz.

Profit & Loss Account	Dr. ₹ 16,000	
To Investment		₹ 16,000

2. The Plant & Machinery of B Ltd. would stand in the books at ₹ 1,42,500 on 1st July, 20X1, considering only six months' depreciation on ₹ 1,50,000 total depreciation being ₹ 15,000. The value put on the assets being ₹ 1,80,000, there is an appreciation to the extent of ₹ 37,500 (1,80,000 – 1,42,500).

3. **Capital profits of B Ltd.**

	₹	₹
Reserve on 1st January, 20X1 (Assumed there is no movement in reserves during the year and hence balance as on 1st January 20X1 is same as of 31st December 20X1)		1,00,000
Profit & Loss Account Balance on 1st January, 20X1	30,000	

Less: Dividend paid		(20,000)	10,000
Profit for 20X1:			
Total	₹ 82,000		
Less:	₹10,000		
	₹ 72,000		
Proportionate upto 1st July, 20X1 on time basis (₹ 72,000/2)			36,000
Appreciation in value of Plant & Machinery			37,500
			1,83,500
Less: 20% due to outsiders			(36,700)
Holding company's share			**1,46,800**

4. Revenue profits of B Ltd.:

Profit after 1st July, 20X1 [(82,000 – 10,000) x ½]		36,000
Less: Depreciation		
10% depreciation on ₹1,80,000 for 6 months	9,000	
Less: Depreciation already charged for 2nd half year on 1,50,000	(7,500)	(1,500)
		34,500
Less: 1/5 due to outsiders		(6,900)
Share of A Ltd.		**27,600**

5. Minority interest:

Par value of 400 shares (2,00,000 X 20%)	40,000
Add: 1/5Capital Profits [WN 3]	36,700
1/5 Revenue Profits [WN 4]	6,900
	83,600

6. Cost of Control:

Amount paid for 1,600 shares	3,40,000	
Less: Dividend out of pre-acquisition profits	(16,000)	3,24,000
Par value of shares	1,60,000	
Capital Profits –share of A Ltd. [WN 3]	1,46,800	(3,06,800)
Cost of Control or Goodwill		17,200

7. Value of plant & Machinery:

		2,40,000
B Ltd.	1,35,000	
Add: Appreciation on 1st July, 20X1 [1,80,000 – (1,50,000 – 7,500)]	37,500	
	1,72,500	
Add: Deprecation for 2nd half charged on pre-revalued value	7,500	
Less: Depreciation on ₹1,80,000 for 6 months	(9,000)	1,71,000
		4,11,000

8. Profit & Loss Account (Consolidated):

A Ltd. as given	57,200	
Less: Dividend transferred to Investment A/c	(16,000)	41,200
Share of A Ltd. in revenue profits of B Ltd. (WN 4)		27,600
		68,800

10. **Consolidated Balance Sheet of H Ltd. and its subsidiary S Ltd. as at 31st March, 20X1**

Particulars	Note No.	(₹ in Lacs)
I. Equity and Liabilities		
(1) **Shareholder's Funds**		

	(a)	Share Capital	1	12,000
	(b)	Reserves and Surplus	2	7,159
(2)	**Minority Interest [W.N.6]**			3,120
(3)	**Current Liabilities**			
	(a)	Trade payables	3	2,802
	(b)	Short term provisions	4	1,249
	(c)	Other current liabilities	5	1,200
		Total		27,530
II.	**Assets**			
(1)	**Non-current assets**			
		Property, Plant and Equipment	6	14,954
(2)	**Current assets**			
	(a)	Inventories	7	5,885
	(b)	Trade receivables	8	4,477
	(c)	Short term loans and advances	9	520
	(d)	Cash and cash equivalents	10	1,694
		Total		27,530

Notes to Accounts

		(₹ in lacs)	**(₹ in lacs)**
1.	**Share Capital**		
	Authorized share capital		15,000
	Equity shares of ₹10 each, fully paid up		
	Issued and Subscribed:		
	Equity shares of ₹ 10 each, fully paid up		12,000
	Total		12,000
2.	**Reserves and surplus**		
	Capital Reserve (Note 5)	1,320	

	General Reserve (2,784 + 108)		2,892	
	Profit and Loss Account:			
	H Ltd.	2,715		
	Less: Dividend wrongly credited 360			
	Unrealized Profit 20	(380)		
		2,335		
	Add: Share in S Ltd.'s Revenue profits	612	2,947	
	Total			7,159
3.	**Trade payables**			
	Creditors			
	H Ltd.	1,461		
	S Ltd.	854	2,315	
	Bills Payable			
	H Ltd.	₹ 372		
	S Ltd.	₹ 160		
		₹ 532		
	Less: Mutual owing	₹ (45)	487	2,802
4.	**Short term provisions**			
	Provision for Taxation			
	H Ltd.		855	
	S Ltd.		394	
	Total			1,249
5.	**Other current liabilities**			
	Dividend payable			
	H Ltd.			1,200

6.	**Property, plant and equipment**			
	Land and Buildings			
	H Ltd.		2,718	
	Plant and Machinery			
	H Ltd.	₹ 4,905		
	S Ltd.	₹ 4,900	9,805	
	Furniture and Fittings			
	H Ltd.	₹ 1,845		
	S Ltd.	₹ 586	2,431	
	Total			14,954
7.	**Inventories**			
	Stock			
	H Ltd.		3,949	
	S Ltd.		1,956	
			5,905	
	Less: Unrealized profit		(20)	5,885
8.	**Trade receivables**			
	Debtors			
	H Ltd.	₹ 2,600		
	S Ltd.	₹ 1,363	3,963	
	Bills Receivable			
	H Ltd.	₹ 360		
	S Ltd.	₹ 199		
		₹ 559		
	Less: Mutual Owing	₹ (45)	514	4,477

9.	**Short term loans and advances**		
	Sundry Advances		520
10.	**Cash and cash equivalents**		
	Cash and Bank Balances		1,694

Share holding pattern of S Ltd.

Shares as on 31st March, 20X1 (Includes bonus shares issued on 1st January, 20X1)	480 lakh shares (4,800 lakhs/ ₹ 10)
H Ltd.'s holding as on 1st April, 20X0	180 lakhs
Add: Bonus received on 1st January, 20X1	108 lakhs (180 / 5 × 3)
Total H Ltd.'s holding as on 31st March, 20X1	288 lakhs i.e. 60 % [288/480×100]
Minority Shareholding	40%

Working Notes:

1. S Ltd.'s General Reserve Account

	₹ in lakhs		*₹ in lakhs*
To Bonus to equity shareholders (WN-8)	1,800	By Balance b/d	3,000
To Balance c/d	1,380	By Profit and Loss A/c (Balancing figure)	180
	3,180		3,180

2. S Ltd.'s Profit and Loss Account

	₹ in lakhs		*₹ in lakhs*
To General Reserve [WN 1]	180	By Balance b/d	1,200
To Dividend paid (20% on ₹3,000 lakhs)	600	By Net Profit for the year* (Balancing figure)	1,200
To Balance c/d	1,620		
	2,400		2,400

*Out of ₹ 1,200 lakhs profit for the year, ₹ 180 lakhs has been transferred to reserves.

3. Distribution of Revenue profits

	₹ in lakhs
Revenue profits (W. N. 2)	1,200
Less: Share of H Ltd. 60% (General Reserve ₹ 108 + Profit and Loss Account ₹ 612)	(720)
Share of Minority Shareholders (40%)	480

Note: The question can also be solved by taking ₹ 1,020 lakhs as post acquisition Profit and Loss balance and ₹ 180 lakhs as post acquisition General Reserve balance. The final answer will be same.

4. Calculation of Capital Profits

	₹ in lakhs
General Reserve on the date of acquisition less bonus shares (₹ 3,000 – ₹ 1,800)	1,200
Profit and loss account on the date of acquisition less dividend paid (₹ 1,200 – ₹ 600)	600
	1,800

H Ltd.'s share = 60% of ₹ 1,800 lakhs = ₹ 1,080 lakhs

Minority interest = ₹ 1,800 – ₹ 1,080 = ₹ 720 lakhs

5. Calculation of capital reserve

	₹ in lakhs
Paid up value of shares held (60% of ₹4,800)	2,880
Add: Share in capital profits [WN 4]	1,080
	3,960
Less: Cost of shares less dividend received (₹ 3,000 – ₹ 360)	(2,640)
Capital reserve	1,320

6. Calculation of Minority Interest

	₹ in lakhs
40% of share capital (40% of ₹ 4,800)	1,920
Add: Share in revenue profits [WN 3]	480
Share in capital profits [WN 4]	720
	3,120

7. Unrealized profit in respect of inventory

$$₹\ 100 \text{ lakhs} \times \frac{25}{125} = ₹\ 20 \text{ lakhs}$$

8. Computation of bonus to equity shareholders

	₹ In lakhs
Shares as on 31 March 20X1 including bonus share issued on 1 January 20X1	4,800
Or we can say these are $1 + \frac{3}{5}$ or $\frac{8}{5}$	
i.e. Shares before bonus issue should have been $\frac{4,800}{8/5} =$	3,000
Accordingly, bonus issue would be (4,800-3,000)	1,800

11. Consolidated statement of profit and loss of Chand Ltd. and its subsidiary Sitara Ltd. for the year ended on 31st March, 20X4

Particulars	Note No.	₹
Revenue from operations	1	50,03,250
Other Income	2	1,81,000
Total revenue (I)		51,84,250
Expenses:		
Cost of material purchased/consumed	3	21,45,500

Changes (Increase) in inventories of finished goods	4	(4,98,750)
Employee benefit expense	5	15,75,000
Finance cost	6	22,750
Depreciation and amortization expense	7	45,500
Other expenses	8	8,43,250
Total expenses (II)		41,33,250
Profit before tax (II-III)		10,51,000

Notes to Accounts:

			₹	₹
1.	Revenue from operations			
	Sales and other operating revenues			
	Chand Ltd.		33,25,000	
	Sitara Ltd.		19,07,500	
			52,32,500	
	Less: Inter-company sales		(1,75,000)	
	Consultancy fees received by Sitara Ltd. from Chand Ltd.		(28,000)	
	Royalty received by Chand Ltd. from Sitara Ltd.		(5,000)	
	Brokage received by Chand Ltd. from Sitara Ltd.		(21,250)	50,03,250
2.	Other Income			
	Dividend income:			
	Chand Ltd.	1,68,000		
	Sitara Ltd.	43,750	2,11,750	
	Loss on sale of investments Sitara Ltd.		(26,250)	
	Other Non-operating Income			
	Chand Ltd.	35,000		

