



THE INSTITUTE OF COST ACCOUNTANTS OF INDIA



CMA KNOWLEDGE PREMIUM REVISION SERIES



CMA FINAL I PAPER 18

Corporate Financial Reporting



Complete Master Revision Handbook

A comprehensive, exam-focused revision guide covering all 8 modules with full ICMAI illustrations, step-by-step solutions, formulas, journal entries, and examiner insights — designed for the December 2026 examination.

8

MODULES

100%

SYLLABUS

100+

ILLUSTRATIONS

500+

EXAM POINTS



December 2026 Edition



Based on ICMAI Study Material



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Master Table of Contents

Eight comprehensive modules covering the entire CMA Final Paper 18 syllabus with exam-focused content, illustrations, and revision notes.

Indian Accounting Standards

Ind AS 8, 12, 16, 116, 21, 23, 36, 38, 102, 108, 113, 115

- ✓ Accounting Policies, Changes in Estimates & Errors (Ind AS 8)
- ✓ Income Taxes (Ind AS 12)
- ✓ Property, Plant and Equipment (Ind AS 16)
- ✓ Leases (Ind AS 116)
- ✓ Foreign Exchange Rates (Ind AS 21)
- ✓ Borrowing Costs (Ind AS 23)
- ✓ Impairment of Assets (Ind AS 36)
- ✓ Intangible Assets (Ind AS 38)
- ✓ Share-based Payment (Ind AS 102)
- ✓ Operating Segments (Ind AS 108)
- ✓ Fair Value Measurement (Ind AS 113)
- ✓ Revenue from Contracts (Ind AS 115)

25% Weightage



Valuation of Shares

Goodwill, Post-Valuation of Tangible & Intangible Assets

- ✓ Introduction to Valuation of Shares
- ✓ Income Approach – DCF Model
- ✓ Dividend Discount Model
- ✓ Maintainable Profits Basis
- ✓ Yield-Basis Method (Profit & Dividend)
- ✓ Fair Value Method
- ✓ Net Assets Approach (Asset-Backing)
- ✓ Valuation of Goodwill
- ✓ Capitalisation Method
- ✓ Super Profits Method
- ✓ Annuity Method
- ✓ Market Approach (P/E, P/S, P/CFO)

 15% Weightage



Accounting of Financial Instruments

Ind AS 32, Ind AS 107, Ind AS 109

- ✓ Ind AS 32 – Financial Instruments: Presentation
- ✓ Financial Asset, Liability, Equity Definitions
- ✓ Puttable Instruments
- ✓ Offsetting Criteria
- ✓ Ind AS 107 – Disclosures
- ✓ Ind AS 109 – Recognition & Measurement
- ✓ Business Model & SPPI Test
- ✓ Amortised Cost, FVOCI, FVTPL
- ✓ Effective Interest Rate Method
- ✓ Expected Credit Loss Model
- ✓ Compound Financial Instruments
- ✓ Embedded Derivatives

 15% Weightage



NBFCs – Provisioning, Accounting & Reporting

RBI Regulations | Asset Classification | Provisioning Norms

- ✓ NBFC Concept & Definition (Sec. 45I(f))
- ✓ Classification of NBFCs
- ✓ Regulatory Approach & Prudential Norms
- ✓ Net Owned Fund (NOF) Requirements
- ✓ Public Funds Definition
- ✓ Asset Classification (Standard, Sub-standard, Doubtful, Loss)
- ✓ Non-Performing Asset (NPA) Classification
- ✓ Provisioning Norms
- ✓ Hire Purchase Asset Provisioning
- ✓ Income Recognition Principles
- ✓ Division III Schedule III Format
- ✓ Disclosure Requirements

 15% Weightage



Business Combination & Restructuring

Ind AS 103 | Acquisition Method | Pooling of Interest

- ✓ Introduction to Ind AS 103
- ✓ Accounting for Business Combination (Basic)
- ✓ Absorptions, Amalgamations, External Reconstruction
- ✓ Detailed Discussion on Business Combination
- ✓ Business Combination Achieved in Stages
- ✓ Reverse Acquisition
- ✓ Purchase/Sale of NCI without Loss of Control
- ✓ Sale of Holding Resulting in Loss of Control
- ✓ Business Combination under Common Control
- ✓ Disclosures
- ✓ Difference between Ind AS 103 and AS 14
- ✓ Internal Reconstruction (Capital Reduction)

 20% Weightage



Consolidated & Separate Financial Statements

Ind AS 27, 28, 110, 111, 112

- ✓ Introduction to Consolidation
- ✓ Significant Influence, Joint Control & Control
- ✓ Consolidation Procedure for Associates, JVs, Subsidiaries
- ✓ Measurement of Fair Value, NCI, Goodwill
- ✓ Consolidated Other Equity
- ✓ Accounting at Acquisition Date
- ✓ Accounting at Subsequent Reporting Date
- ✓ Chain Holding & Cross Holding
- ✓ Inter-company Adjustments
- ✓ Accounting and Reporting of Joint Operation
- ✓ Disclosures (Ind AS 112)

📊 20% Weightage



Recent Developments in Financial Reporting

Sustainability | ESG | Integrated Reporting | XBRL

- ✓ 4P Bottom Line Reporting
- ✓ Sustainability Reporting and GRI
- ✓ Business Responsibility and Sustainability Report
- ✓ Integrated Reporting
- ✓ Corporate Social Responsibility Reporting
- ✓ Environmental, Social and Governance (ESG)
- ✓ Human Resource Reporting
- ✓ Value Added Statement
- ✓ Economic Value Added and Market Value Added
- ✓ Reporting through XBRL
- ✓ Quarterly Earnings Call Management

10% Weightage



Government Accounting in India

C&AG | PAC | GASAB | IGAS | IGFRS

- ✓ General Principles and Comparison with Commercial Accounting
- ✓ Role of Comptroller and Auditor General of India
- ✓ Role of Public Accounts Committee
- ✓ Review of Accounts
- ✓ Government Accounting Standards issued by GASAB
- ✓ IGAS 1 – Guarantees given by Governments
- ✓ IGAS 2 – Grants-in-aid
- ✓ IGAS 3 – Loans and Advances
- ✓ IGAS 7, 9, 10 – Foreign Currency, Investments, Public Debt
- ✓ IGFRS 1-5 – Accrual Based Standards
- ✓ Government Accounting and Reporting
- ✓ Three Funds of Government Accounts

 10% Weightage



Quick Navigation

Jump directly to any module with one click

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Indian Accounting Standards

2

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Financial Instruments

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NBFCs –
Provisioning &
Reporting

5

Business
Combination &
Restructuring

6

Consolidated &
Separate FS

7

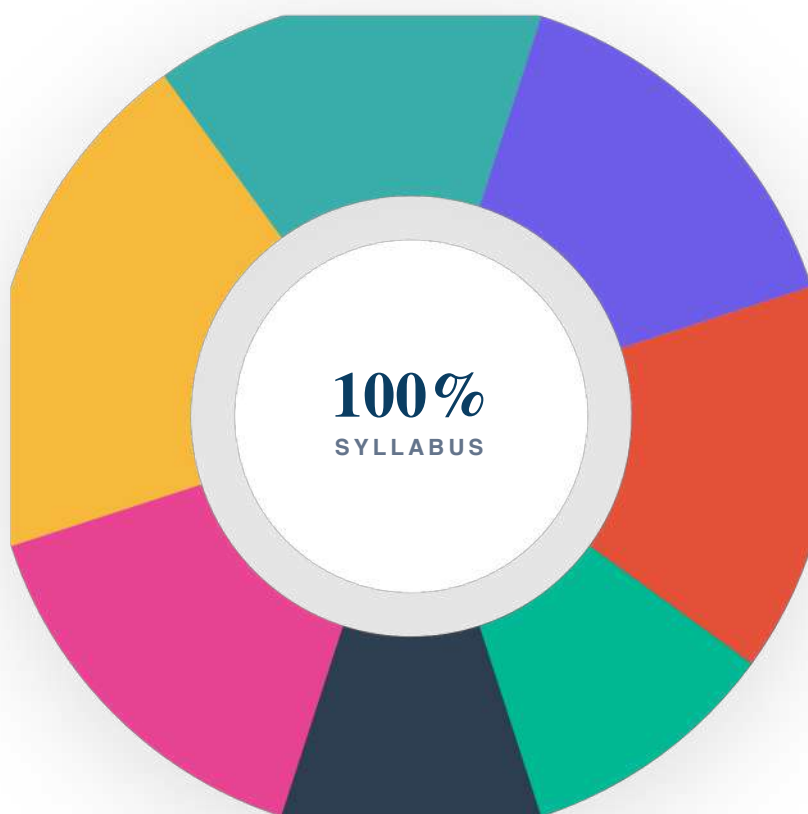
Recent Developments

8

Government
Accounting

Module Weightage Distribution

Strategic weightage analysis to prioritize your preparation for maximum scoring.



Module 1: Indian Accounting Standards 25%

Module 5: Business Combination & Restructuring 20%

Module 6: Consolidated & Separate FS 20%

Module 2: Valuation of Shares 15%

Module 3: Financial Instruments 15%

Module 4: NBFCs – Provisioning & Reporting 15%

☒ **Module 7: Recent Developments**

10%

☐ **Module 8: Government Accounting**

10%

Recommended Study Plan

A structured 3-phase approach to master the entire syllabus efficiently.



Phase 1: Foundation

WEEKS 1–4

- ✓ Module 1: Ind AS 8, 12, 16, 116
- ✓ Module 2: Valuation of Shares
- ✓ Module 3: Financial Instruments
- ✓ Build conceptual foundation
- ✓ Practice basic illustrations



Phase 2: Advanced

WEEKS 5–8

- ✓ Module 1: Ind AS 36, 38, 102, 115
- ✓ Module 4: NBFCs – Provisioning
- ✓ Module 5: Business Combination
- ✓ Module 6: Consolidated FS
- ✓ Comprehensive problem practice



Phase 3: Revision

WEEKS 9–12

- ✓ Module 7: Recent Developments
- ✓ Module 8: Government Accounting
- ✓ Full mock tests
- ✓ Formula sheet revision
- ✓ Previous year papers

CMA Knowledge

PREMIUM REVISION SERIES

8

MODULES

100+

ILLUSTRATIONS

500+

EXAM POINTS

50+

FORMULAS

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CMA Final Paper 18 – Corporate Financial Reporting | December 2026 Edition

Based on ICAI Study Material – Reprint July 2026

THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

PREMIUM REVISION SERIES

CMA Final Paper 18

Corporate Financial Reporting

MODULE 1

Indian Accounting Standards

Complete Revision Handbook with Full ICAI Illustrations, Step-by-Step Solutions,
Formulas, Journal Entries & Exam-Focused Notes

12
IND AS

25%
WEIGHTAGE

30+
ILLUSTRATIONS

100+
EXAM POINTS

December 2026 Examination Edition

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MODULE 1: Indian Accounting Standards

Complete Coverage of 12 Ind AS | 25% Weightage | Highest Scoring Module

12

IND AS COVERED

25%

EXAM WEIGHTAGE

30+

FULL ILLUSTRATIONS

50+

FORMULAS & FRAMEWORKS

★ EXAM IMPORTANT

Module 1 carries **25% weightage** — the highest in Paper 18. Expect **2–3 full questions (15 marks each)** plus short notes and objective questions. Master Ind AS 12, 16, 36, 102, and 115 for maximum scoring.

Table of Contents – Module 1

1 Ind AS 8 – Accounting Policies, Changes in Estimates & Errors

2 Ind AS 12 – Income Taxes

3 Ind AS 16 – Property, Plant and Equipment

4 Ind AS 116 – Leases

5 Ind AS 21 – Effects of Changes in Foreign Exchange Rates

6 Ind AS 23 – Borrowing Costs

7 Ind AS 36 – Impairment of Assets

8 Ind AS 38 – Intangible Assets

9 Ind AS 102 – Share-based Payment

10 Ind AS 108 – Operating Segments

11 Ind AS 113 – Fair Value Measurement

12 Ind AS 115 – Revenue from Contracts with Customers



Syllabus Coverage Matrix

IND AS	TOPIC	WEIGHTAGE	PRIORITY
Ind AS 8	Accounting Policies, Changes in Estimates & Errors	3–5%	★★★★★
Ind AS 12	Income Taxes	5–7%	★★★★★
Ind AS 16	Property, Plant and Equipment	5–7%	★★★★★
Ind AS 116	Leases	4–6%	★★★★★
Ind AS 21	Foreign Exchange Rates	3–5%	★★★★★
Ind AS 23	Borrowing Costs	3–5%	★★★★★
Ind AS 36	Impairment of Assets	4–6%	★★★★★
Ind AS 38	Intangible Assets	3–5%	★★★★★
Ind AS 102	Share-based Payment	4–6%	★★★★★
Ind AS 108	Operating Segments	3–5%	★★★★★
Ind AS 113	Fair Value Measurement	3–5%	★★★★★
Ind AS 115	Revenue from Contracts with Customers	5–7%	★★★★★

Expected Question Types

Practical Problems (15 Marks)

- Deferred tax computation with DTA/DTL table
- PPE initial recognition + depreciation + revaluation + disposal
- Lease accounting (lessee & lessor) with schedules
- Impairment loss allocation to CGU
- Share-based payment (equity & cash settled) with employee departures
- Revenue recognition (5-step model) with contract modifications

Short Notes / Theory (5 Marks)

- Policy vs estimate vs error
- Tax base concepts and temporary differences
- Revaluation model vs cost model
- ROU asset and lease liability measurement
- Qualifying assets and capitalisation criteria
- CGU and impairment allocation
- Internally generated intangibles
- Vesting conditions and market vs non-market
- Reportable segments and 75% test
- Fair value hierarchy Levels 1, 2, 3
- Five-step revenue recognition model

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

1. Chapter Overview

Ind AS 8 prescribes the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates, and corrections of prior period errors. It enhances relevance, reliability, and comparability of financial statements over time and across entities.

2. Learning Objectives

- Understand criteria for selecting and applying accounting policies.
- Distinguish between changes in accounting policies, changes in estimates, and errors.
- Apply retrospective vs prospective treatment correctly.
- Comply with comprehensive disclosure requirements.

3. Important Definitions

DEFINITION

Accounting Policies: Specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements.

DEFINITION

Change in Accounting Estimate: An adjustment to the carrying amount of an asset or liability, or the amount of periodic consumption of an asset, resulting from assessment of present status and expected future benefits/obligations.

DEFINITION

Prior Period Errors: Omissions and misstatements in financial statements for one or more prior periods arising from failure to use, or misuse of, reliable information that was available and could reasonably be expected to have been obtained.

DEFINITION

Retrospective Application: Applying a new accounting policy to transactions as if that policy had always been applied.

DEFINITION

Prospective Application: Applying a new accounting policy to transactions after the date of change; and recognising the effect of change in estimate in current and future periods.

4. Key Concepts

4.1 Selecting and Applying Accounting Policies

- If an Ind AS specifically applies → apply that Ind AS.
- If no specific Ind AS → management judgement for relevant and reliable information.
- Sources in descending order:
 1. Ind ASs dealing with similar/related issues
 2. Definitions, recognition, measurement from Framework
 3. Recent pronouncements of IASB, other standard setters, other accounting literature, accepted industry practices

4.2 Change in Accounting Policy

Only if: (a) required by an Ind AS; or (b) results in reliable and more relevant information.

Not a change: Application of policy for transactions different in substance; application of new policy for transactions that did not occur previously or were immaterial.

4.3 Change in Accounting Estimate

Recognised prospectively by including in profit or loss in: (a) period of change (if affects only that period); or (b) period of change and future periods (if affects both).

4.4 Correction of Prior Period Errors

Corrected retrospectively: restate comparative amounts or opening balances. Disclose nature, amount of correction, and circumstances if retrospective restatement is impracticable.

5. Accounting Standards Covered

IND AS 8 (converged with IAS 8)

6. Important Recognition Criteria

★ EXAM IMPORTANT

- **Change in policy** → Retrospective application (adjust opening equity)
- **Change in estimate** → Prospective application (current & future P&L only)
- **Prior period error** → Retrospective restatement

7. Measurement Principles

- **Retrospective:** Adjust opening balance of each affected component of equity for earliest prior period presented.
- **Prospective:** No restatement of prior periods.
- **Impracticability:** Restate from earliest period practicable.

8. Journal Entry Frameworks

ILLUSTRATION

Change in Accounting Policy (Retrospective):

Dr. Retained Earnings (Opening) xxx

To. Inventory / PPE / etc. xxx

(Adjustment of opening balance for earliest prior period)

ILLUSTRATION

Change in Accounting Estimate (Prospective):

Dr. Depreciation Expense xxx

To. Accumulated Depreciation xxx

(No restatement of prior periods; only current & future periods affected)

ILLUSTRATION

Prior Period Error (Retrospective):

Dr. Retained Earnings (Opening) xxx

To. Liability / Asset xxx

(Restate comparative amounts and opening balances)

9. Disclosure Requirements

- Change in policy due to initial application of Ind AS: title, nature, transitional provisions, amount of adjustment for each line item, EPS adjustment.
- Voluntary change: nature, reasons why new policy provides reliable and more relevant information.
- Change in estimate: nature and amount of change (current and future periods).
- Prior period errors: nature, amount of correction, circumstances if retrospective restatement is impracticable.

10. Exam Focus Areas

★ EXAM IMPORTANT

- Distinguish between change in policy vs change in estimate (common MCQ)
- Retrospective vs prospective treatment
- Disclosure requirements for each type
- Impracticability exception

11. Important Formulae

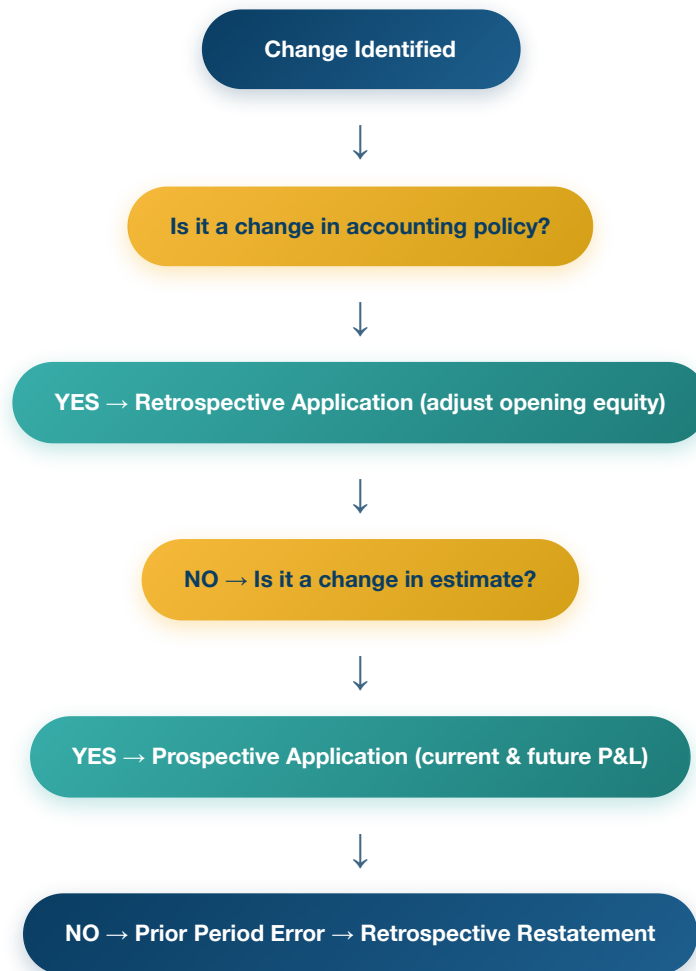
FORMULA

Retrospective Adjustment: Adjust opening balance of each affected component of equity for earliest prior period presented.

FORMULA

Prospective Effect: No adjustment to prior periods; effect recognised in current and future periods only.

12. Flowchart Summary



13. Most Important ICMAI Illustrations

ICMAI ILLUSTRATION

ICMAI Illustration – Change in Depreciation Method

Question: A company changes depreciation method from SLM to WDV. Is it a change in policy or estimate? How should it be accounted?

SOLUTION

Classification: Change in accounting estimate (prospective application).

Reason: Depreciation method is a matter of estimation of pattern of consumption of economic benefits. It is not a change in accounting policy.

Accounting Treatment:

- No restatement of prior periods.
- Depreciation for current and future periods computed using new method.
- Disclose nature and amount of change.

Example:

Machine cost = ₹1,00,000; Residual = ₹10,000; Useful life = 5 years

Year 1-2: SLM = $(1,00,000 - 10,000)/5 = ₹18,000$ p.a.

At beginning of Year 3, change to WDV @ 20%

Carrying amount at end of Year 2 = $1,00,000 - 36,000 = ₹64,000$

Year 3 depreciation (WDV) = $64,000 \times 20\% = ₹12,800$

Year 4 depreciation = $(64,000 - 12,800) \times 20\% = ₹10,240$

ICMAI Illustration – Change in Inventory Valuation

Question: A company changes inventory valuation from FIFO to Weighted Average. How should it be accounted?

SOLUTION

Classification: Change in accounting policy (retrospective application).

Reason: Inventory valuation method is a specific principle/basis — an accounting policy.

Accounting Treatment:

- Retrospective application: adjust opening retained earnings for earliest prior period presented.
- Restate comparative amounts.
- Disclose title, nature, transitional provisions, amount of adjustment, EPS adjustment.

Example:

Opening inventory under FIFO = ₹50,000

Opening inventory under Weighted Average = ₹42,000

Difference = ₹8,000 (decrease in profit)

Journal Entry:

Dr. Retained Earnings (Opening) ₹8,000

To. Inventory ₹8,000

(Retrospective adjustment)

14. Step-wise Solution Approach

1 Read the scenario carefully.

Identify the nature of the change.

2 Classify the change:

Accounting policy, accounting estimate, or prior period error.

3 Apply correct treatment:

Retrospective (policy/error) or Prospective (estimate).

4 Compute adjustment amounts

and pass journal entries.

5 Prepare disclosure notes

as per Ind AS 8.

15. Common Mistakes Students Make

WARNING

- Confusing change in policy with change in estimate.
- Applying retrospective treatment to estimate changes.
- Forgetting to adjust opening retained earnings.
- Ignoring EPS adjustment in disclosures.
- Not considering impracticability exception.

16. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 8 in 60 seconds:

- Policy change → Retrospective (adjust opening equity)
- Estimate change → Prospective (current & future P&L)
- Error → Retrospective restatement
- Disclose: nature, amount, reasons, impracticability
- Key distinction: Policy = principles/bases; Estimate = adjustment to carrying amount
- **Mnemonic: PEE** → Policy/Error = Retrospective; Estimate = Prospective

17. Expected Exam Questions

5 Mark Questions

1. Distinguish between change in accounting policy and change in accounting estimate with examples.
2. Explain the disclosure requirements for prior period errors.
3. What is retrospective application? When is it impracticable?

10 Mark Questions

1. A company changed its inventory valuation from FIFO to weighted average. Explain the accounting treatment and disclosure requirements.
2. Discuss the criteria for selecting and applying accounting policies in the absence of a specific Ind AS.

15 Mark Questions

1. Comprehensive problem: Identify policy vs estimate vs error; pass journal entries; prepare extracts of financial statements; draft disclosure notes.

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 8 ensures comparability and reliability. The key exam skill is correctly classifying the change and applying the correct treatment. Always state the classification, show workings, and disclose properly.

Ind AS 12 – Income Taxes

1. Chapter Overview

Ind AS 12 prescribes the accounting treatment for income taxes. It deals with current and deferred tax consequences of future recovery/settlement of carrying amounts of assets/liabilities, and transactions/events recognised in financial statements.

2. Learning Objectives

- Understand current tax and deferred tax concepts.
- Compute taxable profit, current tax, deferred tax asset/liability.
- Apply recognition criteria for DTA/DTL.
- Presentation and disclosure requirements.

3. Important Definitions

DEFINITION

Accounting Profit: Profit or loss for a period before deducting tax expense.

DEFINITION

Taxable Profit (Tax Loss): Profit (loss) for a period, determined in accordance with tax rules, upon which income taxes are payable (recoverable).

