CMA FINAL · PAPER 18 · GROUP IV

Corporate Financial Reporting (CFR)

Complete Formula & Practical Application Book — module-wise formulas, real exam-style worked illustrations with stepwise solutions, and a 120-question MCQ bank (15 MCQs × 2 marks per module), built on ICMAI Syllabus 2022.

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How to use this book: Each module gives you (1) every formula you need, (2) a plain-English note on when/how to apply it in an exam question, (3) fully worked illustrations with step-by-step solutions, and (4) 15 exam-style MCQs (2 marks each) with answers and explanations. Formulas and illustrations are freshly worked for this book to build genuine conceptual clarity — always cross-check the latest ICMAI Study Material/RTP/MTP and any Ind AS amendments closer to your attempt.

SECTION A

Indian Accounting Standards

Weightage: 25% of total marks (highest-weighted section) | Module 1

MODULE 1 · SECTION A · HIGHEST WEIGHTAGE (25%)

Specific Accounting Standards

Key Ind AS covered: Ind AS 8 (Accounting Policies), 12 (Income Taxes), 16 (PPE), 116 (Leases), 21 (Forex), 23 (Borrowing Costs), 36 (Impairment), 38 (Intangibles), 102 (Share-based Payment), 108 (Segments), 113 (Fair Value), 115 (Revenue).

1. Formulas

Ind AS 12 — Deferred Tax

Deferred Tax Asset/Liability = Temporary Difference × Applicable Tax Rate

Taxable temporary difference → Deferred Tax Liability; Deductible temporary difference → Deferred Tax Asset (recognised only to the extent future taxable profit is probable).

Ind AS 16 — Depreciable Amount & Depreciation

Depreciable Amount = Cost of Asset − Residual Value
Straight-Line Depreciation = Depreciable Amount / Useful Life

Depreciation must be reviewed and split component-wise if significant parts of an asset have materially different useful lives (component accounting).

Ind AS 116 — Right-of-Use (ROU) Asset & Lease Liability

Lease Liability (initial) = PV of unpaid lease payments, discounted at the Incremental Borrowing Rate (or rate implicit in the lease)
ROU Asset = Initial Lease Liability + Initial Direct Costs + Prepaid Lease Payments − Lease Incentives Received

Almost all leases (except short-term/low-value) are now recognised on-balance-sheet by the lessee under Ind AS 116 — a major shift from the old operating/finance lease distinction.

Ind AS 23 — Capitalisation Rate for Borrowing Costs

Capitalisation Rate = Weighted Average Cost of General Borrowings Outstanding During the Period

Applied to expenditure on a qualifying asset (financed from general borrowings) to determine the borrowing cost eligible for capitalisation.

Ind AS 36 — Impairment of Assets

Recoverable Amount = Higher of (Fair Value less Costs of Disposal, Value in Use)
Impairment Loss = Carrying Amount − Recoverable Amount (recognised only if Carrying Amount > Recoverable Amount)

Value in Use = PV of estimated future cash flows expected from continuing use and eventual disposal of the asset.

Ind AS 108 — Operating Segment Thresholds

A segment is "reportable" if it meets ANY of: Revenue ≥ 10% of combined revenue; OR Absolute Profit/Loss ≥ 10% of the greater of combined profits/combined losses; OR Assets ≥ 10% of combined assets of all segments

If total external revenue of reportable segments is <75% of total entity revenue, additional segments must be identified until the 75% threshold is reached.

Ind AS 115 — Revenue Recognition (5-Step Model)

1. Identify the contract 2. Identify performance obligations 3. Determine transaction price 4. Allocate transaction price to performance obligations 5. Recognise revenue as/when each obligation is satisfied

For bundled contracts, allocate the transaction price to each distinct performance obligation based on its relative standalone selling price.

2. Practical Application

Ind AS 116 impact on financial ratios: Bringing operating leases on-balance-sheet increases both assets and liabilities, typically worsening debt-based ratios (e.g., Debt/Equity) while EBITDA improves (since lease "rent" is replaced by depreciation + interest, both below the EBITDA line) — a key exam discussion point.

Deferred tax on revaluation: When an asset is revalued upward under Ind AS 16, the resulting temporary difference (Carrying Amount > Tax Base) creates a Deferred Tax Liability, recognised directly in Other Comprehensive Income (matching where the revaluation gain itself was recognised) — not in P&L.

Impairment testing triggers: Ind AS 36 requires impairment testing whenever there's an indicator of impairment (external: market value decline, adverse changes in the economic environment; internal: physical damage, obsolescence) — certain assets (goodwill, indefinite-life intangibles) require ANNUAL testing regardless of indicators.

3. Worked Illustrations

Illustration 1.1 — Deferred Tax (Ind AS 12)

An asset has a Carrying Amount of ₹10,00,000 and a Tax Base (WDV as per tax records) of ₹7,00,000, due to higher depreciation claimed for tax purposes. Tax Rate = 25%.

Step 1 — Identify the temporary difference: Carrying Amount > Tax Base ⇒ Taxable temporary difference = 10,00,000 − 7,00,000 = **₹3,00,000**

Step 2 — Nature of difference: Since the carrying amount for accounting purposes exceeds the tax base, this will result in higher taxable income in future (when the asset is realised/depreciated for tax purposes) — a Deferred Tax LIABILITY.

Step 3 — Compute DTL: DTL = 3,00,000 × 25% = **₹75,000**

A Deferred Tax Liability of ₹75,000 must be recognised, representing the additional tax the entity will pay in future periods as this temporary difference reverses.

Illustration 1.2 — Impairment of Assets (Ind AS 36)

An asset has a Carrying Amount of ₹50,00,000. Fair Value less Costs of Disposal = ₹38,00,000. Value in Use (PV of future cash flows) = ₹42,00,000.

Step 1 — Determine Recoverable Amount: Recoverable Amount = Higher of (38,00,000, 42,00,000) = **₹42,00,000**

Step 2 — Compare with Carrying Amount: Carrying Amount (50,00,000) > Recoverable Amount (42,00,000) ⇒ Asset IS impaired

Step 3 — Compute Impairment Loss: Impairment Loss = 50,00,000 − 42,00,000 = **₹8,00,000**

An impairment loss of ₹8,00,000 must be recognised in profit or loss (unless the asset is carried at a revalued amount, in which case it first reduces the revaluation surplus), writing the asset down to its recoverable amount of ₹42,00,000.

4. Practice MCQs (15 × 2 Marks)

Q1. Under Ind AS 36, Recoverable Amount is defined as:

A. The lower of Fair Value less Costs of Disposal and Value in Use
B. The higher of Fair Value less Costs of Disposal and Value in Use
C. Always equal to the historical cost
D. Always equal to the market price alone

Answer: B

Recoverable Amount takes the higher of the two measures, since the entity would rationally choose whichever route (sale or continued use) yields more value.

Q2. When Carrying Amount of an asset exceeds its Tax Base, this creates a:

A. Deferred Tax Asset
B. Deferred Tax Liability
C. No deferred tax impact
D. Immediate cash tax refund

Answer: B

A carrying amount exceeding the tax base is a taxable temporary difference, giving rise to a Deferred Tax Liability.

Q3. Under Ind AS 116, which of the following leases can a lessee elect to keep OFF the balance sheet?

A. Any lease longer than 5 years
B. Short-term leases (≤ 12 months) and leases of low-value assets
C. All operating leases without exception
D. Only finance leases

Answer: B

Ind AS 116 provides practical expedients allowing lessees to expense short-term and low-value asset leases directly, without recognising a Right-of-Use asset/liability.

Q4. Under Ind AS 115, revenue is recognised:

A. Only when cash is received
B. As/when each distinct performance obligation in the contract is satisfied
C. Always at the start of the contract, in full
D. Only at the end of the entity's financial year

Answer: B

The 5-step Ind AS 115 model recognises revenue progressively as performance obligations are satisfied, not simply on cash receipt or contract signing.

Q5. The Capitalisation Rate under Ind AS 23, for general (not asset-specific) borrowings, is calculated as:

A. The highest individual borrowing rate available
B. The weighted average cost of the general borrowings outstanding during the period
C. The risk-free government bond rate
D. Always a flat 10%

Answer: B

Since general borrowings are pooled and not tied to a specific asset, a weighted average rate is used to determine capitalisable borrowing costs.

Q6. Bringing operating leases on-balance-sheet under Ind AS 116 typically:

A. Decreases both total assets and total liabilities
B. Increases both total assets (ROU asset) and total liabilities (lease liability), and tends to improve reported EBITDA
C. Has no effect on any financial statement
D. Only affects the cash flow statement, not the balance sheet

Answer: B

Recognising ROU assets and lease liabilities grosses up the balance sheet; since rent expense is replaced by depreciation+interest (both below EBITDA), reported EBITDA typically rises.

Q7. Under Ind AS 108, a segment is reportable if its revenue is at least what percentage of the combined revenue of all segments?

A. 5%
B. 10%
C. 25%
D. 50%

Answer: B

The 10% quantitative threshold on revenue (or profit/loss, or assets) is one of the standard tests for identifying a reportable operating segment.

Q8. If the total external revenue of currently identified reportable segments is less than 75% of the entity's total revenue, the entity must:

A. Stop reporting segment information entirely
B. Identify additional reportable segments until the 75% threshold is met
C. Merge all segments into one
D. Ignore the 75% test, as it is optional

Answer: B

Ind AS 108 requires enough segments to be separately reported so that at least 75% of total entity revenue is covered by reportable segments.

Q9. A deferred tax liability arising from the revaluation of a Property, Plant & Equipment item (Ind AS 16) is recognised in:

A. Profit or Loss
B. Other Comprehensive Income, consistent with where the revaluation gain itself was recognised
C. Retained earnings directly, bypassing OCI
D. It is never recognised

Answer: B

Since the revaluation surplus is recognised in OCI, the related deferred tax effect is also recognised in OCI, maintaining consistency of treatment.

Q10. Under Ind AS 36, goodwill and indefinite-life intangible assets must be tested for impairment:

A. Only when there's a specific indicator of impairment
B. Annually, regardless of whether there is any indication of impairment
C. Never, since goodwill cannot be impaired
D. Only once, at initial recognition

Answer: B

Unlike other assets (tested only when indicators exist), goodwill and indefinite-life intangibles require mandatory annual impairment testing.

Q11. Value in Use, as defined under Ind AS 36, is calculated as:

A. The current market selling price of the asset
B. The present value of estimated future cash flows expected from the asset's continuing use and eventual disposal
C. The historical cost of the asset
D. The replacement cost of the asset

Answer: B

Value in Use captures the entity-specific PV of cash flows the asset is expected to generate, distinct from its market-based fair value.