	Sitara Ltd.	10,500		
	Less: Dividend realized from Sitara Ltd. (5,00,000 x 10%)	(50,000)	4,500	1,81,000
3.	Cost of material purchased/consumed			
	Chand Ltd.	13,93,000		
	Sitara Ltd.	4,72,500		
		18,65,500		
	Less: Purchases by Sitara Ltd. From Chand Ltd.	(1,75,000)	16,90,500	
	Direct expenses (Production)			
	Chand Ltd.	3,15,000		
	Sitara Ltd.	1,40,000	4,55,000	21,45,500
4.	Changes (Increase) in inventories of finished goods			
	Chand Ltd.		4,37,500	
	Sitara Ltd.		75,250	
			5,12,750	
	Less: Unrealized profits ₹ 7,00,00 × 20/100		(14,000)	4,98,750
5.	Employee benefits and expenses			
	Wages and salaries:			
	Chand Ltd.		13,30,000	
	Sitara Ltd.		2,45,000	15,75,000
6	Finance cost			
	Interest:			
	Chand Ltd.		17,500	
	Sitara Ltd.		5,250	22,750

7.	Depreciation			
	Chand Ltd.		31,500	
	Sitara Ltd.		14,000	45,500
8.	Other expenses			
	General & Administrative expenses:			
	Chand Ltd.	2,80,000		
	Sitara Ltd.	1,22,500		
		4,02,500		
	Less: Consultancy fees received by Sitara Ltd. from Chand Ltd.	(28,000)	3,74,500	
	Royalty:			
	Sitara Ltd.	5,000		
	Less: Received by Chand Ltd.	(5,000)	Nil	
	Selling and distribution Expenses:			
	Chand Ltd.	3,32,500		
	Sitara Ltd.	1,57,500		
		4,90,000		
	Less: Brokerage received by Chand Ltd. from Sitara Ltd.	(21,250)	4,68,750	8,43,250

UNIT 2: ACCOUNTING STANDARD 23 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Define the terms 'Associates', 'Significant influence', 'Control', 'Equity method' and other related terms used in the standard.
- Examine the circumstances under which the Equity Method is used.
- Apply the Equity Method in the accounting of investments in the associates.
- Disclose the contingences in the consolidated financial statements.
- Comply with other disclosure requirements as stated in the standard.

2.1 INTRODUCTION

AS 23, came into effect in respect of accounting periods commenced on or after 1-4-2002. AS 23 describes the principles and procedures for recognizing investments in associates (in which the investor has significant influence, but not a subsidiary or joint venture of investor) in the consolidated financial statements of the investor. An investor which presents consolidated financial statements should account for investments in associates as per equity method in accordance with this standard but in its separate financial statements, AS 13 will be applicable.

2.2 OBJECTIVE

The objective of this Standard is to lay down principles and procedures for recognizing the investments in associates and its effect on the financial operations of the group in the consolidated financial statements. Reference to AS 23 is compulsory for the companies following AS 21 and preparing consolidated financial statement for their group. For disclosing investment in associates in the separate financial statement of the investor itself, one should follow AS 13.

2.3 DEFINITIONS OF THE TERMS USED IN THE ACCOUNTING STANDARD

1. A **subsidiary** is an enterprise that is controlled by another enterprise (known as the parent).
2. A **parent** is an enterprise that has one or more subsidiaries.
3. A **group** is a parent and all its subsidiaries.
4. The equity method is a method of accounting whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment is adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The consolidated statement of profit and loss reflects the investor's share of the results of the operations of the investee.
5. **Equity** is the residual interest in the assets of an enterprise after deducting all its liabilities.
6. **Consolidated financial statements** are the financial statements of a group presented as those of a single enterprise.
7. **An associate** is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.
8. **Significant influence** is the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies.

This definition excludes the subsidiaries or joint venture from the scope of an associate but apart from these any other enterprises, which are significantly influenced by the investor, is an associate for the purpose of this standard. Any enterprise having 20% or more of the voting power or any interest directly or indirectly in any other enterprise will be assumed to have significantly influence the other enterprise unless proved otherwise. Significant influence may be gained by share ownership, statute or agreement. Similarly any enterprise that does not have 20% or more control then it is assumed not having significant influence on the enterprise unless proved otherwise.

An enterprise can influence the significant economic decision making by many ways like:

- Having some voting power.
- Representation on the board of directors or governing body of the investee.
- Participation in policy-making processes.

Material transactions between the investor and the investee (Influencing inter-company transactions i.e. sale of goods and services, sharing technical knowledge etc.

- Interchange of managerial personnel.
- Provision of essential technical information.

As a general rule, significant influence is presumed to exist when an investor holds, directly or indirectly through subsidiaries, 20% or more of the voting power of the investee.

As with the classification of any investment, the substance of the arrangement in each case should be considered. If it can be clearly demonstrated that an investor holding 20% or more of the voting power of the investee does not have significant influence, the investment will not be accounted for as an associate.

A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

If the investor holds, directly or indirectly through subsidiaries, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. The presence of one or more of the indicators as above may indicate that an investor has significant influence over a less than 20% owned corporate investee.

Control exists when parent company has either:

a. The ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise.

b. Or control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from subsidiary company's activities.

If any company is controlling the composition of governing body of gratuity trust, provident fund trust etc., since the objective is not the economic benefit and therefore it will not be included in consolidated financial statement.

An enterprise is considered to control the composition of the board of directors of a company or governing body in case of an enterprise other than a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company or members of the body. An enterprise is deemed to have the power to appoint a director/member, if any of the following conditions is satisfied:

(i) A person cannot be appointed as director/member without the exercise in his favour by that enterprise of such a power as aforesaid; or

(ii) A person's appointment as director/member follows necessarily from his appointment to a position held by him in that enterprise; or

(iii) The director/member is nominated by that enterprise or a subsidiary thereof.

To understand the above definitions let us take few examples:

Example 1

A Ltd. has 70% holding in C Ltd. and B Ltd. also has 28% holding in the same company. So, A Ltd. with the majority holding i.e. more than 50% is the parent company i.e. a holding company. Since B Ltd. holds more than 20% but not more than 50% in C Ltd., C Ltd. will be an associate of B Ltd.

Example 2

A Ltd. is holding 90% share in B Ltd. and 10% shares in C Ltd., and B Ltd. is holding 11%shares in C Ltd. In this case, A Ltd. is parent of B Ltd.

As far as the relationship between A Ltd. and C Ltd. is concerned; A Ltd. has a total of direct and indirect holding of (10 + 11) 21% in C Ltd., Thus, C Ltd. is an associate of A Ltd. It may however be noted that for consolidated financial statement purposes, the holding will be 19.9% (10% + 90% of 11%),.

2.4 ASSOCIATES ACCOUNTED FOR USING THE EQUITY METHOD

The equity method is a method of accounting whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment is adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee. The consolidated statement of profit and loss reflects the investor's share of the results of operations of the investee.

Goodwill/capital reserve arising on the acquisition of an associate by an investor should be included in the carrying amount of investment in the associate but should be disclosed separately.

From the definition, following broad conclusions can be drawn:

a. In CFS, investment is to be recorded at cost.

b. Any surplus or deficit in cost and net asset to be recorded as goodwill or capital reserve.

c. Distributions received from an investee reduce the carrying amount of the investment.

d. Any subsequent change in share in net asset is adjusted in cost of investment and goodwill/capital reserve.

e. Consolidated Profit & Loss shows the investor's share in the results of operations of the investee.

Illustration 1

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

Paid up Equity Share Capital	*₹ 10,00,000*
Securities Premium	*₹ 1,00,000*
Reserve & Surplus	*₹ 5,00,000*

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

Solution

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars		₹	₹
Investment in B Ltd.	(A)		15,00,000
Equity Shares		10,00,000	
Security Premium		1,00,000	
Reserves & Surplus		5,00,000	
Net Assets		16,00,000	
45% of Net Asset	(B)		7,20,000
Goodwill (A-B)			7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 x 45%)	1,35,000
Less: Dividend paid (1,00,000 x 45%)	(45,000)
Carrying Amount of Investment	15,90,000

2.5 CIRCUMSTANCES UNDER WHICH EQUITY METHOD IS FOLLOWED

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

a. Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. The term 'Near Future' is explained with AS 21.

b. Or it operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor.

In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

An investor should discontinue the use of the equity method from the date that:

a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter. The reasons for not applying the equity method in accounting for investments in an associate should be disclosed in the consolidated financial statements.

2.6 APPLICATION OF THE EQUITY METHOD

- Many of the rules followed under equity method for an associate is similar to consolidated financial statement rules as in case of subsidiary i.e. AS 21.
- Investment in an associate should be recorded as per the equity method from the date when such relation comes in effect.
- Investment in the associate is recorded at cost and any difference in the cost and investor's share in equity on the date of acquisition is shown as goodwill or capital reserve.

Case 1:

A Ltd. holds 22% share of B Ltd. on 1st April of the year and following are the relevant information as available on the date are Cost of Investment ₹ 33,000 and Total Equity on the date of acquisition ₹ 2,00,000.

A Ltd.'s share in equity (2,00,000 x 22%)	₹ 44,000
Less: Cost of Investment	₹ (33,000)
Capital Reserve	₹ 11,000

Extract of Balance Sheet: ASSETS

Investment in Associate as per AS 23	**₹**	**₹**
Share of Net Assets as on 1 April	44,000	
Less: Capital reserve	(11,000)	33,000

Case 2:

A Ltd. holds 22% share of B Ltd. on 1st April of the year and following are the relevant information as available on the date are Cost of Investment ₹ 55,000 and Total Equity on the date of acquisition ₹ 2,00,000.

Cost of Investment	₹ 55,000
Less: A Ltd.'s share in equity (2,00,000 x 22%)	₹ 44,000
Goodwill	₹ 11,000

Extract of Balance Sheet: ASSETS

Investment in Associate as per AS 23	**₹**	**₹**
Share of Net Assets as on 1 April	44,000	
Add: Goodwill	11,000	55,000

- **Step Acquisition in case of an associate:**

  An enterprise having share of profits of more than 50% in other company, they are said to be in Parent-Subsidiary relationship. However, if the share in profits is more than 20% but upto 50% then this relationship is termed as of associate. This stake of 20% can be acquired either in one go or in more than one transaction. This stake can be increased further say from 25% to 30%. Adjustment should be made with each transaction.

Case 1 Conversion from a passive investor to an associate <u>in the same year</u>:

A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,45,000

Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

Calculations for April 01:

	₹
Cost of investment (8,50,000 x 10%)	1,00,000
Less: 10% share in net asset	(85,000)
Goodwill	15,000

Calculations for October 01:

	₹
15% share in net asset (10,00,000 x 15%)	1,50,000
Less: Cost of investment	(1,45,000)
Capital Reserve	5,000
Total goodwill (15,000 – 5,000)	10,000

Case 2 - Conversion from a passive investor to an associate <u>in the same year</u>:

A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 of the same year. Other information is as follow:

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,55,000

Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

***Calculations for April 01*:**

	₹
Cost of investment	1,00,000

Less: 10% share in net asset	(85,000)
Goodwill	15,000

Calculations for October 01:

	₹
Cost of investment	1,55,000
Less: 15% share in net asset	(1,50,000)
Goodwill	5,000
Total goodwill (15,000 + 5,000)	20,000

Case 3 – Further acquisition in an associate <u>in the same year</u>:

A Ltd. acquired 25% stake of B Ltd. on April 01 and further 5% on October 01 of the same year. Other information is as follow:

Cost of Investment for 25% ₹ 1,50,000 and for 5% ₹ 20,000

Net asset on April 01 ₹ 5,00,000.