DEFINITION

Tax Expense (Income): Aggregate of current tax expense and deferred tax expense.

DEFINITION

Current Tax: Amount of income taxes payable (recoverable) in respect of taxable profit (tax loss) for a period.

DEFINITION

Deferred Tax Liabilities: Amounts of income taxes payable in future periods in respect of taxable temporary differences.

DEFINITION

Deferred Tax Assets: Amounts of income taxes recoverable in future periods in respect of deductible temporary differences, carry forward of unused tax losses, and unused tax credits.

DEFINITION

Temporary Differences: Differences between carrying amount of an asset/liability in balance sheet and its tax base. Classified into: (a) Taxable temporary differences → DTL; (b) Deductible temporary differences → DTA.

DEFINITION

Tax Base of an Asset: Amount deductible for tax purposes against taxable economic benefits flowing to entity when it recovers carrying amount of asset.

DEFINITION

Tax Base of a Liability: Carrying amount less any amount deductible for tax purposes in future periods.

4. Key Concepts

4.1 Current Tax

Based on taxable profit determined per tax laws. May differ from accounting profit due to disallowances, exemptions, etc.

4.2 Deferred Tax

Arises from temporary differences between carrying amount and tax base.

- **Taxable temporary difference:** Carrying amount > Tax base → DTL (tax payable in future).
- **Deductible temporary difference:** Carrying amount < Tax base → DTA (tax recoverable in future).

4.3 Recognition Exceptions

- Goodwill initial recognition → no DTL.
- Initial recognition of asset/liability in transaction not a business combination and not affecting accounting/taxable profit → no DTA/DTL.
- Investments in subsidiaries, branches, associates, JVs → DTL recognised except when parent can control reversal and reversal not probable in foreseeable future.

4.4 Measurement

- Tax rates enacted or substantively enacted by reporting date.
- Expected manner of recovery/settlement.
- DTAs reviewed at each reporting date; reduced if no longer probable.

5. Accounting Standards Covered

IND AS 12 (converged with IAS 12)

6. Important Recognition Criteria

★ EXAM IMPORTANT

- DTL: Recognise for all taxable temporary differences (with exceptions).
- DTA: Recognise to extent probable that taxable profit available against which deductible temporary difference can be utilised.
- DTA for unused tax losses/credits: Recognise to extent probable.

7. Measurement Principles

- Current tax: Amount expected to be paid/recovered using tax rates enacted/substantively enacted.
- Deferred tax: Using tax rates expected to apply when asset realised/liability settled.
- Discounting not permitted.
- Measurement reflects tax consequences of manner of recovery/settlement.

8. Journal Entry Frameworks

ILLUSTRATION

Current Tax:

Dr. Current Tax Expense xxx
To. Current Tax Payable xxx

ILLUSTRATION

Deferred Tax Liability:

Dr. Deferred Tax Expense xxx
To. Deferred Tax Liability xxx

ILLUSTRATION

Deferred Tax Asset:

Dr. Deferred Tax Asset xxx
To. Deferred Tax Income xxx

9. Disclosure Requirements

- Major components of tax expense (current, deferred, adjustments for prior periods, changes in tax rates).
- Aggregate current and deferred tax relating to items charged/credited directly to equity.
- Income tax relating to each component of OCI.
- Reconciliation between tax expense and accounting profit $\times$ tax rate.
- Explanation of changes in tax rate.
- Amount of deductible temporary differences, unused tax losses/credits for which no DTA recognised.

10. Important Formulae

FORMULA

Taxable Profit = Accounting Profit + Accounting Expenses (disallowed) – Tax Deductions (allowed but not in accounting) $\pm$ Other adjustments

FORMULA

Current Tax = Taxable Profit $\times$ Tax Rate

FORMULA

Deferred Tax = Temporary Difference $\times$ Tax Rate

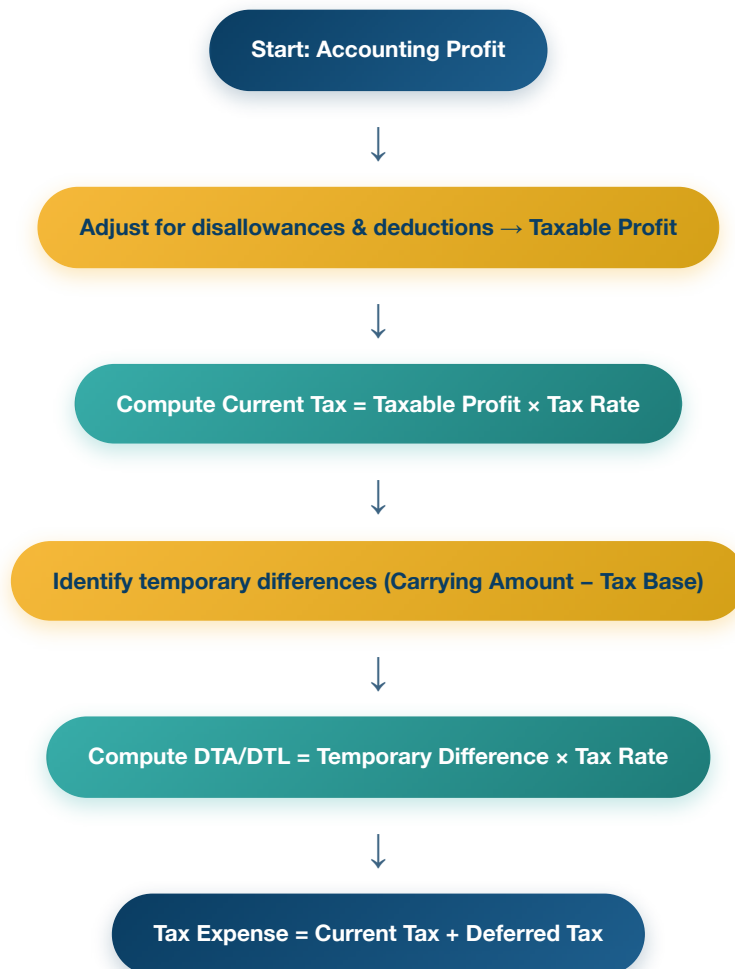
 FORMULA

Temporary Difference = Carrying Amount – Tax Base

 FORMULA

Tax Expense = Current Tax + Deferred Tax

11. Flowchart Summary



12. Full ICMAl Illustrations with Step-by-Step Solutions

ICMAl ILLUSTRATION

ICMAI Illustration 1 – Comprehensive Deferred Tax Computation

Question: A company measured accounting profit of ₹80,000 after charging depreciation of ₹12,000. On interest receivable, income tax is levied on cash basis. Included in accounting profit is Interest accrued ₹5,000, which is not included in taxable profit of ₹67,000. Tax rate is 30%. For tax purpose, depreciation admissible is ₹20,000. Carrying amount of fixed assets was ₹68,000 and tax base of fixed assets ₹60,000 before charging depreciation for the current year.

Required: Find (i) Carrying amount and tax base of fixed assets and tax base of interest accrued at year end; (ii) Temporary Differences; (iii) Current tax expenses and deferred tax expenses; (iv) Deferred tax liabilities and deferred tax assets.

COMPLETE SOLUTION

Step 1: Compute Taxable Profit

Accounting Profit = ₹80,000

Add: Accounting Depreciation = ₹12,000

Add: Interest Accrued (not taxed) = ₹5,000

Less: Tax Depreciation = (₹20,000)

Taxable Profit = ₹67,000

Step 2: Compute Carrying Amount and Tax Base

Fixed Assets:

Carrying Amount (before dep) = ₹68,000

Less: Accounting Depreciation = (₹12,000)

Carrying Amount = ₹56,000

Tax Base (before dep) = ₹60,000

Less: Tax Depreciation = (₹20,000)

Tax Base = ₹40,000

Interest Accrued:

Carrying Amount = ₹5,000

Tax Base = ₹0 (not yet taxed)

Step 3: Compute Temporary Differences

Fixed Assets: CA ₹56,000 – TB ₹40,000 = **₹16,000 (Taxable TD → DTL)**

Interest Accrued: CA ₹5,000 – TB ₹0 = **₹5,000 (Taxable TD → DTL)**

Total Taxable TD = ₹21,000

Step 4: Compute Deferred Tax

DTL on Fixed Assets = ₹16,000 × 30% = **₹4,800**

DTL on Interest Accrued = ₹5,000 × 30% = **₹1,500**

Total DTL = ₹6,300

Deferred Tax Expense = ₹6,300 (increase in DTL)

Step 5: Compute Current Tax

Current Tax = ₹67,000 × 30% = **₹20,100**

Step 6: Compute Tax Expense

Tax Expense = Current Tax + Deferred Tax

= ₹20,100 + ₹6,300 = **₹26,400**

PARTICULARS	CARRYING AMOUNT	TAX BASE	TAXABLE TEMPORARY DIFFERENCE	DTL @ 30%
Fixed Assets (before dep)	₹68,000	₹60,000	—	—
Less: Depreciation	(₹12,000)	(₹20,000)	—	—
Balance	₹56,000	₹40,000	₹16,000	₹4,800
Interest Accrued	₹5,000	₹0	₹5,000	₹1,500
Total			₹21,000	₹6,300

ICMAI Illustration 2(a) – Depreciation Timing Difference

Question: A fixed asset is acquired at ₹1,50,000 with life 5 years, no residual value, and depreciation chargeable at SLM for accounting purpose. For tax purpose, depreciation is admissible at ₹50,000 for first 3 years only. Show tax consequences for all the years.

COMPLETE SOLUTION

Step 1: Compute Carrying Amount and Tax Base for each year

YEAR	0	1	2	3	4	5
a. Fixed Asset (Cost)	1,50,000	1,50,000	1,50,000	1,50,000	1,50,000	1,50,000
b. Accounting Depreciation (SLM)	–	25,000	25,000	25,000	25,000	25,000
c. Carrying Amount (a–b)	1,50,000	1,25,000	1,00,000	75,000	50,000	25,000
d. Tax Depreciation	–	50,000	50,000	50,000	0	0
e. Tax Base (a–d)	1,50,000	1,00,000	50,000	0	0	0
f. Temporary Difference (c–e)	0	25,000	50,000	75,000	50,000	25,000
g. DTL @ 30%	0	7,500	15,000	22,500	15,000	7,500

Step 2: Deferred Tax Expense (Change in DTL)

Year 1: $7,500 - 0 = ₹7,500$

Year 2: $15,000 - 7,500 = ₹7,500$

Year 3: $22,500 - 15,000 = ₹7,500$

Year 4: $15,000 - 22,500 = (₹7,500)$

Year 5: $7,500 - 15,000 = (₹7,500)$

Year 6: $0 - 7,500 = (₹7,500)$

ICMAI Illustration 2(b) – Tax Expense Computation

Question: Show the tax expenses for the above case if before depreciation, accounting profits are same as before depreciation taxable profits for the years as stated below:

YEAR	1	2	3	4	5	6
Accounting Profit before Dep	1,80,000	2,00,000	1,60,000	1,90,000	2,20,000	2,40,000

COMPLETE SOLUTION

YEAR	1	2	3	4	5	6
a. Accounting Profit before Dep	1,80,000	2,00,000	1,60,000	1,90,000	2,20,000	2,40,000
b. Accounting Depreciation	25,000	25,000	25,000	25,000	25,000	25,000
c. Accounting Profit (a-b)	1,55,000	1,75,000	1,35,000	1,65,000	1,95,000	2,15,000
d. Tax Depreciation	50,000	50,000	50,000	0	0	0
e. Taxable Profit (a-d)	1,30,000	1,50,000	1,10,000	1,90,000	2,20,000	2,40,000
f. Current Tax @ 30%	39,000	45,000	33,000	57,000	66,000	72,000
g. Deferred Tax Expense	7,500	7,500	7,500	(7,500)	(7,500)	(7,500)
h. Tax Expense (f+g)	46,500	52,500	40,500	49,500	58,500	64,500

ICMAI Illustration 3 – Provision for Gratuity and Leave Encashment

Question: A company creates provision for Gratuity and Leave encashment and recognises liability of ₹50,000. This is the only difference between taxable profits and accounting profits. The company measures current tax of ₹48,000 at tax rate of 25%. Compute Tax Expenses.

COMPLETE SOLUTION

PARTICULARS	AMOUNT (₹)
(i) Carrying amount of Liabilities for Gratuity and Leave encashment	50,000
(ii) Tax base (since provision is not admissible for tax purpose)	0
(iii) Temporary difference (i) – (ii)	50,000
(iv) Deferred tax asset $25\% \times$ (iii)	12,500
(v) Deferred tax expenses (change in deferred tax asset)	(12,500)
(vi) Current tax expenses (given)	48,000
(vii) Tax expenses (v) + (vi)	35,500

Note: Carrying amount is payable and it is greater than tax base → tax is deductible in future → DTA arises.

13. Step-wise Solution Approach

1 Compute taxable profit
from accounting profit by adjusting disallowances and deductions.

2 Compute current tax
 $= \text{Taxable profit} \times \text{Tax rate}.$

3 Identify assets/liabilities
with differences between carrying amount and tax base.

4 Compute temporary differences
and classify as taxable/deductible.

5 Compute DTA/DTL
 $= \text{Temporary difference} \times \text{Tax rate}.$

6 Compute deferred tax expense/income
and total tax expense.

7 Pass journal entries
and prepare disclosure notes.

14. Common Mistakes Students Make

⚠ WARNING

- Forgetting to add back accounting depreciation.
- Incorrect tax base computation.
- Confusing taxable vs deductible temporary differences.
- Not considering recognition exceptions.
- Applying discounting to deferred tax.

15. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 12 in 90 seconds:

- $\text{Taxable Profit} = \text{Accounting Profit} + \text{Disallowances} - \text{Deductions}$
- $\text{Current Tax} = \text{Taxable Profit} \times \text{Tax Rate}$
- $\text{Temporary Difference} = \text{Carrying Amount} - \text{Tax Base}$
- Taxable TD $\rightarrow$ DTL; Deductible TD $\rightarrow$ DTA
- $\text{Deferred Tax} = \text{TD} \times \text{Tax Rate}$
- $\text{Tax Expense} = \text{Current Tax} + \text{Deferred Tax}$
- No discounting. Use enacted/substantively enacted rates.
- **Mnemonic: CAT** $\rightarrow$ Carrying Amount – Tax Base = Temporary Difference

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 12 is a high-weightage topic. Master the taxable profit computation, tax base determination, and DTA/DTL table. Practice at least 5 comprehensive problems before the exam.

Ind AS 16 – Property, Plant and Equipment

1. Chapter Overview

Ind AS 16 prescribes the accounting treatment for PPE so that users can discern information about an entity's investment in PPE and changes in such investment. It covers recognition, determination of carrying amounts, depreciation, impairment, and derecognition.

2. Learning Objectives

- Identify PPE and apply recognition criteria.
- Measure initial cost including directly attributable costs.
- Apply cost model and revaluation model.
- Compute depreciation and impairment.
- Account for derecognition.

3. Important Definitions

DEFINITION

Property, Plant and Equipment: Tangible items held for use in production/supply of goods/services, rental to others, or administrative purposes, and expected to be used during more than one period.

DEFINITION

Cost: Amount of cash/cash equivalents paid or fair value of other consideration given to acquire an asset at the time of acquisition or construction.

DEFINITION

Depreciable Amount: Cost of an asset or other amount substituted for cost, less its residual value.

DEFINITION

Useful Life: Period over which an asset is expected to be available for use by an entity, or number of production/units expected to be obtained.

DEFINITION

Residual Value: Estimated amount currently obtainable from disposal of asset, after deducting estimated costs of disposal, if asset were already of age and in condition expected at end of useful life.

DEFINITION

Carrying Amount: Amount at which asset is recognised after deducting accumulated depreciation and accumulated impairment losses.

DEFINITION

Revaluation Surplus: Increase in carrying amount arising from revaluation, credited to OCI and accumulated in equity.

4. Key Concepts

4.1 Recognition Criteria

- Probable that future economic benefits will flow to entity.
- Cost can be measured reliably.

4.2 Initial Measurement (Cost)

- Purchase price (net of trade discounts/rebates, add non-refundable duties/taxes, exclude GST if creditable).
- Directly attributable costs: employee costs, site preparation, freight, installation, testing, professional fees.
- Dismantling/restoration cost at present value.
- Exclude: administration overhead, advertising, relocation, initial losses, incidental costs.

4.3 Subsequent Measurement

- **Cost model:** Cost – accumulated depreciation – accumulated impairment losses.
- **Revaluation model:** Fair value at revaluation date – subsequent depreciation – subsequent impairment losses. Revaluations must be regular.

4.4 Depreciation

- Systematic allocation of depreciable amount over useful life.
- Methods: Straight Line, Reducing Balance, Units of Production.
- Depreciation begins when asset is available for use; ceases at earlier of derecognition or when classified as held for sale.
- Residual value and useful life reviewed at least annually.

4.5 Revaluation

- Increase → OCI (Revaluation Surplus).
- Decrease → P&L (to extent of reversal of previous surplus).
- Transfer from revaluation surplus to retained earnings for excess depreciation.

4.6 Derecognition

- On disposal or when no future economic benefits expected.
- Gain/loss = Net disposal proceeds – Carrying amount.
- Gain not classified as revenue.

5. Accounting Standards Covered

IND AS 16 (converged with IAS 16); related: Ind AS 36, Ind AS 23, Ind AS 113

6. Important Recognition Criteria

★ EXAM IMPORTANT

- Probable future economic benefits.
- Reliable measurement of cost.
- Subsequent expenditure: capitalise if enhances economic benefits; else expense.

7. Measurement Principles

- Initial: Cost.
- Subsequent: Cost model or Revaluation model.
- Depreciation: Systematic allocation.
- Impairment: Ind AS 36.

8. Journal Entry Frameworks

ILLUSTRATION

Purchase of PPE:

Dr. PPE A/c xxx
Dr. Input GST A/c xxx
To. Bank/Creditor A/c xxx
To. Liability for Dismantling A/c xxx

ILLUSTRATION

Depreciation:

Dr. Depreciation Expense xxx
To. Accumulated Depreciation xxx

ILLUSTRATION

Revaluation Increase:

Dr. PPE A/c xxx
To. Revaluation Surplus (OCI) xxx

ILLUSTRATION

Revaluation Decrease:

Dr. Revaluation Surplus (OCI) xxx (to extent of surplus)
Dr. Impairment Loss (P&L) xxx
To. PPE A/c xxx

ILLUSTRATION

Derecognition:

Dr. Bank A/c xxx
Dr. Accumulated Depreciation xxx
Dr. Loss on Disposal (P&L) xxx
To. PPE A/c xxx
To. Gain on Disposal (P&L) xxx (if any)

9. Disclosure Requirements

- Depreciation methods used.
- Useful lives or depreciation rates.
- Gross carrying amount and accumulated depreciation at beginning and end.

- Reconciliation of carrying amount (additions, disposals, revaluations, impairment, depreciation, exchange differences).
- Restrictions on title, PPE pledged as security.
- Contractual commitments for acquisition.
- Compensation from third parties for impaired/lost assets.

10. Important Formulae

FORMULA

Depreciable Amount = Cost (or revalued amount) – Residual Value

FORMULA

SLM Depreciation = (Cost – Residual Value) / Useful Life

FORMULA

WDV Depreciation = Carrying Amount × Depreciation Rate

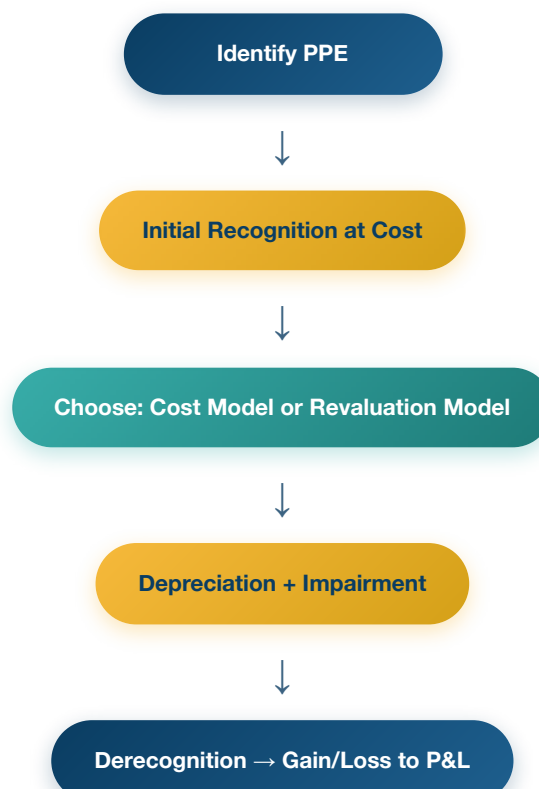
FORMULA

Units of Production = (Annual Production / Lifetime Production) × Depreciable Amount

FORMULA

Gain/Loss on Disposal = Net Disposal Proceeds – Carrying Amount

11. Flowchart Summary



12. Full ICMAl Illustrations with Step-by-Step Solutions

ICMAI ILLUSTRATION

ICMAI Illustration 4 – Initial Cost Measurement with Dismantling Provision

Question: X Ltd. sets up a plant at the purchase price of ₹5,00,000 plus GST at 18% (Intra-state). Freight paid ₹20,000 plus GST at 18% (Intra-state). Paid ₹10,000 as employee expenses for installation of the plant. After the plant was put to use, maintenance cost incurred ₹5,000. Estimated dismantling cost ₹30,000, present value ₹12,000. Measure the initial cost to be recognized and pass journal.

COMPLETE SOLUTION

Step 1: Identify Capitalisable Costs

Purchase Price = ₹5,00,000

Freight = ₹20,000

Installation Cost = ₹10,000

PV of Dismantling Cost = ₹12,000

Total Initial Cost = ₹5,42,000

Step 2: Costs NOT Capitalised

GST (creditable) = Not capitalised

Maintenance Cost = ₹5,000 (expensed to P&L)

Step 3: GST Computation

On ₹5,00,000: CGST 9% = ₹45,000; SGST 9% = ₹45,000

On ₹20,000: CGST 9% = ₹1,800; SGST 9% = ₹1,800

Total CGST = ₹46,800; Total SGST = ₹46,800

DATE	PARTICULARS	DR. (₹)	CR. (₹)
	Machinery A/c Dr.	5,42,000	
	Input CGST A/c Dr.	46,800	
	Input SGST A/c Dr.	46,800	
	Maintenance Exp. A/c Dr.	5,000	
	To, Bank A/c		6,28,600
	To, Liability for Dismantling A/c		12,000

ICMAI Illustration 5 – Asset Acquired in Exchange

Question: B Ltd. has incurred the following transactions in respect of acquiring a plant in exchange of an old plant: (i) Old site dismantled at ₹8,000. No estimated dismantling cost was capitalized for old plant. Scrap sold at ₹1,000. (ii) New site constructed at ₹48,000. (iii) Supplier agreed to take old plant at fair value ₹1,26,000. (iv) New plant price ₹3,20,000. Carrying amount of old plant ₹1,00,000. (v) PV of dismantling site ₹16,000. (vi) Wages for installation ₹4,000, trial run ₹1,600. (vii) Freight ₹8,000. (viii) GST 18% on plant and freight. (ix) Loss ₹40,000 for low capacity utilization. (x) ₹10,000 cost of launching product. Recognize asset value and pass journal.

COMPLETE SOLUTION

Step 1: Compute Initial Cost of New Plant

Cost of construction of new site = ₹48,000

Price of new plant = ₹3,20,000

PV of dismantling site = ₹16,000

Installation and Trial Run = ₹5,600

Freight = ₹8,000

Initial Cost = ₹3,97,600

Step 2: Compute Profit/Loss on Old Plant

Carrying amount of old plant = ₹1,00,000

Add: Dismantling cost = ₹8,000

Less: Scrap realized = (₹1,000)

Net carrying amount = ₹1,07,000

Fair value (taken by supplier) = ₹1,26,000

Profit on Sale = ₹1,26,000 – ₹1,07,000 = ₹19,000

PARTICULARS	DR. (₹)	CR. (₹)
Old Machinery A/c Dr.	8,000	
To, Cash A/c		8,000
<i>(Dismantling of old site)</i>		
Cash A/c Dr.	1,000	
To, Old Machinery A/c		1,000
<i>(Scrap realized)</i>		
Machinery (New) A/c Dr.	3,97,600	
To, Old Machinery A/c (1,00,000+8,000–1,000)		1,07,000
To, Profit on Sale of Old Plant A/c		19,000
To, Supplier A/c (3,20,000–1,26,000)		1,94,000
To, Cash A/c (Freight + Installation + Site)		61,600
To, Liability for Dismantling A/c		16,000

Note: (ix) Loss ₹40,000 and (x) Cost of launching product ₹10,000 are charged to Profit and Loss A/c. GST accounting not shown.