Q12. Ind AS 21 requires monetary items denominated in a foreign currency to be translated, at each reporting date, using:

A. The historical exchange rate at the transaction date
B. The closing (spot) exchange rate at the reporting date
C. An average rate for the entire year, always
D. A rate fixed by the company's management arbitrarily

Answer: B

Monetary items (cash, receivables, payables in foreign currency) are retranslated at the closing rate at each reporting date, with exchange differences recognised in P&L.

Q13. Ind AS 102 (Share-Based Payment) requires the cost of employee stock options to be measured based on:

A. The par value of the shares only
B. The fair value of the equity instruments granted, at the grant date
C. The book value of the company's total assets
D. Zero cost, since no cash changes hands

Answer: B

Ind AS 102 requires recognition of an expense based on the grant-date fair value of the options/shares granted to employees, spread over the vesting period.

Q14. Under Ind AS 113, the "Fair Value Hierarchy" prioritises which level of inputs as most reliable?

A. Level 3 — unobservable inputs based on management's own assumptions
B. Level 1 — quoted prices in active markets for identical assets/liabilities
C. Level 2 and Level 3 equally
D. There is no hierarchy; all inputs are treated equally

Answer: B

Level 1 inputs (quoted prices in active markets) are considered the most reliable and are given the highest priority in the fair value hierarchy.

Q15. Component accounting under Ind AS 16 requires that:

A. An entire asset must always be depreciated as a single unit, regardless of its components

B. Significant parts of an asset with materially different useful lives are depreciated separately

C. Depreciation is prohibited under Ind AS 16

D. Only the largest component of an asset needs to be recorded

Answer: B

Component accounting requires separately identifying and depreciating significant parts of an asset that have different useful lives from the asset as a whole.

SECTION B

Valuation of Shares, Financial Instruments & NBFCs

Weightage: 15% of total marks | Modules 2–4

MODULE 2 · SECTION B

Valuation of Shares

Methods for valuing unquoted/private company shares — Net Assets, Yield (Earnings) and Fair Value methods — plus goodwill and asset revaluation adjustments feeding into the valuation.

1. Formulas

Net Asset Value (NAV) Method

`Value per Share = Net Assets Available to Equity Shareholders / Number of Equity Shares`

Net Assets Available to Equity = Total Assets (at agreed/fair values) − Total Outside Liabilities − Preference Share Capital (including any arrears of preference dividend, if cumulative).

Yield (Earnings) Method

`Value per Share = (Expected Rate of Return / Normal Rate of Return) × Paid-Up Value per Share`

Expected Rate of Return = (Average/Maintainable Profit available to equity / Paid-up Equity Capital) × 100. Reflects the earning capacity of the business rather than its net assets.

Fair Value Method

`Fair Value per Share = (Net Asset Value per Share + Yield Value per Share) / 2`

A common compromise/practical approach, balancing the asset backing view (NAV) with the earning capacity view (Yield) — the simple average is the most typical weighting used in exams unless a different weighting is specified.

Maintainable Profit (for Yield Method)

`Maintainable Profit = Average of Past Adjusted Profits, after removing non-recurring items (abnormal gains/losses, one-off items) and adjusting for expected future normal conditions`

This is the "normalised" profit figure that best represents ongoing, sustainable earning capacity — NOT simply the last reported year's profit.

Capitalisation of Earnings Method (alternative Yield-based approach)

`Value of Business (Equity) = Maintainable Profit / Normal Rate of Return; Value per Share = Value of Business / Number of Shares`

Directly capitalises the maintainable profit at the normal (expected) rate of return to arrive at total equity value.

2. Practical Application

When each method is most relevant: NAV method suits liquidation/asset-heavy scenarios; Yield method suits going-concern, profit-generating businesses; Fair Value method is commonly used for statutory/regulatory purposes (e.g., transfer pricing, family settlements) needing a balanced, defensible figure.

Adjustments before computing NAV: Assets must be revalued to fair/agreed value (not book value), contingent liabilities likely to crystallise must be provided for, and fictitious assets (e.g., preliminary expenses, debit balance in P&L) must be written off before computing net assets.

Preference shares in NAV calculation: Preference share capital (plus arrears of cumulative preference dividend, if any) is deducted BEFORE arriving at net assets available to equity shareholders — a frequently tested adjustment.

3. Worked Illustration

Illustration 2.1 — Fair Value of Shares (NAV & Yield Combined)

Total Assets (at agreed values) = ₹1,20,00,000; Total Outside Liabilities = ₹40,00,000; 10% Preference Share Capital = ₹20,00,000 (no arrears); Equity Shares = 5,00,000 of ₹10 each. Maintainable Profit (after preference dividend) = ₹9,00,000. Normal Rate of Return in the industry = 12%.

Step 1 — Net Assets available to Equity: 1,20,00,000 − 40,00,000 − 20,00,000 = **₹60,00,000**

Step 2 — NAV per share: 60,00,000 / 5,00,000 = **₹12 per share**

Step 3 — Expected Rate of Return: (9,00,000 / 50,00,000 paid-up equity capital) × 100 = **18%**

Step 4 — Yield Value per share: (18%/12%) × ₹10 (paid-up value) = 1.5 × 10 = **₹15 per share**

Step 5 — Fair Value per share: (12 + 15) / 2 = **₹13.50 per share**

Fair Value per share = ₹13.50, balancing the asset-backing view (₹12 NAV) with the stronger earning capacity view (₹15 Yield Value), which shows the business earns above the industry-normal 12% return.

4. Practice MCQs (15 × 2 Marks)

Q1. Under the Net Asset Value method, assets should be valued at:

A. Historical book value always
B. Fair/agreed values for the purpose of the valuation
C. Zero
D. Only the original purchase price, ignoring depreciation

Answer: B

NAV valuation requires assets to be restated at fair/agreed values, not historical book values, to reflect true current worth.

Q2. Under the Yield Method, Value per Share is calculated as:

A. (Normal Rate of Return / Expected Rate of Return) × Paid-up value
B. (Expected Rate of Return / Normal Rate of Return) × Paid-up value
C. Expected Rate of Return × Normal Rate of Return
D. Net Assets / Number of Shares

Answer: B

The Yield method scales the paid-up value by the ratio of the company's actual expected return to the industry's normal return.

Q3. Preference share capital (with cumulative arrears, if any) is treated in the NAV method by:

A. Adding it to net assets
B. Deducting it (along with any arrears) before arriving at net assets available to equity shareholders
C. Ignoring it entirely
D. Multiplying it by the number of equity shares

Answer: B

Preference capital ranks ahead of equity, so it (plus any cumulative dividend arrears) must be deducted before computing net assets attributable to equity holders.

Q4. Maintainable Profit, used in the Yield Method, is best described as:

A. The exact profit of the most recent year, unadjusted
B. A normalised average profit figure after removing non-recurring/abnormal items
C. The company's total revenue
D. The company's total assets

Answer: B

Maintainable profit represents sustainable, ongoing earning capacity — hence one-off/abnormal items are excluded from the average used.

Q5. Fictitious assets (e.g., preliminary expenses not yet written off) should be treated in NAV computation by:

A. Including them at full book value as a real asset
B. Writing them off / excluding them from the asset base before computing net assets
C. Doubling their value
D. Treating them as a liability

Answer: B

Fictitious assets have no realisable value, so they are excluded (written off) when computing the true net asset value.

Q6. If NAV per share = ₹20 and Yield Value per share = ₹30, the Fair Value per share (simple average) is:

A. ₹20
B. ₹25
C. ₹30
D. ₹50

Answer: B

Fair Value = (20+30)/2 = ₹25.

Q7. The Yield Method of share valuation is most relevant when the primary concern is:

A. The company is about to be liquidated
B. Valuing the business as a going concern, based on its earning capacity
C. Only the resale value of fixed assets
D. The company has no future operations planned

Answer: B

The Yield method captures the value of ongoing earning power, making it most suitable for a going-concern business rather than a liquidation scenario.

Q8. Contingent liabilities that are likely to crystallise should be treated, when valuing shares under the NAV method, by:

A. Ignoring them entirely since they are "contingent"
B. Providing for them as a liability, reducing net assets accordingly
C. Adding them to the asset side
D. Treating them as share capital

Answer: B

If a contingent liability is likely to materialise, prudence requires providing for it, which reduces the net assets available to equity shareholders.

Q9. If a company's Expected Rate of Return (18%) exceeds the industry's Normal Rate of Return (12%), the Yield Value per share compared to the paid-up value per share will be:

A. Lower than the paid-up value
B. Higher than the paid-up value
C. Exactly equal to the paid-up value
D. Always zero

Answer: B

Since the ratio (Expected/Normal Rate) exceeds 1 in this case, the Yield Value will exceed the paid-up value per share, reflecting above-average earning capacity.

Q10. Under the Capitalisation of Earnings method, Value of Business is calculated as:

A. Maintainable Profit × Normal Rate of Return
B. Maintainable Profit / Normal Rate of Return
C. Net Assets × Number of Shares
D. Paid-up Capital / Maintainable Profit

Answer: B

This method directly capitalises maintainable profit at the normal rate of return to determine the implied value of the entire business/equity.

Q11. Share valuation methods (NAV, Yield, Fair Value) are commonly required for purposes such as:

A. Only routine day-to-day bookkeeping entries
B. Mergers, family settlements, taxation (angel tax), and statutory/regulatory compliance
C. Recording petty cash transactions

D. Calculating GST liability

Answer: B

Share valuation is required in numerous statutory and commercial contexts, including M&A, family arrangements, and various tax/regulatory compliance requirements.

Q12. If Total Assets (fair value) = ₹80,00,000, Outside Liabilities = ₹30,00,000, and Preference Capital = ₹10,00,000, Net Assets available to Equity is:

A. ₹30,00,000
B. ₹40,00,000
C. ₹50,00,000
D. ₹60,00,000

Answer: B

Net Assets to Equity = 80,00,000 − 30,00,000 − 10,00,000 = ₹40,00,000.

Q13. Which of these items would typically be EXCLUDED when computing "maintainable" profit for the Yield Method?

A. Recurring operating income from core business activities
B. A one-time profit from the sale of a factory building (a non-recurring gain)
C. Normal cost of goods sold
D. Regular administrative expenses

Answer: B

Non-recurring items like a one-off asset sale gain distort the picture of sustainable earning capacity and are excluded from maintainable profit.