Profit for the year ₹ 90,000 earned in the ratio 2:1 respectively.

Calculations for April 01:

	₹
Cost of investment	1,50,000
Less: 25% share in net asset (5,00,000 x2 5%)	(1,25,000)
Goodwill	25,000

***Calculations for October 01*:**

	₹
Profits for the first half (90,000/3) x 2	60,000
Additional share of A Ltd. 5%	
Pre-acquisition profits i.e. capital reserve (60,000 x 5%)	3,000
5% share in net asset	25,000

Total share of net assets for 5% stake (5,00,000+60,000)x5%	28,000
Cost of investment	20,000
Capital Reserve	8,000
Cost of Investment on April 01	1,50,000
Less: Goodwill	₹ 25,000
	1,25,000
Calculation of net assets of associates as on 31st March	
Carrying Amount on April 01	1,25,000
Add: Additional Share in Net Asset on October 01	25,000
Add: Capital share of Profits for first half	3,000
Add: Revenue shares of Profits for first half (60,000 x 25%)	15,000
Add: Revenue shares of Profits for second half (30,000 x 30%)	9,000
Net Assets Of Associate As On 31st March	1,77,000

Alternatively

Balance sheet	₹
Investment in associate (inclusive of goodwill of 25,000)	1,25,000
Add: Further investment	28,000
Add: (90,000 x 25% + 30,000 x 5 %)	
i.e (22,500+1,500)	24,000
or (60,000 x 25% +30,000 x30%)	1,77,000

- If there is any transaction between the Investor Company and investee concern then the unrealised profits on such goods to the extent of investor's share should be eliminated from consolidated financial statement.
- Any loss on such transactions are not eliminated to the extent that such loss is not recoverable. Otherwise such losses are written off from consolidated financial statement fully.

Illustration 2

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000. Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Solution

Calculation of Goodwill/Capital Reserve under Equity Method

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

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

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April 1	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 20X1	4,80,000
Add: Goodwill	5,20,000
Cost of Investment	10,00,000

Less: Loss for the year (10,00,000 x 40%)	(4,00,000)
Carrying Amount of Investment	6,00,000

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

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above	(4,00,000)	
	80,000	
Add: Goodwill	5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 20X2	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

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

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 20X1	4,80,000	
Less: Share of Loss as above (₹ 4,00,000 + ₹ 5,00,000)	(4,20,000)	
Add: Goodwill		1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment	1,00,000
Less: Loss for the year (5,00,000 x 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) -refer note below	
Carrying Amount of Investment	

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

Investment in Associate as per AS 23	**₹**
Investment in B Ltd.	-

- If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.

- As far as possible the reporting date of the financial statements should be same for consolidated financial statement. If practically it is not possible to draw up the financial statements of one or more enterprise to such date and, accordingly, those financial statements are drawn up to reporting dates different from the reporting date of the investor, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the consolidated financial statements. In any case, the difference between reporting dates of the concern and consolidated financial statement should not be more than six months.

- Accounting policies followed in the preparation of the financial statements of the investor, investee and consolidated financial statement should be uniform for like transactions and other events in similar circumstances.

  If accounting policies followed by different enterprises in the group are not uniform, then adjustments should be made in the items of the individual financial statements to bring it in line with the accounting policy of the consolidated statement.

- The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.

2.7 CONTINGENCIES

In accordance with AS 4, the investor discloses in the consolidated financial statements:

a. Its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and

b. Those contingencies that arise because the investor is severally liable for the liabilities of the associate.

2.8 WHY IS EQUITY METHOD OF ACCOUNTING ADOPTED FOR INVESTMENT IN ASSOCIATES?

♦ Investments in associates cannot be treated as a normal investment under AS 13. The intent of investing to such an extent (i.e.; 20% or more but less than 50% of equity) in an associate is an expression of the fact that the investor is not merely interested in the dividend distribution, but also is interested in the participation of decision-making process in the associate.

♦ Thus, recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. As the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of results of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated. As a result, application of the equity method in consolidated financial statements provides more informative reporting of the net assets and net income of the investor.

2.9 DISCLOSURE

- In addition to the disclosures required above, an appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements.
- Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed.
- The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.
- In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies.
- If an associate is not accounted for using the equity method the reasons for not doing the same.
- Goodwill/capital reserve arising on the acquisition of an associate by an investor should be disclosed separately though it is included in the carrying amount of the investment.

2.10 RELEVANT EXPLANATIONS TO AS 23

2.10.1 Treatment of Proposed Dividend in Associates in Consolidated Financial Statements

In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.

2.10.2 Consideration of Potential Equity Shares for Determining whether an Investee is an Associate

The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor.

Reference: The students are advised to refer the full text of AS 23 "Accounting for Investments in Associates in Consolidated Financial Statements" (issued 2001).

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *Identity which of the statements are correct.*

   An enterprise can influence the significant economic decision making by many ways like:

   (i) Representation on the board of directors or governing body of the investee.

   (ii) Participation in policy-making processes.

   (iii) Interchange of managerial personnel.

   (iv) Provision of essential technical information.

   (a) Statement (i) and (ii) are correct.

(b) Statement (i), (ii) and (iii) are correct.

(c) Statement (i), (ii), (iii) and (iv) are correct.

(d) Statement (ii) and (iii) are correct.

2. *A Ltd. is holding 90% share in B Ltd. and 10% shares in C Ltd., and B Ltd. is holding 11% shares in C Ltd.*

   Identity which of the statements are incorrect.

   (i) In this case, A Ltd. is parent of B Ltd.

   (ii) As far as the relationship between A Ltd. and C Ltd. is concerned; A Ltd. has a total of direct and indirect holding of (10% + 90% of 11%) 19.9 % in C Ltd.

   (iii) C Ltd. is an associate of A Ltd.

   (a) Statement (ii) is incorrect.

   (b) Statement (iii) is incorrect.

   (c) Statement (ii) and (iii) both are incorrect.

   (d) All statements are incorrect.

3. *A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 of the same year. Other information is as follows:*

   Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,55,000

   Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

   What is the amount of goodwill or capital reserve arising on significant influence?

   (a) Goodwill = ₹ 10,000.

   (b) Goodwill = ₹ 20,000.

   (c) Capital Reserve = ₹ 10,000.

   (d) Capital Reserve = ₹ 20,000.

4. *A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:*

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,45,000

Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

What is the amount of goodwill or capital reserve arising on significant influence?

(a) Goodwill = ₹ 10,000.

(b) Goodwill = ₹ 20,000.

(c) Capital Reserve = ₹ 10,000.

(d) Capital Reserve = ₹ 20,000.

5. *Identity which of the statements are correct.*

(i) *In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.*

(ii) *In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed after taking into consideration the proposed dividend.*

(iii) *The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor.*

(iv) *The potential equity shares of the investee held by the investor should be taken into account for determining the voting power of the investor.*

(a) Statement (i) and (iii).

(b) Statement (ii) and (iv).

(c) Statement (i) only.

(d) Statement (iii) only.

Theoretical Questions

6. *Describe the cases when AS 23 does not allow the use of equity method of accounting?*

7. *When is an investor required to discontinue the use of the equity method of accounting?*

Scenario based Questions

8. *Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.*

   Calculate the carrying amount of investment in:

   (i) Separate financial statements of Bright Ltd. as on 31-03-20X2;

   (ii) Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;

   (iii) What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

9. *A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:*

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000
Property, Plant and Equipment	5,00,000
Investments	2,00,000
Current Assets	3,00,000
	10,00,000

During the year ended 31.3.20X2 the following are the additional information available:

(i) On 30.4.20X1 A Ltd. received a dividend from B Ltd. for the year ended 31.3.20X1 at 40% from the Reserves. The above balance sheet is before the adjustment of dividend.

(ii) B Ltd. made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.

(iii) B Ltd. declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.

A Ltd. is preparing Consolidated Financial Statements for 20X1-X2 in accordance with AS 21 for its various subsidiaries. Calculate:

(i) Goodwill if any on investment in shares of B Ltd.'s .

(ii) How the dividend received for 31.3.20X2 on 30.4.20X2 from B Ltd. will be shown in the Consolidated Financial Statements?

(iii) How A Ltd. will reflect the value of investment in B Ltd., in its Consolidated Financial Statements?

ANSWERS/SOLUTION

Answer to the Multiple Choice Questions

1.	(c)	**2.**	(a)	**3.**	(b)	**4.**	(a)	**5.**	(a)

Answer to the Theoretical Questions

6. Equity method of accounting is to be followed by all the enterprises having significant influence on their associates except in the following cases:

a. Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or;

b. It operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the investor.

In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

7. An investor should discontinue the use of the equity method from the date that:

a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.

b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.

Answer to the Scenario based Questions

8. (i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2

	₹
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 x 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements* of Bright Ltd. as on 31.3.20X2 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000

*It is assumed that Bright Ltd. has a subsidiary company and it is preparing Consolidated Financial Statements.

Add: Proportionate share of 10-month profit of investee as per equity method (30% of ₹ 3,00,000 x 10/12)	75,000
Carrying amount as on 31.3.20X2	2,60,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2 as per AS 23

	₹
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (₹ 60,000 x 30%)	(18,000)
Carrying amount as on 30.6.20X2	2,42,000

9. In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill	*(₹ in lakhs)*
Amount paid towards acquisition of stake in B Ltd.	3.00
Less: Pre-acquisition dividend (₹ 5,00,000 x 40% x 25%)	0.50
Cost of Investment in B Ltd.	2.50
Less: Share in the value of Equity of B Ltd.	
as at the date of investment	
[25% of ₹ 8 lakhs (₹ 5 lakhs + ₹ 5 lakhs – ₹ 2 lakhs)]	(2.00)
Goodwill	0.50

(ii) A Ltd.

Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd. (7x 25%)		1.75
Pre-acquisition Dividend received from		

B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd.	2.50	
(including goodwill)		
Share of profit for year 20X1 – 20X2	1.75	4.25

Working Notes:

1. Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.

2. B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.

3. Dividend declared on 30.4.20X2 will not be recognized in the consolidated financial statement of A Ltd.

UNIT 3: ACCOUNTING STANDARD 27 FINANCIAL REPORTING OF INTERESTS IN JOINT VENTURES

LEARNING OUTCOMES

After studying this unit, you will be able to:

- Define 'Joint venture' 'joint Control', 'control', 'venturer' and investor.
- Appreciate different forms of joint venture
- Examine the contractual arrangements which will differentiate the control as of Associate or Joint venture
- Evaluate the nitty-gritty of different forms of Joint ventures and differentiate among them
- Present the separate and consolidated financial statements of the venturers
- Accounting for transactions between the venturer and Joint venture
- Comply with the disclosure requirements as stated in the standard.

3.1 INTRODUCTION

You would have come across many examples where 2 or more entities would have worked together to achieve a certain purpose. Hindustan Unilever Ltd (HUL), Tata Starbucks Ltd, Tata SIA Airlines Ltd. (Vistara), etc. are a few popular examples of Joint Ventures. Entities enter into such arrangements considering sharing of risk and expense, collaboration of know-how and skill-set, while also impacted by different work-cultures and management style. Depending on the contractual arrangement, the accounting and reporting for Joint Ventures is done.