ICMAI Illustration 6 – Aircraft with Major Inspection and Component Replacement

Question: A Ltd. purchased an aircraft at ₹6,300 crores that requires major inspection and overhauling every 4 years. Estimated life 15 years. Purchased in 2015, major inspection in 2019 at ₹100 crores. In 2020, repair and maintenance to raise engine capacity by 10% amounting to ₹70 crores. One worn out component replaced at ₹80 crores. Carrying amount of old component ₹30 crores. Scrap realized ₹12 crores. Residual value ₹300 crores. Find amount recognized as expense and asset in 2019 and 2020, and show carrying amount.

COMPLETE SOLUTION

Step 1: Compute Carrying Amount and Depreciation

YEAR	EXPENSE (₹ CR)	ASSET RECOGNISED (₹ CR)	CARRYING AMOUNT (₹ CR)
In 2018	–	–	4,700
Depreciation $(6,300-300)/15$	400		
Carrying amount $(6300-4 \times 400)$			4,700
In 2019			
Depreciation = $400 + (100/4)$	425		
Major Inspection overhauling		100	
Carrying amount [$4,700+100-425$]			4,375
In 2020			
Depreciation	425		
Repair & Maintenance (Capacity increase)	70		
Replacement		80	
Old component derecognized		(30)	
Loss on disposal $(30-12)$	18		
Carrying amount $(4,375+70+80-30-437)$			4,058

Notes:

1. Depreciation at straight line for 15 years useful life.
2. Major inspection and overhauling capitalized and depreciated at SLM for 4 years.
3. Repair & maintenance and replacement of old component depreciated at SLM for residual life i.e. $15-5=10$ years.
4. Full depreciation is charged in the year it is recognized.

ICMAI Illustration 7 – Comprehensive PPE with Dismantling and Overhauling

Question: X Ltd. purchased a machine at ₹1,200 Lakhs. Paid freight ₹40 Lakhs and installation cost ₹80 Lakhs. IGST paid at 18%. Share of general overhead for trial run ₹30 Lakhs. Labour cost and direct expenses for trial run ₹60 Lakhs. Machine put to use on 01.04.2019. Estimated dismantling cost at end of useful life of 10 years is ₹400 Lakhs. Discounting rate 5%. PV estimated at ₹246 Lakhs. Machine requires major overhauling every 2 years at cost of ₹26 Lakhs. Pass journal entries and accounting treatments for 2019-20 and 2020-21.

COMPLETE SOLUTION

Working Note 1: Initial Cost Recognised

PARTICULARS	₹ IN LAKHS
Purchase Price	1,200
Freight	40
Installation Cost	80
IGST not considered	–
General overhead not considered	–
Labour cost and expense for trial run	60
PV of estimated dismantling cost	246
Depreciable amount	1,626
Less: Overhauling cost (depreciated in 2 years)	(26)
Balance (depreciated in 10 years)	1,600
Annual depreciation: ₹13 + ₹160 =	₹173 Lakhs

Working Note 2: Dismantling Provision Unwinding

PV of Dismantling Cost = ₹246 Lakhs

5% discounting unwinded in Year 1 = ₹246 × 5% = ₹12.3 Lakhs

Provision revised to = ₹246 + ₹12.3 = **₹258.3 Lakhs**

Discount unwinded in Year 2 = ₹258.3 × 5% = ₹12.92 Lakhs

Provision raised to = ₹258.3 + ₹12.92 = **₹271.22 Lakhs**

ICMAI Illustration 8 – Replacement, Revaluation and Impairment

Question: Alfa Ltd. has machinery at cost ₹4,800 and provision for depreciation ₹1,600 as on 01.04.2018. Remaining life 6 years with residual value ₹800. On same date, one component replaced: new component price ₹600, old component cost ₹500 with accumulated depreciation ₹200. Supplier took old component at fair value ₹360. On 31.03.2019 machine revalued at ₹5,000. On 31.03.2020 impairment loss of ₹900 recognized. Pass journal entries and show accounting treatments for years ending 31.03.2019, 31.03.2020, and 31.03.2021. Depreciation on SLM.

COMPLETE SOLUTION

Working Note 1: Carrying Amount and Depreciation

On 1.4.2018: Carrying amount $(4,800 - 1,600) = ₹3,200$

Add: Replacement Cost of New Component = ₹600 - (₹500 - ₹200) = ₹300

[Profit on disposal of old machinery = ₹360 - ₹300 = ₹60]

Carrying amount = ₹3,500

Depreciation for 2018-19 = $(₹3,500 - ₹800)/6 = ₹450$

On 31.03.2019 Depreciated value = ₹3,050

On 31.03.2019: Revalued at ₹5,000

Depreciation for 2019-2020 = ₹450 + ₹1,950/5 = ₹840

Depreciated value $(5,000 - 840) = ₹4,160$

Less: Impairment Loss = (₹900)

On 31.03.2020 Carrying amount = ₹3,260

Depreciation for 2020-2021 = $(₹3,260 - ₹800)/4 = ₹615$

DATE	PARTICULARS	DR. (₹)	CR. (₹)
01.04.2018	Machinery A/c Dr.	600	
	To, Supplier A/c		600
	Prov. for Depreciation A/c Dr.	200	
	Supplier A/c Dr.	360	
	To, Machinery A/c		500
	To, Profit on Disposal of Machinery A/c		60
31.03.19	Depreciation A/c Dr.	450	
	To, Provision for Depreciation A/c		450
31.03.19	Machinery A/c Dr.	100	
	Provision for Depn. A/c Dr.	1,850	
	To, Revaluation Surplus A/c		1,950
31.03.20	Depreciation A/c Dr.	840	
	To, Provision for Depreciation A/c		840
	Impairment loss A/c Dr.	900	
	To, Machinery A/c.		900
31.03.21	Depreciation A/c Dr.	615	
	To, Provision for Depreciation A/c		615

13. Step-wise Solution Approach

- 1 Identify cost elements.**
Separate capital vs revenue expenditure.
- 2 Compute present value of dismantling cost**
and include in initial cost.
- 3 Determine initial carrying amount.**
- 4 Choose depreciation method**
and compute annual depreciation.
- 5 Account for revaluation**
(OCI for increase; P&L for decrease).
- 6 Compute impairment**
if applicable.
- 7 Account for disposal**
and compute gain/loss.
- 8 Prepare disclosure notes.**

14. Common Mistakes Students Make

⚠ WARNING

- Including administration overhead in cost.
- Forgetting dismantling cost PV.
- Incorrect depreciation base after revaluation.
- Not transferring excess depreciation to retained earnings.
- Treating gain on disposal as revenue.

15. 1-Day Before Exam Revision Sheet

📅 1 DAY BEFORE EXAM

Ind AS 16 in 90 seconds:

- $\text{Cost} = \text{Purchase Price} + \text{Directly Attributable} + \text{PV of Dismantling}$
- Exclude: Admin, Advertising, Relocation, Initial Losses
- $\text{Depreciation} = (\text{Cost} - \text{Residual}) / \text{Life (SLM)}$
- Revaluation Increase → OCI; Decrease → P&L
- Transfer excess depreciation from surplus to retained earnings
- Derecognition: $\text{Gain/Loss} = \text{Proceeds} - \text{Carrying Amount}$
- **Mnemonic: PDD** → Purchase Price + Directly Attributable + Dismantling PV

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 16 is a core topic. Master initial cost computation, depreciation methods, revaluation accounting, and component accounting. Practice at least 5 comprehensive problems.

Ind AS 116 – Leases

1. Chapter Overview

Ind AS 116 sets out principles for recognition, measurement, presentation, and disclosure of leases. It requires lessees to recognise right-of-use (ROU) assets and lease liabilities for most leases. Lessors classify leases as operating or finance leases.

2. Learning Objectives

- Identify a lease contract.
- Account for leases in lessee's books (ROU asset & lease liability).
- Classify leases in lessor's books (operating vs finance).
- Apply measurement and disclosure requirements.

3. Important Definitions

DEFINITION

Lease: Contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

DEFINITION

Right-of-Use Asset: Asset that represents the lessee's right to use the underlying asset for the lease term.

DEFINITION

Lease Liability: Present value of lease payments not paid at commencement date.

DEFINITION

Finance Lease: Lease that transfers substantially all risks and rewards incidental to ownership of an underlying asset.

DEFINITION

Operating Lease: Lease that does not transfer substantially all risks and rewards incidental to ownership.

DEFINITION

Incremental Borrowing Rate: Rate of interest lessee would have to pay to borrow over similar term, with similar security, funds necessary to obtain an asset of similar value.

4. Key Concepts

4.1 Lease Identification

- Identified asset.
- Right to obtain substantially all economic benefits.
- Right to direct use of asset.

4.2 Lessee Accounting

- Recognise ROU asset and lease liability at commencement date.
- Exemptions: short-term leases (≤ 12 months) and low-value assets.
- ROU asset initial measurement: Lease liability + payments before commencement + initial direct costs + dismantling/restoration PV.
- Lease liability: PV of lease payments discounted at implicit rate or incremental borrowing rate.
- Subsequent: Depreciate ROU asset; interest expense on lease liability.

4.3 Lessor Accounting

- Classify as finance or operating lease.
- Finance lease: Recognise net investment in lease; interest income at IRR.
- Operating lease: Recognise lease income on straight-line or systematic basis; depreciation expense.

5. Accounting Standards Covered

IND AS 116 (converged with IFRS 16); related: Ind AS 16, Ind AS 36, Ind AS 109, Ind AS 115

6. Important Formulae

FORMULA

Lease Liability = PV of lease payments discounted at implicit rate or incremental borrowing rate

FORMULA

ROU Asset = Lease Liability + Prepaid Lease Payments + Initial Direct Costs + Dismantling PV – Lease Incentives

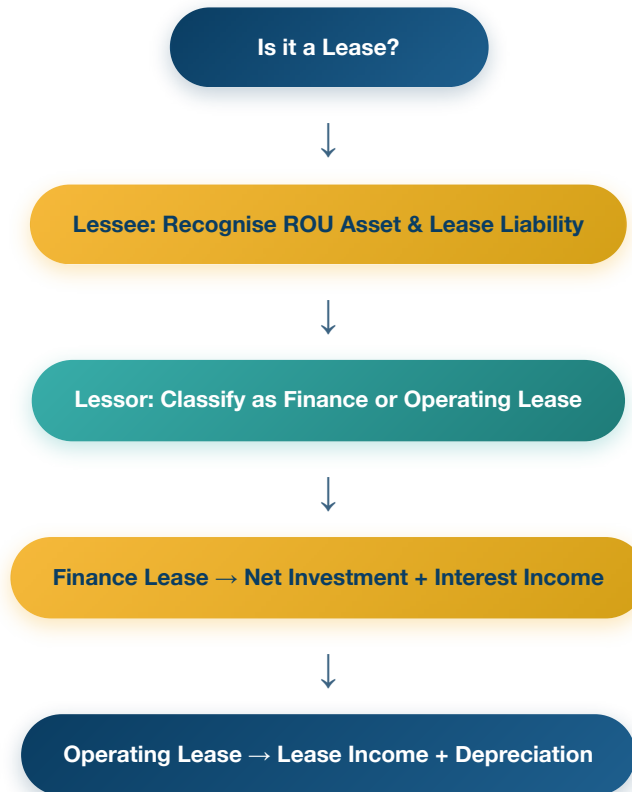
FORMULA

Interest Expense = Opening Lease Liability $\times$ Discount Rate

FORMULA

Depreciation = ROU Asset Cost / Lease Term (or Useful Life)

7. Flowchart Summary



8. Full ICMAI Illustration 9 – Comprehensive Lessee and Lessor Accounting

ICMAI ILLUSTRATION

ICMAI Illustration 9 – Complete Lease Accounting

Question: Lessor Y leases out an equipment (carrying amount ₹1,36,000 having 5 years life) to Lessee X for 3 years for annual payment of ₹50,000 (at the end of every year) and residual value of ₹50,000 guaranteed by X up to loss of ₹30,000. Interest rate implicit is 10%. At the end of the lease, the equipment is valued at ₹33,000. Show accounting in books of X. Interest rate implicit in lease payments is 10%. Show accounting of lease classified as finance lease in books of Y. The rate of interest income on the net investment in lease, however, is 19.274%.

COMPLETE SOLUTION

PART A: In Books of Lessee X

Step 1: Compute PV of Lease Payments at 10%

YEAR	PAYMENTS (₹)	DISC. FACTOR	DCF AT 10% (₹)
1	50,000	0.909091	45,454.55
2	50,000	0.826446	41,322.31
3	50,000	0.751315	37,565.74
3	Guaranteed 30,000	0.751315	22,539.44
Present Value			1,46,882

Step 2: Lease Liability Repayment and Interest

YEAR	INTEREST (₹)	PAYMENTS (₹)	BALANCE (₹)
0	–	–	1,46,882
1	14,688	50,000	1,11,570
2	11,157	50,000	72,727
3	7,273	50,000	30,000
3	–	17,000	13,000
3	–	13,000	0

Step 3: ROU Asset Depreciation (SLM over 3 years)

YEAR	DEPRECIATION (₹)	BALANCE (₹)
0	–	1,46,882
1	48,961	97,921
2	48,961	48,960
3	48,960	0

DATE	PARTICULARS	DR. (₹)	CR. (₹)
At inception	ROU Asset A/c Dr.	1,46,882	
	To, Lease Liability A/c		1,46,882
End of Year 1	Interest Expenses A/c Dr.	14,688	
	To, Lease Liability A/c		14,688
	Lease Liability A/c Dr.	50,000	
	To, Bank A/c		50,000
	Depreciation A/c Dr.	48,961	
	To, ROU Asset A/c		48,961
End of Year 2	Interest Expenses A/c Dr.	11,157	
	To, Lease Liability A/c		11,157
	Lease Liability A/c Dr.	50,000	
	To, Bank A/c		50,000
	Depreciation A/c Dr.	48,961	
	To, ROU Asset A/c		48,961
End of Year 3	Interest Expenses A/c Dr.	7,273	
	To, Lease Liability A/c		7,273
	Lease Liability A/c Dr.	50,000	
	To, Bank A/c		50,000
	Depreciation A/c Dr.	48,960	
	To, ROU Asset A/c		48,960
	Lease Liability A/c Dr.	30,000	
	To, Bank A/c (50,000 – 33,000 = 17,000)		17,000
	To, P&L A/c (liability remission = 30,000 – 17,000)		13,000

PART B: In Books of Lessor Y

Step 1: Present Value of Lease Receivable

(Same as above: ₹1,46,882 at 10%)

Step 2: Deferred Selling Profits at Inception

PARTICULARS	₹
Revenue = PV of lease receivable	1,46,882
Cost of goods sold = 1,36,000 – 15,026 (PV of unguaranteed residual)	1,20,974
Deferred selling profits at inception	25,908

$*20,000 \times 0.7513 = 15,026$ (PV of unguaranteed residual)

Step 3: Net Investment in Lease at Inception

= PV of lease receivable + PV of unguaranteed residual – Deferred selling profits
= 1,46,882 + 15,026 – 25,908 = **₹1,36,000** (= carrying amount)

Step 4: Interest Income at 19.274%

YEAR	NET INVESTMENT (₹)	INTEREST @ 19.274% (₹)	PAYMENT (₹)	BALANCE (₹)
0	1,36,000	–	–	1,36,000
1	1,36,000	26,213	50,000	1,12,213
2	1,12,213	21,628	50,000	83,841
3	83,841	16,159	50,000	50,000
3	–	–	17,000	33,000
3	–	–	33,000	0

DATE	PARTICULARS	DR. (₹)	CR. (₹)
At inception	Net Investment in Lease A/c Dr.	1,36,000	
	To, PPE		1,36,000
End of Year 1	Bank A/c Dr.	50,000	
	To, Interest Income A/c		26,213
	To, Net Investment in Lease A/c		23,787
End of Year 2	Bank A/c Dr.	50,000	
	To, Interest Income A/c		21,628
	To, Net Investment in Lease A/c		28,372
End of Year 3	Bank A/c Dr.	50,000	
	To, Interest Income A/c		16,159
	To, Net Investment in Lease A/c		33,841
	PPE A/c Dr.	33,000	
	Bank A/c Dr.	17,000	
	To, Net Investment in Lease A/c		50,000

9. Common Mistakes Students Make

⚠ WARNING

- Forgetting guaranteed residual value in PV.
- Incorrect discount rate.
- Not depreciating ROU asset over correct period.
- Confusing finance lease and operating lease accounting.
- Not accounting for guarantee remission.

10. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 116 in 90 seconds:

- $\text{ROU Asset} = \text{Lease Liability} + \text{Prepaid} + \text{Initial Direct} + \text{Dismantling PV} - \text{Incentives}$
- $\text{Lease Liability} = \text{PV of lease payments}$
- Depreciate ROU over lease term.
- $\text{Interest} = \text{Opening Liability} \times \text{Rate}$.
- Lessor: Finance Lease $\rightarrow$ Net Investment + Interest Income.
- Operating Lease $\rightarrow$ Lease Income + Depreciation.
- **Mnemonic: ROU-LIP** $\rightarrow$ ROU = Liability + Initial Direct + Prepaid + Dismantling PV – Incentives

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 116 is a high-weightage topic. Master the lease liability and ROU asset schedules. Practice comprehensive problems covering both lessee and lessor accounting.

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

1. Chapter Overview

Ind AS 21 prescribes how to include foreign currency transactions and foreign operations in financial statements, and how to translate financial statements into a presentation currency.

2. Important Definitions

DEFINITION

Functional Currency: Currency of the primary economic environment in which entity operates.

DEFINITION

Presentation Currency: Currency in which financial statements are presented.

DEFINITION

Monetary Items: Units of currency held and assets/liabilities to be received/paid in fixed or determinable number of currency units.

DEFINITION

Non-Monetary Items: Items other than monetary items.

3. Key Concepts

- Initial recognition: Spot rate at transaction date.
- Monetary items at reporting date: Closing rate.
- Non-monetary at historical cost: Transaction date rate.
- Non-monetary at fair value: Fair value date rate.
- Exchange differences on monetary items → P&L.
- Net investment in foreign operation → OCI.

4. Full ICMAl Illustrations

ICMAl ILLUSTRATION

ICMAI Example 1 – Impairment Loss in Functional Currency

Question: Entity A's functional currency is Rupee. It has a building located in US acquired at a cost of US\$20,000 when the exchange rate was US\$1 = ₹60. The building is carried at cost. At balance sheet date, there is an indication of impairment. Recoverable amount is US\$19,000. Exchange rate at balance sheet date is US\$1 = ₹64. Determine if impairment loss should be recognised.

SOLUTION

Step 1: Translate Cost at Acquisition Date Rate

$$\text{Cost} = \text{US\$}20,000 \times ₹60 = ₹12,00,000$$

Step 2: Translate Recoverable Amount at Closing Rate

$$\text{Recoverable amount} = \text{US\$}19,000 \times ₹64 = ₹12,16,000$$

Step 3: Compare

$$\text{Carrying amount} = ₹12,00,000$$

$$\text{Recoverable amount} = ₹12,16,000$$

Since recoverable amount > carrying amount, **NO impairment loss is recognised.**

Conclusion

Though there is an impairment loss of US\$1,000 in foreign currency terms, there is no impairment loss in functional currency terms because the recoverable amount in functional currency exceeds the carrying amount.

ICMAI Example 2 – Net Investment in Foreign Operation

Question: Entity P has a foreign subsidiary Entity S1. Functional currencies: P = Rupee, S1 = US\$. Accounting year ends on March 31. P owes S1 US\$2,000 towards a loan obtained some years back. Exchange rates: 31 March 20X0: US\$1 = ₹58; 31 March 20X1: US\$1 = ₹60. Show accounting treatment.

SOLUTION

Step 1: In S1's Individual Financial Statements

No exchange difference arises on the loan since it is denominated in its own functional currency (US\$).

Step 2: In P's Separate Financial Statements

Loan asset of US\$2,000 translated at:

- 31 March 20X0: US\$2,000 × ₹58 = ₹1,16,000
- 31 March 20X1: US\$2,000 × ₹60 = ₹1,20,000

Exchange gain = ₹4,000

Step 3: In Consolidated Financial Statements

Exchange gain of ₹4,000 recognised in **Other Comprehensive Income (OCI)** and accumulated in equity.

5. Common Mistakes Students Make

⚠ WARNING

- Using closing rate for non-monetary items at historical cost.
- Recognising all exchange differences in P&L.
- Forgetting OCI treatment for net investment.
- Incorrect functional currency determination.

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 21 in 60 seconds:

- Functional Currency = Primary economic environment.
- Initial: Spot rate.
- Monetary → Closing rate; Non-monetary → Historical/FV rate.
- Exchange differences → P&L (or OCI for net investment).
- Presentation currency: Assets/Liabilities → Closing rate; Income/Expenses → Transaction date rate.
- **Mnemonic: MCHN** → Monetary → Closing Rate; Historical Cost Non-Monetary → No change

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 21 is a moderate-weightage topic. Focus on functional currency determination, monetary vs non-monetary classification, and exchange difference treatment.

Ind AS 23 – Borrowing Costs

1. Chapter Overview

Ind AS 23 provides principles for recognising borrowing costs as asset or expense. Borrowing costs directly attributable to acquisition, construction, or production of a qualifying asset are capitalised; others are expensed.

2. Important Definitions

DEFINITION

Borrowing Costs: Interest and other costs incurred in connection with borrowing of funds.

DEFINITION

Qualifying Asset: Asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

DEFINITION

Capitalisation Rate: Weighted average of borrowing costs applicable to borrowings outstanding during the period, other than specific borrowings.

3. Important Formulae

FORMULA

Capitalisation Rate = Weighted Average of Borrowing Costs / Weighted Average Borrowings

FORMULA

Borrowing Costs Eligible = Capitalisation Rate × Expenditure on Qualifying Asset

FORMULA

Exchange Difference Adjustment = Exchange Loss not exceeding difference between cost of borrowing in functional currency vs foreign currency

4. Full ICMAl Illustrations

ICMAl ILLUSTRATION

ICMAI Illustration – Specific Borrowing with Exchange Difference

Question: X Ltd. borrowed US\$6,000 for construction of a qualifying asset at 3% interest p.a. on 01.04.2021 when US\$1 = ₹60, due for payment on 31.03.2023. The company could borrow the amount in rupees at 12% interest p.a. Interest is payable on 31.03.2023. Construction continues till 31.03.2023. If on 31.03.2022 US\$1 = ₹70, compute the borrowing cost.

COMPLETE SOLUTION

Step 1: Compute Exchange Loss

$$\text{Exchange loss} = (\text{₹}70 - \text{₹}60) \times \text{US\$}6,000 = \text{₹}60,000$$

Step 2: Compute Cost of Borrowing in Foreign Currency

$$= 3\% \times \text{US\$}6,000 \times \text{₹}70 = \text{₹}12,600$$

Step 3: Compute Cost of Borrowing in Functional Currency

$$= 12\% \times \text{US\$}6,000 \times \text{₹}60 = \text{₹}43,200$$

Step 4: Compute Difference

$$\text{Difference} = \text{₹}43,200 - \text{₹}12,600 = \text{₹}30,600$$

(not exceeding exchange loss of ₹60,000)

Step 5: Total Borrowing Cost

$$= \text{₹}12,600 + \text{₹}30,600 = \text{₹}43,200$$

ICMAI Illustration – General Borrowings

Question: X Ltd. borrowed ₹6,00,000 at 15% from bank and issued 12% Debentures of ₹4,00,000 for construction of a factory and office building on 01.04.2021. Amount utilised: factory ₹3,00,000 on 01.07.2021 and building ₹7,00,000 on 01.10.2021. Unutilised amount invested at 10% Bonds. Compute capitalisable borrowing costs.