Q14. A key limitation of the NAV method alone (without considering earnings) is that it:

A. Always overstates the value of a highly profitable, asset-light business
B. May understate the value of a business whose worth lies mainly in future earning potential rather than its current asset base
C. Cannot be calculated at all for any company
D. Ignores liabilities entirely

Answer: B

A profitable but asset-light business (e.g., a service firm) might be significantly undervalued by NAV alone, since its true worth lies in future earnings, not its net asset base.

Q15. In practice, when an examiner does not specify a particular weighting between NAV and Yield values, the Fair Value is generally computed as:

A. NAV value alone, ignoring Yield value
B. A simple (equal-weighted) average of NAV and Yield values
C. Yield value alone, ignoring NAV
D. The higher of the two values only

Answer: B

Absent any specified weighting, the standard convention is to take a simple average of the NAV and Yield values as the Fair Value.

MODULE 3 · SECTION B

Accounting of Financial Instruments

Classification and measurement of financial instruments under Ind AS 109, presentation under Ind AS 32, and the Effective Interest Rate (EIR) and Expected Credit Loss (ECL) models.

1. Formulas

Amortised Cost using the Effective Interest Rate (EIR) Method

Amortised Cost = Initial Recognition Amount − Principal Repayments ± Cumulative Amortisation of Discount/Premium (using EIR) − Impairment Allowance

EIR is the rate that exactly discounts estimated future cash flows through the expected life of the instrument to the instrument's initial carrying amount.

Interest Income under EIR Method

Interest Income (for the period) = Opening Amortised Cost × Effective Interest Rate

This differs from the nominal/coupon interest when the instrument was issued at a discount or premium to its face value.

Expected Credit Loss (ECL) — Ind AS 109

ECL = Probability of Default (PD) × Loss Given Default (LGD) × Exposure at Default (EAD)

"12-month ECL" applies at initial recognition (Stage 1); "Lifetime ECL" applies once credit risk has increased significantly (Stage 2) or the asset is credit-impaired (Stage 3).

Compound Financial Instrument — Split Accounting (Ind AS 32)

Liability Component = PV of contractual cash flows, discounted at the market interest rate for an equivalent NON-convertible instrument

Equity Component = Total Proceeds Received − Liability Component (residual value)

Applies to instruments like convertible bonds/debentures, which contain both a liability (debt) and an equity (conversion option) component that must be separated ("split accounting").

2. Practical Application

Classification categories under Ind AS 109: A debt instrument is classified based on the entity's business model AND the contractual cash flow characteristics — "hold to collect" with SPPI (solely payments of principal and interest) cash flows → Amortised Cost; "hold to collect and sell" with SPPI → FVTOCI; anything else (e.g., trading, equity investments by default) → FVTPL.

Why EIR matters: When a bond/debenture is issued at a discount or premium, using the EIR (rather than the nominal coupon rate) ensures interest income/expense is recognised at a constant rate on the CARRYING amount over the instrument's life — smoothing the effective yield.

ECL is forward-looking: Unlike the old "incurred loss" model (which waited for an actual trigger event), Ind AS 109's ECL model requires recognising expected credit losses based on forward-looking information from the very start — a fundamental shift increasing the timeliness of loss recognition.

3. Worked Illustration

Illustration 3.1 — Amortised Cost using EIR

A company issues a bond with a Face Value of ₹10,00,000 for ₹9,50,000 (at a discount), bearing a nominal coupon of 8% p.a. payable annually. The Effective Interest Rate (EIR), given the discount, works out to approximately 9%.

Step 1 — Interest Income/Expense for Year 1 (at EIR): Opening Amortised Cost × EIR = 9,50,000 × 9% = **₹85,500**

Step 2 — Actual Coupon Paid (at nominal rate): 10,00,000 × 8% = **₹80,000**

Step 3 — Amortisation of Discount for Year 1: EIR-based interest − Actual coupon = 85,500 − 80,000 = **₹5,500**

Step 4 — Closing Amortised Cost: 9,50,000 + 5,500 = **₹9,55,500**

The bond's carrying (amortised cost) value increases from ₹9,50,000 to ₹9,55,500 over Year 1, as the initial discount of ₹50,000 is gradually amortised (unwound) over the bond's life using the effective interest rate of 9%.

4. Practice MCQs (15 × 2 Marks)

Q1. A debt instrument held under a "hold to collect" business model with SPPI cash flows is classified at:

A. Fair Value through Profit or Loss (FVTPL)
B. Amortised Cost
C. Fair Value through OCI (FVTOCI) always
D. Historical cost, unadjusted

Answer: B

Instruments held solely to collect contractual cash flows (principal + interest) are measured at Amortised Cost under Ind AS 109.

Q2. The Effective Interest Rate (EIR) is defined as the rate that:

A. Equals the nominal coupon rate always
B. Exactly discounts estimated future cash flows over the expected life to the instrument's initial carrying amount
C. Is set arbitrarily by management
D. Is always higher than the market rate

Answer: B

EIR is the internal-rate-of-return-style rate that equates the present value of future cash flows to the initial carrying amount of the instrument.

Q3. Ind AS 109's Expected Credit Loss (ECL) model differs from the old "incurred loss" model because ECL:

A. Only recognises losses after an actual default has occurred
B. Recognises expected losses based on forward-looking information from the outset, before an actual loss event occurs
C. Never requires any provision for credit losses
D. Applies only to equity instruments

Answer: B

ECL is a forward-looking model, requiring earlier recognition of expected losses compared to the reactive, trigger-based "incurred loss" approach.

Q4. In a compound financial instrument (e.g., a convertible debenture), the Equity Component is calculated as:

A. The full face value of the instrument
B. Total proceeds received minus the Liability Component (as a residual value)
C. The market interest rate on similar debt
D. Always zero

Answer: B

Split accounting values the liability component first (as the PV of cash flows at the market rate for a non-convertible instrument), with the equity component being the residual.

Q5. If a bond is issued at a discount to its face value, the Effective Interest Rate compared to the nominal coupon rate will be:

A. Lower than the nominal rate
B. Higher than the nominal rate
C. Exactly equal to the nominal rate
D. Always zero

Answer: B

Since the issuer receives less than face value but repays the full face value plus coupons, the effective yield (EIR) exceeds the stated nominal coupon rate.

Q6. "12-month ECL" is applied when a financial asset is in which stage under the Ind AS 109 impairment model?

A. Stage 1 — no significant increase in credit risk since initial recognition
B. Stage 3 — the asset is already credit-impaired
C. Only after the asset has already defaulted
D. Never applied under Ind AS 109

Answer: A

12-month ECL is the default measurement basis at initial recognition (Stage 1), before any significant deterioration in credit quality.

Q7. ECL is calculated using the formula:

A. PD + LGD + EAD
B. PD × LGD × EAD
C. PD / LGD / EAD
D. EAD − PD − LGD

Answer: B

Expected Credit Loss combines Probability of Default, Loss Given Default, and Exposure at Default multiplicatively.

Q8. Equity investments (other than in subsidiaries/associates/JVs) are, by default, measured under Ind AS 109 at:

A. Amortised Cost
B. Fair Value through Profit or Loss (FVTPL), unless an irrevocable FVTOCI election is made
C. Historical cost, never remeasured
D. Always at par value

Answer: B

Equity investments generally do not qualify for amortised cost (they lack SPPI cash flows) and default to FVTPL unless the entity elects FVTOCI at initial recognition.

Q9. Once a financial asset is credit-impaired (Stage 3), interest income is calculated on:

A. The gross carrying amount, ignoring impairment
B. The net carrying amount (amortised cost, after deducting the loss allowance)
C. The original face value only
D. Zero — no interest is ever recognised

Answer: B

Once credit-impaired, effective interest is calculated by applying the EIR to the net (amortised cost) carrying amount, i.e., after deducting the loss allowance.

Q10. Ind AS 32 is primarily concerned with the:

A. Recognition and measurement of financial instruments
B. Presentation of financial instruments (e.g., classification as liability vs equity)
C. Disclosure requirements only for banks
D. Tax treatment of financial instruments

Answer: B

Ind AS 32 governs how financial instruments are presented/classified (liability vs equity), while Ind AS 109 covers recognition and measurement.

Q11. If interest income calculated at EIR exceeds the actual coupon received, the difference represents:

A. A cash payment to the issuer
B. Amortisation of a discount, increasing the carrying (amortised cost) value of the instrument
C. An immediate impairment loss
D. A reduction in the face value of the instrument

Answer: B

The excess of EIR-based interest income over the cash coupon received represents the unwinding/amortisation of the original discount, added to the carrying value.

Q12. A financial asset held under a "hold to collect and sell" business model, with SPPI cash flows, is measured at:

A. Amortised Cost

B. Fair Value through Other Comprehensive Income (FVTOCI)
C. Fair Value through Profit or Loss (FVTPL)
D. Historical cost only

Answer: B

This mixed business model (both collecting cash flows and potentially selling) with SPPI-qualifying cash flows leads to FVTOCI classification.

Q13. "SPPI" in the context of Ind AS 109 stands for:

A. Standard Price Per Instrument
B. Solely Payments of Principal and Interest
C. Systematic Portfolio Performance Index
D. Special Purpose Public Investment

Answer: B

The SPPI test checks whether contractual cash flows represent solely payments of principal and interest on the principal outstanding — a key classification criterion.

Q14. Loss Given Default (LGD), a component of the ECL formula, represents:

A. The total exposure amount at the time of default
B. The proportion of the exposure the lender expects to lose if default occurs, after considering recoveries (e.g., from collateral)
C. The probability that a default will occur at all
D. The interest rate charged on the loan

Answer: B

LGD captures the expected severity of loss (net of recoveries) in the event that a default actually happens.

Q15. Split accounting for a compound instrument (e.g., convertible bond) is required because it:

A. Contains both a liability (debt) component and an equity (conversion option) component that must be presented separately
B. Is always classified fully as equity
C. Is always classified fully as a liability
D. Has no financial substance and can be ignored

Answer: A

A compound instrument's economic substance includes both a debt obligation and an equity-like conversion feature, requiring separate presentation of each component.

MODULE 4 · SECTION B

NBFCs — Provisioning Norms, Accounting & Reporting

Non-Banking Financial Company (NBFC) asset classification, RBI-prescribed provisioning norms, and Capital Adequacy (CRAR) requirements.