AS 27, came into effect in respect of accounting periods commenced on or after 01.04.2002. This standard set out principles and procedures for accounting of interests in joint venture and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors regardless of the structures or forms under which the joint venture activities take place.

The standard deals with three broad types of joint ventures –

1. Jointly controlled operations,
2. Jointly controlled assets and
3. Jointly controlled entities.

The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, apply only when consolidated financial statements are prepared by venturer Similarly existence of a contractual arrangement distinguishes interests which involve joint control from investments in associates in which the investor has significant influence (see Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements). An investor in joint venture, which does not have joint control, should report its interest in a joint venture in its consolidated financial statements in accordance with AS 13, AS 21 and AS 23.

3.2 SCOPE

This Standard should be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.

The provisions of this AS need to be referred to for consolidated financial statement only when CFS is prepared and presented by the venturer.

3.3 DEFINITIONS

1. **A joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

   From the above definition we conclude that the essential conditions for any business relation to qualify as joint venture are:

   - **Two or more parties coming together:** Parties can be an individual or any form of business organization say, BOI, AOP, Company, firm.

- **Venturers undertake some economic activity:** Economic activity means activities with the profit-making motive. Joint venture is separate from the regular identity of the venturers, it may be in the form of independent and separate legal organization other than regular concern of the venturer engaged in the economic activity.
- **Venturers have joint control on the economic activity:** The operating and financial decisions are influenced by the venturers and they also share the results of the economic activity.
- **There exists a contractual agreement:** The relationship between venturers is governed by the contractual agreement. This agreement can be in the form of written and signed agreement or as minutes of venturer meeting or in any other written form.

2. **Joint control** is the contractually agreed sharing of control over an economic activity.
3. **Control** is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.
4. A **venturer** is a party to a joint venture and has joint control over that joint venture.
5. An **investor** in a joint venture is a party to a joint venture and does not have joint control over that joint venture.
6. Proportionate consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

3.4 CONTRACTUAL ARRANGEMENT

The joint venture covered under this statement is governed on the basis of contractual agreement. Non-existence of contractual agreement will disqualify an organization to be covered in AS 27. Joint ventures with contractual agreement will be excluded from the scope of AS 27 only if the investment qualifies as subsidiary under AS 21, in this case, it will be covered by AS 21. Contractual agreement can be in the form of written contract, minutes of discussion between parties (venturers), articles of the concern or by-laws of the relevant joint venture.

Irrespective of the form of the contract, the content of the contract ideally should include the following points:

- The activity, duration and reporting obligations of the joint venture.
- The appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers.
- Capital contributions by the venturers.
- The sharing by the venturers of the output, income, expenses or results of the joint venture.

The main object of contractual agreement is to distribute the economic control among the venturers, it ensures that no venturer should have unilateral control. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers. If contractual agreement is signed by a party to safeguard its right, such agreement will not make the party a venturer.

The contractual arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies which have been agreed to by the venturers in accordance with the contractual arrangement and delegated to the operator

Example 1

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

Example 2

X Ltd invested ₹ 200 crore as initial capital along with Y Ltd and Z Ltd in GFH Ltd. The purpose of X Ltd making this investment is to grow the business of GFH Ltd along with the other investors. All investors have a right to attend to the meetings *and to take decisions with respect to the business of GFH Ltd. All investors are actively involved in running the business of GFH Ltd and have a share in the returns generated by GFH Ltd in an agreed proportion.*

GFH Ltd is an example of a Joint Venture and X Ltd, Y Ltd and Z Ltd are all Venturers.

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

Example 3

Mr. A, M/s. B & Co. and C Ltd. entered into a joint venture, where according to the agreement, all the policies making decisions on financial and operating activities will be taken in a regular meeting attended by them or their representatives. Implementation and execution of these policies will be the responsibility of Mr. A. Here Mr. A is acting as venturer as well as manager of the concern.

3.5 FORMS OF JOINT VENTURES

Joint ventures may take many forms and structures, this Statement identifies them in three broad types –

- **Jointly Controlled Operations (JCO),**
- **Jointly Controlled Assets (JCA) and**
- **Jointly Controlled Entities (JCE).**

Any structure which satisfies the following characteristics can be classified as joint ventures:

(a) Two or more venturers are bound by a contractual arrangement and

(b) The contractual arrangement establishes joint control.

3.6 JOINTLY CONTROLLED OPERATIONS (JCO)

Under this set up, venturers do not create a separate entity for their joint venture business but they use their own resources for the purpose. They raise any funds required for joint venture on their own, they incur any expenses and sales are also realised individually. They use same set of assets and employees for joint venture business and their own business. The joint venture agreement usually provides means by which the revenue from the jointly controlled operations and any expenses incurred in common are shared among the venturers.

Since there is no separate legal entity and venturers don't recognize the transactions separately, they do not maintain a separate set of books for joint venture. All the transactions of joint venture are recorded in their books only.

Following are the key features of JCO:

a. Each venturer has his own separate business.

b. There is no separate entity for joint venture business.

c. All venturers are creating their own assets and maintain them.

d. Each venturer record only his own transactions without any separate set of books maintained for the joint venture business.

e. There is a common agreement between all of them.

f. Venturers use their assets for the joint venture business.

g. Venturers met the liabilities created by them for the joint venture business.

h. Venturers met the expenses of the joint venture business from their funds.

i. Any revenue generated or income earned from the joint venture is shared by the venturers as per the contract.

Since the jointly controlled operation is not purchasing assets or raising finance in its own right, the assets and liabilities used in the activities of the joint venture are those of the ventures. As such, they are accounted for in the financial statements of the venture to which they belong. The only accounting issue that arises is that the output from the project is to be shared among the venturers and, therefore, there must be some mechanism for specifying the allocation of the proceeds and the sharing of any joint expenses.

In respect of its interests in jointly controlled operations, a venturer should recognise in its separate financial statements and consequently in its consolidated financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the joint venture.

Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Example 4

Mr. A (dealer in tiles and marbles), Mr. B (dealer in various building materials) and Mr. C (Promoter) enters into a joint venture business, where any contract for construction received will be completed jointly, say, Mr. A will supply all tiles and marbles, Mr. B will supply other materials from his godown and Mr. C will look after the completion of construction. As per the contractual agreement, they will share any profit/loss in a predetermined ratio. None of them are using separate staff or other resources for the joint venture business and neither do they maintain a separate account. Everything is recorded in their personal business only.

Venturer doesn't maintain a separate set of books but they record only their own transactions of the joint venture business in their books. Any transaction of joint venture recorded separately is only for internal reporting purpose. Once all transactions recorded in venturer financial statement, they don't need to be adjusted for in consolidated financial adjustment.

Illustration 1

Mr. A, Mr. B and Mr. C entered into a joint venture to purchase a land, construct and sell flats. Mr. A purchased a land for ₹ 60,00,000 on 01.01.20X1 and for the purpose he took loan from a bank for ₹ 50,00,000 @ 8% interest p.a. He also paid registering fees ₹ 60,000 on the same day. Mr. B supplied the materials for ₹ 4,50,000 from his godown and further he purchased the materials for ₹ 5,00,000 for the joint venture. Mr. C met all other expenses of advertising, labour and other incidental expenses which turnout to be ₹ 9,00,000. On 30.06.20X1 each of the venturer agreed to take away one flat each to be valued at ₹ 10,00,000 each flat and rest were sold by them as follow: Mr. A for ₹ 40,00,000; Mr. B for ₹ 20,00,000 and Mr. C for ₹ 10,00,000. Loan was repaid on the same day by Mr. A along with the interest and net proceeds were shared by the partners equally.

You are required to prepare the draft Consolidated Profit & Loss Account and Joint Venture Account in the books of each venturer.

Solution

Draft Consolidated Profit & Loss Account

Particulars	₹	₹	Particulars	₹	₹
To Purchase of Land:			By Sale of Flats:		
Mr. A		60,00,000	Mr. A	40,00,000	
To Registration Fees:			Mr. B	20,00,000	
Mr. A		60,000	Mr. C	10,00,000	70,00,000
To Materials:			By Flats taken by Venturers:		
Mr. B		9,50,000	Mr. A	10,00,000	
To Other Expenses:			Mr. B	10,00,000	
Mr. C		9,00,000	Mr. C	10,00,000	30,00,000
To Bank Interest:					
Mr. A		2,00,000			
To Profits:					
Mr. A	6,30,000				
Mr. B	6,30,000				
Mr. C	6,30,000	18,90,000			
		1,00,00,000			1,00,00,000

In the Books of Mr. A
Joint Venture Account

Particulars	₹	Particulars	₹
To Bank Loan (Purchase of Land)	50,00,000	By Bank (Sale of Flats)	40,00,000
To Bank:(Purchase of Land)	10,00,000	By Land & Building	10,00,000
To Bank (Registration Fees)	60,000	By Bank (Received from Mr. B)	14,20,000
To Bank (Bank Interest)	2,00,000	By Bank (Received from Mr. C)	4,70,000
To Profit on JV	6,30,000		
	68,90,000		68,90,000

In the Books of Mr. B
Joint Venture Account

Particulars	₹	***Particulars***	₹
To Purchases (Material Supplied)	4,50,000	By Bank (Sale of Flats)	20,00,000
To Bank (Materials)	5,00,000	By Land & Building	10,00,000
To Profit on JV	6,30,000		
To Bank (Paid to Mr. A)	14,20,000		
	30,00,000		30,00,000

In the Books of Mr. C
Joint Venture Account

Particulars	₹	***Particulars***	₹
To Bank (Misc. Expenses)	9,00,000	By Bank (Sale of Flats)	10,00,000
To Profit on JV	6,30,000	By Land & Building	10,00,000
To Bank (Paid to Mr. A)	4,70,000		
	20,00,000		20,00,000

3.7 JOINTLY CONTROLLED ASSETS (JCA)

Separate legal entity is not created in this form of joint venture but venturer owns the assets jointly, which are used by them for the purpose of generating economic benefit to each of them. They take up any expenses and liabilities related to the joint assets as per the contract. We can conclude the following points:

- There is no separate legal identity.
- There is a common control over the joint assets.
- Venturers use this asset to derive some economic benefit to themselves.
- Each venturer incurs separate expenses for their transactions.
- Expenses on jointly held assets are shared by the venturers as per the contract.
- In their financial statement, venturer shows only their share of the asset and total income earned by them along with total expenses incurred by them.
- Since the assets, liabilities, income and expenses are already recognised in the separate financial statements of the venturer and consequently in its consolidated financial statements, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
- Financial statements may not be prepared for the joint venture, although the venturers may prepare accounts for internal management reporting purposes so that they may assess the performance of the joint venture.

Example 5

ABC Ltd., BP Ltd. and HP Ltd. having the same point of oil refinery and same place of customers agreed to spread a pipeline from their unit to customers place jointly. They agreed to share the expenditure on the pipeline construction and maintenance in the ratio 3:3:4 respectively and the time allotted to use the pipeline was in the ratio 4:3:3 respectively.