COMPLETE SOLUTION

Step 1: Compute Capitalisation Rate

Bank loan: ₹6,00,000 × 15% = ₹90,000

Debentures: ₹4,00,000 × 12% = ₹48,000

Total borrowing cost = ₹1,38,000

Total borrowings = ₹10,00,000

Capitalisation rate = $1,38,000 / 10,00,000 = 13.8\%$

Step 2: Compute Borrowing Cost for Factory

Expenditure = ₹3,00,000

Period = 9 months (01.07.2021 to 31.03.2022)

Borrowing cost = $13.8\% \times ₹3,00,000 \times 9/12 = ₹31,050$

Step 3: Compute Borrowing Cost for Building

Expenditure = ₹7,00,000

Period = 6 months (01.10.2021 to 31.03.2022)

Borrowing cost = $13.8\% \times ₹7,00,000 \times 6/12 = ₹48,300$

Step 4: Compute Investment Income

Factory: ₹3,00,000 × 3/12 × 7% = ₹5,250

Building: ₹7,00,000 × 6/12 × 7% = ₹24,500

Total investment income = ₹29,750

Step 5: Net Capitalisable Borrowing Cost

Factory: ₹31,050 + ₹5,250 = ₹36,300 (approximately)

Building: ₹48,300 + ₹24,500 = ₹72,800 (approximately)

5. Common Mistakes Students Make

WARNING

- Capitalising all borrowing costs.
- Forgetting to deduct investment income.
- Incorrect capitalisation rate.
- Ignoring exchange difference adjustment.
- Not checking cessation criteria.

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 23 in 60 seconds:

- Qualifying Asset = Substantial period to get ready.
- Specific Borrowing → Actual Cost – Investment Income.
- General Borrowing → Capitalisation Rate × Expenditure.
- Capitalisation Rate = Weighted Average.
- Commence: Expenditure + Borrowing Costs + Activities.
- Suspend: Extended period of inactivity.
- Cease: Substantially complete.
- **Mnemonic: Q-S-G-C** → Qualifying Asset → Specific → General → Capitalisation Rate

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 23 is a moderate-weightage topic. Focus on capitalisation rate computation and specific vs general borrowings. Practice exchange difference adjustment.

Ind AS 36 – Impairment of Assets

1. Chapter Overview

Ind AS 36 prescribes procedures to ensure assets are carried at no more than their recoverable amount. It specifies when to reverse impairment loss and prescribes disclosures.

2. Important Definitions

DEFINITION

Impairment Loss: Amount by which carrying amount exceeds recoverable amount.

DEFINITION

Recoverable Amount: Higher of fair value less costs to sell and value in use.

DEFINITION

Value in Use: Present value of estimated future cash flows expected from asset and from disposal at end of useful life.

DEFINITION

Cash Generating Unit (CGU): Smallest identifiable group of assets that generates cash inflows largely independent of other assets.

3. Important Formulae

FORMULA

Recoverable Amount = Higher of (Fair Value Less Costs to Sell, Value in Use)

FORMULA

Impairment Loss = Carrying Amount – Recoverable Amount

FORMULA

Value in Use = PV of estimated future cash flows

4. Full ICMAl Illustrations

ICMAl ILLUSTRATION

ICMAI Illustration 10 – Basic Impairment Loss Computation

Question: A Ltd. has a machine whose original cost was ₹45,000. Accumulated depreciation is ₹15,000. Similar machine recently sold at ₹25,000 with selling expenses ₹2,000. Management determined entity specific present value of future cash flows as ₹28,000. Find (a) Fair value less cost to sell, (b) Recoverable amount, (c) Impairment loss, (d) Carrying amount after impairment.

COMPLETE SOLUTION

Step 1: Fair Value Less Cost to Sell

$$= ₹25,000 - ₹2,000 = ₹23,000$$

Step 2: Recoverable Amount

$$\begin{aligned} &= \text{Higher of FV less costs (₹23,000) and Value in use (₹28,000)} \\ &= ₹28,000 \end{aligned}$$

Step 3: Impairment Loss

$$\begin{aligned} \text{Carrying amount} &= ₹45,000 - ₹15,000 = ₹30,000 \\ \text{Impairment loss} &= ₹30,000 - ₹28,000 = ₹2,000 \end{aligned}$$

Step 4: Carrying Amount After Impairment

$$= ₹30,000 - ₹2,000 = ₹28,000 \text{ (= recoverable amount)}$$

ICMAI Illustration 11 – CGU Impairment Allocation with Goodwill

Question: An entity has the following assets with relevant data on reporting date:

ASSETS	CARRYING AMOUNT (₹ LAKHS)	FAIR VALUE LESS COST TO SELL (₹ LAKHS)	VALUE-IN-USE (₹ LAKHS)
A	280	300	250
B	460	400	390
C	220	240	270
D	180	150	170
E	100	80	—

Assets C and D were revalued before. Revaluation surplus: C = ₹40 Lakhs, D = ₹30 Lakhs. Asset E falls in CGU consisting of goodwill ₹50 Lakhs and intangible asset ₹90 Lakhs. Fair value less cost to sell of CGU = ₹180 Lakhs and value-in-use = ₹170 Lakhs. Determine impairment loss and revised carrying amounts.

COMPLETE SOLUTION

Step 1: Individual Asset Impairment

ASSET	CARRYING AMOUNT	RECOVERABLE AMOUNT	IMPAIRMENT LOSS	REVISED CA
A	280	300	–	280
B	460	400	60	400
C	220	270	–	220
D	180	170	10 (β)	170

β: Impairment Loss charged against revaluation surplus.

Step 2: CGU Impairment

CGU consists of: Goodwill ₹50 + Intangible ₹90 + Asset E ₹100 = ₹240 Lakhs

Recoverable amount = ₹180 Lakhs

Impairment loss = ₹240 – ₹180 = ₹60 Lakhs

Step 3: Allocate CGU Impairment

First, reduce goodwill by ₹50 Lakhs → NIL

Remaining ₹10 Lakhs allocated pro-rata to:

Intangible: $(90/190) \times 10 = ₹4.47$ Lakhs

Asset E: $(100/190) \times 10 = ₹5.26$ Lakhs

ASSET	REVISED CA
Goodwill	NIL
Intangible Asset	₹85.53 Lakhs
Asset E	₹94.74 Lakhs

ICMAI Illustration 12 – Impairment with Revaluation and Subsequent Reversal

Question: An entity has machinery on 01.04.2017 with carrying amount ₹28,00,000 after annual depreciation of ₹3,00,000 with remaining useful life of 9 years and residual value ₹1,00,000. Depreciation on SLM. On 31.03.2018 machine revalued at ₹29,00,000. On 31.03.2020 fair value less cost to sell ₹20,00,000 and value in use ₹21,00,000. Show transactions in financial statements as on 31.03.18, 31.03.19, 31.03.20, 31.03.21.

COMPLETE SOLUTION

Working Note 1: Carrying Amount and Depreciation

PARTICULARS	₹
Carrying Amount on 01.04.2017	28,00,000
Less: Depreciation during 2017-18	(3,00,000)
Carrying amount	25,00,000
Add: Revaluation Profit (29,00,000 – 25,00,000)	4,00,000
Carrying amount on 31.03.2018	29,00,000
Less: Depreciation 2018-19 = (29,00,000 – 1,00,000)/8	(3,50,000)
Carrying amount on 31.03.2019	25,50,000
Less: Depreciation 2019-20	(3,50,000)
Carrying amount on 31.03.2020 (before impairment)	22,00,000
Less: Impairment loss (22,00,000 – 21,00,000)	(1,00,000)
Carrying amount on 31.03.2020	21,00,000
Less: Depreciation 2020-21 = (21,00,000 – 1,00,000)/6	(3,33,333)
Carrying amount on 31.03.2021	17,66,667

Financial Statement Extracts

STATEMENT OF P&L	31.03.18	31.03.19	31.03.20	31.03.21
Depreciation	(3,00,000)	(3,50,000)	(3,50,000)	(3,33,333)
Revaluation Profit (OCI)	+4,00,000			
Transfer to Retained Earnings		(50,000)	(50,000)	(33,333)
Impairment loss			(1,00,000)	

BALANCE SHEET	31.03.18	31.03.19	31.03.20	31.03.21
PPE – Machinery	29,00,000	25,50,000	21,00,000	17,66,667
Revaluation Profit (Other Equity)	4,00,000	3,50,000	2,00,000	1,66,667

5. Common Mistakes Students Make

⚠ WARNING

- Using lower of FV and value in use.
- Not allocating goodwill first.
- Forgetting pro-rata allocation.
- Not checking revised carrying amount limits.
- Reversing goodwill impairment.

6. 1-Day Before Exam Revision Sheet

📅 1 DAY BEFORE EXAM

Ind AS 36 in 60 seconds:

- Recoverable Amount = Higher of FV – Costs and Value in Use.
- Impairment Loss = CA – Recoverable Amount.
- CGU: Goodwill first, then pro-rata.
- Revised CA not below highest of net selling price, VIU, zero.
- Reversal: Not for goodwill.
- **Mnemonic: FV-VIU** → Recoverable = Higher of Fair Value less costs and Value In Use.
- **Mnemonic: G-PRO** → Goodwill first, then PRO-rata.

🔑 KEY TAKEAWAY

Chapter End Key Notes: Ind AS 36 is a high-weightage topic. Master CGU allocation and reversal rules. Practice comprehensive problems with goodwill and multiple assets.

Ind AS 38 – Intangible Assets

1. Chapter Overview

Ind AS 38 prescribes accounting treatment for intangible assets not dealt with specifically in another Standard. It requires recognition if specified criteria are met.

2. Important Definitions

DEFINITION

Intangible Asset: Identifiable non-monetary asset without physical substance.

DEFINITION

Research: Original and planned investigation undertaken with prospect of gaining new scientific or technical knowledge.

DEFINITION

Development: Application of research findings to a plan or design for production of new or substantially improved materials, devices, products, processes, systems, or services before commencement of commercial production.

DEFINITION

Amortisation: Systematic allocation of depreciable amount of intangible asset over its useful life.

3. Key Concepts

- Recognition: Identifiable + Controlled + Probable benefits + Reliable measurement.
- Research expenditure → Expense.
- Development expenditure → Capitalise if conditions met.
- Internally generated goodwill, brands, customer lists → Not recognised.
- Finite life → Amortise; Indefinite life → Annual impairment test.
- Revaluation only if active market exists.

4. Full ICMAI Illustration

ICMAI ILLUSTRATION

ICMAI Case 1 – Intangible Assets in Consolidated Balance Sheet

Question: After acquiring control of the subsidiary company, the draft of consolidated balance sheet of parent included the following intangible assets which did not appear in the draft individual balance sheet of the subsidiary: (i) Customers list (ii) Publishing titles. One view is that as the items were not recognized by the subsidiary company, it should not be recognized by the parent also. Do you agree?

SOLUTION

Analysis: The intangible assets may be internally generated (or not fulfill the conditions of being recognized as intangible asset) and hence they were not recognized as intangible asset by the subsidiary company.

Conclusion: **No, the parent should recognize them.** Under Ind AS 103, such intangible assets are identifiable and arising based on contractual/legal rights, and are recognized at fair value in the consolidated balance sheet of parent.

Reason: Business combination accounting requires recognition of all identifiable assets acquired, regardless of whether they were recognized by the acquiree before acquisition.

5. Common Mistakes Students Make

WARNING

- Capitalising research expenditure.
- Recognising internally generated goodwill.
- Amortising indefinite-life intangibles.
- Forgetting annual impairment test for indefinite-life intangibles.
- Using revaluation model without active market.

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 38 in 60 seconds:

- Intangible = Identifiable + Non-monetary + No physical substance.
- Recognition: Identifiable + Controlled + Probable + Reliable.
- Research → Expense; Development → Capitalise if conditions met.
- Internally generated brands, customer lists → Not recognised.
- Finite life → Amortise; Indefinite life → Annual impairment test.
- Revaluation → Only if active market.
- **Mnemonic: R-E-D** → Research → Expense; Development → Capitalise if conditions met.

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 38 is a moderate-weightage topic. Focus on research vs development, capitalisation conditions, and amortisation rules. Practice classification and journal entries.

Ind AS 102 – Share-based Payment

1. Chapter Overview

Ind AS 102 specifies financial reporting when an entity undertakes share-based payment transactions. It requires reflection of effects of share-based payment transactions in profit or loss and financial position.

2. Important Definitions

DEFINITION

Share-based Payment Transaction: Transaction in which entity receives goods or services as consideration for equity instruments or incurs liability to transfer cash/other assets based on value of equity instruments.

DEFINITION

Equity-settled: Transaction settled by issue of equity instruments.

DEFINITION

Cash-settled: Transaction settled by transfer of cash or other assets based on value of equity instruments.

DEFINITION

Grant Date: Date on which share-based payment plan is announced and accepted by counterparty.

DEFINITION

Vesting Date: Date on which employee becomes entitled to payment.

DEFINITION

Vesting Period: Period between grant date and vesting date.

DEFINITION

Vesting Conditions: Conditions that determine whether entity receives services that entitle counterparty to receive cash, assets, or equity instruments.

DEFINITION

Market Condition: Performance condition related to market price of equity instruments.

DEFINITION

Non-Market Performance Condition: Performance condition not related to market price.

3. Important Formulae

FORMULA

Equity-Settled Expense = Fair Value of Options × Number of Employees Expected to Vest × (Period Expired / Vesting Period)

FORMULA

Cash-Settled Liability = Fair Value of Liability × Number of Employees Expected to Vest × (Period Expired / Vesting Period)

FORMULA

Equity Component = FV of Equity Alternative – FV of Cash Alternative

4. Full ICAI Illustrations with Step-by-Step Solutions

ICAI ILLUSTRATION

ICAI Illustration 13 – Types of Share-Based Payment Transactions

Question (a): D Ltd. offers shares to its employees as bonus for meeting a target. Is it a share based payment transaction? Is it equity settled or cash settled?

SOLUTION

It is share-based payment transaction. It is **equity settled** share based payment transaction as D issues its own shares against receiving of services from the employees.

Question (b): Mr. Z is granted share options conditional upon completing 2 years' service. How is the transaction recognised?

SOLUTION

The transaction will be recognized as equity-settled share based payment transaction. The services from the employee will be assumed to be rendered in future during the vesting period. In each financial statements falling in the vesting period the fair value of the share options as on the grant date will be recognized in proportion of the period expired to the total vesting period.

Question (c): Mr. X is an employee of P Ltd. and also holder of equity shares of P. P makes a right issue on equity and X receives his right. Is it a share-based payment transaction?

SOLUTION

No. For the purpose of this standard, a transaction with an employee or other party in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction.

Question (d): D Ltd. grants 10 share appreciation rights to Q, an employee, entitling him to receive cash payment for the increase in quoted price of D's shares from the exercise price of ₹500 per share after 3 years. How the transaction should be recognized if it is assumed for i) his past service, ii) his service in future 3 years?

SOLUTION

The transaction should be recognized as **cash-settled** share based payment transaction.

(a) For past service, the entity shall recognize immediately the services received and a liability to pay for them at fair value of the rights on the grant date.

(b) For future service, transaction will be recognized in the financial statements at fair value of the rights on the grant date proportionate to the period expired to total vesting period.

Question (e): What amount of expenses will be recognized in each year?

SOLUTION

(i) Z Ltd. grants 100 share options to each of its 400 employees conditional on their continuing in service for 3 years. Fair value of share option on the grant date is ₹30.

YEAR	CALCULATION	CUMULATIVE REMUNERATION EXPENSE (₹)	REMUNERATION EXPENSE RECOGNIZED IN EACH YEAR (₹)
1	$400 \times 100 \times 30 \times 1/3$	4,00,000	4,00,000
2	$400 \times 100 \times 30 \times 2/3$	8,00,000	4,00,000
3	$400 \times 100 \times 30 \times 3/3$	12,00,000	4,00,000

(ii) Z Ltd. estimates that 20 per cent of employees will leave during the three-year period and therefore forfeit their rights to the share options.

YEAR	CALCULATION	CUMULATIVE REMUNERATION EXPENSE (₹)	REMUNERATION EXPENSE RECOGNIZED IN EACH YEAR (₹)
1	$400 \times 100 \times 30 \times 80\% \times 1/3$	3,20,000	3,20,000
2	$400 \times 100 \times 30 \times 80\% \times 2/3$	6,40,000	3,20,000
3	$400 \times 100 \times 30 \times 80\% \times 3/3$	9,60,000	3,20,000

ICMAI Illustration 14 – Equity Settled with Service Condition and Revision in Number of Employees

Question: Z Ltd. grants 100 share options to each of its 400 employees conditional on their continuing in service for 3 years. Fair value of share option on the grant date is ₹30. During year 1, 18 employees leave. The entity revises its estimate of total employee departures over the three-year period from 20 per cent to 16 per cent. During year 2, a further 20 employees leave. The entity revises its estimate of total employee departures from 16 per cent to 13 per cent. During year 3, a further 14 employees leave. All the continuing employees exercised the option to subscribe in the equity shares of ₹10 each at ₹50 only, when market price stands at ₹84. Pass Journal Entries of all the years and show the working.

COMPLETE SOLUTION

Working Note 1: Calculation of Expenses during Vesting Period

YEAR	CALCULATION	CUMULATIVE REMUNERATION EXPENSE (₹)	REMUNERATION EXPENSE RECOGNIZED IN EACH YEAR (₹)
1	$400 \times 100 \times 30 \times 84\% \times 1/3$	3,36,000	3,36,000
2	$400 \times 100 \times 30 \times 87\% \times 2/3$	6,96,000	3,60,000
3	$348 \times 100 \times 30 \times 3/3$	10,44,000	3,48,000

Note: At end of Year 1, 16% is revised estimated departure, balance 84% is taken. At end of Year 2, 13% is revised estimated departure, balance 87%. At end of Year 3, 52 is actual departure, balance 348 is taken.

YEAR	PARTICULARS	DR. (₹)	CR. (₹)
Year 1	Employee Expenses A/c Dr.	3,36,000	
	To, Share Based Payment Reserve (Other Equity) A/c		3,36,000
Year 2	Employee Expenses A/c Dr.	3,60,000	
	To, Share Based Payment Reserve (Other Equity) A/c		3,60,000
Year 3	Employee Expenses A/c Dr.	3,48,000	
	To, Share Based Payment Reserve (Other Equity) A/c		3,48,000

When shares are actually issued:

Exercise price = ₹50. Fair Value of Option granted = ₹30. Equity credited by (Exercise price + option value) = ₹80; nominal value ₹10; Security premium ₹70. Market price ₹84 is not recognised.

PARTICULARS	DR. (₹)	CR. (₹)
Bank A/c [348 × 100 × 50] Dr.	17,40,000	
Share Based Payment Reserve (Other Equity) A/c Dr.	10,44,000	
To, Equity Share Capital A/c [348 × 100 × 10]		3,48,000
To, Other Equity (Security Premium) A/c		24,36,000

ICMAI Illustration 15 – Cash Settled Share Appreciation Rights (SARs)

Question: PQR Ltd. grants 80 cash share appreciation rights (SARs) to each of its 400 employees, on condition that the employees remain in its employment for the next three years. During year 1, 30 employees leave. The entity estimates that a further 50 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 30 will leave during year 3. During year 3, 40 employees leave. At the end of year 3, all SARs held by the remaining employees vest. At the end of year 3, 100 employees exercise their SARs, another 120 employees exercise at end of year 4 and remaining at end of year 5. Fair values: Year 1 = ₹15, Year 2 = ₹16, Year 3 = ₹18. Intrinsic values: Year 3 = ₹15, Year 4 = ₹20, Year 5 = ₹24.

COMPLETE SOLUTION

Step 1: Basis of Calculation

AT END OF YEAR	ACTUAL + ESTIMATED DEPARTURES	EXPENSE & LIABILITY	EXERCISED	REMAINING EMPLOYEES
1	$[30] + 50 = 80$	320 employees at ₹15		
2	$[30+40] + 30 = 100$	300 employees at ₹16		
3	$[30+40+40] = 110$	290 employees at ₹18	100 employees at ₹15	190 at ₹18
4			120 employees at ₹20	70 at ₹20
5			70 employees at ₹24	0

Step 2: Calculation of Employee Expense and Liability

YEAR	CALCULATION	ANNUAL EXPENSE (₹)	LIABILITY AT END (₹)
1	$(400 - 80) \times 80 \times 15 \times 1/3$	1,28,000	1,28,000
2	$(400 - 100) \times 80 \times 16 \times 2/3 - 1,28,000$	1,28,000	2,56,000
3	$(400 - 110 - 100) \times 80 \times 18 - 2,73,600$	17,600	2,73,600

ICMAI Illustration 16 – Compound Financial Instrument (Settlement by Choice)

Question: On condition of completion of 3 years service an employee is granted the right to choose either: (i) right to cash payment equal to the value of 3000 shares, or (ii) 3600 shares with restriction to hold them for 3 years after vesting. The share price (nominal value ₹10) at the grant date is ₹60 and after taking the effect of the post-vesting transfer restriction the fair value is estimated at ₹54 per share. At the end of years 1, 2 and 3 the share price is ₹64, ₹68 and ₹72 respectively. At the end of year 3, the employee chooses: (a) the cash alternative; (b) the equity alternative. Show the necessary workings and pass journal entries.

COMPLETE SOLUTION

Working Note 1: Fair Value of Equity Component

Fair value of equity alternative = 3600 shares × ₹54 = ₹1,94,400

Fair value of cash alternative = 3000 shares × ₹60 = ₹1,80,000

Fair value of equity component = ₹1,94,400 – ₹1,80,000 = ₹14,400

Working Note 2: Expenses, Equity and Liabilities Recognized

YEAR	EXPENSES (₹)	EQUITY (₹)	LIABILITIES (₹)
1	Liability: $3000 \times 64 \times 1/3 = 64,000$ Equity: $14,400 \times 1/3 = 4,800$	4,800	64,000
2	Liability: $3000 \times 68 \times 2/3 - 64,000 = 72,000$ Equity: $14,400 \times 1/3 = 4,800$	4,800	72,000
3	Liability: $3000 \times 72 - 1,36,000 = 80,000$ Equity: $14,400 \times 1/3 = 4,800$	4,800	80,000
Total	$2,16,000 + 14,400 = 2,30,400$	14,400	2,16,000

YEAR	PARTICULARS	DR. (₹)	CR. (₹)
1	Employee Expenses A/c Dr.	68,800	
	To, Share Based Payment Reserve (Other Equity) A/c		4,800
	To, Share Based Payment Liability A/c		64,000
2	Employee Expenses A/c Dr.	76,800	
	To, Share Based Payment Reserve (Other Equity) A/c		4,800
	To, Share Based Payment Liability A/c		72,000
3	Employee Expenses A/c Dr.	84,800	
	To, Share Based Payment Reserve (Other Equity) A/c		4,800
	To, Share Based Payment Liability A/c		80,000
3(a)	Cash alternative: Share Based Payment Liability A/c Dr.	2,16,000	
	To, Cash A/c		2,16,000
3(b)	Equity alternative: Share Based Payment Liability A/c Dr.	2,16,000	
	To, Equity Share Capital (₹10 × 3000) A/c		30,000
	To, Security Premium (₹62 × 3000) A/c		1,86,000
	Share Based Payment Reserve A/c Dr.	14,400	
	To, Equity Share Capital (₹10 × 600) A/c		6,000
	To, Security Premium (Balancing figure)		8,400

5. Common Mistakes Students Make

⚠ WARNING

- Using market price at vesting date for equity-settled.
- Forgetting to remeasure cash-settled liability.
- Incorrect vesting period proportion.
- Not revising estimates for employee departures.
- Confusing equity-settled and cash-settled.