1. Formulas

Asset Classification (NPA Categories)

Standard Asset → Sub-Standard Asset (overdue > specified period, typically >90 days for NBFC-ND-SI/deposit-taking) → Doubtful Asset (remains sub-standard beyond a further specified period) → Loss Asset (identified as uncollectible)

Provisioning requirements escalate significantly as an asset moves down this classification chain, reflecting increasing risk of non-recovery.

Provisioning Norms (illustrative RBI-prescribed rates)

Standard Assets: 0.25%–0.40% (varies by asset category)
Sub-Standard Assets: 10% of outstanding amount
Doubtful Assets: 20%/30%/50%/100% of the secured/unsecured portion, depending on the period doubtful
Loss Assets: 100% (entire asset written off/fully provided)

Actual rates are periodically revised by RBI Master Directions — always verify against the CURRENT applicable circular for exam purposes.

Capital to Risk-Weighted Assets Ratio (CRAR)

$$\text{CRAR} = (\text{Tier I Capital} + \text{Tier II Capital}) / \text{Total Risk-Weighted Assets} \times 100$$

RBI mandates a minimum CRAR for NBFCs (the specific minimum percentage varies by NBFC category and is periodically revised) — a key solvency/capital adequacy metric.

Provision on Doubtful Assets — Secured vs Unsecured Split

Total Provision = (100% of Unsecured Portion) + (Applicable % of Secured Portion, based on how long the asset has been doubtful)

The unsecured portion of a doubtful asset is provided for in FULL, regardless of how long it has been doubtful; only the secured portion gets graduated provisioning rates.

2. Practical Application

Why NBFC provisioning matters for financial reporting: Since NBFCs' core business is lending, the adequacy of provisions directly determines reported profit and net worth — under-provisioning can materially overstate an NBFC's financial health, a key area of regulatory and audit scrutiny.

Ind AS ECL vs RBI provisioning norms: NBFCs applying Ind AS must compute provisions under the Ind AS 109 ECL model; however, RBI also prescribes minimum regulatory provisioning — where RBI norms require HIGHER provisioning than ECL, the NBFC must maintain the higher of the two (transferred to a separate "Impairment Reserve" if ECL provision is lower).

CRAR as an early warning indicator: A declining CRAR trend signals eroding capital buffers relative to risk-weighted exposure — regulators use CRAR breaches as a trigger for corrective action, similar to how Altman's Z-Score flags corporate distress.

3. Worked Illustration

Illustration 4.1 — NBFC Provisioning on Asset Classification

An NBFC's loan portfolio (₹ in lakh): Standard Assets ₹800 (provisioning rate 0.40%); Sub-Standard Assets ₹50 (rate 10%); Doubtful Assets (Secured portion) ₹30, doubtful for <1 year (rate 20%); Doubtful Assets (Unsecured portion) ₹10 (rate 100%); Loss Assets ₹5 (rate 100%).

Step 1 — Provision on Standard Assets: 800 × 0.40% = ₹3.20 lakh

Step 2 — Provision on Sub-Standard Assets: 50 × 10% = ₹5.00 lakh

Step 3 — Provision on Doubtful Assets (Secured portion): 30 × 20% = ₹6.00 lakh

Step 4 — Provision on Doubtful Assets (Unsecured portion): 10 × 100% = ₹10.00 lakh

Step 5 — Provision on Loss Assets: 5 × 100% = ₹5.00 lakh

Step 6 — Total Provision Required: 3.20 + 5.00 + 6.00 + 10.00 + 5.00 = **₹29.20 lakh**

Total provisioning of ₹29.20 lakh is required across the portfolio — note that the UNSECURED portion of the doubtful asset attracts a full 100% provision, regardless of how briefly it has been classified as doubtful, unlike the graduated rate applied to the secured portion.

4. Practice MCQs (15 × 2 Marks)

Q1. The asset classification categories for an NBFC's loan portfolio, in order of increasing risk, are:

A. Loss → Doubtful → Sub-Standard → Standard
B. Standard → Sub-Standard → Doubtful → Loss
C. Sub-Standard → Standard → Loss → Doubtful
D. All categories carry identical risk

Answer: B

Assets progressively deteriorate through these categories as their recoverability weakens, with provisioning requirements rising at each stage.

Q2. The UNSECURED portion of a Doubtful Asset requires provisioning of:

A. 10% only
B. 100%, in full, regardless of how long it has been doubtful
C. 0%, since it's unsecured
D. Exactly the same rate as the secured portion

Answer: B

Since there is no collateral backing, the unsecured portion of a doubtful asset must be fully (100%) provided for.

Q3. A Loss Asset, once identified, requires provisioning of:

A. 0%
B. 10%
C. 50%
D. 100% (fully written off or fully provided)

Answer: D

Loss assets are considered uncollectible and must be either written off entirely or fully provided for.

Q4. CRAR is calculated as:

A. (Tier I + Tier II Capital) / Total Risk-Weighted Assets × 100
B. Total Assets / Total Liabilities
C. Net Profit / Total Capital
D. Total Deposits / Total Loans

Answer: A

CRAR measures the adequacy of an NBFC's capital (Tier I + Tier II) relative to its risk-weighted exposure.

Q5. When RBI's prescribed regulatory provisioning norm is HIGHER than the Ind AS 109 ECL-based provision, an NBFC must:

A. Use only the lower ECL provision and ignore RBI norms
B. Maintain the higher regulatory provision, transferring the difference to an Impairment Reserve
C. Ignore both requirements entirely
D. Report negative provisions

Answer: B

NBFCs must comply with the more conservative (higher) of the two requirements, maintaining an Impairment Reserve for any shortfall in ECL relative to RBI norms.

Q6. A declining CRAR trend over successive periods is a signal that:

A. The NBFC's capital buffer is strengthening relative to its risk exposure
B. The NBFC's capital buffer is weakening relative to its risk-weighted exposure — an early warning sign
C. The NBFC has no loans outstanding
D. CRAR has no relevance to NBFC solvency

Answer: B

A falling CRAR indicates capital is not keeping pace with risk-weighted assets, a warning sign regulators monitor closely.

Q7. Standard Assets in an NBFC's portfolio typically require provisioning of approximately:

A. 0.25%–0.40% (a relatively small percentage, reflecting low risk)
B. 50%
C. 75%
D. 100%

Answer: A

Standard assets carry minimal credit risk, so provisioning rates are correspondingly low compared to sub-standard/doubtful/loss categories.

Q8. If a Sub-Standard Asset outstanding is ₹40 lakh and the prescribed provisioning rate is 10%, the provision required is:

A. ₹2 lakh
B. ₹4 lakh
C. ₹8 lakh
D. ₹40 lakh

Answer: B

Provision = 40 lakh × 10% = ₹4 lakh.

Q9. The graduated provisioning rates (e.g., 20%/30%/50%) for Doubtful Assets typically apply to:

A. The unsecured portion only
B. The SECURED portion, based on how long the asset has remained doubtful
C. Neither the secured nor unsecured portion
D. Only Standard Assets

Answer: B

The secured portion of a doubtful asset attracts graduated rates that increase the longer the asset remains doubtful; the unsecured portion is separately provided at 100%.

Q10. Why is under-provisioning by an NBFC a serious concern for financial reporting quality?

A. It has no impact on reported profit or net worth
B. It can materially overstate reported profit and net worth, masking the true credit risk in the loan book
C. It only affects the cash flow statement
D. It automatically improves the NBFC's credit rating

Answer: B

Insufficient provisioning understates expected losses, artificially inflating reported profitability and capital position — a key audit and regulatory concern.

Q11. Tier I Capital, for CRAR purposes, generally represents:

A. The NBFC's total loan book

B. Core capital — primarily equity capital and disclosed reserves, considered the highest-quality capital
C. Only short-term deposits
D. Contingent liabilities

Answer: B

Tier I is the core, highest-quality capital (equity and free reserves) able to absorb losses on an ongoing basis.

Q12. RBI's provisioning and CRAR norms for NBFCs are periodically revised primarily to:

A. Remain permanently fixed and never change
B. Reflect evolving risk assessment and maintain financial system stability
C. Increase NBFC profits artificially
D. Eliminate all regulatory oversight of NBFCs

Answer: B

Prudential norms are updated periodically by RBI to reflect the current risk environment and safeguard the stability of the financial system.

Q13. For exam purposes, provisioning rates and asset classification periods for NBFCs should be:

A. Assumed to never change from any textbook example
B. Verified against the CURRENT applicable RBI Master Direction, as these rates are periodically revised
C. Irrelevant to CFR exam questions
D. Always identical to banking sector norms

Answer: B

Since RBI periodically updates these norms, students should verify current applicable rates rather than relying on potentially outdated figures.

Q14. An asset classified as "doubtful" for MORE than a specified extended period (as per RBi norms) will attract:

A. A LOWER provisioning rate than when it was first classified doubtful
B. A HIGHER (graduated) provisioning rate on the secured portion, reflecting increasing doubt about recovery
C. No provisioning at all
D. Automatic reclassification as a Standard Asset

Answer: B

The longer an asset remains doubtful, the higher the prescribed provisioning rate on its secured portion, reflecting diminishing prospects of recovery over time.

Q15. NBFCs became subject to Ind AS-based financial reporting requirements starting from:

A. A phased implementation date specified by MCA/RBI (in a manner similar to other Ind AS roadmap phases)
B. NBFCs have never been required to follow Ind AS
C. From the very first year of Ind AS introduction in India, with no phasing
D. Only after complete privatisation of all NBFCs

Answer: A

Like other sectors, NBFCs were brought under Ind AS through a phased roadmap notified by the regulators, rather than all at once.

SECTION C

Business Combinations & Restructuring

Weightage: 20% of total marks | Module 5

MODULE 5 · SECTION C

Accounting for Business Combinations & Restructuring (Ind AS 103)

The acquisition method under Ind AS 103 — purchase consideration, goodwill/bargain purchase, non-controlling interest measurement, and business combinations under common control.

1. Formulas

Purchase Consideration (Fair Value of Consideration Transferred)

Purchase Consideration = Fair Value of Cash Paid + Fair Value of Equity Instruments Issued + Fair Value of Contingent Consideration (at acquisition date)

Acquisition-related costs (legal, advisory fees) are EXPENSED as incurred — they are NOT included in the purchase consideration or added to goodwill.

Goodwill on Acquisition

Goodwill = Purchase Consideration + Fair Value of Non-Controlling Interest (NCI) − Fair Value of Identifiable Net Assets Acquired

If the result is negative, it is NOT "negative goodwill" but a "Gain on Bargain Purchase," recognised directly in Profit or Loss on the acquisition date.