For the joint venture, each venturer will record his share of joint assets as ***classified according to the nature of the assets rather than as an investment*** *and any expenditure incurred or revenue generated will be recorded with other items similar to JCO.*

Following are the few differences between JCO and JCA for better understanding:

- In JCO, venturers use their own assets for joint venture business but in JCA they jointly own the assets to be used in joint venture.
- JCO is an agreement to joint carry on the operations to earn income whereas, JCA is an agreement to jointly construct and maintain an asset to generate revenue to each venturer.
- Under JCO all expenses and revenues are shared at an agreed ratio, in JCA only expenses on joint assets are shared at the agreed ratio.

Illustration 2

A Ltd., B Ltd. and C Ltd. decided to jointly construct a pipeline to transport the gas from one place to another that was manufactured by them. For the purpose following expenditure was incurred by them: Buildings ₹ 12,00,000 to be depreciated @ 5% p.a., Pipeline for ₹ 60,00,000 to be depreciated @ 15% p.a., computers and other electronics for ₹ 3,00,000 to be depreciated @ 40% p.a. and various vehicles of ₹ 9,00,000 to be depreciated @ 20% p.a.

They also decided to equally bear the total expenditure incurred on the maintenance of the pipeline that comes to ₹ 6,00,000 each year.

You are required to show the consolidated balance sheet and the extract of Statement of Profit & Loss and Balance Sheet for each venturer.

Solution

Consolidated Balance Sheet

		Note	**(₹)**
I	**Equity and liabilities**		
	Shareholders' funds:		
	Share Capital	1	71,40,000
			71,40,000
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment:	2	71,40,000
			71,40,000

Notes to Accounts

			(₹)
1.	Share capital		
	A Ltd.	23,80,000	
	B Ltd.	23,80,000	
	C Ltd.	23,80,000	71,40,000
2.	Property, Plant and Equipment		
	Land & Building:		
	A Ltd.	3,80,000	
	B Ltd.	3,80,000	
	C Ltd.	3,80,000	11,40,000
	Plant & Machinery:		
	A Ltd.	17,00,000	
	B Ltd.	17,00,000	
	C Ltd.	17,00,000	51,00,000
	Computers:		
	A Ltd.	60,000	
	B Ltd.	60,000	
	C Ltd.	60,000	1,80,000
	Vehicles:		
	A Ltd.	2,40,000	
	B Ltd.	2,40,000	
	C Ltd.	2,40,000	7,20,000

In the Books of A Ltd.

Extract of statement of Profit & Loss

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of B Ltd.
Extract of draft Profit & Loss Account

Particulars	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

In the Books of C Ltd.

Extract of Draft Profit & Loss Account	Note No.	₹
Depreciation and amortisation expense	1	4,20,000
Other operating Expenses (Pipeline Expenses)		200,000

Extract of Balance Sheet

	Note No.	₹
Assets		
Non-current assets		
Property, Plant and Equipment	2	23,80,000

Notes to Accounts

		₹	₹
1.	Depreciation and amortisation expense		
	Land & Building	20,000	
	Plant & Machinery	3,00,000	
	Computers	40,000	
	Vehicles	60,000	4,20,000
2.	Land & Building	4,00,000	
	Less: Depreciation	(20,000)	3,80,000
	Plant & Machinery	20,00,000	
	Less: Depreciation	(3,00,000)	17,00,000
	Computers	1,00,000	
	Less: Depreciation	(40,000)	60,000
	Vehicles	3,00,000	
	Less: Depreciation	(60,000)	2,40,000
			23,80,000

3.8 JOINTLY CONTROLLED ENTITIES (JCE)

This is the format where venturer creates a new entity for their joint venture business. A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity. All the venturers pool their resources under new banner and this entity purchases its own assets, create its own liabilities, expenses are incurred by the entity itself and sales are also made by this entity. The net result of the entity is shared by the venturers in the ratio agreed upon in the contractual agreement. This contractual agreement also determines the joint control of the venturer. Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in the accounting records of the venturer and are recognised in its separate financial statements as an investment in the jointly controlled entity.

A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other enterprises in conformity with the requirements applicable to that jointly controlled entity

Example

A Ltd and B Ltd are two infrastructure companies operating in City A. The local authority has issued a tender to construct a metro stretch for ₹ 2,000 crore and had invited bidders to apply for the tender. A Ltd and B Ltd, jointly form a new entity AB Ltd that bids for the tender. All machinery and equipment will be the responsibility of A Ltd. All funding will be managed and controlled by B Ltd. Revenue and operating expenses will be shared jointly by A Ltd and B Ltd in the proportion of 60:40.

In the above example AB Ltd constitutes a Jointly Controlled Entity (JCE).

Example (Jointly Controlled Entity (JCE))

Three separate aerospace companies form a separate entity, Aero Ltd, to jointly manufacture an aircraft. They carry responsibility for different areas of expertise, such as: manufacturing engines; manufacturing fuselage and wings; and aerodynamics.

The companies carry out different parts of the manufacturing process, each using its own resources and expertise in order to manufacture, market and distribute the aircraft jointly. The three entities share the revenues from the sale of aircraft and jointly incur expenses.

The revenues and common costs are shared, as agreed in the consortium contract. Parties also incur their own separate costs, such as labour costs, manufacturing costs, supplies, inventory of unused parts and work in progress. Each party recognises its separately incurred costs in full.

Aero Ltd maintains separate accounting records. The consortium agreement comprises the following:

Aero Ltd will invoice the customers on the investors' behalf. The allocation of revenue from the aircraft's sale is in proportion to the investors' interests.

All administrative costs incurred by Aero Ltd are shared by the parties in proportion to their interests; Aero Ltd will recharge these, with no additional margin.

The companies carry out different parts of the manufacturing process, each using its own resources and expertise to manufacture, market and distribute the aircraft jointly.

Each company incurs its own separate costs, such as labour costs, manufacturing costs, supplies, inventory of unused parts and work in progress. Each company recognises its separately incurred costs in full.

Being a separate entity, separate set of books is maintained for the joint venture and in the individual books of venturers the investment in joint venture is recorded as investment (AS 13). Joint venture can be a foreign company operating in India through an Indian concern say Gremo Insurance of Germany contributes 49% of the assets in joint venture in India with Indo Bank Ltd. of India. They agreed to share the net results in 1:1 ratio. The main objective of the joint venture is to exploit the technical expertise of Gremo Insurance and Goodwill of Indo Bank Ltd. It can also be two or more local concerns opening an organization or firm or company contributing their assets to this new joint venture concern and share the profits of the operation in the agreed ratio.

Illustration 3

A Ltd. a UK based company entered into a joint venture with B Ltd. in India, wherein B Ltd. will import the goods manufactured by A Ltd. on account of joint venture and sell them in India. A Ltd. and B Ltd. agreed to share the expenses & revenues in the ratio of 5:4 respectively whereas profits are distributed equally. A Ltd. invested 49% of total capital but has equal share in all the assets and is equally liable for all the liabilities of the joint venture. Following is the trial balance of the joint venture at the end of the first year:

Particulars	***Dr. (₹)***	***Cr. (₹)***
Purchases	*9,00,000*	
Other Expenses	*3,06,000*	
Sales		*13,05,000*
Property, Plant and Equipment	*6,00,000*	
Current Assets	*2,00,000*	
Unsecured Loans		*2,00,000*
Current Liabilities		*1,00,000*
Capital		*4,01,000*

Closing inventory was valued at ₹ 1,00,000.

You are required to prepare the Consolidated Financial Statement.

Solution

Consolidated Profit & Loss Account

Particulars	***Note No.***	***(₹)***
Revenue from operations	1	13,05,000
Total Revenue (A)		13,05,000
Less: Expenses		
Purchases	2	9,00,000
Other expenses	3	3,06,000

Changes in inventories of finished goods	4	(1,00,000)
Total Expenses (B)		11,06,000
Profit Before Tax (A-B)		1,99,000

Consolidated Balance Sheet

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital	5	4,01,000
	Reserves and Surplus	6	1,99,000
	2. Non-current liabilities		
	Long term borrowings	7	2,00,000
	3. Current Liabilities	8	1,00,000
			9,00,000
II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment	9	6,00,000
	Current Assets		
	Inventories	10	1,00,000
	Other current assets	11	2,00,000
			9,00,000

Notes to Accounts

	Particulars		(₹)
1.	**Revenue from operations**		
	Sales:		
	A Ltd.	7,25,000	
	B Ltd.	5,80,000	13,05,000

2.	**Purchases**		
	A Ltd.	5,00,000	
	B Ltd.	4,00,000	9,00,000
3.	**Other expenses**		
	A Ltd.	1,70,000	
	B Ltd.	1,36,000	3,06,000
4.	**Closing Inventory**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
5.	**Share Capital**		
	A Ltd.	1,96,490	
	B Ltd.	2,04,510	4,01,000
6.	**Reserves and Surplus**		
	Profit & Loss Account:		
	A Ltd.	99,500	
	B Ltd.	99,500	1,99,000
7.	**Long Term Borrowings**		
	Unsecured Loans:		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000
8.	**Current Liabilities**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
9.	**Property, Plant and Equipment**		
	A Ltd.	3,00,000	
	B Ltd.	3,00,000	6,00,000

10.	**Inventories**		
	A Ltd.	50,000	
	B Ltd.	50,000	1,00,000
11.	**Other Current Assets**		
	A Ltd.	1,00,000	
	B Ltd.	1,00,000	2,00,000

3.9 CONSOLIDATED FINANCIAL STATEMENTS OF A VENTURER

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

Proportionate consolidation method of accounting is to be followed except in the following cases:

a. Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future. And

b. joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investee is treated as investment according to AS 13.

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

a. It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.

b. The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturers.

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

a. If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.

b. If interest is 20% or more but upto 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statement.

c. For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

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

Following are the features of Proportionate Consolidation Method:

a. Stress is given on substance over form i.e., more importance is given to the share of venturers in the profit or loss of the venture from the share of assets and liabilities rather than the nature and form of the joint venture.

b. Venturer's share of joint assets, liabilities, expenses and income are shown on the separate lines in the consolidated financial statement.

For example, Mr. A enters into a joint venture with Mr. B and has contributed 33% of the total Property, Plant and Equipment and has share of 40% in current assets and current liabilities. Its share in net result is 50%. Consolidated Balance Sheet will be prepared by Mr. A as follow:

Consolidated Balance Sheet

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital	1	1,00,000
	2. Current Liabilities	2	50,000
			1,50,000

II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment	3	75,000
	Current Assets	4	75,000
			1,50,000

Notes to Accounts

1.	Share Capital *:		
	A (25,000 + 30,000 - 20,000)	35,000	
	B (50,000 + 45,000 - 30,000)	65,000	1,00,000
2.	Current Liabilities:		
	A	20,000	
	B	30,000	50,000
3.	Property, Plant and Equipment:		
	A	25,000	
	B	50,000	75,000
4.	Current Assets:		
	A	30,000	
	B	45,000	75,000

* Contribution to Share capital taken as a balancing figure in absence of information in this regard in the example

Similar to above all the items of expenses and income will also be classified line by line for each item. The whole basis of this provision is to bring transparency in the books of account. If there is any special clause for sharing of expenses, income or any other item that should be clearly disclosed in the consolidated financial statement.

c. Most of the provisions of Proportionate Consolidation Method are similar to the provisions of AS 21.

d. As far as possible the reporting date of the financial statements of jointly controlled entity and venturers should be same. If practically it is not possible to draw up the financial statements to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made in joint venturer's books for the effects of significant transactions or other events that occur between the jointly controlled entity's date and the date of the venturer's financial statements. In any case, the difference between reporting dates should not be more than six months.

e. Accounting policies followed in the preparation of the financial statements of the jointly controlled entity and venturer should be uniform for like transactions and other events in similar circumstances.