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 102 in 60 seconds:

- Equity-settled → FV at Grant Date → Equity Reserve.
- Cash-settled → FV at Recognition → Liability → Remeasure.
- Expense = FV × Expected Vesting × (Period / Total Vesting).
- Market condition → Grant date FV.
- Non-market → Revise transaction amount.
- Compound → Equity = FV Equity Alt – FV Cash Alt.
- **Mnemonic: E-G-C** → Equity-settled → Grant date FV → Credit Equity.
- **Mnemonic: C-R-L** → Cash-settled → Remeasure → Liability.

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 102 is a high-weightage topic. Master the computation of expense for equity-settled and cash-settled transactions, and compound instruments. Practice journal entries for all stages.

Ind AS 108 – Operating Segments

1. Chapter Overview

Ind AS 108 establishes principles for reporting financial information about different segments. It helps users understand performance, assess risks and returns, and make informed judgements.

2. Important Definitions

DEFINITION

Operating Segment: Component of entity that engages in business activities, whose operating results are regularly reviewed by chief operating decision maker (CODM), and for which discrete financial information is available.

DEFINITION

Reportable Segment: Operating segment that meets quantitative thresholds or is identified as reportable.

3. Important Formulae

FORMULA

Revenue Threshold = 10% of Combined Revenue (Internal + External)

FORMULA

Profit/Loss Threshold = 10% of Higher of Combined Profit or Combined Loss

FORMULA

Asset Threshold = 10% of Combined Assets

FORMULA

75% Test = External Revenue of Reportable Segments $\geq$ 75% of Total External Revenue

4. Full ICAI Illustration 21

ICAI ILLUSTRATION

ICMAI Illustration 21 – Identification of Reportable Segments

Question: An enterprise operates through eight segments, namely, A, B, C, D, E, F, G and H. The relevant information is given below (amounts in ₹'000):

PARTICULARS	A	B	C	D	E	F	G	H	TOTAL
External Sales	—	663	37	25	13	12	—	—	1,000
Inter Segment Sales	250	150	75	13	—	—	12	—	500
Segment Results	15	(270)	45	(15)	24	(15)	15	21	
Segment Assets	15	55	60	35	5	2	10	0	100

Identify the reportable segments as per Ind AS 108.

COMPLETE SOLUTION

Step 1: Segment Revenue Criterion

Threshold = 10% of total revenue = 10% of (1,000 + 500) = ₹150

Segments meeting threshold:

A: 250 (inter) $\geq 150 \rightarrow$ Reportable

B: 663 + 150 = 813 $\geq 150 \rightarrow$ Reportable

C: 37 + 75 = 112 $< 150 \rightarrow$ Not reportable

D: 25 + 13 = 38 $< 150 \rightarrow$ Not reportable

E: 13 $< 150 \rightarrow$ Not reportable

F: 12 $< 150 \rightarrow$ Not reportable

G: 12 $< 150 \rightarrow$ Not reportable

H: 0 $< 150 \rightarrow$ Not reportable

Reportable Segments based on Revenue: A and B

Step 2: Result Criterion

Total Profit = 15 + 45 + 24 + 15 + 21 = ₹120

Total Loss = 270 + 15 + 15 = ₹300

Higher of the two = ₹300

Threshold = 10% of ₹300 = ₹30

Segments meeting threshold:

B: $| -270 | = 270 \geq 30 \rightarrow$ Reportable

C: 45 $\geq 30 \rightarrow$ Reportable

A: 15 $< 30 \rightarrow$ Not reportable

D: $| -15 | = 15 < 30 \rightarrow$ Not reportable

E: 24 $< 30 \rightarrow$ Not reportable

F: $| -15 | = 15 < 30 \rightarrow$ Not reportable

G: 15 $< 30 \rightarrow$ Not reportable

H: 21 $< 30 \rightarrow$ Not reportable

Reportable Segments based on Result: B and C

Step 3: Asset Criterion

Threshold = 10% of total assets = 10% of 100 = ₹10

Segments meeting threshold:

A: 15 $\geq 10 \rightarrow$ Reportable

B: 55 $\geq 10 \rightarrow$ Reportable

C: 60 $\geq 10 \rightarrow$ Reportable

D: 35 $\geq 10 \rightarrow$ Reportable

E: 5 $< 10 \rightarrow$ Not reportable

F: 2 $< 10 \rightarrow$ Not reportable

G: 10 $\geq 10 \rightarrow$ Reportable

H: 0 $< 10 \rightarrow$ Not reportable

Reportable Segments based on Assets: A, B, C, D, G

Step 4: 75% Test

Total external revenue = ₹1,000

75% of total external revenue = ₹750

External revenue of A, B, C, D = 0 + 663 + 37 + 25 = ₹725

725 $< 750 \rightarrow$ Additional segment needed

Assume company selects segment F to meet the 75% threshold.

Final Reportable Segments: A, B, C, D, and F

5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 108 in 60 seconds:

- Operating Segment = Business activity + CODM review + Discrete financial info.
- 10% Thresholds: Revenue, Profit/Loss, Assets.
- 75% Test: External revenue of reportable segments $\geq$ 75% of total.
- Disclose: General info, segment P&L, assets, liabilities, reconciliations.
- Entity-wide: Products/services, geography, major customers.
- **Mnemonic: RPA-10** → Revenue, Profit/Loss, Assets → 10% thresholds.

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 108 is a moderate-weightage topic. Master the 10% thresholds and 75% test. Practice identification of reportable segments and disclosure preparation.

Ind AS 113 – Fair Value Measurement

1. Chapter Overview

Ind AS 113 defines fair value, sets out a framework for measuring fair value, and requires disclosures about fair value measurements.

2. Important Definitions

DEFINITION

Fair Value: Price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

DEFINITION

Principal Market: Market with greatest volume and level of activity for the asset or liability.

DEFINITION

Most Advantageous Market: Market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability.

DEFINITION

Highest and Best Use: Use of a non-financial asset by market participants that would maximise the value of the asset.

DEFINITION

Fair Value Hierarchy: Level 1 (quoted prices), Level 2 (observable inputs), Level 3 (unobservable inputs).

3. Full ICAI Case Studies

ICAI ILLUSTRATION

ICMAI Case 3 – Highest and Best Use

Question: Dawn Ltd. owns one acre of land with an old building beside a river. Currently used as a holiday resort. Market value: land ₹2 crores, building ₹0.5 crore. Alternative use: amusement park. Market value of land at potential use: ₹4 crores. Conversion costs: ₹80 lakhs. Determine fair value under different propositions.

SOLUTION

Applicable Standard: Ind AS 113 Fair Value Measurement. The 'highest and best use' is the appropriate model.

Analysis of Propositions

(i) **Current use value ₹2.5 crores:** Not acceptable. Current use is not the highest and best use.

(ii) **Potential use ₹4 crores:** Not acceptable. Conversion costs not adjusted.

(iii) **₹4.5 crores (land + building):** Not acceptable. Conversion costs not adjusted; building attracts no value as it must be demolished.

(iv) **Land ₹3.2 crores + building ₹0.5 crore:** Not acceptable. Building value is nil in highest and best use.

(v) **Land ₹3.2 crores, Building NIL:** Acceptable.

Land = ₹4 crores – ₹80 lakhs = **₹3.2 crores**

Building = **NIL** (to be demolished for highest and best use)

ICMAI Case 4 – Principal Market and Information-Adjusted Inputs

Question: Dust Ltd. holds shares in Dark Ltd. quoted at ₹780 in BSE and ₹875 equivalent in Japan Exchange Group. Significant activities in BSE only. After market close on 31.03.2022, bad news announced. Next morning: BSE opens at ₹645, Japan at ₹730. Examine validity of accountant's arguments and determine fair value.

SOLUTION

(i) Accountant's Argument – Higher Price ₹875

Not tenable. Most advantageous market can be considered only in absence of a principal market. Since significant activities are in BSE only, BSE is the principal market. Fair value = ₹780 (Level 1 input). No valuation technique needed when Level 1 input is available.

(ii) Accountant's Argument – Stick to ₹875

Not tenable. The quoted price does not faithfully represent fair value on measurement date due to bad news announced after close of trading. Dust Ltd. should adjust the quoted price for the new information and measure fair value at ₹645 (information-adjusted observable input) and disclose as **Level 2 input**.

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 113 in 60 seconds:

- Fair Value = Exit price in orderly transaction.
- Principal Market = Greatest volume/activity.
- Most Advantageous = Maximises proceeds.
- Highest & Best Use for non-financial assets.
- Valuation Techniques: Market, Cost, Income.
- Hierarchy: Level 1 (quoted), Level 2 (observable), Level 3 (unobservable).
- No adjustment for transaction costs; adjust for transport costs.
- **Mnemonic: P-M-H-V-F** → Principal Market → Most Advantageous → Highest & Best Use → Valuation Techniques → Fair Value Hierarchy.

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 113 is a moderate-weightage topic. Focus on principal market, highest and best use, and fair value hierarchy. Practice case studies on market selection and disclosure.

Ind AS 115 – Revenue from Contracts with Customers

1. Chapter Overview

Ind AS 115 establishes principles for reporting useful information to users about nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. It introduces a five-step model for revenue recognition.

2. Important Definitions

DEFINITION

Revenue: Consideration for satisfying performance obligation undertaken in contract.

DEFINITION

Performance Obligation: Promise to transfer a good or service (or bundle) that is distinct.

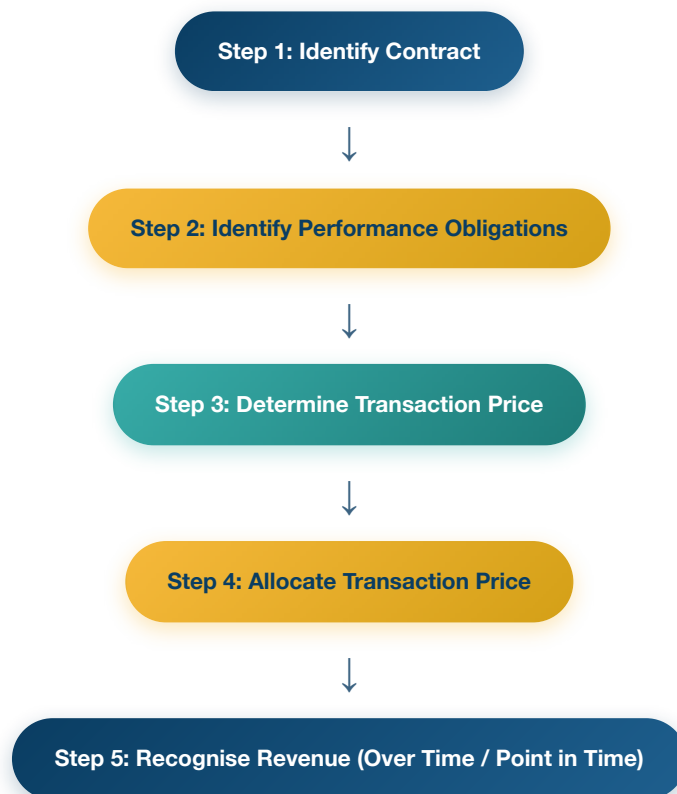
DEFINITION

Transaction Price: Amount of consideration to which entity expects to be entitled in exchange for transferring promised goods/services.

DEFINITION

Stand-alone Selling Price: Price at which entity would sell promised good/service separately to a customer.

3. Five-Step Model



4. Full ICMAl Illustrations with Step-by-Step Solutions

ICMAI ILLUSTRATION

ICMAI Illustration 22A – Contract Modification (Separate Contract)

Question: Z Ltd. agrees to sell 200 units of product A to a customer for ₹3,20,000 (₹1,600 per unit). Units transferred from 01.01.2019 to 30.06.2019. On 31.03.2020, after transfer of control of 100 units, contract modified to deliver additional 50 units at market price of ₹1,400 per unit to be delivered in following 3 months. Show accounting.

SOLUTION

Analysis

The modification is accounted as a distinct separate contract with its stand-alone price.

F.Y. 2019-20 Revenue

Original contract: $(100/200) \times ₹3,20,000 = ₹1,60,000$

F.Y. 2020-21 Revenue

Balance original contract = ₹1,60,000

New contract $(50 \times ₹1,400) = ₹70,000$

Total = ₹2,30,000

ICMAI Illustration 22B – Contract Modification (Termination + New Contract)

Question: On 1.4.2020 contract modified to deliver 150 units of A instead of remaining 100 units by 30.6.2020 at ₹1,500 per unit. Additional performances distinct but additional consideration not stand-alone selling price. Show accounting.

SOLUTION**Modification B Analysis**

Remaining performances distinct but price not stand-alone → Termination of existing + creation of new contract.

F.Y. 2019-20

Revenue = 100 units × ₹1,600 = **₹1,60,000**

F.Y. 2020-21

Unrecognized revenue of original contract (as if terminated) = **NIL**

Contract modification: 150 × ₹1,500 = **₹2,25,000**

Total = **₹2,25,000**

ICMAI Illustration 22C – Contract Modification (Continuation with Modifications)

Question: Original contract price ₹50,000 based on estimated 200 production hours at ₹250 per hour. After revenue recognition for 100 hours, contract modified to increase required hours by 50: (i) at hourly rate ₹200; (ii) at ₹200 for remaining hours; (iii) at ₹200 for total hours required. Remaining performance not distinct. Show accounting.

SOLUTION

Modification C Analysis

Remaining performance not distinct → Continuation with modifications; cumulative catch-up basis.

(i) At ₹200 for 50 hours

PARTICULARS	HOURS	RATE (₹)	AMOUNT (₹)
Original contract	200	250	50,000
Modification	50	200	10,000
Total	250	240	60,000
Revenue recognized (A)	100	250	25,000
Modified recognition (B)	100	240	24,000
Adjustment (A–B)			(1,000)
Future revenue	150	240	36,000

(ii) At ₹200 for 150 hours

PARTICULARS	HOURS	RATE (₹)	AMOUNT (₹)
Revenue recognized (A)	100	250	25,000
Modification for remaining hours	150	200	30,000
Total	250	220	55,000
Modified recognition (B)	100	220	22,000
Adjustment (A–B)			(3,000)
Future revenue	150	220	33,000

(iii) At ₹200 for 250 hours

PARTICULARS	HOURS	RATE (₹)	AMOUNT (₹)
Modification for total hours	250	200	50,000
Revenue recognized (A)	100	250	25,000
Modified recognition (B)	100	200	20,000
Adjustment (A-B)			(5,000)
Future revenue	150	200	30,000

ICMAI ILLUSTRATION

ICMAI Illustration 24 – Discount Voucher (Multiple Performance Obligations)

Question: On 31.03.2020 A Ltd. enters into a contract with a customer for sale of goods of ₹4,000 granting 50% discount voucher to be availed in future purchase up to ₹3,000 within 30 days. Ordinarily 10% discount is allowed. 60% probability customer will redeem voucher; estimated purchase ₹2,000. In April 2020 vouchers redeemed for purchase of additional goods ₹2,800. Find revenue recognition in 2019-20 and 2020-21.

COMPLETE SOLUTION

Step 1: Identify Performance Obligations

Two performance obligations: (1) Sale of goods, (2) Discount voucher.

Step 2: Determine Stand-alone Selling Prices

Goods: ₹4,000 less 10% ordinary discount = ₹3,600

Voucher: $(50\% - 10\%) \times ₹2,000 \times 60\% = ₹480$

Total = ₹4,080

Step 3: Allocate Transaction Price (₹3,600)

Goods: $₹3,600 \times (3,600/4,080) = ₹3,176$

Voucher: $₹3,600 \times (480/4,080) = ₹424$

Step 4: Revenue Recognition

2019-20: Revenue = ₹3,176; Liability (voucher) = ₹424

2020-21: Transaction price = ₹2,800 – 50% discount = ₹1,400

Total revenue = ₹1,400 + ₹424 = ₹1,824

ICMAI Illustration 27 – Significant Financing Component

Question (A): On 31.03.2017 X Ltd. sold goods at ₹1,33,100 payable on 31.03.2020. Implicit interest rate 10% p.a. What would be the revenue to be recognized for 2016-17, 2017-18, 2018-19 and 2019-20?

COMPLETE SOLUTION

Step 1: Compute Revenue for 2016-17

$$\text{Revenue} = ₹1,33,100 / (1.10)^3 = ₹1,00,000$$

Step 2: Interest Income Recognition

$$2017-18: 10\% \times ₹1,00,000 = ₹10,000$$

$$2018-19: 10\% \times ₹1,10,000 = ₹11,000$$

$$2019-20: 10\% \times ₹1,21,000 = ₹12,100$$

Step 3: Journal Entries

YEAR	PARTICULARS	DR. (₹)	CR. (₹)
16-17	Customer A/c Dr.	1,00,000	
	Accrued Interest A/c Dr.	33,100	
	To, Sales A/c		1,00,000
	To, Liability for Unearned Interest A/c		33,100
17-18	Liability for Unearned Interest A/c Dr.	10,000	
	To, Interest Income A/c		10,000
18-19	Liability for Unearned Interest A/c Dr.	11,000	
	To, Interest Income A/c		11,000
19-20	Liability for Unearned Interest A/c Dr.	12,100	
	To, Interest Income A/c		12,100
19-20	Bank A/c Dr.	1,33,100	
	To, Customer A/c		1,00,000
	To, Accrued Interest A/c		33,100

5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 115 in 90 seconds:

- 5 Steps: Contract → Performance Obligations → Transaction Price → Allocation → Recognition.
- Variable Consideration: Expected Value or Most Likely Amount.
- Financing Component: Significant if > 1 year.
- Allocation: Relative Stand-alone Selling Price.
- Over Time: Customer receives/consumes, or no alternative use + right to payment.
- Contract Modifications: A (Separate), B (Termination + New), C (Continuation with Modifications).
- **Mnemonic: C-P-T-A-R** → Contract → Performance Obligations → Transaction Price → Allocation → Recognition.

KEY TAKEAWAY

Chapter End Key Notes: Ind AS 115 is a high-weightage topic. Master the five-step model, allocation of transaction price, and contract modifications. Practice comprehensive problems with multiple performance obligations.

MODULE 1 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top 100 Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 1 covers 12 Indian Accounting Standards: Ind AS 8, 12, 16, 116, 21, 23, 36, 38, 102, 108, 113, and 115. This module carries **25% weightage** — the highest in Paper 18. Master the core principles, formulas, and full ICMAI illustrations provided in this handbook.

B. Mega Revision Sheet

IND AS	CORE PRINCIPLE	KEY FORMULA/TREATMENT
Ind AS 8	Policy vs Estimate vs Error	Policy/Error → Retrospective; Estimate → Prospective
Ind AS 12	Current + Deferred Tax	Taxable Profit × Rate; TD × Rate = DTA/DTL
Ind AS 16	PPE Recognition & Measurement	Cost = Purchase + Directly Attributable + Dismantling PV
Ind AS 116	Lease Accounting	ROU = Liability + Prepaid + Initial Direct + Dismantling PV – Incentives
Ind AS 21	Foreign Exchange	Monetary → Closing Rate; Non-monetary → Historical/FV Rate
Ind AS 23	Borrowing Costs	Specific: Actual – Investment Income; General: Rate × Expenditure
Ind AS 36	Impairment	Recoverable = Higher of FV–Costs and VIU; CGU: Goodwill first
Ind AS 38	Intangible Assets	Research → Expense; Development → Capitalise if conditions met
Ind AS 102	Share-based Payment	Equity-settled: Grant Date FV; Cash-settled: Remeasure
Ind AS 108	Operating Segments	10% Thresholds; 75% Test
Ind AS 113	Fair Value	Exit Price; Principal Market; Hierarchy Level 1/2/3
Ind AS 115	Revenue	5-Step Model: Contract → PO → Price → Allocation → Recognition

C. Formula Sheet – Quick Reference

IND AS	FORMULA
Ind AS 12	$\text{Taxable Profit} = \text{Accounting Profit} + \text{Disallowances} - \text{Deductions}$; $\text{Current Tax} = \text{Taxable Profit} \times \text{Rate}$; $\text{Deferred Tax} = \text{TD} \times \text{Rate}$
Ind AS 16	$\text{Depreciation} = (\text{Cost} - \text{Residual}) / \text{Life}$; $\text{Gain/Loss} = \text{Proceeds} - \text{CA}$
Ind AS 116	$\text{Lease Liability} = \text{PV of payments}$; $\text{ROU} = \text{Liability} + \text{Prepaid} + \text{Initial Direct} + \text{Dismantling PV} - \text{Incentives}$
Ind AS 21	$\text{Exchange Difference} = (\text{Closing Rate} - \text{Transaction Rate}) \times \text{FC Amount}$
Ind AS 23	$\text{Capitalisation Rate} = \text{Weighted Average}$; $\text{Borrowing Cost} = \text{Rate} \times \text{Expenditure}$
Ind AS 36	$\text{Recoverable Amount} = \text{Higher of FV-Costs and VIU}$; $\text{Impairment Loss} = \text{CA} - \text{RA}$
Ind AS 38	$\text{Amortisation} = (\text{Cost} - \text{Residual}) / \text{Useful Life}$
Ind AS 102	$\text{Expense} = \text{FV} \times \text{Expected Vesting} \times (\text{Period} / \text{Total Vesting})$
Ind AS 108	$\text{Threshold} = 10\% \text{ of Combined Revenue/Profit/Assets}$; 75% Test
Ind AS 113	$\text{Fair Value} = \text{Exit Price in Principal Market}$
Ind AS 115	$\text{Allocation} = (\text{SSP} / \text{Total SSP}) \times \text{Transaction Price}$

D. Top 100 Exam Points – Quick Revision

1. Ind AS 8: Policy = Retrospective; Estimate = Prospective; Error = Retrospective.
2. Impracticability exception in retrospective application.
3. Disclose title, nature, amount, EPS for policy changes.
4. Tax base of asset = Amount deductible for tax purposes.
5. Taxable temporary difference → DTL.
6. Deductible temporary difference → DTA.
7. DTA recognised only if probable.
8. No discounting of deferred tax.
9. Use enacted/substantively enacted tax rates.
10. PPE recognition: Probable benefits + Reliable measurement.
11. Include dismantling cost at PV in initial cost.
12. Exclude administration, advertising, relocation, initial losses.
13. Depreciation methods: SLM, WDV, Units of Production.
14. Revaluation increase → OCI; decrease → P&L.
15. Transfer excess depreciation from revaluation surplus to retained earnings.
16. Component accounting mandatory for major parts.
17. ROU asset = Lease liability + Prepaid + Initial direct +
54. Aggregation criteria: Similar economic characteristics.
55. Fair value = Exit price in orderly transaction.
56. Principal market = Greatest volume/activity.
57. Most advantageous = Maximises proceeds.
58. Highest and best use for non-financial assets.
59. Valuation techniques: Market, Cost, Income.
60. Fair value hierarchy: Level 1 (quoted), Level 2 (observable), Level 3 (unobservable).
61. No adjustment for transaction costs; adjust for transport costs.
62. Five-step revenue model: Contract → PO → Price → Allocation → Recognition.
63. Variable consideration: Expected value or most likely amount.
64. Significant financing component: If > 1 year.
65. Allocation: Relative stand-alone selling price.
66. Over time: Customer receives/consumes, or no alternative use + right to payment.
67. Contract modifications: A (Separate), B (Termination + New), C (Continuation).
68. Contract asset vs contract liability.

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly. Step-wise presentation fetches marks.
- State the Ind AS reference for each treatment.
- For practical problems, draw tables for computations.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: Ind AS 12, 16, 36, 102, 115.
- Practice at least 10 comprehensive problems per high-weightage Ind AS.
- Read the question carefully for adjustments like "ignore tax", "assume fair value equals book value", etc.

F. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ All definitions and scope of each Ind AS.
- ☒ Recognition criteria for each Ind AS.
- ☒ Measurement principles (initial and subsequent).
- ☒ Journal entry frameworks for key transactions.
- ☒ Disclosure requirements for each Ind AS.
- ☒ Important formulae.
- ☒ Key illustrations from ICAI study material.
- ☒ Common mistakes to avoid.
- ☒ Examiner adjustments and frequent questions.
- ☒ 1-day before exam revision sheets.