Non-Controlling Interest (NCI) — Two Measurement Options

Option 1 (Proportionate Method): NCI = NCI% × Fair Value of Identifiable Net Assets Acquired
Option 2 (Fair Value / "Full Goodwill" Method): NCI = Fair Value of NCI's Shareholding (often based on quoted price or a valuation)

The choice is made on an acquisition-by-acquisition basis. The Fair Value method results in HIGHER total goodwill being recognised (since it includes goodwill attributable to the NCI too).

Fair Value of Identifiable Net Assets Acquired

FV of Identifiable Net Assets = FV of Identifiable Assets Acquired (including newly recognised intangibles) − FV of Liabilities Assumed (including contingent liabilities meeting recognition criteria)

Assets/liabilities are recognised and measured at their acquisition-date FAIR VALUES, not the acquiree's previous book values — this often surfaces intangibles (brands, customer lists) not previously recognised on the acquiree's own books.

Step Acquisition (Business Combination Achieved in Stages)

Goodwill = [Fair Value of Previously-Held Equity Interest (remeasured) + Fair Value of New Consideration Paid + FV of NCI] − FV of Identifiable Net Assets

Any previously held equity interest is REMEASURED to fair value at the date control is obtained, with the resulting gain/loss recognised in P&L.

2. Practical Application

Acquisition-related costs — a common exam trap: Legal fees, due diligence costs, and advisory fees related to the acquisition are expensed in P&L as incurred — they must NOT be added to the purchase consideration or capitalised into goodwill, unlike costs of issuing debt/equity instruments (which follow their respective standards).

Choosing the NCI measurement option: The Fair Value (full goodwill) method is more common when NCI shares are actively traded (giving a reliable fair value) or when a "full" picture of total goodwill (including NCI's share) is desired for reporting purposes; the Proportionate method is simpler and often used for wholly-owned or near-wholly-owned subsidiaries.

Business Combinations under Common Control (Appendix C, Ind AS 103): These are SCOPED OUT of the standard acquisition method — instead, the "pooling of interests" method is typically applied (assets/liabilities recorded at existing book values, no new goodwill recognised), since these are essentially internal group reorganisations, not third-party acquisitions.

3. Worked Illustration

Illustration 5.1 — Goodwill on Acquisition (Proportionate NCI Method)

Acquirer purchases 80% of Target for a Purchase Consideration of ₹90,00,000. Target's identifiable net assets at fair value on the acquisition date = ₹1,00,00,000. NCI is measured using the Proportionate Method.

Step 1 — NCI (Proportionate Method): NCI = 20% × 1,00,00,000 = **₹20,00,000**

Step 2 — Apply the Goodwill formula: Goodwill = Purchase Consideration + NCI − FV of Identifiable Net Assets
= 90,00,000 + 20,00,000 − 1,00,00,000

Step 3 — Compute Goodwill: = 1,10,00,000 − 1,00,00,000 = **₹10,00,000**

Goodwill of ₹10,00,000 is recognised on consolidation, representing the excess the Acquirer paid (proportionately, for its 80% stake) over its share of the fair value of Target's identifiable net assets.

4. Practice MCQs (15 × 2 Marks)

Q1. Under Ind AS 103, acquisition-related costs (legal fees, due diligence costs) should be:

A. Added to the purchase consideration
B. Expensed in Profit or Loss as incurred
C. Capitalised as part of goodwill
D. Deducted from the Non-Controlling Interest

Answer: B

Ind AS 103 specifically requires acquisition-related costs to be expensed as incurred, not included in the consideration or goodwill calculation.

Q2. If the Fair Value of Identifiable Net Assets Acquired exceeds Purchase Consideration plus NCI, the result is:

A. Goodwill, recognised as an intangible asset
B. A Gain on Bargain Purchase, recognised in Profit or Loss
C. A reduction in share capital
D. Negative Retained Earnings

Answer: B

A negative "goodwill" result under Ind AS 103 is termed a Gain on Bargain Purchase and taken directly to P&L, not capitalised as an asset.

Q3. Under the Fair Value (full goodwill) method of measuring NCI, compared to the Proportionate method, total Goodwill recognised will generally be:

A. Lower
B. Higher, since it includes goodwill attributable to the NCI's share as well
C. Exactly the same
D. Always zero

Answer: B

The Fair Value method captures goodwill attributable to BOTH the controlling and non-controlling interests, resulting in higher total goodwill than the Proportionate method.

Q4. In a step acquisition, any equity interest previously held by the Acquirer before obtaining control is:

A. Ignored entirely
B. Remeasured to fair value at the date control is obtained, with the gain/loss recognised in P&L
C. Kept at its original historical cost
D. Automatically written off to zero

Answer: B

Step acquisitions require the previously-held stake to be remeasured to fair value at the control date, recognising any resulting gain or loss in profit or loss.

Q5. Business Combinations under Common Control (Appendix C, Ind AS 103) are typically accounted for using:

A. The standard acquisition method, with full fair valuation and new goodwill
B. The "pooling of interests" method, using existing book values with no new goodwill
C. Liquidation accounting
D. No accounting entries at all

Answer: B

Since common control transactions are essentially internal reorganisations (not genuine third-party acquisitions), pooling of interests (book value) accounting is applied instead of the acquisition method.

Q6. Identifiable assets acquired in a business combination are measured at:

A. The acquiree's original historical cost
B. Their acquisition-date fair values
C. Zero
D. Book value as per the acquiree's last audited financial statements, unadjusted

Answer: B

Ind AS 103 requires identifiable assets and liabilities to be measured at their fair values as of the acquisition date, not at historical book values.

Q7. If Purchase Consideration = ₹60,00,000, NCI (Proportionate) = ₹15,00,000, and Fair Value of Identifiable Net Assets = ₹70,00,000, Goodwill/Bargain Purchase is:

A. Goodwill of ₹5,00,000
B. Gain on Bargain Purchase of ₹5,00,000
C. Goodwill of ₹10,00,000
D. No goodwill or bargain purchase gain

Answer: B

60,00,000 + 15,00,000 − 70,00,000 = 5,00,000 (negative goodwill), recognised as a ₹5,00,000 Gain on Bargain Purchase in P&L.

Q8. Contingent consideration in a business combination is measured, at the acquisition date, at:

A. Zero, since it is uncertain
B. Its fair value at the acquisition date
C. Its maximum possible future payout, undiscounted
D. Its minimum possible future payout only

Answer: B

Even though contingent, the consideration is measured and included in the purchase price at its acquisition-date fair value, based on the probability-weighted likely outcomes.

Q9. The choice between the Proportionate Method and the Fair Value Method for measuring NCI is made:

A. Once, for the entity as a whole, applying to all future acquisitions
B. On an acquisition-by-acquisition basis
C. Only by the acquiree, never the acquirer
D. It is not a choice; only one method is permitted

Answer: B

Ind AS 103 permits the entity to choose either method separately for each individual business combination transaction.

Q10. Under Ind AS 103, newly recognised intangible assets (e.g., a customer list not previously on the acquiree's books) arise because:

A. Fair value measurement at acquisition can identify and value intangibles the acquiree never recognised under its own accounting policies
B. All intangibles must always be assigned a value of zero
C. Only tangible assets can ever be recognised in a business combination
D. Intangibles are always ignored in a business combination

Answer: A

The acquisition method's fair value focus often surfaces internally-generated intangibles (which the acquiree couldn't recognise under its own accounting rules) as separately identifiable assets.

Q11. If an Acquirer sells part of its holding in a Subsidiary but RETAINS control, this is accounted for as:

A. A disposal resulting in a gain/loss in P&L, similar to selling any other asset
B. An equity transaction between owners (adjusting NCI and equity), with no gain/loss in P&L
C. A full deconsolidation of the subsidiary
D. Recognition of new goodwill

Answer: B

Since control is retained, this is treated purely as a transaction between owners (adjusting the NCI and parent's equity), not as a disposal generating a P&L gain/loss.

Q12. If a Parent sells its ENTIRE holding in a Subsidiary, resulting in LOSS of control, this is accounted for by:

A. Continuing to consolidate the subsidiary as before
B. Derecognising the subsidiary's assets/liabilities/NCI and recognising a gain/loss on disposal in P&L
C. Ignoring the transaction entirely
D. Treating it as a pure equity transaction with no P&L impact

Answer: B

Loss of control triggers full derecognition of the subsidiary's net assets and NCI, with any resulting difference (compared to consideration received plus fair value of any retained interest) recognised as a gain/loss in P&L.

Q13. Under Ind AS 103, the "acquisition date" is defined as:

A. The date the acquirer first expressed interest in the target
B. The date the acquirer obtains control of the acquiree
C. The date the deal is publicly announced in the media
D. The date the acquiree's financial year ends

Answer: B

The acquisition date — when control is legally/effectively obtained — is the reference date for measuring fair values and calculating goodwill.

Q14. A key difference between Ind AS 103 and the old AS 14 (Accounting for Amalgamations) is that Ind AS 103:

A. Uses only book values, never fair values
B. Consistently applies the acquisition method with fair valuation of identifiable net assets, unlike AS 14's pooling-of-interest option for certain amalgamations
C. Prohibits any goodwill recognition whatsoever
D. Applies only to government entities

Answer: B

Ind AS 103 mandates the acquisition (fair value) method for most business combinations, a significant shift from AS 14's broader use of pooling-of-interests for certain amalgamation types.

Q15. Goodwill recognised on a business combination is subsequently:

A. Amortised over a fixed useful life, like other intangibles
B. Tested annually for impairment, and NOT amortised, under Ind AS
C. Written off immediately in full at the end of the acquisition year
D. Revalued upward every year automatically

Answer: B

Under Ind AS (consistent with Ind AS 36), goodwill is not amortised but is subject to mandatory annual impairment testing.

SECTION D

Consolidated & Separate Financial Statements

Weightage: 20% of total marks | Module 6

MODULE 6 · SECTION D

Consolidated & Separate Financial Statements (Ind AS 110, 111, 28, 27)

Consolidation mechanics for subsidiaries (Ind AS 110), joint arrangements (Ind AS 111), the equity method for associates (Ind AS 28), and separate financial statements (Ind AS 27).

1. Formulas

Goodwill on Consolidation (at acquisition)

`Goodwill = Cost of Investment (by Parent) + Fair Value of NCI − Parent's Share of Fair Value of Subsidiary's Identifiable Net Assets at Acquisition`

This is computed once, at the date the Parent acquires control, and (subject to impairment) carried forward in the Consolidated Balance Sheet.