   If accounting policies followed by venturer and jointly controlled entity are not uniform, then adjustments should be made in the items of the venturer to bring it in line with the accounting policy of the joint venture.

f. Any asset or liability should not be adjusted by another liability or asset. Similarly any income or expense cannot be adjusted with another expense or income. Such adjustment can be made only when legally it is allowed to adjust them and such items does lead to settlement of obligation or writing off of assets.

g. On the date when interest in joint entity is acquired, if the interest of venturer in net assets of the entity is less than the cost of investment in joint entity, the difference will be recognized as goodwill in the consolidated financial statement and if net asset is more than cost of investment, then the difference is recognized as capital reserve.

   In case the carrying amount of investment is different than cost of investment, we take carrying amount for the purpose of the above calculation.

h. An investor who don't have joint control in the entity is like associate as discussed in AS 23, therefore the treatment of losses will be similar to AS 23. If investor's share in loss of the joint entity is in excess of his interest in net asset, this excess loss will be recognized by the venturers. In future when entity starts reporting profits, investor's share of profits will be provided to venturer till total amount is equivalent to absorbed losses.

Illustration 4

A Ltd. entered into a joint venture with B Ltd. on 1:1 basis and a new company C Ltd. was formed for the same purpose and following is the balance sheet of all the three companies:

Particulars	*A Ltd.*	*B Ltd.*	*C Ltd.*
Share Capital	*10,00,000*	*7,50,000*	*5,00,000*
Reserve & Surplus	*18,00,000*	*16,00,000*	*12,00,000*
Loans	*3,00,000*	*4,00,000*	*2,00,000*
Current Liabilities	*4,00,000*	*2,50,000*	*1,00,000*
Property, Plant and Equipment	*30,50,000*	*26,25,000*	*19,50,000*
Investment in JV	*2,50,000*	*2,50,000*	*-*
Current Assets	*2,00,000*	*1,25,000*	*50,000*

Prepare the balance sheet of A Ltd. and B Ltd. under proportionate consolidation method.

Solution

Balance Sheet of A Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		10,00,000
	Reserves and Surplus	1	24,00,000
	2. Non-current liabilities	2	4,00,000
	3. Current Liabilities	3	4,50,000
	TOTAL		42,50,000

II	**Assets**		
	Non-current Assets		
	Property, Plant and Equipment:	4	40,25,000
	Current Assets	5	2,25,000
			42,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	18,00,000	
	C Ltd.	6,00,000	24,00,000
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	3,00,000	
	C Ltd.	1,00,000	4,00,000
3.	Current Liabilities:		
	A Ltd.	4,00,000	
	C Ltd.	50,000	4,50,000
4.	Property, Plant and Equipment:		
	A Ltd.	30,50,000	
	C Ltd.	9,75,000	40,25,000
5.	Current Assets:		
	A Ltd.	2,00,000	
	C Ltd.	25,000	2,25,000

Balance Sheet of B Ltd.

		Note No.	(₹)
I	**Equity and liabilities**		
	1. Shareholders' funds:		
	Share Capital		7,50,000
	Reserves and Surplus	1	22,00,000
	2. Non-current liabilities	2	5,00,000
	3. Current Liabilities	3	
			3,00,000
			37,50,000

II	**Assets**		
	1. Non-current Assets		
	Property, Plant and Equipment	4	36,00,000
	2. Current Assets	5	
			1,50,000
			37,50,000

Notes to Accounts

		₹	₹
1.	Reserves and Surplus		
	A Ltd.	16,00,000	
	C Ltd.	6,00,000	22,00,000
2.	Long Term Borrowings		
	Loans:		
	A Ltd.	4,00,000	
	C Ltd.	1,00,000	5,00,000
3.	Current Liabilities:		
	A Ltd.	2,50,000	
	C Ltd.	50,000	3,00,000
4.	Property, Plant and Equipment:		
	A Ltd.	26,25,000	
	C Ltd.	9,75,000	36,00,000
5.	Current Assets:		
	A Ltd.	1,25,000	
	C Ltd.	25,000	1,50,000

3.10 TRANSACTIONS BETWEEN A VENTURER AND JOINT VENTURE

When venturer transfers or sells assets to Joint Venture, the venturer should recognise only that portion of the gain or loss which is attributable to the interests of the other venturers. The venturer should recognise the full amount of any loss only when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.

When the venturer from the joint venture purchases the assets, venturer will not recognized his share of profits in the joint venture of such transaction unless he disposes off the assets. A venturer should recognise his share of the losses resulting from these transactions in the same way as profits except that losses will be recognised in full immediately only when they represent a reduction in the net realisable value of current assets or an impairment loss.

In case the joint venture is in the form of separate entity (i.e., JCE) then provisions of above the Para will be followed only for consolidated financial statement and not for venturer's own financial statement. In the books of venturer, profit or loss from such transactions are recognised in full.

Example

A and B established a separate vehicle i.e. entity J, wherein each operator has a 50% ownership interest and each takes 50% of the output. On formation of the joint venture, A contributed a property with fair value of ₹ 110 crore and agreed to contribute his experience over the years towards this venture; and B contributed equipment with a fair value of ₹ 120 crore. The carrying values of the contributed assets were ₹ 100 crore and ₹ 80 crore, respectively.

Answer

A – Gain in consolidated financial statements

A's share in the fair value of assets contributed by entity B (50% × 120)	*60*
A's share in the carrying value of asset contributed by A to the joint venture (50% × 100)	*(50)*
Gain recognised by A	*10*

3.11 REPORTING INTERESTS IN JOINT VENTURES IN THE FINANCIAL STATEMENTS OF AN INVESTOR

The investors who don't have joint control over the entity recognized his share of net results and his investments in joint venture as per AS 13. In the consolidated financial statement it is recognized as per AS 13, AS 21 or AS 23 as appropriate.

3.12 OPERATORS OF JOINT VENTURES

Payment to operators is recognized as expense in CFS and in the books of the operators as per AS 9, Revenue Recognition. The operator may be any of the venturers, in this case any amount received by him, as management fees for the service will be recognized as stated above in this Para.

3.13 DISCLOSURE

A venturer should disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

a. Any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturers;

b. Its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and

c. Those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

a. Any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and

b. Its share of the capital commitments of the joint ventures themselves.

A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence. A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

Reference: The students are advised to refer the full text of AS 27 "Financial Reporting of Interests in Joint Ventures"

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. *State which of the following statements are incorrect.*

    (i) *The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, applies only when consolidated financial statements are prepared by venturer.*

    (ii) *The requirements relating to accounting for joint ventures in consolidated financial statements according to proportionate consolidation method, as contained in AS 27, applies irrespective whether consolidated financial statements are prepared by venturer or not.*

    (iii) *An investor in joint venture, which does not have joint control, should report its interest in a joint venture in its consolidated financial statements in accordance with AS 13, AS 21 and AS 23as the case may be.*

    (a) *Point (i) is incorrect.*

    (b) *Point (ii) is incorrect.*

    (c) *Point (iii) is incorrect.*

    (d) None of the above.

2. *Identify which of the following is not a feature of a Jointly controlled operations (JCO):*

   (a) Each venturer has his own separate business.

   (b) There is a separate entity for joint venture business.

   (c) Each venturer record only his own transactions without any separately set of books maintained for the joint venture business.

   (d) There is a common agreement between all of them.

3. *Identify which of the following is/are not a feature of a Jointly controlled assets (JCA):*

   (i) There is a separate legal identity.

   (ii) There is a common control over the joint assets.

   (iii) Expenses on jointly held assets are shared by the venturers as per the contract.

   (iv) In their financial statement, venturer shows only their share of the asset and total income earned by them along with total expenses incurred by them.

   (a) Point no. (i) only.

   (b) Point no. (i) and (iii).

   (c) Point no. (iii) and (iv).

   (d) Point (i) and (ii).

4. *Identify which is/ are features of a Jointly controlled entity (JCE):*

   (i) Venturer creates a new entity for their joint venture business.

   (ii) All the venturers pool their resources under new banner and this entity purchases its own assets, create its own liabilities, expenses are incurred by the entity itself and sales are also made by this entity.

   (iii) The revenues and expenses of the entity is shared by the venturers in the equal ratio only.

   (a) Point no. (i) only.

(b) Point no. (i) and (ii).

(c) Point no. (ii).

(d) Point no. (iii).

5. *Identify the correct statements.*

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

(i) If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statements.

(ii) If interest is 20% or more but upto 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statements.

(iii) For all other cases investment in joint venture is treated as per AS 13, Accounting for Investments.

(iv) For this purpose, the fair value of the investment at the date on which joint venture relationship ceases to exist should be regarded as cost thereafter.

(a) Point no. 1 and 2.

(b) Point no. 1, 2 and 3.

(c) Point no. 1, 2, 3 and 4.

(d) None of the above.

Theoretical Questions

6. *Describe the cases when AS 27 does not allow the use of Proportionate consolidation method of accounting?*

7. *When is a venturer required to discontinue the use of the proportionate consolidation method?*

Scenario based Questions

8. *JVR Limited has made investments of ₹ 97.84 crores in equity shares of QSR Limited in pursuance of Joint Venture agreement till 20X1-X2 (i.e., more than 12 months). The investment has been made at par. QSR Limited has been in continuous losses for the last 2 years. JVR Limited is willing to reassess the carrying amount of its investment in QSR Limited and wish to provide for diminution in value of investments. However, QSR Limited has a futuristic and profitable business plans and projection for the coming years. Discuss whether the contention of JVR Limited to bring down the carrying amount of investment in QSR Limited is in accordance with the Accounting Standard.*

ANSWERS/SOLUTION

Answer to the Multiple Choice Questions

1.	(b)	**2.**	(b)	**3.**	(a)	**4.**	(**b**)	**5.**	(b)

Answer to the Theoretical Questions

6. Proportionate consolidation method of accounting is to be followed except in the following cases:

a. Investment is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

The term 'Near Future' is explained with AS 21.

Or

b. joint venture operates under severe long-term restrictions, which significantly impair its ability to transfer funds to the venturers.

In both the above cases, investment of venturer in the share of the investee is treated as investment according to AS 13.

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

a. It ceases to have joint control in the joint venture but retains, either in whole or in part, its investment.

b. The use of the proportionate consolidation method is no longer appropriate because the joint venture operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturers.