END OF MODULE 1 – INDIAN ACCOUNTING STANDARDS

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THE INSTITUTE OF COST ACCOUNTANTS OF INDIA

PREMIUM REVISION SERIES

CMA Final Paper 18

Corporate Financial Reporting

MODULE 2

Valuation of Shares

Complete Revision Handbook with Full ICMAI Illustrations, Step-by-Step Solutions,
Formulas, and Exam-Focused Notes

3

APPROACHES

15%

WEIGHTAGE

15+

ILLUSTRATIONS

50+

FORMULAS

December 2026 Examination Edition

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MODULE 2: Valuation of Shares

Including Determination of Goodwill, Post-Valuation of Tangible and Intangible Assets | 15% Weightage

3

APPROACHES

15%

EXAM WEIGHTAGE

15+

FULL ILLUSTRATIONS

50+

FORMULAS &
FRAMEWORKS

★ EXAM IMPORTANT

Module 2 carries **15% weightage** in Paper 18. Expect **1–2 full questions (15 marks each)** plus short notes and objective questions. Master the three approaches: Income Approach, Net Assets Approach, and Market Approach. Focus heavily on Goodwill valuation and DCF method.

Table of Contents – Module 2

- 1 Introduction to Valuation of Shares
- 2 Income Approach (DCF, Dividend Discount, Maintainable Profits, Yield-Basis, Fair Value)
- 3 Net Assets Approach (Asset-Backing Method)
- 4 Valuation of Goodwill (Capitalisation, Super Profits, Annuity)
- 5 Market Approach (P/E, P/S, P/CFO Ratios)
- 6 Full ICMAI Illustrations with Step-by-Step Solutions
- ★ Module Summary & Mega Revision

Syllabus Coverage Matrix

TOPIC	SUB-TOPICS	WEIGHTAGE	PRIORITY
Introduction	Purpose, Factors Affecting Valuation	2–3%	★★★
Income Approach	DCF, Dividend Discount, Maintainable Profits, Yield-Basis, Fair Value	5–7%	★★★★★
Net Assets Approach	Asset-Backing, Intrinsic Value, Break-up Value	3–5%	★★★★★
Goodwill Valuation	Capitalisation, Super Profits, Annuity, Number of Years' Purchase	4–6%	★★★★★
Market Approach	P/E Ratio, P/S Ratio, P/CFO Ratio, Comparators	2–3%	★★★★★
Intangible Assets	Cost, Market, Income Basis	1–2%	★★★

Expected Question Types

Practical Problems (15 Marks)

- DCF valuation of business and equity
- Intrinsic value per share (Net Assets Approach)
- Yield value per share (Profit Basis / Dividend Basis)
- Fair value per share (Average of Intrinsic and Yield)
- Goodwill valuation: Super Profits, Capitalisation, Annuity
- Market approach: P/E ratio, P/S ratio application
- Comprehensive problems combining multiple approaches

Short Notes / Theory (5 Marks)

- Purpose of share valuation
- Factors affecting valuation of shares
- DCF model: Merits and demerits
- Yield-Basis method: Profit vs Dividend Basis
- Super Profit method variables
- Annuity method of goodwill valuation
- Market approach: Relative/multiple concept
- Valuation of intangible assets: Cost, Market, Income basis

Introduction to Valuation of Shares

1. Chapter Overview

The valuation of shares of a company uses information not restricted to financial statements only and it is also not an integral part of financial accounting in true sense. Valuation of share is essentially connected with valuation of business, valuation of goodwill, valuation of tangible net assets and valuation of other intangible assets. A share is the smallest unit of ownership of a company. The value of a share does not remain static over its life-time; it changes over the period due to various circumstances. Thus, knowing the value of share at a particular point of time is of great importance.

2. Learning Objectives

- Understand the concept and purpose of share valuation.
- Identify factors affecting valuation of shares.
- Apply the three major approaches: Income, Net Assets, and Market.
- Develop skill in measuring value of business and shares based on different approaches.

3. Important Definitions

DEFINITION

Share: The smallest unit of ownership of a company. It is one of the sources by which a company raises funds from the market.

DEFINITION

Valuation of Shares: The process of determining the fair economic value of a company's shares for various purposes including sale, merger, acquisition, and regulatory compliance.

DEFINITION

Intrinsic Value: The actual value of a share based on the underlying net assets of the company, also known as asset-backing value.

DEFINITION

Yield Value: The value of a share based on its expected future earnings or dividends, capitalized at a normal rate of return.

DEFINITION

Fair Value: The arithmetic mean of Intrinsic Value and Yield Value, providing a balanced indication of a share's worth.

4. Purpose of Share Valuation

The shares of a company are required to be valued for various purposes. Some of the most important purposes include:

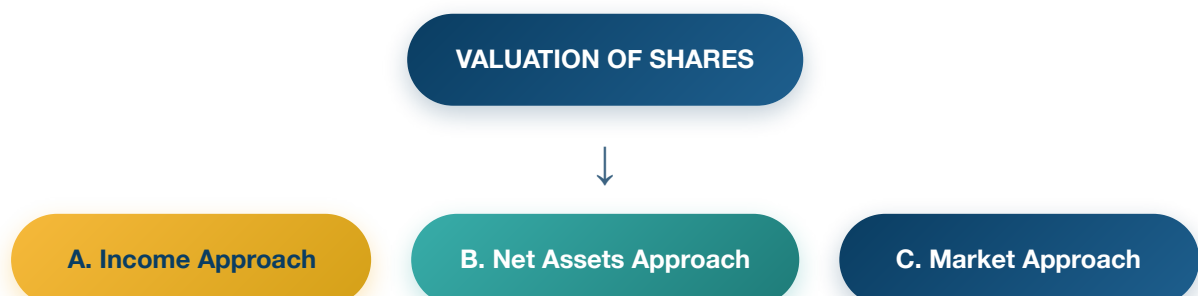
1. For selling shares of a shareholder to a purchaser (which are not quoted in the stock exchange).
2. For acquiring a block of shares which may or may not give the holder thereof a controlling interest in the company.
3. To shares by employees of the company where the retention of such shares is limited to the period of their employment.
4. To formulate schemes of merger and acquisition.
5. To acquire interest of dissenting shareholders under a scheme of reconstruction.
6. For granting loans on the basis of security of shares.
7. To compensate shareholders on the acquisition of their shares by the government under a scheme of nationalization.
8. For conversion of securities, say preference shares into equity shares.
9. To resolve a deadlock in the management of a company on the basis of the controlling block of shares given to either of the parties.

5. Factors Affecting Valuation of Shares

The different factors that affect the valuation of shares are:

1. Nature of the industry to which the company belongs.
2. The company's past performance.
3. Economic conditions of the country.
4. Other political and economic factors (e.g., possibility of nationalization, excise duty on goods produced, etc.).
5. Demand and supply of shares.
6. Income yielding capacity of the company.
7. The availability of sufficient assets over liabilities.
8. Proportion of liabilities and capital.
9. Rate of proposed dividend and past profit of the company.
10. Yield of other related shares of the Stock Exchange.

6. The Three Major Approaches



KEY TAKEAWAY

Key Takeaway: The true value of a share remains always unknown and all valuation techniques are applied to find the value nearest to its true value. An accountant must use judgement, experience, and knowledge to find the relevant value based on the purpose of valuation.

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Module 2 Introduction in 60 seconds:

- Share = Smallest unit of ownership.
- Purpose: Sale, merger, acquisition, loan security, nationalization, conversion.
- Factors: Industry nature, past performance, economic conditions, demand-supply, income capacity, assets-liabilities ratio.
- Three Approaches: Income, Net Assets, Market.
- **Mnemonic: INM** → Income, Net Assets, Market

Income Approach

1. Chapter Overview

The Income Approach indicates the value of a business or equity based on the value of the future income (represented by cash flows, operating profits, net profits or dividends) that a business is expected to generate in future. This approach is appropriate in most going concern situations as the worth of a business or equity is generally a function of its ability to earn income/cash flow in future.

2. Learning Objectives

- Understand the various models under the Income Approach.
- Apply the DCF model for business valuation.
- Use the Dividend Discount Model and Maintainable Profits Basis.
- Apply the Yield-Basis Method and Fair Value Method.

3. Models Under Income Approach

1. Discounted Cash Flow (DCF)

- Value based on future cash flows
- Uses NOPAT, FCFF, FCFE
- Applies WACC as discount rate
- Terminal value computed for infinity

2. Dividend Discount Model

- Value based on dividends
- Constant dividend: D/K_e
- Growing dividend: $D/(K_e - g)$
- Based on Gordon's model

3. Maintainable Profits Basis

- Value based on future profits
- Eliminates abnormal items
- Capitalizes at K_e
- Simple or weighted average

4. Yield-Basis Method

- Profit Basis: Capitalized profit
- Dividend Basis: Capitalized dividend
- Uses normal rate of return
- For minority/majority holding

5. Fair Value Method

- Average of Intrinsic and Yield
- Balanced indication

- Arithmetic mean

4. Discounted Cash Flow (DCF) Model

It indicates the fair market value of a business (or Equity) based on the value of cash flows that the business (or Equity) is expected to earn in future. This method involves the estimation of Net Operating Profits Adjusted Tax (NOPAT) for the projected period, the business's requirement of reinvestment in terms of capital expenditure and incremental working capital, and appropriate cost of capital that reflects the risks of the corresponding return.

4.1 Merits of DCF Model

- Cash flows are unaffected by any differences of accounting policies, principles, conventions, and methods.
- It provides the intrinsic or economic value unaffected by market forces.

4.2 Demerits of DCF Model

- It is hard to estimate future cash flows.
- It is hard to apply appropriate rate of discounting.

4.3 Important Formulae

FORMULA

Value per Share = Value of Equity / No. of Equity Shares

FORMULA

Value of Equity = Value of Business – Value of Debt Capital

FORMULA

Value of Business = Aggregate of future cash flows (or Free Cash Flows) discounted at present worth

FORMULA

NOPAT = EBIT $\times$ (1 – t)

FORMULA

CF = NOPAT + Depreciation, amortisation, impairment etc. +/- Decrease (Increase) in non-cash working capital

 FORMULA

$$\text{FCFF} = \text{CF} - \text{Capex}$$

 FORMULA

$$\text{FCFE} = \text{Net Income} - \text{Increase in non-cash WC} - \text{Net Capex} + \text{Net Debt Issue}$$

 FORMULA

$$\text{FCFE} = \text{FCFF} - \text{Interest net of tax} + \text{Net Debt Issued}$$

 FORMULA

$$\text{Interest net of tax} = \text{Interest} \times (1 - t)$$

4.4 Terminal Value

 FORMULA

$$\text{Terminal Value (Constant CF)} = \text{TV}_n = \text{CF}_{(n+1)} / k$$

 FORMULA

$$\text{Terminal Value (Constant Growth)} = \text{TV}_n = \text{CF}_{(n+1)} / (k - g)$$

 FORMULA

$$\text{Value of Business (No Projection Period)} = V_0 = \text{CF}_1 / k \text{ (constant) or } \text{CF}_1 / (k - g) \text{ (growth)}$$

 FORMULA

$$\text{Value of Business (n Periods)} = V_0 = \sum \text{DCF (Years 1 to n)} + \text{TV}_n \text{ discounted for n years}$$

 FORMULA

$$\text{Growth Rate (g)} = \text{Re-investment Rate (RR)} \times \text{Return on Invested Capital (ROIC)}$$

5. Dividend Discount Model

FORMULA

Value per Share (Constant Dividend) = Dividend per Share / K_e

FORMULA

Value per Share (Constant Growth) = Dividend per Share / ($K_e - g$)

This model is based on Gordon's model of share pricing.

6. Maintainable Profits Basis

FORMULA

Value of Equity = Maintainable Profits available to equity / Equity capitalisation rate (K_e)

FORMULA

Value per Share = Value of Equity / No. of equity shares

Average Maintainable Profits are computed to find out expected future earnings of the Equity. Hence all non-recurring or abnormal items of income and expenses are eliminated. Simple or weighted average of past years (excluding any abnormal year) adjusted earnings are computed.

7. Yield-Basis Method

Yield is the effective rate of return on investments which is invested by the investors. It is always expressed in terms of percentage. Since the valuation of shares is made on the basis of Yield, it is called Yield-Basis Method. Under Yield-Basis method, valuation of shares is made on either of the following basis:

7.1 Profit Basis

FORMULA

Capitalised Value of Profit = (Profit / Normal Rate of Return) $\times$ 100

FORMULA

Value of each Equity Share = Capitalised Value of Profit / Number of Shares

FORMULA

Value of each Equity Share = Profit / (Normal Rate of Return $\times$ Number of Equity Shares) $\times$ 100

7.2 Dividend Basis

FORMULA

Capitalised Value of Profit = Dividend Profit / Normal Rate of Return

FORMULA

Value of each Equity Share = Dividend Profit / (Normal Rate of Return × Number of Equity Shares)

FORMULA

Value of each Equity Share = (Rate of Dividend / Normal Rate of Return) × Paid-up Value per Share

FORMULA

Rate of Dividend = (Profit / Equity Share Capital) × 100

NOTE

Profit Basis vs Dividend Basis: Profit Basis should be followed in the case of Majority Holding, and Dividend Basis should be followed in the case of Non-controlling Holding (Minority Holding).

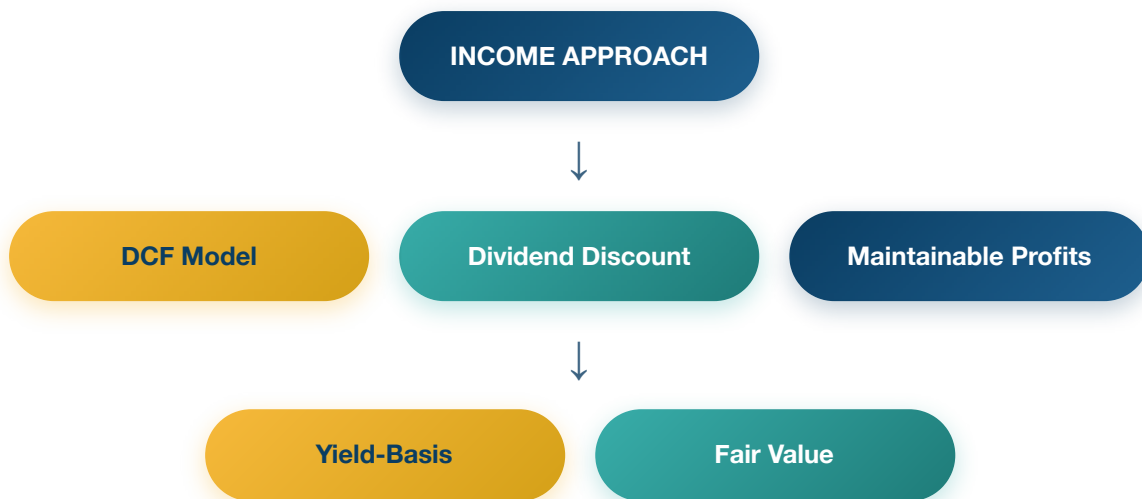
8. Fair Value Method

FORMULA

Fair Value = (Intrinsic Value + Yield Value) / 2

This method provides a better indication about the value of shares than the earlier two methods.

9. Flowchart Summary



10. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Income Approach in 90 seconds:

- DCF: $\text{Value} = \text{CF} / (k - g)$; $\text{FCFF} = \text{CF} - \text{Capex}$; $\text{NOPAT} = \text{EBIT} \times (1 - t)$
- Dividend Discount: D/K_e or $D/(K_e - g)$
- Maintainable Profits: Capitalize at K_e
- Yield-Basis: Profit Basis (majority), Dividend Basis (minority)
- Fair Value = $(\text{Intrinsic} + \text{Yield}) / 2$
- **Mnemonic: DDMYF** → DCF, Dividend, Maintainable, Yield, Fair Value

Net Assets Approach (Asset-Backing Method)

1. Chapter Overview

Since the valuation is made on the basis of the assets of the company, it is known as Asset-Basis or Asset-Backing Method. At the same time, the shares are valued on the basis of real internal value of the assets of the company and that is why the method is also termed Intrinsic Value Method or Real Value Basis Method. Under net assets basis, value of equity is determined by subtracting ascertained value of liabilities from the value of assets.

2. Learning Objectives

- Understand the Net Assets Approach for share valuation.
- Apply going concern basis and break-up value basis.
- Compute intrinsic value per share.
- Handle different categories of equity shares (fully paid, partly paid).

3. Important Definitions

DEFINITION

Net Assets Approach: Valuation method where shares are valued on the basis of the real internal value of the company's assets.

DEFINITION

Going Concern Basis: Valuation based on the utility of assets for continued operations.

DEFINITION

Break-up Value Basis: Valuation based on the realizable value of individual assets and remission value of individual liabilities (liquidation scenario).

4. Key Concepts

4.1 Valuation of Assets and Liabilities

There are three major bases of asset valuation for a going concern:

- Book Value
- Net Replacement Value
- Net Realisable Value

Assets include all tangible assets including contingent assets and intangible assets including goodwill. Liabilities include contingent liabilities also. For valuing equity shares, dues of preference shareholders are also considered as liabilities.

4.2 Computation of Net Assets

FORMULA

Value per Share = Net Assets / No. of Equity Shares

FORMULA

Net Assets = Value of all tangible assets including contingent assets + Value of Goodwill and other Intangible assets – Ascertained value of liabilities including Contingent liabilities and dues of preference shareholders

4.3 Computation Format

PARTICULARS	AMOUNT (₹)
Fixed Assets (PPE)	XXXX
Investments (Financial assets)	XXXX
Current Assets	XXXX
Goodwill (if any)	XXXX
Total Assets	XXXXXX
Less: Current Liabilities (including Contingent Liability)	XXXX
Less: Debentures	XXXX
Less: Preference Share Capital (with arrear dividend)	XXXX
Net Assets/Funds Available for Equity Shareholders	XXXXXX
Value per Share = Net Assets / No. of Equity Shares	XXXXXX

4.4 Handling Different Categories of Equity Shares

- **Fully paid shares:** Value per share = Net Assets / Total equivalent shares.
- **Partly paid shares:** Compute notional calls (uncalled liability). Add notional calls to Net Assets. Divide by equivalent fully paid shares.
- **Different denominations:** Convert all shares to equivalent shares of a common denomination (usually ₹10).

FORMULA

Notional Calls = Number of partly paid shares × Uncalled amount per share

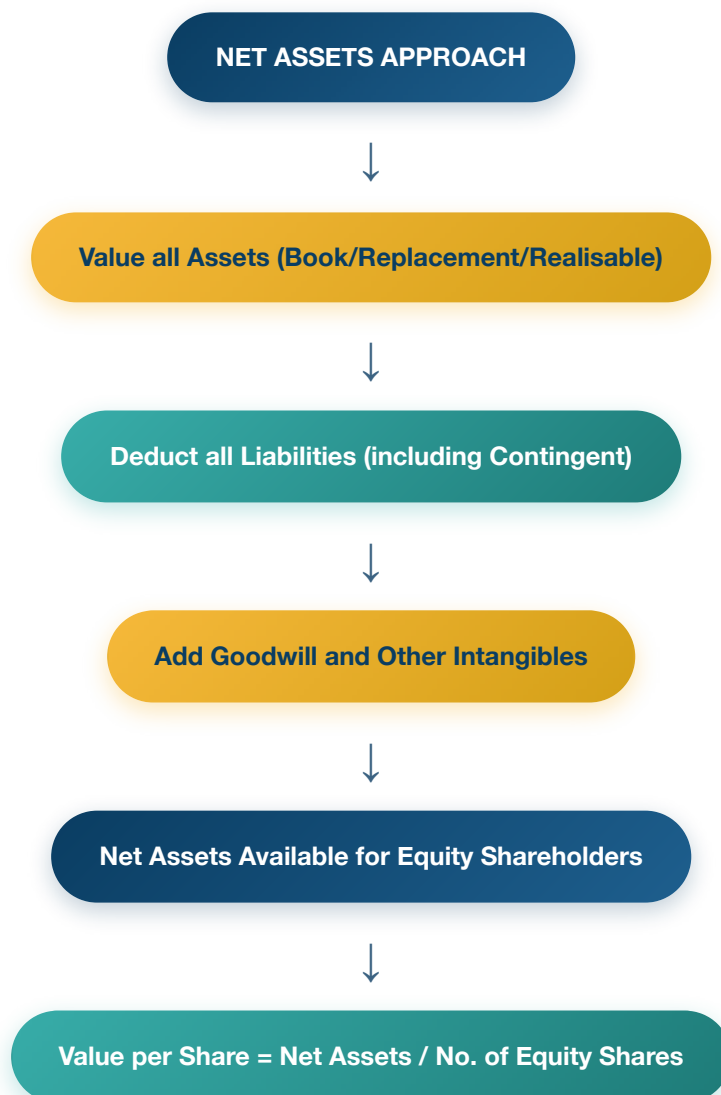
FORMULA

Net Assets for Deemed Fully Paid = Net Assets + Notional Calls

FORMULA

Equivalent Fully Paid Shares = Sum of (Number of shares × Paid-up value / ₹10)

5. Flowchart Summary



6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Net Assets Approach in 60 seconds:

- Value all assets (tangible + intangible + contingent)
- Deduct all liabilities (including contingent + preference capital)
- $\text{Net Assets} = \text{Total Assets} - \text{Total Liabilities}$
- $\text{Value per share} = \text{Net Assets} / \text{No. of equity shares}$
- For partly paid: Add notional calls; convert to equivalent shares
- Going concern: Net Replacement Value; Break-up: Net Realisable Value
- **Mnemonic: ALN** → Assets – Liabilities = Net Assets

Valuation of Goodwill

1. Chapter Overview

Goodwill represents the capacity of the business to earn excess profit for a period of time over normal profit. The value of goodwill is the aggregate of such excess profit for the period of consideration duly discounted to their present worth (or without adjusting for time value of money). The popular measure of determining excess profit or super profit is the average maintainable profits less normal profits. The period for which such excess profit is computed may be assumed to be infinite time or it may be assumed to be limited to certain years (3 to 5 years, for instance).

2. Learning Objectives

- Understand the concept and nature of goodwill.
- Compute Average Maintainable Profits (Simple and Weighted).
- Compute Average Capital Employed and Normal Profits.
- Apply different methods of goodwill valuation: Capitalisation, Super Profits, Annuity.
- Handle adjustments for abnormal items and non-recurring items.

3. Important Definitions

DEFINITION

Goodwill: The capacity of the business to earn excess profit for a period of time over normal profit.

DEFINITION

Super Profit: The excess of Average Maintainable Profit over Normal Profit.

DEFINITION

Normal Profit: $\text{Average Capital Employed} \times \text{Normal Rate of Return}$.

DEFINITION

Average Capital Employed: $(\text{Opening Capital Employed} + \text{Closing Capital Employed}) / 2$, or Capital Employed at the end of the year less $1/2$ of current year's profit after tax.

DEFINITION

Capital Employed: Excess of current value of Total Assets (excluding Goodwill and Fictitious assets) over external liabilities.

DEFINITION

Number of Years' Purchase: Expected number of future years for which the firm is expected to earn the average profit from the year of purchase.

DEFINITION

Annuity: A series of continuous cash flows of equal amount that occur in every period, over a specified period of time.