Non-Controlling Interest (NCI) — at Reporting Date

`NCI (at reporting date) = NCI's Share of Subsidiary's Net Assets at Acquisition + NCI's Share of Subsidiary's Post-Acquisition Profits (or Losses) − NCI's Share of any Dividends Paid by Subsidiary`

NCI is presented within Equity in the Consolidated Balance Sheet, separately from the Parent's own equity.

Consolidated Retained Earnings / Reserves

`Consolidated Reserves = Parent's Own Reserves + Parent's Share of Subsidiary's Post-Acquisition Profits − Unrealised Profit on Intra-Group Transactions (to the extent of Parent's holding) − Consolidation Adjustments (e.g., additional depreciation on fair value uplift)`

Only POST-acquisition profits of the subsidiary are added; PRE-acquisition profits form part of the goodwill calculation, not consolidated reserves.

Unrealised Profit on Intra-Group (Inventory) Transactions

`Unrealised Profit = Closing Inventory (at transfer price) × [Profit Margin / (100 + Profit Margin)] (if margin is on cost)  OR  × Profit Margin % (if margin is on selling price)`

This unrealised profit must be eliminated from both consolidated inventory (asset) and consolidated reserves, since the group hasn't sold the goods to an outside party yet.

Equity Method — Associates (Ind AS 28)

`Carrying Amount of Investment = Cost of Investment + Investor's Share of Post-Acquisition Profit/Loss of Associate − Dividends Received from Associate`

Unlike full consolidation (line-by-line), the equity method shows the investment as a SINGLE LINE in the Investor's balance sheet, adjusted each period for its share of the associate's results.

Joint Venture — Ind AS 111 (Equity Method)

`Same mechanics as the Equity Method for Associates: Carrying Amount = Cost + Share of Post-Acquisition Profit/Loss − Dividends Received`

Ind AS 111 requires JOINT VENTURES to use the equity method (unlike some older GAAPs which permitted proportionate consolidation) — only a "Joint Operation" (not a Joint Venture) uses direct proportionate recognition of assets/liabilities/income/expenses.

2. Practical Application

Full consolidation vs equity method — the key distinction: A Subsidiary (control, generally >50% voting power or otherwise controlled) is fully consolidated line-by-line; an Associate (significant influence, typically 20-50%) uses the equity method (single-line investment); a Joint Venture (joint control) also uses the equity method under Ind AS 111.

Why unrealised profit elimination matters: If a Parent sells goods to its Subsidiary at a profit, and the Subsidiary hasn't yet sold those goods outside the group, the group as a WHOLE hasn't earned that profit yet — failing to eliminate it would overstate consolidated profit and inventory.

Uniform accounting policies: Ind AS 110 requires the Parent to adjust the Subsidiary's financial statements to align with the Group's accounting policies BEFORE consolidation, if the Subsidiary uses different policies for similar transactions — a frequently tested adjustment.

3. Worked Illustrations

Illustration 6.1 — Goodwill & NCI on Consolidation

Parent acquires 75% of Subsidiary for ₹45,00,000 on 1 April. At that date, Subsidiary's identifiable net assets (fair value) = ₹50,00,000. NCI is measured at its proportionate share of net assets. By the reporting date, Subsidiary has earned post-acquisition profit of ₹8,00,000 (no dividends paid).

Step 1 — NCI at Acquisition (Proportionate): 25% × 50,00,000 = **₹12,50,000**

Step 2 — Goodwill: Cost of Investment + NCI − FV of Net Assets = 45,00,000 + 12,50,000 − 50,00,000 = **₹7,50,000**

Step 3 — NCI's share of post-acquisition profit: 25% × 8,00,000 = **₹2,00,000**

Step 4 — NCI at Reporting Date: 12,50,000 + 2,00,000 = **₹14,50,000**

Step 5 — Parent's share of post-acquisition profit added to Consolidated Reserves: 75% × 8,00,000 = **₹6,00,000** (added to Parent's own reserves in the Consolidated Balance Sheet)

Goodwill of ₹7,50,000 is carried in the Consolidated Balance Sheet (subject to impairment testing); NCI is presented within equity at ₹14,50,000, having grown from its initial ₹12,50,000 by its 25% share of the Subsidiary's post-acquisition profits.

Illustration 6.2 — Unrealised Profit on Intra-Group Inventory

Parent sold goods to its Subsidiary during the year at a price of ₹12,00,000, including a profit margin of 20% on cost. At the reporting date, the Subsidiary still holds 25% of these goods in its closing inventory.

Step 1 — Closing inventory (at transfer price) still held: 25% × 12,00,000 = ₹3,00,000

Step 2 — Unrealised profit margin (20% on cost, so profit = 20/120 of the transfer price): 3,00,000 × (20/120) = **₹50,000**

₹50,000 of unrealised profit must be eliminated: reduce Consolidated Inventory by ₹50,000 and reduce Consolidated Reserves (Parent's share, since Parent made the sale) by ₹50,000 — the group has not yet earned this profit as the goods remain unsold outside the group.

4. Practice MCQs (15 × 2 Marks)

Q1. Under Ind AS 28, an Associate is defined as an entity over which the investor has:

A. Control
B. Significant influence (typically 20%-50% voting power), but not control
C. No relationship at all
D. Joint control shared equally with one other party

Answer: B

Significant influence (the ability to participate in financial/operating policy decisions, without controlling those policies) characterises an Associate relationship.

Q2. Under Ind AS 111, a Joint Venture is accounted for using:

A. Full line-by-line consolidation, as with a subsidiary
B. The Equity Method
C. Proportionate consolidation of assets/liabilities
D. No accounting recognition at all

Answer: B

Ind AS 111 mandates the equity method for Joint Ventures, a departure from proportionate consolidation permitted under some earlier GAAPs.

Q3. Pre-acquisition profits of a subsidiary are:

A. Added to Consolidated Reserves in full
B. Factored into the Goodwill calculation (as part of net assets at acquisition), NOT added to consolidated reserves
C. Ignored entirely
D. Distributed as dividends automatically

Answer: B

Since pre-acquisition profits form part of the subsidiary's net assets AT acquisition, they factor into the goodwill computation, not into post-acquisition consolidated reserves.

Q4. Unrealised profit on intra-group inventory transactions must be eliminated because:

A. The group as a whole has not yet earned that profit from an external party
B. Tax authorities require it
C. It has no impact on the consolidated financial statements
D. It only affects the subsidiary's separate financial statements

Answer: A

From the group's perspective, profit is only realised when goods are sold outside the group — unrealised intra-group profit must be eliminated on consolidation.

Q5. Under the Equity Method (Ind AS 28), the Investor's Balance Sheet shows the investment in the Associate as:

A. A line-by-line breakdown of all the associate's assets and liabilities
B. A single-line item, adjusted periodically for the investor's share of the associate's profit/loss
C. At original cost only, never adjusted
D. As a current liability

Answer: B

Unlike full consolidation, the equity method shows the investment as one line, with its carrying amount adjusted for the investor's share of the associate's subsequent results.

Q6. Non-Controlling Interest (NCI) is presented in the Consolidated Balance Sheet as:

A. A liability
B. A separate component within Equity
C. A contra-asset
D. It is not presented anywhere

Answer: B

Ind AS 110 requires NCI to be presented within equity, separately from the equity attributable to the Parent's owners.

Q7. Ind AS 110 requires the Parent to adjust a Subsidiary's financial statements, prior to consolidation, when:

A. The Subsidiary is 100% owned
B. The Subsidiary uses different accounting policies from the Group for similar transactions
C. The Subsidiary is located in the same city as the Parent
D. Never — no adjustments are ever required

Answer: B

Consolidation requires uniform group accounting policies; if the subsidiary's policies differ, adjustments must be made before consolidating.

Q8. A "Joint Operation" (as distinct from a "Joint Venture") under Ind AS 111 is accounted for by each operator recognising:

A. A single-line equity-method investment
B. Its own share of the assets, liabilities, revenues, and expenses of the joint operation directly (proportionate recognition)
C. Nothing at all
D. Full consolidation of the entire joint operation

Answer: B

Unlike a Joint Venture (equity method), a Joint Operator directly recognises its own proportionate share of the underlying assets, liabilities, revenues, and expenses.

Q9. If Cost of Investment = ₹30,00,000, NCI (proportionate) = ₹10,00,000, and FV of Subsidiary's Net Assets at acquisition = ₹35,00,000, Goodwill is:

A. ₹5,00,000
B. ₹10,00,000
C. ₹15,00,000
D. Nil, since it's a bargain purchase of ₹5,00,000

Answer: A

Goodwill = 30,00,000 + 10,00,000 − 35,00,000 = ₹5,00,000 (positive, so it IS goodwill, not a bargain purchase).

Q10. Ind AS 27 primarily governs:

A. Consolidated Financial Statements only
B. Separate Financial Statements of a Parent, Investor, or Venturer, prepared IN ADDITION to consolidated statements
C. Government Accounting
D. Segment reporting

Answer: B

Ind AS 27 sets out the accounting requirements for an entity's own Separate Financial Statements, where investments in subsidiaries/associates/JVs are accounted for at cost, in accordance with Ind AS 109, or using the equity method.

Q11. If a Subsidiary pays a dividend during the year, the Parent's Consolidated Reserves are affected by:

A. Adding the full dividend amount to consolidated reserves
B. Eliminating the intra-group dividend received by the Parent (since it's an internal group transaction), and reducing NCI for its share of the dividend paid
C. No effect at all on consolidation
D. Doubling the dividend for consolidation purposes

Answer: B

Dividends paid by a subsidiary to its parent are intra-group transactions eliminated on consolidation; the NCI's share of the dividend reduces the NCI balance.

Q12. Significant Influence, for the purposes of Ind AS 28, is generally PRESUMED to exist when the investor holds:

A. Less than 5% of voting power
B. 20% or more of the voting power of the investee
C. Exactly 100% of voting power
D. No voting rights at all

Answer: B

A holding of 20% or more of voting power creates a rebuttable presumption of significant influence under Ind AS 28.

Q13. If an associate reports a LOSS for the year, the investor's Equity Method carrying amount of the investment is:

A. Increased by the investor's share of the loss
B. Decreased by the investor's share of the loss
C. Unaffected by the associate's results
D. Automatically written off to zero regardless of the loss amount

Answer: B

The equity method decreases the carrying amount of the investment by the investor's proportionate share of any losses reported by the associate.

Q14. Which of the following relationships would typically require FULL CONSOLIDATION under Ind AS 110?