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

a. If interest in entity is more than 50%, investments in such joint ventures should be accounted for in accordance with AS 21, Consolidated Financial Statement.

b. If interest is 20% or more but up to 50%, investments are to be accounted for in accordance with AS 23, Accounting for Investment in Associates in Consolidated Financial Statement.

c. For all other cases investment in joint venture is treated as per AS 13, Accounting for Investment.

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

Answer to the Scenario based Questions

8. As per para 26 of AS 27 "Financial Reporting of Interests in Joint Ventures", in a venturer's separate financial statements, interest in a jointly controlled entity should be accounted for as an investment in accordance with AS 13 'Accounting for Investments'.

As per para 17 of AS 13 "Accounting for Investments", long-term investments are usually carried at cost. However, when there is a decline, other than temporary, in the value of a long-term investment, the carrying amount is reduced to recognize the decline. Indicators of the value of an investment are obtained by reference to its market value, the investee's assets and results and the expected cash flows from the investment. The type and extent of the investor's stake in the investee are also taken into account. However, where there is a decline, other than temporary, in the carrying amounts of long-term investments, the resultant reduction in the carrying amount is charged to the profit and loss statement.

Since the investment was made in the year 20X1-20X2 i.e., more than a year, it is a long-term investment. In the given case, though the QSR Ltd. is in continuous losses for past 2 years, yet it has a futuristic and profitable business plans and projections for the coming years. Here, one of the indicators i.e. 'losses incurred to the company' may lead to diminution in the value of the shares while the other indicator that 'the company has positive expected cash flows from its business plans' does not lead to decline in the value of shares.

Considering both the facts, in case the expectation of profitable business plans and positive cash flows is based reliable presumptions (such as tender in favour of QSR Ltd., strong order book etc.), the decline will be regarded as temporary in nature and the investment in equity shares will continue to be carried at cost only.

However, should the aforesaid presumptions be based on projections without reasonable evidence backing the claims, the decline could be regarded as non-temporary in nature in which case the write down of the carrying amount become necessary in line with AS 13, thereby implying the contention of QSR Ltd. to be correct.

CASE SCENARIOS

Case Scenario 1

RTS Ltd, ("RTS" or the "Company"), is engaged in the business of manufacturing of equipments/components. The Company has a contract with the Indian Railways for a brake component which is structured such that:

- The Company's obligation is to deliver the component to the Railways' stockyard, while the delivery terms are ex-works, the Company is responsible for engaging a transporter for delivery.
- Railways sends an order for a defined quantity.
- The Company manufactures the required quantity and informs Railways for carrying out the inspection.
- Railways representatives visit the Company's factory and inspect the components, and mark each component with a quality check sticker.
- Goods once inspected by Railways, are marked with a hologram sticker to earmark for delivery identification by the customer when they are delivered to the customer's location.
- The Company raises an invoice once it dispatches the goods.

The management of RTS is under discussion with the auditors of the Company in respect of accounting of a critical matter as regards its accounting with respect subsequent events i.e. events after the reporting period. They have been checking as to which one of the following events after the reporting period provide evidence of conditions that existed at the end of the reporting period?

i. Nationalisation or privatization by government

ii. Out of court settlement of a legal claim

iii. Rights issue of equity shares

iv. Strike by workforce

v. Announcing a plan to discontinue an operation

The Company has received a grant of ₹ 8 crores from the Government for setting up a factory in a backward area. Out of this grant, the Company distributed ₹ 2 crores as dividend. The Company also received land, free of cost, from the State Government but it has not recorded this at all in the books as no money has been spent.

RTS has a subsidiary, A Ltd, which is evaluating its production process wherein normal waste is 5% of input. 5,000 MT of input were put in process resulting in wastage of 300 MT. Cost per MT of input was ₹ 1,000. The entire quantity of waste was on stock at the end of the financial year.

(i) When should RTS Ltd recognize revenue as per the Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006? Would your answer be different if inspection is normally known to lead to no quality rejections?

(a) Revenue should be recognized on dispatch of components. The assessment would not change even in case where inspection is normally known to lead to no quality rejections.

(b) Revenue should be recognized on completion of inspection of components. The assessment would not change even in case where inspection is normally known to lead to no quality rejections.

(c) Revenue should be recognized on dispatch of components. The assessment would change where inspection is normally known to lead to no quality rejections.

(d) Revenue should be recognized on delivery of the component to the Railways' stockyard. The assessment would change where inspection is normally known to lead to no quality rejections.

(ii) In respect of A Ltd, state with reference to Accounting Standards notified under the Companies (Accounting Standards) Rules, 2006, what would be value of the inventory to be recorded in the books of accounts?

(a) ₹ 4,700,000.

(b) ₹ 5,000,000.

(c) ₹ 4,950,000.

(d) ₹ 4,947,368.

(iii) Please guide regarding the accounting treatment of both the grants mentioned above in line with the requirements of Accounting Standard 12.

(a) Distribution of dividend out of grant is correct. In the second case also not recording land in the books of accounts is correct.

(b) Distribution of dividend out of grant is incorrect. In the second case, not recording land in the books of accounts is correct.

(c) Distribution of dividend out of grant is correct. In the second case, land should be recorded in the books of accounts at a nominal value.

(d) Distribution of dividend out of grant is incorrect. In the second case, land should be recorded in the books of accounts at a nominal value.

Answers

(i)	(b)	**(ii)**	(d)	**(iii)**	(d)

Case Scenario 2

Suman Ltd. is in the business of manufacturing electronics equipment and selling these at its various outlets. It provides installation services for the equipment sold and also provide free 1 year warranty on all the sold products.

Beach Resorts are leading resorts in the city. It purchased 5 air conditioners (AC) from Suman Ltd. for its resort. Suman Ltd. sold 5 AC to Beach resort for ₹ 45,000 each which includes installation fees of ₹ 1,000 for each AC. The Company also offers 1 year warranty for any repair etc. The Company also offered ₹ 500 per AC as trade discount. Beach resort placed order on March 15, 2024 and made payment on March 20, 2024. The ACs were delivered on March 27, 2024 and the installation was completed on April 5, 2024.

(i) How much revenue should be recognised by the Company as on March 31, 2024:

(a) ₹ 2,25,000

(b) ₹ 2,17,500

(c) ₹ 2,00,000

(d) ₹ 2,30,000

(ii) How much revenue should be recognised by the Company in the financial year 2024-25:

(a) ₹ 5000

(b) ₹ 2,20,000

(c) ₹ 10,000

(d) ₹ 2,40,000

(iii) What will be the accounting for trade discount:

(a) The same will be recognised separately in the profit and loss.

(b) The trade discounts are deducted in determining the revenue.

(c) Trade discount will be recognised after one year, when the warranty will be over.

(d) Trade discount will be recognised after installation is complete.

(iv) Is the Company required to do any accounting for 1 year warranty provided by it:

(a) No accounting treatment is required till some warranty claim is actually received by the Company.

(b) As there exist a present obligation to provide warranty to customers for 1 year, the Company should estimate the amount that it may have to incur considering various factors including past trends and create a provision as per AS 29.

(c) Accounting for claims will be done on cash basis i.e. expense will be recognised when expense is made.

(d) As the Company is not charging separately for the warranty provided, there is no need to create any provision.

Answers

(i)	(b)	**(ii)**	(a)	**(iii)**	(b)	**(iv)**	(b)

Case Scenario 3

Mars Ltd. is a manufacturing enterprise which is starting a new manufacturing plant at X Village. It has commenced construction of the plant on April 1, 2023 and has incurred following expenses:

- It has acquired land for installing Plant for ₹ 50,00,000
- It incurred ₹ 35,00,000 for material and direct labour cost for developing the Plant.
- The Company incurred ₹ 10,00,000 for head office expenses at New Delhi which included rent, employee cost and maintenance expenditure.
- The Company borrowed ₹ 25,00,000 for construction work of Plant @12% per annum on April 1, 2023. Director finance of the Company incurred travel and meeting expenses amounting to ₹ 5,00,000 during the year for arranging this loan.
- On November 1, 2023, the construction activities of the plant were interrupted as the local people alongwith the activists have raised issues relating to environmental impact of plant being constructed. Due to agitation the construction activities came to standstill for 3 months.
- With the help of Government and NGOs, the agitation was over by February 28, 2024 and the work resumed. However, to balance the impact on environment, government ordered the company to install certain devices for which the Company had to incur ₹ 6,00,000 in March 2024.
- The rate of depreciation on Plant is 10%.

Based on the above information, answer the following questions.

(i) Which of the following expenses cannot be included in the cost of plant:

(a) Cost of Land

(b) Construction material and labour cost

(c) Head office expenses

(d) Borrowing cost

(ii) How much amount of borrowing cost can be capitalised with the plant:

(a) ₹ 300,000

(b) ₹ 2,00,000

(c) ₹ 7,00,000

(d) ₹ 6,00,000

(iii) The total cost of plant as on march 31, 2024 will be:

(a) ₹ 85,00,000

(b) ₹ 98,00,000

(c) ₹ 93,00,000

(d) ₹ 95,00,000

(iv) The amount of depreciation to be charged for the year end March 31, 2024

(a) ₹ 4,30,000

(b) ₹ 9,30,000

(c) ₹ 9,80,000

(d) Nil

Answers

(i)	(c)	**(ii)**	(b)	**(iii)**	(c)	**(iv)**	(d)

Case Scenario 4

Beloved Finance Ltd. is a financial enterprise which is in the business of lending loan to small businesses and earn interest on loans.

- During the year the Company has lend 50 crores and earned ₹ 1.5 crore as interest on loans.

- The Company had surplus funds during the year and invested then in Fixed Deposits with bank and earned interest on fixed deposits of ₹ 20 lacs.
- The Company also acquired a gold loan unit for ₹ 10 crore during the year and the Company provided interest free loan of ₹ 15 crore to its wholly-owned subsidiary.
- The Company paid a total income tax of ₹ 75 lacs for the year.

Based on the above information, answer the following questions.

(i) In the Cash Flow Statement as per AS 3, the interest income of ₹ 1.5 crore earned on earned on loans given by the Company will be disclosed as:

(a) Cash Flow from Operating Activities

(b) Cash Flow from Investing Activities

(c) Cash Flow from Financing Activities

(d) Non-cash Items

(ii) In the Cash Flow Statement as per AS 3, the interest income of ₹ 20 Lacs earned fixed deposits with bank will be disclosed as:

(a) Cash Flow from Operating Activities

(b) Cash Flow from Investing Activities

(c) Cash Flow from Financing Activities

(d) Non-cash Items

(iii) In the Cash Flow Statement as per AS 3, amount paid for acquiring gold loan unit will be disclosed as:

(a) Cash Flow from Operating Activities

(b) Cash Flow from Investing Activities

(c) Cash Flow from Financing Activities

(d) Non-cash Items

(iv) In the Cash Flow Statement as per AS 3, total income tax of ₹ 75 lacs paid for the year will be disclosed as:

(a) Cash Flow from Operating Activities

(b) Cash Flow from Investing Activities

(c) Cash Flow from Financing Activities

(d) Non-cash Items

(v) Is any specific disclosures required to made in relation to the interest free loan of ₹ 15 crore provided by the Company to its wholly-owned subsidiary, if yes, as per which Accounting Standard:

(a) Yes, disclosure is required to be made as per AS 3, Cash Flow Statements.