4. Methods of Goodwill Valuation

A. Capitalisation Method

- Capitalisation of Average Profits
- Capitalisation of Super Profits
- Assumes constant profit for infinite years

B. Number of Years' Purchase

- Super Profits Method
- Average Maintainable Profits Method
- Annuity Method
- Assumes constant profit for limited years

4.1 Capitalisation Method

FORMULA

Goodwill (Capitalisation of Super Profits) = Super Profits / Normal Rate of Return

FORMULA

Super Profits = Average Maintainable Profits – Normal Profits

FORMULA

Normal Profits = Average Capital Employed × Normal Rate of Return

FORMULA

Goodwill (Capitalisation of Average Profits) = Capitalised Value of Average Maintainable Profits – Average Capital Employed

FORMULA

Capitalised Value of Average Profits = Average Maintainable Profits / Normal Rate of Return

4.2 Number of Years' Purchase Method

Super Profits Method

FORMULA

Goodwill = Super Profits × Number of Years' Purchase

FORMULA

Goodwill (Annuity Method) = Super Profits × Present Value of Annuity

Average Maintainable Profits Method

FORMULA

Goodwill = Average Maintainable Profits × Number of Years' Purchase

FORMULA

Goodwill (Annuity Method) = Average Maintainable Profits × Present Value of Annuity

4.3 Annuity Method

FORMULA

Value of Goodwill = Super Profit × Annuity Value

FORMULA

Annuity Value = $(1 - r)^n / [r(1 - r)^n]$

Where: r = Rate of Interest per period; n = Number of periods

5. Computation of Average Maintainable Profits

Adjustments Required:

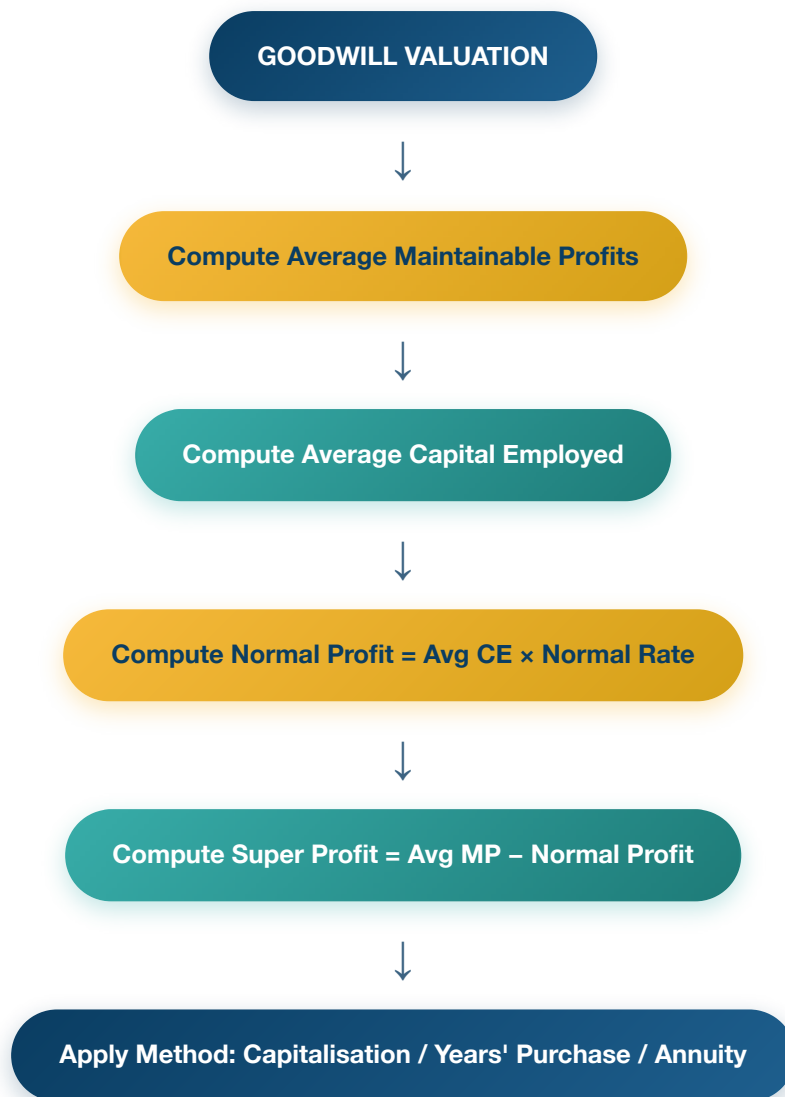
- **Add back:** Abnormal losses, non-recurring expenses, capital expenditure wrongly charged to revenue, overvaluation of opening stock.
- **Deduct:** Abnormal gains, non-recurring income, overvaluation of closing stock, under-valuation of opening stock.
- **Adjust:** Depreciation on revalued assets, income from non-trade investments, expected increase in expenditure, anticipated R&D expenses.
- **Tax adjustment:** Convert PAT to PBT using current tax rate, then apply expected future tax rate.

6. Computation of Average Capital Employed

Format:

PARTICULARS	AMOUNT (₹)
Fixed Assets (at revalued amount)	xxxx
Trade Investments (at proper value)	xxxx
Current Assets (adjusted)	xxxx
Total Assets	xxxxxx
Less: Outside Liabilities (including preference dividend)	(xxxx)
Capital Employed at the end of the year	xxxxxx
Less: 1/2 of current year's Accounting Profit after Tax	(xxxx)
Average Capital Employed	xxxxxx

7. Flowchart Summary



8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Goodwill Valuation in 90 seconds:

- Average Maintainable Profit = Adjusted past profits average
- Add back: Abnormal loss, capital expenditure, overvalued opening stock
- Deduct: Abnormal gain, non-recurring income, overvalued closing stock
- Normal Profit = Average Capital Employed × Normal Rate
- Super Profit = Average Maintainable Profit – Normal Profit
- Capitalisation: Goodwill = Super Profit / Normal Rate
- Years' Purchase: Goodwill = Super Profit × Years
- Annuity: Goodwill = Super Profit × PV of Annuity
- **Mnemonic: ANS** → Average Profit – Normal Profit = Super Profit

Market Approach

1. Chapter Overview

Under market approach, value of equity is determined by applying relative or multiple to the base value of the company. Relative or multiple is the ratio of market price to some accounting variable of the company taken as the base value. Most common multiples are price-earnings (P/E) ratio, price-sales (P/S) ratio, price-cash flow from operations (P/CFO) ratio etc.

2. Learning Objectives

- Understand the market approach for share valuation.
- Compute relative or multiple ratios.
- Apply comparators to base values.
- Compute value per share based on market approach.

3. Important Definitions

DEFINITION

Market Approach: Valuation method where equity value is determined by applying relative or multiple to the base value of the company.

DEFINITION

Relative or Multiple: Ratio of market price to some accounting variable (base value) of the company.

DEFINITION

Comparator: Average of the multiples of the peer group of companies.

DEFINITION

Market Capitalisation: Product of market price of shares and the number of shares outstanding; represents market value of equity.

4. Key Concepts

4.1 Steps Involved

1. Market capitalisation of each of the peer group companies is related to any fundamental element of that company (called base value such as Profits, Cash Flows, Net assets, Sales). The ratio obtained is called relative or multiple.
2. To decide what will be the base value on which multiple will be applied. More than one multiple is usually considered in practice.
3. To compute the average of the multiples of the peer group of companies (Comparator) for each base value.
4. To apply the average multiple (Comparator) to a particular base value of the required company for valuation of its equity for that base. Then to find average of the different equity values based on different base values.
5. To divide average value of equity by the no. of shares in order to find value per share.

4.2 Important Formulae

FORMULA

Relative or Multiple = Market Capitalisation / Base Value

FORMULA

Comparator = Average of multiples of peer group companies

FORMULA

Value of Equity = Base Value of Company $\times$ Comparator

FORMULA

Value per Share = Value of Equity / No. of Shares

FORMULA

P/E Ratio = Market Price per Share / Earnings per Share

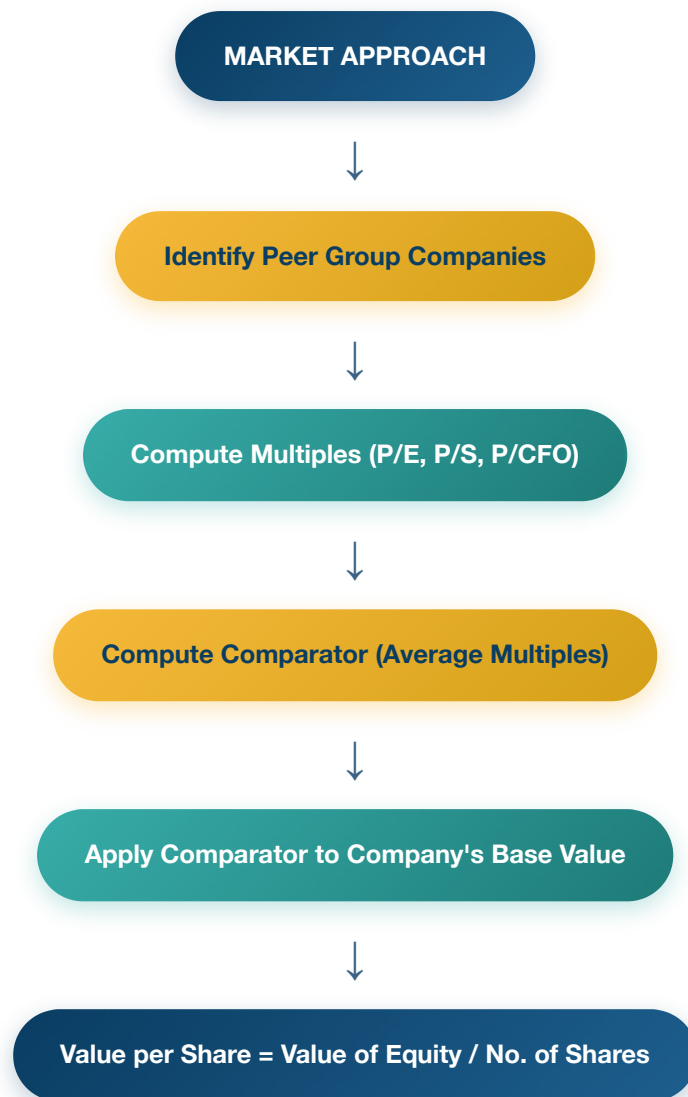
FORMULA

P/S Ratio = Market Capitalisation / Sales

FORMULA

P/CFO Ratio = Market Capitalisation / Cash Flow from Operations

5. Flowchart Summary



6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Market Approach in 60 seconds:

- Relative = Market Capitalisation / Base Value
- Comparator = Average of peer group multiples
- Value of Equity = Base Value × Comparator
- Value per Share = Value of Equity / No. of Shares
- Common Multiples: P/E, P/S, P/CFO
- **Mnemonic: RCV** → Relative, Comparator, Value

CHAPTER 6

Full ICMAI Illustrations with Step-by-Step Solutions

★ EXAM IMPORTANT

This chapter contains all the illustrations from the ICMAI study material for Module 2, presented with complete step-by-step solutions. Practice each illustration thoroughly — they form the foundation for exam problems.

ICMAI Illustration 1 – Discounted Cash Flow (DCF) Model

Question: Given the following cash flows:

YEAR	2018	2019	2020	2021	2022
CF (₹)	500	600	700	800	800 continued at 800

- (a) Find value of the business on 01-01-2021, given WACC = 10%.
- (b) Find value of the business on 01-01-2020, given WACC = 10%.
- (c) Find value of the business on 01-01-2019, given WACC = 10%.

COMPLETE SOLUTION

(a) Value on 01-01-2021

From 01-01-2021, all future cash flows are constant at ₹800.

$$V_0 = CF_1 / k = 800 / 10\% = \text{₹}8,000$$

(b) Value on 01-01-2020

Projected CF for 2020 = ₹700; Terminal Value at end of 2020 = ₹8,000

$$V = 700/(1.1) + 8,000/(1.1) = 636.36 + 7,272.73 = \text{₹}7,909$$

(c) Value on 01-01-2019

Projected CF for 2019 = ₹600; 2020 = ₹700; TV at end of 2020 = ₹8,000

$$\begin{aligned}
 V &= 600/(1.1) + 700/(1.1)^2 + 8,000/(1.1)^2 \\
 &= 545.45 + 578.51 + 6,611.57 = \text{₹}7,736
 \end{aligned}$$

ICMAI Illustration 2 – NOPAT, CF, FCFF Computation

Question: For the forthcoming Year 1:

PARTICULARS	₹ IN LAKH
EBIT	700
Depreciation	120
Capex	180
Interest	60
Increase in non-cash working capital	100
Debt Capital	3,000

Tax rate = 25%, WACC = 10%, No. of equity shares = 50,00,000.

Find: (a) NOPAT, (b) CF, (c) FCFF, (d) Value of business based on CF and FCFF, (e) Value of business when growth rate is 5%, (f) Value per share based on FCFF with 5% growth, (g) Value per share based on FCFE with 5% growth.

COMPLETE SOLUTION

(a) NOPAT

$$\text{NOPAT} = \text{EBIT} \times (1 - t) = 700 \times (1 - 0.25) = \text{₹525 Lakh}$$

(b) CF (Cash Flow)

$$\text{CF} = \text{NOPAT} + \text{Depreciation} - \text{Increase in WC} = 525 + 120 - 100 = \text{₹545 Lakh}$$

(c) FCFF

$$\text{FCFF} = \text{CF} - \text{Capex} = 545 - 180 = \text{₹365 Lakh}$$

(d) Value of Business (Constant)

(i) Based on CF: $V = 545 / 0.10 = \text{₹5,450 Lakh}$

(ii) Based on FCFF: $V = 365 / 0.10 = \text{₹3,650 Lakh}$

(e) Value of Business (Growth 5%)

(i) Based on CF: $V = 545 / (0.10 - 0.05) = \text{₹10,900 Lakh}$

(ii) Based on FCFF: $V = 365 / (0.10 - 0.05) = \text{₹7,300 Lakh}$

(f) Value per Share (FCFF, Growth 5%)

$$\text{Value of Equity} = 7,300 - 3,000 = \text{₹4,300 Lakh}$$

$$\text{Value per share} = 4,300 / 50 = \text{₹86}$$

(g) Value per Share (FCFE, Growth 5%)

$$\text{FCFE} = \text{FCFF} - \text{Interest net of tax} + \text{Net Debt Issued}$$

$$= 365 - 80 \times (1 - 0.25) + (140 - 90) = 365 - 60 + 50 = \text{₹355 Lakh}$$

$$\text{Value of Equity} = 355 / (0.125 - 0.05) = 355 / 0.075 = \text{₹4,733.33 Lakh}$$

$$\text{Value per share} = 4,733.33 / 50 = \text{₹91.67}$$

ICMAI Illustration 3 – Intrinsic Value, Dividend Yield, and EPS

Question: The following abridged Balance Sheet as on 31st March, 2021 pertains to S Ltd. (₹ in Lakhs):

LIABILITIES	₹	ASSETS	₹
180 lakh Equity shares of ₹10 each, fully paid up	1,800	Goodwill, at cost	420
90 lakh Equity shares of ₹10 each, ₹8 paid up	720	Other Fixed Assets	11,166
150 lakh Equity shares of ₹5 each, fully paid-up	750	Current Assets	2,910
Reserves and Surplus	5,457	Loans and Advances	933
Secured Loans	4,500		
Current Liabilities	1,242		
Provisions	960		
Total	15,429	Total	15,429

Additional Information: Normal rate of dividend = 15%, Company has been paying 20% dividend. Profit after tax for year ended 31.03.2021 = ₹1,371 lakh. Average EPS for a fully paid share of ₹10 = ₹2.

Calculate: (i) Intrinsic value based on book values, (ii) Value per share based on dividend yield, (iii) Value per share based on EPS.

COMPLETE SOLUTION

(A) Calculation of Intrinsic Value (Book Value Basis)

PARTICULARS	₹ IN LAKHS
Goodwill	420
Fixed Assets	11,166
Current Assets	2,910
Loans and Advances	933
Total Assets	15,429
Less: Provisions	(960)
Less: Current Liabilities	(1,242)
Less: Secured Loans	(4,500)
Net Assets available for Equity Shareholders	8,727
Add: Notional Calls (90 × 2)	180
Net Assets for Deemed Fully Paid	8,907

Equivalent Equity Shares

CATEGORY	NO. OF SHARES	EQUIVALENT ₹10 SHARES
₹10 fully paid	180 lakh	180 lakh
₹8 paid up	90 lakh	$90 \times 8/10 = 72$ lakh
₹5 fully paid	150 lakh	$150 \times 5/10 = 75$ lakh
Total Equivalent Shares		327 lakh

Intrinsic Value per Share

Value of ₹10 fully paid share = $8,907 / 327 = ₹27.24$

Value of ₹8 paid-up share = $27.24 - 2 = ₹25.24$

Value of ₹5 fully paid share = $27.24 \times 5/10 = ₹13.62$

(B) Value per Share on Dividend Yield Basis

Rate of Dividend = 20%

Normal Rate = 15%

Value of ₹10 fully paid = $(20/15) \times 10 = \text{₹}13.33$

Value of ₹8 paid-up = $(20/15) \times 8 = \text{₹}10.67$

Value of ₹5 fully paid = $(20/15) \times 5 = \text{₹}6.67$

(C) Value per Share on EPS Basis

EPS of S Ltd. = PAT / Equivalent shares = $1,371 / 327 = \text{₹}4.19$

Industry average EPS for ₹10 share = ₹2

Value of ₹10 fully paid = $(4.19/2) \times 10 = \text{₹}20.95$

Value of ₹8 paid-up = $(4.19/2) \times 8 = \text{₹}16.76$

Value of ₹5 fully paid = $(4.19/2) \times 5 = \text{₹}10.48$

ICMAI Illustration 4 – Goodwill Valuation (Multiple Cases)

Question: AB Ltd. earned profits during the past 5 years:

YEAR	20×1	20×2	20×3	20×4	20×5
Profits (₹)	30,000	36,000	40,000	44,000	50,000

Determine the value of goodwill at the end of 20×5 in each of the following independent cases:

- 2 years' purchase of average profit of last five years.
- 4 years' purchase of average profit after giving weights 1, 2, 3, 6 and 8.
- 3 years' purchase of weighted average profit giving maximum weightage to recent results.
- 3 years' annuity of expected annual profits of ₹50,000 at 10% discounting.
- 4 years' purchase of super profits, normal rate 10%, average capital employed ₹4,00,000, FMP = simple average.
- Capitalization of super profits, capitalization rate 10%, average capital employed ₹4,00,000, FMP = ₹50,000.
- 2.5 years' purchase of simple average profit with adjustments: abnormal loss ₹1,000 in 20×3; non-recurring receipt ₹2,000 in 20×4; closing stock of 2015 over-valued by ₹3,000.

COMPLETE SOLUTION

Case (a): 2 Years' Purchase of Simple Average

Average Profit = $(30,000 + 36,000 + 40,000 + 44,000 + 50,000) / 5 = ₹40,000$

Goodwill = $40,000 \times 2 = ₹80,000$

Case (b): 4 Years' Purchase of Weighted Average (1,2,3,6,8)

Weighted Average = $(30,000 \times 1 + 36,000 \times 2 + 40,000 \times 3 + 44,000 \times 6 + 50,000 \times 8) / (1+2+3+6+8)$

= $(30,000 + 72,000 + 120,000 + 264,000 + 400,000) / 20$

= $886,000 / 20 = ₹44,300$

Goodwill = $44,300 \times 4 = ₹1,77,200$

Case (c): 3 Years' Purchase of Weighted Average (Maximum Weight to Recent)

Weighted Average = $(30,000 \times 1 + 36,000 \times 2 + 40,000 \times 3 + 44,000 \times 4 + 50,000 \times 5) / (1+2+3+4+5)$

= $(30,000 + 72,000 + 120,000 + 176,000 + 250,000) / 15$

= $648,000 / 15 = ₹43,200$

Goodwill = $43,200 \times 3 = ₹1,29,600$

Case (d): 3 Years' Annuity of ₹50,000 at 10%

PV of Annuity for 3 years at 10% = 2.4869 (approx)

Goodwill = $50,000 \times 2.4869 = ₹1,24,345$

Case (e): 4 Years' Purchase of Super Profits

Average Profit = ₹40,000

Normal Profit = $4,00,000 \times 10\% = ₹40,000$

Super Profit = $40,000 - 40,000 = ₹0$

Goodwill = ₹0

Case (f): Capitalization of Super Profits

FMP = ₹50,000

Normal Profit = $4,00,000 \times 10\% = ₹40,000$

Super Profit = $50,000 - 40,000 = ₹10,000$

Goodwill = $10,000 / 10\% = ₹1,00,000$

Case (g): 2.5 Years' Purchase with Adjustments

Adjusted Profits:

20×1: ₹30,000

20×2: ₹36,000

20×3: ₹40,000 + ₹1,000 = ₹41,000

20×4: ₹44,000 – ₹2,000 = ₹42,000

20×5: ₹50,000 – ₹3,000 = ₹47,000

Adjusted Average = (30,000 + 36,000 + 41,000 + 42,000 + 47,000) / 5 = ₹39,200

Goodwill = 39,200 × 2.5 = ₹98,000

ICMAI Illustration 5 – Goodwill Valuation with Revaluation Adjustments

Question: The following is the Balance Sheet of Z Ltd. as on 31st March, 2021 (₹ in Lakh):

EQUITY AND LIABILITIES	₹	ASSETS	₹
3,00,000 Equity shares of ₹10 each fully paid	30,00,000	Building	20,00,000
12% Redeemable preference shares of ₹100 each fully paid	19,00,000	Plant & Machinery	22,00,000
General Reserve	15,00,000	Furniture	10,00,000
Profit & Loss A/c	3,00,000	Investments	16,00,000
Secured Loan	10,00,000	Stock	12,00,000
Creditors	27,00,000	Debtors	20,00,000
		Bank Balance	4,00,000
Total	1,04,00,000	Total	1,04,00,000

Additional Information: (i) PPE worth 10% more; Stock overvalued by ₹2,00,000; Debtors reduced by ₹80,000; Trade investments (10% of total) valued at 20% below cost. (ii) Trade investments purchased on 01.04.2020; 50% non-trade on 01.04.2019, rest on 01.04.2020; Non-trade yielded 15% return. (iii) Furniture sold at loss of ₹50,000 in 2019-20 (non-recurring). (iv) New machinery ₹2,00,000 wrongly charged to revenue in 2018-19; depreciation @ 10% WDV. (v) Return on capital employed = 18%. (vi) Profits: 2017-18: ₹13,00,000; 2018-19: ₹14,00,000; 2019-20: ₹17,00,000; 2020-21: ₹20,00,000. (vii) Preference dividend paid. (viii) Depreciation on additional value of only plant and machinery to be considered. Compute Goodwill at 3 years' purchase of super profits based on simple average profits of last four years.

COMPLETE SOLUTION

Step 1: Computation of Capital Employed

PARTICULARS	₹	₹
Building		20,00,000
Plant & Machinery (22,00,000 + 1,45,800)		23,45,800
Furniture		10,00,000
Sub-total		53,45,800
Add: 20% Appreciation		10,69,160
Total Fixed Assets		64,14,960
Trade investments (16,00,000 × 10% × 90%)		1,44,000
Debtors (20,00,000 – 40,000)		19,60,000
Stock (12,00,000 – 1,00,000)		11,00,000
Bank Balance		4,00,000
Total Assets		1,00,18,960
Less: Redeemable preference shares	19,00,000	
Less: Secured Loan	10,00,000	
Less: Creditors	30,00,000	(59,00,000)
Capital Employed		41,18,960

Step 2: Computation of Future Maintainable Profit (Average Adjusted Profit)

PARTICULARS	2017-18 (₹)	2018-19 (₹)	2019-20 (₹)	2020-21 (₹)
Profit	13,00,000	14,00,000	16,00,000	18,00,000
Add: Capital Expenditure charged to revenue		2,00,000		
Add: Loss on sale of furniture			50,000	
Sub-total	13,00,000	16,00,000	16,50,000	18,00,000
Less: Depreciation on machinery		(20,000)	(18,000)	(16,200)
Less: Income from non-trade investments		(1,08,000)	(2,16,000)	
Less: Reduction in value of stock			(1,00,000)	
Less: Bad debts			(40,000)	
Adjusted Profit	13,00,000	15,80,000	15,24,000	14,27,800

Step 3: Future Maintainable Profit

Total Adjusted Profit = 13,00,000 + 15,80,000 + 15,24,000 + 14,27,800 = ₹58,31,800

Average Profit = 58,31,800 / 4 = ₹14,57,950

Less: Depreciation @ 10% on additional value of machinery = (22,00,000 + 1,45,800) × 20% × 10% = (₹46,916)

Future Maintainable Profit = ₹14,11,034

Step 4: Normal Profit and Super Profit

Normal Profit = 20% × ₹41,18,960 = ₹8,23,792

Super Profit = ₹14,11,034 – ₹8,23,792 = **₹5,87,242**

Step 5: Goodwill

Goodwill = Super Profit $\times$ 2 years' purchase = $5,87,242 \times 2 = \text{₹}11,74,484$

ICMAI Illustration 6 – Goodwill Valuation (Multiple Cases)

Question: XY Ltd, a partnership firm, earned profits during the past 5 years:

YEAR	2017	2018	2019	2020	2021
Profits (₹)	27,000	36,000	37,200	42,000	46,800

Determine the value of goodwill in each of the following independent cases:

- 2 years' purchase of average profit of last five years.
- 3½ years' purchase of average profit after giving weights 1, 2, 3, 6 and 8.
- 3 years' purchase of weighted average profit giving maximum weightage to recent results.
- 2½ years' purchase of simple average profit with adjustments: abnormal loss ₹1,800 in 2019; non-recurring receipt ₹2,500 in 2020; closing stock of 2015 over-valued by ₹2,400.