A. A 15% shareholding with no board representation or other influence
B. A 65% shareholding giving the investor control over the investee's relevant activities
C. A 30% shareholding with significant influence but no control
D. A 50:50 joint venture with joint control

Answer: B

A majority shareholding giving control (the power to direct relevant activities and exposure to variable returns) triggers full consolidation as a subsidiary under Ind AS 110.

Q15. In the equity method, if the investor's cumulative share of an associate's losses exceeds the carrying amount of the investment, the investor generally:

A. Continues recognising further losses, creating a negative investment balance with no limit

B. Discontinues recognising further losses once the investment carrying amount reaches zero (unless it has incurred obligations or made payments on the associate's behalf)

C. Immediately consolidates the associate as a subsidiary instead

D. Reverses all previously recognised losses

Answer: B

Under the equity method, the investment carrying amount is generally not reduced below zero from recognising further losses, unless the investor has a legal/constructive obligation to fund the associate's losses.

SECTION E

Recent Developments in Financial Reporting

Weightage: 10% of total marks | Module 7

MODULE 7 · SECTION E

Recent Developments in Financial Reporting

Largely conceptual — Sustainability/ESG Reporting, Integrated Reporting, Fair Value Measurement (Ind AS 113), XBRL, and evolving corporate reporting trends beyond traditional financial statements.

1. Key Concepts & Applicable Formula

Concept	Exam-Relevant Point
Integrated Reporting (IR)	Combines financial and non-financial information (the "Six Capitals": Financial, Manufactured, Intellectual, Human, Social & Relationship, Natural) into a single concise report showing how the organisation creates value over time.
Sustainability Reporting	Discloses an entity's Environmental, Social, and Governance (ESG) performance — often following frameworks like GRI (Global Reporting Initiative) or, in India, the mandated Business Responsibility and Sustainability Report (BRSR) for top listed companies.
Triple Bottom Line (TBL) Reporting	Evaluates performance across three dimensions: People (social), Planet (environmental), and Profit (financial) — moving beyond purely financial profit as the sole success measure.
Corporate Social Responsibility (CSR) Reporting	Under the Companies Act, 2013, specified companies must spend at least 2% of average net profits (of the preceding 3 financial years) on CSR activities and report on it.
Fair Value Measurement (Ind AS 113)	Establishes a single framework for fair value measurement, including the 3-level Fair Value Hierarchy (Level 1: quoted prices; Level 2: observable inputs other than quoted prices; Level 3: unobservable inputs).
XBRL (eXtensible Business Reporting Language)	A structured, machine-readable digital "tagging" language for financial reporting, mandated by MCA for specified classes of companies filing with the Registrar of Companies — enables faster, more consistent data analysis by regulators/ analysts.
Business Responsibility Reporting	Disclosure of a company's initiatives on environmental, social, and governance fronts, now largely superseded/expanded by the more detailed BRSR framework for top listed entities in India.

CSR Spend Requirement (Companies Act, 2013, Section 135)

$$\text{Minimum CSR Spend} = 2\% \times \text{Average Net Profit of the company during the 3 immediately preceding financial years}$$

Applies to companies meeting specified thresholds of net worth, turnover, or net profit — any shortfall (beyond specified exceptions) must be transferred to a specified fund or an "Unspent CSR Account."

2. Practical Application

Why non-financial reporting matters increasingly: Investors, lenders, and regulators increasingly assess ESG/sustainability performance as a proxy for long-term risk and resilience — a company's non-financial disclosures can now materially influence its cost of capital and investor base (e.g., ESG-focused funds).

Fair Value Hierarchy and its exam relevance: Understanding WHICH level (1, 2, or 3) applies to a given asset/liability is frequently tested — e.g., actively traded equity shares (Level 1), most bonds valued using observable market yield curves (Level 2), and an early-stage startup investment valued using unobservable internal projections (Level 3).

XBRL's practical benefit: By tagging every financial statement line item with a standardised, machine-readable identifier, XBRL enables regulators to instantly compare and analyse filings across thousands of companies — a significant improvement over manually extracting data from PDF-format financial statements.

3. Illustrative Scenario

Illustration 7.1 — CSR Spend & Fair Value Hierarchy Classification

(a) A company's average net profit for the preceding 3 years is ₹40,00,00,000. (b) The company holds: (i) shares of a company listed on the NSE, (ii) a corporate bond valued using an observable market yield curve, and (iii) an investment in an unlisted early-stage startup valued using the company's own unobservable cash flow projections.

Step 1 — CSR Spend Requirement: 2% × 40,00,00,000 = **₹80,00,000** minimum required CSR spend for the year

Step 2 — Classify each investment in the Fair Value Hierarchy:
(i) NSE-listed shares → **Level 1** (quoted price in an active market)
(ii) Corporate bond (market yield curve) → **Level 2** (observable inputs, not a direct quoted price)
(iii) Unlisted startup (internal projections) → **Level 3** (unobservable inputs)

The company must spend at least ₹80,00,000 on CSR activities for the year, and must disclose its three investments applying the appropriate fair value hierarchy level to each — reflecting the differing degree of market observability behind each valuation.

4. Practice MCQs (15 × 2 Marks)

Q1. Integrated Reporting (IR) is built around the concept of:

A. Reporting only financial capital
B. The "Six Capitals" (Financial, Manufactured, Intellectual, Human, Social & Relationship, and Natural) showing how value is created over time
C. Reporting exclusively on tax compliance
D. Only reporting employee headcount

Answer: B

Integrated Reporting's central framework is the Six Capitals model, illustrating a holistic view of how an organisation creates and preserves value.

Q2. Under Section 135 of the Companies Act, 2013, the minimum CSR spend requirement for qualifying companies is:

A. 1% of average net profit of the preceding 3 years
B. 2% of average net profit of the preceding 3 years
C. 5% of average net profit of the preceding 3 years
D. 10% of current year's net profit

Answer: B

Section 135 mandates a minimum 2% of the average net profit of the three immediately preceding financial years to be spent on CSR.

Q3. Under the Ind AS 113 Fair Value Hierarchy, "Level 1" inputs are:

A. Unobservable inputs based purely on management's own assumptions
B. Quoted prices in active markets for identical assets or liabilities
C. Observable inputs other than quoted prices
D. There is no Level 1 in the hierarchy

Answer: B

Level 1 represents the highest-quality, most reliable fair value inputs — direct quoted prices in active markets.

Q4. Triple Bottom Line (TBL) reporting evaluates organisational performance across which three dimensions?

A. Sales, Marketing, and Finance
B. People, Planet, and Profit
C. Assets, Liabilities, and Equity
D. Revenue, Cost, and Tax

Answer: B

TBL expands the traditional profit-only view to include social (People) and environmental (Planet) performance alongside financial (Profit) results.

Q5. XBRL is best described as:

A. A physical paper-based filing format
B. A structured, machine-readable digital tagging language for financial reporting data
C. A type of audit opinion
D. A tax computation software

Answer: B

XBRL is a standardised digital language that "tags" each financial statement line item, enabling structured, machine-readable regulatory filings.

Q6. A corporate bond valued using an observable market yield curve (rather than a direct quoted price) would typically be classified under the Fair Value Hierarchy as:

A. Level 1
B. Level 2
C. Level 3
D. Outside the fair value hierarchy entirely

Answer: B

Since the valuation relies on OBSERVABLE inputs (a market yield curve) rather than a direct quote, it falls under Level 2 of the hierarchy.

Q7. An investment valued using an entity's own unobservable internal cash flow projections would be classified as:

A. Level 1
B. Level 2
C. Level 3
D. Not subject to fair value measurement at all

Answer: C

Level 3 applies when fair value must rely on unobservable inputs, such as an entity's own internal projections/assumptions.

Q8. In India, the Business Responsibility and Sustainability Report (BRSR) is mandated for:

A. All companies, regardless of size or listing status
B. The top listed companies (by market capitalisation), as specified by SEBI
C. Only government-owned entities
D. Only companies with no employees

Answer: B

SEBI has mandated BRSR reporting for the top listed companies by market capitalisation, as part of enhanced ESG disclosure requirements.

Q9. If a qualifying company's average net profit for the preceding 3 years is ₹25,00,00,000, its minimum CSR spend requirement is:

A. ₹25,00,000
B. ₹50,00,000
C. ₹1,25,00,000
D. ₹2,50,00,000

Answer: B

2% × 25,00,00,000 = ₹50,00,000.

Q10. Sustainability Reporting frameworks (e.g., GRI) primarily disclose:

A. Only quarterly profit figures
B. An entity's Environmental, Social, and Governance (ESG) performance
C. Only the company's tax payments
D. Only employee salary details

Answer: B

Sustainability reporting frameworks like GRI focus on comprehensive ESG performance disclosure, beyond pure financial metrics.

Q11. A key benefit of XBRL for regulators and analysts is that it:

A. Makes financial data harder to compare across companies
B. Enables fast, automated, and consistent extraction and comparison of financial data across many filings
C. Eliminates the need for any financial statements at all
D. Only works for a single company at a time, with no cross-company comparison possible

Answer: B

Standardised tagging allows automated tools to extract and compare data across thousands of company filings far more efficiently than manual review.

Q12. Integrated Reporting differs from traditional annual financial reporting mainly because it:

A. Reports ONLY on financial capital, ignoring everything else
B. Provides a concise, holistic view combining financial AND non-financial value drivers
C. Is legally required to be identical to the financial statements
D. Cannot be prepared by any listed company

Answer: B

Integrated Reporting aims for conciseness while capturing the full range of capitals/resources that drive an organisation's value creation, not just financial results.

Q13. Investors increasingly consider ESG/sustainability disclosures because they:

A. Have no bearing on investment risk or returns
B. Can serve as a proxy for long-term business risk and resilience, potentially affecting a company's cost of capital
C. Are purely a public relations exercise with no financial relevance
D. Are only relevant to government-owned companies

Answer: B

ESG performance is increasingly viewed by capital markets as material to long-term risk assessment, influencing investment decisions and cost of capital.

Q14. Unutilised/unspent CSR amounts (beyond specified exceptions), under the Companies Act framework, must be:

A. Simply retained as free cash with no further obligation
B. Transferred to a specified fund (e.g., a Schedule VII fund) or an "Unspent CSR Account," as prescribed
C. Distributed to shareholders as a dividend
D. Used to buy back company shares

Answer: B

The CSR framework requires unspent amounts (with limited exceptions for ongoing projects) to be transferred to prescribed funds or a designated Unspent CSR Account, ensuring compliance accountability.