(b) Yes, disclosure is required to be made as per AS 18, Related Party Disclosures

(c) Yes, disclosure is required to be made as per AS 13, Accounting for Investments

(d) No specific disclosures are required.

Answers

(i)	(a)	**(ii)**	(a)	**(iii)**	(b)	**(iv)**	(a)	**(v)**	(b)

Case Scenario 5

Venus Limited received a parcel of land at no cost from the government for the purpose of developing a factory in an outlying area. The land is valued at ₹ 75 lakhs, while the nominal value is ₹ 10 lakhs. Additionally, the company received a government grant of ₹ 30 lakhs, which represents 25% of the total investment needed for the factory development. Furthermore, the company received ₹ 15 lakhs with the stipulation that it be used to purchase machinery. There is no expectation from the government for the repayment of these grants.

Answer the following questions based on the above information:

(i) The land received from Government, free of cost should be presented at:

(a) ₹ 75 Lakhs

(b) ₹ 30 Lakhs

(c) ₹ 10 Lakhs

(d) ₹ 45 Lakhs

(ii) As per AS 12, how the Government Grant of ₹ 30 Lakhs should be presented:

(a) It should be recognised in the profit and loss statement as per the related cost.

(b) It will be treated as capital reserve.

(c) It will be treated as deferred income.

(d) It will not be recognised in the financial statements.

(iii) As per AS 12, how the Government Grant of ₹ 15 Lakhs with a condition to purchase machinery may be presented as:

(a) Capital Reserve

(b) Shareholders Fund

(c) Deferred Income

(d) Income in statement of profit and loss as received.

(iv) Which of the above grants are required to be recognised in the statement of profit and loss on a systematic and rational basis over the useful life of the asset:

(a) Land received as Grant

(b) Government Grant of ₹ 30 Lakhs

(c) Government Grant of ₹ 15 Lakhs with a condition to purchase machinery

(d) Noe of the above

Answers

(i)	(c)	**(ii)**	(b)	**(iii)**	(c)	**(iv)**	(c)

Case Scenario 6

Axis limited is a manufacturing company. It purchased a machinery costing ₹ 10 Lakhs in April 2023. It paid ₹ 4 lakhs upfront and paid the remaining ₹ 6,00,000 as deferred payment by paying instalment of ₹ 1,05,000 for the next 6 months. During the year, the Company sold a land which was classified as its 'property, plant and equipment' for ₹ 25,00,000 and paid ₹ 1,00,000 as income tax as long term capital gain on such sale. During the year, the Company also received income tax refund along with interest.

(i) As per the requirements of AS 3, 'Cash Flow Statements', how the amount for purchase of machinery should be presented:

(a) ₹ 10 lakhs as 'Cash flows from Investing Activities' and ₹ 30,000 will simply be booked in profit and loss with no presentation if Cash Flow Statement.

(b) ₹ 10.30 lakhs as 'Cash flows from Investing Activities' as entire amount is spend on purchase of machinery.

(c) ₹ 10 lakhs as 'Cash flows from Investing Activities' and ₹ 30,000 as 'Cash flows from Financing Activities'.

(d) ₹ 10.30 lakhs as 'Cash flows from Financing Activities' as the machinery has been purchased on finance.

(ii) At what amount, the machinery should be recognised in the financial statements:

(a) ₹ 400,000

(b) ₹ 10,30,000

(c) ₹ 600,000

(d) ₹ 10,00,000

(iii) How should the income tax paid on sale of land should be disclosed in the Cash Flows Statement:

(a) Cash flows from Operating Activities

(b) Cash flows from Investing Activities

(c) Cash flows from Financing Activities

(d) No disclosure in Cash Flow Statement

(iv) How should the interest on income tax refunds should be disclosed in the Cash Flows Statement:

(a) Cash flows from Operating Activities

(b) Cash flows from Investing Activities

(c) Cash flows from Financing Activities

(d) No disclosure in Cash Flow Statement

Answers

(i)	(c)	**(ii)**	(d)	**(iii)**	(b)	**(iv)**	(b)

Case Scenario 7

SEAS Ltd., the "Company", is in the business of tours and travels. It sells holiday packages to the customers. The Company negotiates upfront with the Airlines for specified number of seats in flight. The Company agrees to buy a specific number of tickets and pay for those tickets regardless of whether it is able to resell all of those in package.

The rate paid by the Company for each ticket purchased is negotiated and agreed in advance. The Company also assists the customers in resolving complaints with the service provided by airlines. However, each airline is responsible for fulfilling obligations associated with the ticket, including remedies to a customer for dissatisfaction with the service.

The Company bought a forward contract for three months of US$ 1,00,000 on 1 March 2024 at 1 US$ = INR 83.10 when exchange rate was US$ 1 = INR 83.02. On 31 March 2024, when the Company closed its books, exchange rate was US$ 1 = INR 83.15. On 1 April 2024, the Company decided for premature settlement of the contract due to some exceptional circumstances.

The Company is evaluating below mentioned schemes:

i. Introduction of a formal retirement gratuity scheme by an employer in place of ad hoc ex-gratia payments to employees on retirement.

ii. Management decided to pay pension to those employees who have retired after completing 5 years of service in the organization. Such employees will get pension of ₹ 20,000 per month. Earlier there was no such scheme of pension in the organization.

SEAS Ltd. has a subsidiary, ADI Ltd., which is in the business of construction having turnover of ₹ 200 crores. SEAS Ltd. and ADI Ltd. hold 9% and 23% respectively in an associate company, ASOC Ltd. Both SEAS Ltd. and ADI Ltd. prepare consolidated financial statements as per Accounting Standards notified under the Companies (Accounting Standards) Rules, 2021.

(i) What would be the basis of revenue recognition for SEAS Ltd. as per the requirements of Accounting Standards?

(a) Gross basis.

(b) Net basis.

(c) Depends on the accounting policy of the Company.

(d) Indian GAAP allows a choice to the Company to recognize revenue on gross basis or net basis.

(ii) Please suggest accounting treatment of forward contract for the year ended 31 March 2024 as per Accounting Standard 11.

(a) MTM (marked to market value) of contract will be recorded on 31 March 2024.

(b) MTM (marked to market value) of contract will be computed as at 31 March 2024 and only if there is loss, it will be recorded during the year ended 31 March 2024.

(c) No accounting will be done during the year ended 31 March 2024.

(d) Premium on contract will be amortized over the life of the contract.

(iii) You are requested to advise the Company in respect of the accounting requirements of above schemes related to employee benefits as to which one of those schemes should be considered as a change in accounting policy during the year.

(a) 1 – Change in accounting policy. 2 – Change in accounting policy.

(b) 1– Not a change in accounting policy. 2 – Change in accounting policy.

(c) 1 – Not a change in accounting policy. 2 – Not a change in accounting policy.

(d) 1– Change in accounting policy. 2 – Not a change in accounting policy.

(iv) Please comment regarding consolidation requirements for SEAS Ltd. and ADI Ltd. using the below mentioned options as to which one should be correct.

(a) ADI Ltd. would using equity method of accounting for 23% in ASOC Ltd. SEAS Ltd. would consolidate ADI Ltd. and consequently automatically equity account 23% and separately account for the balance 9% as per AS 13.

(b) ADI Ltd. would account for 23% in ASOC Ltd. as per AS 13. SEAS Ltd. would consolidate ADI Ltd. and consequently automatically account 23% and separately account for the balance 9%.

(c) ADI Ltd. would account for 23% share in ASOC Ltd using equity method of accounting. SEAS Ltd. would consolidate ADI Ltd. and consequently, automatically account for ASOC Ltd 23% share and separately account for 9% share in ASOC Ltd. using equity method of accounting in consolidated financial statements.

(d) ADI Ltd. would account for 23% in ASOC Ltd. as per AS 13. SEAS Ltd. would consolidate ADI Ltd. and using equity method of accounting 23% in ASOC Ltd. and separately account for the balance 9% as per AS 13.

Answers

(i)	(a)	**(ii)**	(d)	**(iii)**	(c)	**(iv)**	(c)

Case Scenario 8

On 1st April, 2022, Shubham Limited purchased some land for ₹ 30 lakhs for the purpose of constructing a new factory. This cost of 30 lakhs included legal cost of ₹ 2 lakhs incurred for the purpose of acquisition of this land. Construction work could start on 1st May, 2022 and Shubham Limited provides you the details of the following costs incurred in relation to its construction:

	₹
Preparation and levelling of the land	80,000
Employment costs of the construction workers (per month)	29,000
Purchase of materials for the construction	21,24,000
Cost of relocating employees to new factory for work	60,000
Costs of inauguration ceremony on 1st January, 2023	80,000
Overhead costs incurred directly on the construction of the factory (per month)	25,000

General overhead costs allocated to construction project by the Manager is ₹ 30,000. However, as per company's normal overhead allocation policy, it should be ₹ 24,000. The auditor of the company has support documentation for the cost of ₹ 15,000 only) and raised objection for the balance amount.

The construction of the factory was completed on 31st December, 2022 and production could begin on 1st February, 2023. The overall useful life of the factory building was estimated at 40 years from the date of completion. However, it was estimated that the roof will need to be replaced 20 years after the date of completion and that the cost of replacing the roof at current prices would be 25% of the total cost of the building.

The construction of the factory was partly financed by a loan of ₹ 28 lakhs borrowed on 1st April, 2022. The loan was taken at an annual rate of interest of 9%. During the period when the loan proceeds had been fully utilized to finance the construction, Shubham Limited received investment income of ₹ 25,000 on the temporary investment of the proceeds.

You are required to assume that all of the net finance costs to be allocated to the cost of factory (not land) and interest cost to be capitalized based on nine months' period.

Based on the information given in the above scenario, answer the following multiple choice questions:

(i) Which of the following cost (incurred directly on construction) will be capitalized to the cost of factory building?

(a) ₹ 2,00,000 incurred as legal cost

(b) ₹ 60,000 – costs of relocating employees

(c) ₹ 80,000 costs of inauguration ceremony

(d) ₹ 24,000 – allocated general overhead cost

(ii) What amount of employment cost of construction workers will be capitalized to the cost of factory building?

(a) ₹ 2,90,000

(b) ₹ 3,48,000

(c) ₹ 2,32,000

(d) ₹ 29,000

(iii) What is the amount of net borrowing cost capitalized to the cost of the factory?

(a) ₹ 1,89,000

(b) ₹ 1,68,000

(c) ₹ 1,44,000

(d) ₹ 1,64,000

(iv) What will be the carrying amount (i.e. value after charging depreciation) of the factory in the Balance Sheet of Shubham Limited as at 31st March, 2023?

(a) ₹ 30,00,000

(b) ₹ 57,78,125

(c) ₹ 27,78,125

(d) ₹ 58,00,000

Answers

(i)	(a)	**(ii)**	(c)	**(iii)**	(d)	**(iv)**	(b)