Q15. The overarching theme connecting most "recent developments" in financial reporting (IR, sustainability reporting, XBRL) is:

A. A move away from any form of disclosure entirely
B. Expanding the scope, transparency, and usability of corporate reporting beyond traditional financial statements alone
C. Reducing all reporting requirements to a single line item
D. Eliminating audit requirements

Answer: B

These developments collectively reflect a broader trend toward richer, more transparent, and more usable/comparable corporate disclosure, going well beyond the traditional financial statement format alone.

SECTION F

Government Accounting in India

Weightage: 10% of total marks | Module 8

MODULE 8 · SECTION F

Government Accounting in India

Largely conceptual — the structure of government funds, the cash-basis system of government accounting, budgetary control, and the role of the Comptroller and Auditor General (CAG).

1. Key Concepts & Applicable Formula

Concept	Exam-Relevant Point
Consolidated Fund of India (CFI)	The principal government fund into which all revenues received and loans raised by the Government flow; all government expenditure is met from this fund, and withdrawals require Parliamentary authorisation (via an Appropriation Act).
Contingency Fund of India	A fund at the disposal of the President, used to meet unforeseen/urgent expenditure pending Parliamentary approval — amounts drawn are subsequently recouped from the Consolidated Fund once Parliament authorises the expenditure.
Public Account of India	Holds monies (e.g., provident fund balances, small savings) for which the Government acts merely as a banker/trustee — these do not belong to the Government and don't require Parliamentary appropriation for payments out.
Cash Basis of Accounting	Indian Government accounts are maintained substantially on a CASH basis (transactions recorded when cash is actually received/paid), unlike the accrual basis increasingly used in corporate/Ind AS reporting.
Appropriation Accounts	Compare actual expenditure (under each Grant/Appropriation) against the amounts authorised by Parliament through the Appropriation Act, highlighting excesses or savings.
Comptroller and Auditor General (CAG)	The constitutional authority (Article 148) responsible for auditing all receipts and expenditure of the Union and State Governments, ensuring accountability for public funds.
Finance Accounts	Present the complete financial position of the Government for the year, detailing receipts and disbursements across the Consolidated Fund, Contingency Fund, and Public Account.

Fiscal Deficit (Conceptual)

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Fiscal Deficit = Total Expenditure − Total Receipts (Revenue Receipts + Non-Debt Capital Receipts, EXCLUDING borrowings)
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Represents the government's total borrowing requirement for the year to bridge the gap between expenditure and non-borrowed receipts.

Revenue Deficit (Conceptual)

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Revenue Deficit = Total Revenue Expenditure − Total Revenue Receipts
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Indicates that the government's day-to-day operating expenses exceed its regular (non-capital) revenue — a sign of potential fiscal stress if persistent.

2. Practical Application

Cash vs Accrual — why this distinction matters for a CMA: Since government accounts are largely cash-based, they don't naturally capture accrued liabilities (e.g., pension obligations building up) or depreciation on government assets — this is a key limitation increasingly debated in public financial management reform discussions (a good exam discussion point).

Role of the Contingency Fund: The Contingency Fund allows the Government to meet genuinely URGENT, unforeseen expenditure WITHOUT waiting for prior Parliamentary approval — but the amount drawn must subsequently be recouped from the Consolidated Fund once Parliament sanctions the expenditure through a Supplementary Appropriation.

CAG's audit role vs statutory (company) audit: Unlike a statutory auditor's opinion on a private company's financial statements, the CAG's audit of government accounts focuses heavily on regularity (was spending properly authorised?), propriety (was it a wise use of public money?), and performance (did it achieve its intended objectives) — a broader mandate than typical financial statement audit.

3. Illustrative Scenario

Illustration 8.1 — Classifying Government Fund Transactions

Classify each of the following into the Consolidated Fund, Contingency Fund, or Public Account of India: (a) Income tax collections received by the Government; (b) An urgent, unforeseen disaster-relief expenditure sanctioned by the President pending Parliamentary approval; (c) Provident Fund contributions held on behalf of government employees.

(a) Income tax collections: These are regular government REVENUE receipts → form part of the **Consolidated Fund of India**

(b) Urgent disaster-relief expenditure (pending Parliamentary approval): Drawn from the **Contingency Fund of India**, to be recouped from the Consolidated Fund once Parliament formally sanctions it

(c) Provident Fund contributions (Government as trustee): These belong to the employees, not the Government → recorded in the **Public Account of India**

Each transaction is classified based on WHOSE money it fundamentally is and the URGENCY/authorisation status of the expenditure — a foundational distinction tested repeatedly in Government Accounting questions.

4. Practice MCQs (15 × 2 Marks)

Q1. All government revenue receipts and loans raised by the Government flow into the:

A. Contingency Fund of India
B. Consolidated Fund of India
C. Public Account of India
D. A private bank account of the Finance Minister

Answer: B

The Consolidated Fund of India is the principal fund receiving all government revenues and loan proceeds, from which most expenditure is authorised.

Q2. Withdrawal of money from the Consolidated Fund of India requires:

A. No approval of any kind
B. Parliamentary authorisation, typically via an Appropriation Act
C. Only the Finance Minister's personal signature
D. Approval from a private bank

Answer: B

Parliamentary sanction (through the Appropriation Act, following the Budget process) is constitutionally required before money can be withdrawn from the Consolidated Fund.

Q3. The Contingency Fund of India is used for:

A. Routine, planned annual expenditure
B. Urgent, unforeseen expenditure, pending subsequent Parliamentary approval
C. Employee provident fund balances
D. Foreign exchange reserves only

Answer: B

This fund exists specifically to enable the Government to respond to genuinely urgent, unforeseen needs without delay, with formal Parliamentary sanction following afterward.

Q4. Provident Fund balances of government employees are accounted for in the:

A. Consolidated Fund of India
B. Contingency Fund of India
C. Public Account of India, since the Government acts merely as a banker/trustee for this money
D. Not accounted for anywhere

Answer: C

Since these funds belong to the employees (not the Government), they sit in the Public Account, where the Government's role is custodial rather than as owner.

Q5. Indian Government accounts are maintained substantially on which basis of accounting?

A. Full accrual basis, identical to Ind AS-compliant corporate accounts
B. Cash basis — transactions recorded when cash is actually received or paid
C. A hybrid basis identical to IFRS
D. No consistent basis is followed

Answer: B

Indian government accounting remains substantially cash-based, a key distinction from the accrual-based corporate financial reporting covered elsewhere in this syllabus.

Q6. Appropriation Accounts compare:

A. Only revenue receipts against expenditure
B. Actual expenditure under each Grant against the amount authorised by Parliament
C. Two different companies' balance sheets
D. Import and export figures

Answer: B

Appropriation Accounts specifically track how actual spending compares to what Parliament sanctioned for each Grant/Appropriation, highlighting excesses or savings.

Q7. The Comptroller and Auditor General (CAG) of India derives authority from:

A. A private company's Articles of Association
B. Article 148 of the Constitution of India
C. The Companies Act, 2013 only
D. A State Government notification only

Answer: B

The CAG's constitutional mandate to audit government accounts is established under Article 148 of the Indian Constitution.

Q8. A key limitation of cash-based government accounting is that it:

A. Perfectly captures all accrued future liabilities like pension obligations
B. Does not naturally capture accrued liabilities or asset depreciation, unlike accrual accounting
C. Requires no auditing at all
D. Is identical to Ind AS in every respect

Answer: B

Since cash accounting only records actual cash flows, it misses non-cash items like accrued pension liabilities or depreciation — a recognised limitation prompting reform discussions.

Q9. Fiscal Deficit is calculated as:

A. Total Revenue Receipts − Total Revenue Expenditure
B. Total Expenditure − Total Receipts (excluding borrowings)
C. Total Assets − Total Liabilities
D. Capital Expenditure − Capital Receipts only

Answer: B

Fiscal Deficit measures the government's total borrowing requirement, being the gap between total expenditure and total non-borrowed receipts.

Q10. Revenue Deficit occurs when:

A. Total Revenue Receipts exceed Total Revenue Expenditure
B. Total Revenue Expenditure exceeds Total Revenue Receipts
C. Capital receipts exceed capital expenditure
D. There is no borrowing at all

Answer: B

A Revenue Deficit arises when day-to-day (revenue) expenditure exceeds regular (revenue) receipts, indicating the government is borrowing even to cover routine operating costs.

Q11. Amounts drawn from the Contingency Fund of India for urgent expenditure are subsequently:

A. Written off permanently with no further action
B. Recouped from the Consolidated Fund once Parliament grants formal (often supplementary) approval
C. Charged directly to the Public Account
D. Never repaid under any circumstances

Answer: B

The Contingency Fund is designed to be replenished — once Parliament sanctions the expenditure, an equivalent amount is transferred back from the Consolidated Fund.

Q12. The CAG's audit of government accounts, compared to a typical statutory company audit, has a BROADER mandate that also examines:

A. Only whether the financial statements are mathematically accurate
B. Regularity (proper authorisation), propriety (wise use of public money), and performance (achievement of objectives)
C. Only tax computation accuracy
D. Only the company's share price movement

Answer: B

CAG audits extend beyond financial accuracy to assess whether public expenditure was properly authorised, prudently used, and effective in achieving its stated goals.

Q13. Finance Accounts of the Government present the complete financial position covering:

A. Only the Consolidated Fund
B. Receipts and disbursements across the Consolidated Fund, Contingency Fund, and Public Account together
C. Only private sector companies' accounts
D. Only foreign exchange transactions

Answer: B

Finance Accounts provide a comprehensive view spanning all three government fund categories, not just the Consolidated Fund alone.

Q14. If a state disaster requires immediate, unbudgeted relief expenditure before Parliament can convene to approve it, the appropriate source of funds is:

A. The Public Account, since it holds trust monies
B. The Contingency Fund of India, specifically designed for such urgent, unforeseen situations
C. A private bank loan taken by the Finance Minister personally
D. No funding mechanism exists for such situations

Answer: B

This is precisely the scenario the Contingency Fund is designed for — urgent, unforeseen expenditure needs that cannot wait for prior Parliamentary sanction.

Q15. Ongoing public financial management reform discussions in India have increasingly explored moving toward:

A. Abandoning all forms of government accounting entirely
B. Greater elements of accrual-based accounting, to better capture the government's true financial position (including liabilities and asset consumption)
C. Eliminating the role of the CAG
D. Removing all Parliamentary oversight of government spending

Answer: B

Recognising the limitations of pure cash accounting, reform discussions have explored incorporating more accrual elements to give a fuller picture of government finances.