COMPLETE SOLUTION

Case (a): 2 Years' Purchase of Simple Average

Average Profit = $(27,000 + 36,000 + 37,200 + 42,000 + 46,800) / 5 = ₹37,800$

Goodwill = $37,800 \times 2 = ₹75,600$

Case (b): 3½ Years' Purchase of Weighted Average (1,2,3,6,8)

Weighted Average = $(27,000 \times 1 + 36,000 \times 2 + 37,200 \times 3 + 42,000 \times 6 + 46,800 \times 8) / (1+2+3+6+8)$

= $(27,000 + 72,000 + 111,600 + 252,000 + 374,400) / 20 = 837,000 / 20 = ₹41,850$

Goodwill = $41,850 \times 3.5 = ₹1,46,475$

Case (c): 3 Years' Purchase of Weighted Average (Max Weight to Recent)

Weighted Average = $(27,000 \times 1 + 36,000 \times 2 + 37,200 \times 3 + 42,000 \times 4 + 46,800 \times 5) / (1+2+3+4+5)$

= $(27,000 + 72,000 + 111,600 + 168,000 + 234,000) / 15 = 612,600 / 15 = ₹40,840$

Goodwill = $40,840 \times 3 = ₹1,22,520$

Case (d): 2½ Years' Purchase of Simple Average with Adjustments

Adjusted Profits:

2017: ₹27,000

2018: ₹36,000

2019: ₹37,200 + ₹1,800 = ₹39,000

2020: ₹42,000 – ₹2,500 = ₹39,500

2021: ₹46,800 – ₹2,400 = ₹44,400

Adjusted Average = $(27,000 + 36,000 + 39,000 + 39,500 + 44,400) / 5 = ₹37,180$

Goodwill = $37,180 \times 2.5 = ₹92,950$

ICMAI Illustration 7 – Super Profits Method

Question: XY Ltd, a partnership firm, earned profits during the past 4 years:

YEAR	2018	2019	2020	2021
Profits (₹)	42,000	46,000	52,000	46,500

Firm has total assets worth ₹82,000 and current liabilities ₹12,800. Normal rate of return is 10%. Determine goodwill on the basis of 2½ years' purchase of super profits.

COMPLETE SOLUTION

Step 1: Average Future Maintainable Profit

$$= (42,000 + 46,000 + 52,000 + 46,500) / 4 = \text{₹}46,625$$

Step 2: Capital Employed

$$= \text{Total Assets} - \text{Current Liabilities} = ₹82,000 - ₹12,800 = \text{₹}69,200$$

Step 3: Normal Profit

$$= \text{Capital Employed} \times \text{Normal Rate} = ₹69,200 \times 10\% = \text{₹}6,920$$

Step 4: Super Profit

$$= \text{Average FMP} - \text{Normal Profit} = ₹46,625 - ₹6,920 = \text{₹}39,705$$

Step 5: Goodwill

$$= \text{Super Profit} \times 2.5 \text{ years' purchase} = ₹39,705 \times 2.5 = \text{₹}99,263 \text{ (approx)}$$

ICMAI Illustration 8 – Annuity Method of Goodwill

Question: From the following particulars, determine value of goodwill of ABX Ltd.: Super Profit (Computed) = ₹4,50,000; Normal rate of return = 12%; Present value of annuity of ₹1 for 4 years @ 12% = 3.0374.

COMPLETE SOLUTION

Goodwill

$$\begin{aligned} &= \text{Super Profit} \times \text{PV of Annuity of ₹1 for 4 years @ 12\%} \\ &= ₹4,50,000 \times 3.0374 = \text{₹13,66,830} \end{aligned}$$

ICMAI Illustration 9 – Annuity of Super Profit

Question: The following details relate to M/s XYZ, a firm: Average profit of last four years = ₹7,00,000; Average capital employed = ₹55,00,000; Normal rate of return = 10%; PV of annuity of ₹1 for 4 years @ 10% = 3.1699. Determine the value of goodwill on the basis of annuity of super profit.

COMPLETE SOLUTION

Step 1: Super Profit

$$\begin{aligned} &= \text{Average FMP} - \text{Normal Profit} \\ &= ₹7,00,000 - (₹55,00,000 \times 10\%) \\ &= ₹7,00,000 - ₹5,50,000 = \text{₹1,50,000} \end{aligned}$$

Step 2: Goodwill

$$\begin{aligned} &= \text{Super Profit} \times \text{PV of Annuity of ₹1 for 4 years @ 10\%} \\ &= ₹1,50,000 \times 3.1699 = \text{₹4,75,485} \end{aligned}$$

ICMAI Illustration 10 – Capitalisation of Profits Method

Question: A firm values goodwill under 'Capitalisation of profits' method. Its average profits for past 4 years has been determined at ₹72,000. Net Assets = ₹4,80,000; Capital employed = ₹5,00,000; Normal rate of return = 12%. Determine value of goodwill based on: (a) Capitalisation of Average Profits, (b) Capitalisation of Super Profits.

COMPLETE SOLUTION

(a) Capitalisation of Average Profits

Capitalised Value of Business = Expected Average Profit / Normal Rate of Return

$$= ₹72,000 / 12\% = ₹6,00,000$$

Value of Goodwill = Capitalised Value – Net Assets

$$= ₹6,00,000 - ₹4,80,000 = ₹1,20,000$$

(b) Capitalisation of Super Profits

Super Profit = Average Profit – Normal Profit

$$\begin{aligned} \text{Normal Profit} &= \text{Capital Employed} \times \text{Normal Rate} = ₹5,00,000 \times 12\% = \\ &₹60,000 \end{aligned}$$

$$\text{Super Profit} = ₹72,000 - ₹60,000 = ₹12,000$$

Value of Goodwill = Super Profit / Normal Rate of Return

$$= ₹12,000 / 12\% = ₹1,00,000$$

ICMAI Illustration 11 – Market Approach (P/E, P/S, P/CFO)

Question: X Ltd. has EPS ₹12 and no. of shares 1000. Its CF = ₹15,000 and Sales = ₹80,000. Find value per share of X Ltd. based on the data of similar other companies:

COMPANIES	PAT (₹)	CF (₹)	SALES (₹)	MC (₹)
A	20,000	25,000	1,20,000	1,50,000
B	16,000	20,000	1,40,000	1,75,000
C	25,000	32,000	1,60,000	2,00,000
D	18,000	24,000	1,44,000	1,92,000

COMPLETE SOLUTION

Step 1: Compute Multiples for Peer Group

COMPANIES	M1 = MC/PAT	M2 = MC/CF	M3 = MC/SALES
A	7.50	6.00	1.25
B	10.94	8.75	1.25
C	8.00	6.25	1.25
D	10.67	8.00	1.33
Comparator (Average)	9.28	7.25	1.27

Step 2: Compute PAT of X Ltd.

$$\text{PAT} = \text{EPS} \times \text{No. of shares} = ₹12 \times 1,000 = ₹12,000$$

Step 3: Compute Value of Equity for Each Base

$$\text{Based on PAT: } ₹12,000 \times 9.28 = ₹1,11,312.5$$

$$\text{Based on CF: } ₹15,000 \times 7.25 = ₹1,08,750$$

$$\text{Based on Sales: } ₹80,000 \times 1.27 = ₹1,01,666.7$$

Step 4: Value per Share

$$\text{Based on PAT: } ₹1,11,312.5 / 1,000 = ₹111.31$$

$$\text{Based on CF: } ₹1,08,750 / 1,000 = ₹108.75$$

$$\text{Based on Sales: } ₹1,01,666.7 / 1,000 = ₹101.67$$

Step 5: Average Value per Share

$$= (111.31 + 108.75 + 101.67) / 3 = ₹107.24$$

ICMAI Solved Case Study – Comprehensive Valuation

Question: Your client is willing to acquire a stake in equity of Desert Ltd. and asks you to find the value per share giving equal importance to the future free cash flows, the net asset value of the business, and market price of the shares in peer group. Data: EPS = ₹3.20; FCFF for last year = ₹40 lakhs; growth = 4% p.a.; Debt capital = ₹66 lakhs; WACC = 14%; Ke = 17%; No. of equity shares = 10 lakhs; Net asset value excluding goodwill = ₹300 lakhs; Peer group P/E ratios = 11, 12, 13; Super profit = ₹6 lakhs for forthcoming 5 years; PV of annuity for 5 years = 3.43 at 14% and 3.2 at 17%.

COMPLETE SOLUTION

A. Value based on Income Approach (DCF)

$$\text{FCFF}_1 = \text{FCFF}_0 \times (1 + g) = ₹40 \times 1.04 = ₹41.6 \text{ lakhs}$$

$$V_0 = \text{FCFF}_1 / (\text{WACC} - g) = 41.6 / (0.14 - 0.04) = ₹416 \text{ lakhs}$$

$$\text{Value of Equity} = V_0 - \text{Debt Capital} = 416 - 66 = ₹350 \text{ lakhs}$$

$$\text{Value per share} = 350 / 10 = \text{₹35}$$

B. Value based on Market Approach (EPS)

$$\text{Comparator} = \text{Average of P/E of peer group} = (11 + 12 + 13) / 3 = 12$$

$$\text{Value per share} = \text{EPS} \times \text{Comparator} = ₹3.20 \times 12 = \text{₹38.40}$$

C. Value based on Net Asset Approach

$$\text{Net asset excluding goodwill} = ₹300 \text{ lakhs}$$

$$\text{Goodwill} = \text{PV of super profit for 5 years} = 3.43 \times ₹6 = ₹20.58 \text{ lakhs}$$

$$\text{Value of business} = ₹300 + ₹20.58 = ₹320.58 \text{ lakhs}$$

$$\text{Value per share} = ₹320.58 / 10 = \text{₹32.06}$$

D. Value per Share Giving Equal Importance

$$= (35 + 38.40 + 32.06) / 3 = \text{₹35.15}$$

ICMAI Illustration 12 – Break-up Value and Market Value

Question: The Balance Sheet of Q Limited as on 31.12.2021 (₹ in Lakh):

LIABILITIES	₹	ASSETS	₹
1,00,000 Equity shares of ₹10 each fully paid-up	10	Goodwill	5
1,00,000 Equity shares of ₹6 each fully paid-up	6	Fixed Assets	15
Reserves & Surplus	2	Other Tangible Assets	5
Liabilities	10	Intangible Assets (Market Value)	3
		Misc. Expenditure to the extent	2
Total	28	Total	28

Fixed assets worth ₹24 lakhs; Other tangible assets valued at ₹3 lakhs. Disputed bonus claim of ₹1 lakh not provided. Goodwill appearing in Balance Sheet is purchased goodwill. Increase in value of goodwill by average of book value and 3 years' purchase of average super profit for last 4 years. Profits: 2014: 3.00 (11% dividend); 2015: 3.50 (12%); 2016: 4.00 (13%); 2017: 4.10 (14%). Normal expectation = 10%. Kamallesh holds 20,000 equity shares of ₹10 each fully paid and 10,000 equity shares of ₹4 each fully paid. He wants to sell his holdings. Determine: (i) break-up value and market value of both kinds of shares; (ii) fair value of shares, if controlling interest is being sold.

COMPLETE SOLUTION

Working Note 1: Net Assets Available for Shareholders

PARTICULARS	₹ LAKH
Fixed Assets	24.00
Other Tangible Assets	3.00
Intangible Assets	3.00
Less: Liabilities	(10.00)
Less: Bonus	(1.00)
Net Assets (excluding goodwill)	19.00
Less: 1/2 of profits [1/2 (4.10 – 1.0)]	(1.55)
Average Capital Employed	17.45

Working Note 2: Average Super Profit

Average Profit = $\frac{1}{4} [3 + 3.5 + 4 + 4.1 - 1.0] = \frac{1}{4} \times 13.60 = ₹3.40$ lakh

Normal Profit = 10% of ₹17.45 lakh = ₹1.745 lakh

Super Profit = $3.40 - 1.745 = ₹1.655$ lakh

Working Note 3: Goodwill

3 years' purchase of average super profit = $3 \times 1.655 = ₹4.965$ lakh

Increase in value of goodwill = $\frac{1}{2} (\text{Book value} + 3 \text{ years super profit})$
 $= \frac{1}{2} (5 + 4.965) = ₹4.9825$ lakh

Net Assets Available for Shareholders

Net assets as valued (W.N.1) including book value of goodwill = ₹19.00 lakh

Add: Goodwill as per Balance Sheet = ₹5.00 lakh

Add: Increase in goodwill (rounded) = ₹4.98 lakh

Net Assets = ₹28.98 lakh

(i) Break-up Value

Break-up value per ₹1 of share capital = $28.98 / 16.00 = ₹1.81$

Break-up value of ₹10 paid up share = $1.81 \times 10 = ₹18.10$

Break-up value of ₹6 paid up share = $1.81 \times 6 = ₹10.86$

Market Value of Shares

Average Dividend = $(11\% + 12\% + 13\% + 14\%) / 4 = 12.5\%$

Market value of ₹10 paid up = $(12.5\% / 10\%) \times 10 = \text{₹}12.50$

Market value of ₹6 paid up = $(12.5\% / 10\%) \times 4 = \text{₹}7.50$

(ii) Fair Value (Controlling Interest)

Average Profit = $(3.4 / 16) \times 100 = 21.25\%$

For ₹10 paid up: $(21.25\% / 10\%) \times 10 = \text{₹}21.25$

For ₹6 paid up: $(21.25\% / 10\%) \times 6 = \text{₹}12.75$

Fair value of ₹10 paid up = $(18.10 + 21.25) / 2 = \text{₹}19.68$

Fair value of ₹6 paid up = $(10.86 + 12.75) / 2 = \text{₹}11.81$

ICMAI Illustration 13 – Intrinsic Value of Equity Share

Question: The following is the Balance Sheet of K Ltd. as on 31st March, 2021 (₹ in Lakh):

LIABILITIES	₹	ASSETS	₹
3,00,000 Equity shares of ₹10 each fully paid	30,00,000	Building	20,00,000
12.5% Redeemable preference shares of ₹100 each fully paid	19,00,000	Plant & Machinery	22,00,000
General Reserve	15,00,000	Furniture	10,00,000
Profit & Loss A/c	3,00,000	Investments	16,00,000
Secured Loan	10,00,000	Stock	12,00,000
Creditors	27,00,000	Debtors	20,00,000
		Bank Balance	4,00,000
Total	1,04,00,000	Total	1,04,00,000

Additional Information: (i) Fixed assets worth 20% more; Stock overvalued by ₹1,00,000; Debtors reduced by ₹40,000; Trade investments (10% of total) valued at 10% below cost. (ii) Trade investments purchased on 01.04.2020; 50% non-trade on 01.04.2019, rest on 01.04.2020; Non-trade yielded 15% return. (iii) Furniture sold at loss of ₹50,000 in 2019-20 (non-recurring). (iv) New machinery ₹2,00,000 wrongly charged to revenue in 2018-19; depreciation @ 10% WDV. (v) Return on capital employed = 20%. (vi) Profits: 2017-18: ₹13,00,000; 2018-19: ₹14,00,000; 2019-20: ₹16,00,000; 2020-21: ₹18,00,000. (vii) Preference dividend paid. (viii) Depreciation on overall increased value not considered; only on additional value of plant and machinery. Compute intrinsic value of equity share.

COMPLETE SOLUTION

Step 1: Computation of Goodwill - Capital Employed

PARTICULARS	₹	₹
Building		20,00,000
Plant and Machinery (22,00,000 + 1,45,800)		23,45,800
Furniture		10,00,000
Sub-total		53,45,800
Add: 20% Appreciation		10,69,160
Total Fixed Assets		64,14,960
Trade investments (16,00,000 × 10% × 90%)		1,44,000
Debtors (20,00,000 – 40,000)		19,60,000
Stock (12,00,000 – 1,00,000)		11,00,000
Bank Balance		4,00,000
Total Assets		1,00,18,960
Less: Redeemable preference shares	19,00,000	
Less: Secured Loan	10,00,000	
Less: Creditors	30,00,000	(59,00,000)
Capital Employed		41,18,960

Step 2: Future Maintainable Profit (Average Adjusted Profit)

PARTICULARS	2017-18	2018-19	2019-20	2020-21
Profit	13,00,000	14,00,000	16,00,000	18,00,000
Add: Capital Expenditure		2,00,000		
Add: Loss on sale of furniture			50,000	
Sub-total	13,00,000	16,00,000	16,50,000	18,00,000
Less: Depreciation		(20,000)	(18,000)	(16,200)
Less: Non-trade income		(1,08,000)	(2,16,000)	
Less: Stock reduction			(1,00,000)	
Less: Bad debts			(40,000)	
Adjusted Profit	13,00,000	15,80,000	15,24,000	14,27,800

Total = ₹58,31,800; Average = ₹14,57,950

Less: Depreciation on additional machinery = $(22,00,000 + 1,45,800) \times 20\% \times 10\% = (\text{₹}46,916)$

Average Adjusted Profit = ₹14,11,034

Step 3: Normal Profit and Super Profit

Normal Profit = $20\% \times \text{₹}41,18,960 = \text{₹}8,23,792$

Super Profit = $\text{₹}14,11,034 - \text{₹}8,23,792 = \text{₹}5,87,242$

Step 4: Goodwill

Goodwill = 2 years' purchase $\times$ Super Profit = $5,87,242 \times 2 = \text{₹}11,74,484$

Step 5: Net Assets Available for Equity Shareholders

PARTICULARS	₹
Goodwill	11,74,484
Sundry Fixed Assets	64,14,960
Trade and Non-trade Investments	15,84,000
Debtors	19,60,000
Stock	11,00,000
Bank Balance	4,00,000
Total Assets	1,26,33,444
Less: Redeemable Preference Shares	(19,00,000)
Less: Secured Loan	(10,00,000)
Less: Creditors	(30,00,000)
Net Assets Available	67,33,444

Step 6: Intrinsic Value per Share

Value of equity share = $67,33,444 / 3,00,000 = ₹22.44$ (approx)

KEY TAKEAWAY

Key Takeaway: These illustrations cover every method and adjustment pattern tested in the CMA Final examination. Practice each one until you can solve them independently. Pay special attention to:

- Adjustments for abnormal and non-recurring items
- Treatment of partly paid shares and notional calls
- Capital employed computation with revaluation adjustments
- Super profit and goodwill computation under different methods
- DCF terminal value computation
- Market approach with multiple base values

MODULE 2 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top 100 Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 2 covers Valuation of Shares including Determination of Goodwill and Post-Valuation of Tangible and Intangible Assets. This module carries **15% weightage** in Paper 18. Master the three approaches — Income, Net Assets, and Market — and the multiple methods of goodwill valuation.

B. Mega Revision Sheet

APPROACH	CORE PRINCIPLE	KEY FORMULA
Income Approach – DCF	Value based on future cash flows	$V = CF / (k - g)$; $FCFF = CF - \text{Capex}$
Income Approach – Dividend Discount	Value based on dividends	D/Ke or $D/(Ke - g)$
Income Approach – Maintainable Profits	Value based on future profits	Profit / Ke
Income Approach – Yield-Basis	Capitalized profit/dividend	$(\text{Profit} / \text{Normal Rate}) \times 100$
Income Approach – Fair Value	Average of Intrinsic and Yield	$(\text{Intrinsic} + \text{Yield}) / 2$
Net Assets Approach	Value based on net assets	$\text{Net Assets} / \text{No. of Shares}$
Goodwill – Capitalisation	Capitalized super profit	$\text{Super Profit} / \text{Normal Rate}$
Goodwill – Years' Purchase	Super profit $\times$ years	$\text{Super Profit} \times \text{Years}$
Goodwill – Annuity	Super profit $\times$ PV annuity	$\text{Super Profit} \times \text{PV of Annuity}$
Market Approach	Relative multiple application	$\text{Base Value} \times \text{Comparator}$

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA
Value per Share (DCF)	Value of Equity / No. of Equity Shares
Value of Equity (DCF)	Value of Business – Debt Capital
NOPAT	$EBIT \times (1 - t)$
CF	$NOPAT + Depreciation - Increase\ in\ WC$
FCFF	$CF - Capex$
FCFE	$FCFF - Interest(1 - t) + Net\ Debt\ Issued$
Terminal Value (Constant)	CF / k
Terminal Value (Growth)	$CF / (k - g)$
Value per Share (Dividend)	$D/Ke\ or\ D/(Ke - g)$
Yield Value (Profit Basis)	$(Profit / Normal\ Rate) \times 100 / No.\ of\ Shares$
Yield Value (Dividend Basis)	$(Rate\ of\ Dividend / Normal\ Rate) \times Paid-up\ Value$
Fair Value	$(Intrinsic\ Value + Yield\ Value) / 2$
Net Assets	Total Assets – Total Liabilities
Value per Share (Net Assets)	Net Assets / No. of Equity Shares
Notional Calls	Partly paid shares × Uncalled amount
Average Maintainable Profit	Average of adjusted past profits
Normal Profit	Average Capital Employed × Normal Rate
Super Profit	Average Maintainable Profit – Normal Profit
Goodwill (Capitalisation)	Super Profit / Normal Rate
Goodwill (Years' Purchase)	Super Profit × Years
Goodwill (Annuity)	Super Profit × PV of Annuity
Relative / Multiple	Market Capitalisation / Base Value

Value per Share (Market)

Value of Equity / No. of Shares

D. Top Exam Points – Quick Revision

1. Share = smallest unit of ownership of a company.
2. Valuation of shares is used for sale, merger, acquisition, loan security, nationalization, conversion.
3. Three major approaches: Income, Net Assets, Market.
4. Income Approach includes DCF, Dividend Discount, Maintainable Profits, Yield-Basis, Fair Value.
5. DCF uses NOPAT, FCFF, FCFE, WACC.
6. $\text{NOPAT} = \text{EBIT} \times (1 - t)$.
7. $\text{CF} = \text{NOPAT} + \text{Depreciation} - \text{Increase in working capital}$.
8. $\text{FCFF} = \text{CF} - \text{Capex}$.
9. $\text{FCFE} = \text{FCFF} - \text{Interest} (1 - t) + \text{Net Debt Issued}$.
10. Terminal Value (constant) = CF / k .
11. Terminal Value (growth) = $\text{CF} / (k - g)$.
12. Dividend Discount Model: D/K_e or $D/(K_e - g)$.
13. Maintainable Profits: Capitalize at K_e .
51. Contingent assets and liabilities considered in Net Assets Approach.
52. Preference shareholders' dues considered as liabilities.
53. Goodwill appearing in Balance Sheet is purchased goodwill.
54. Increase in goodwill = Average of book value and calculated goodwill.
55. Super profit method variables: Super profit, Capital employed, Normal rate, Years' purchase.
56. Annuity method considers time value of money.
57. Capitalisation of Average Profits = Capitalised value – Net Assets.
58. Capitalisation of Super Profits = Super Profit / Normal Rate.
59. DCF merits: Unaffected by accounting policies; intrinsic value.
60. DCF demerits: Hard to estimate future cash flows; hard to determine discount rate.
61. Growth rate $g = \text{Re-investment Rate} \times \text{ROIC}$.
62. Re-investment Rate = Re-investment / NOPAT.

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly. Step-wise presentation fetches marks.
- State the approach and method used for each valuation.
- For practical problems, draw tables for computations.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: DCF, Goodwill valuation, Intrinsic value, Yield value.
- Practice at least 10 comprehensive problems covering all approaches.
- Read the question carefully for adjustments like "ignore tax", "assume fair value equals book value", etc.
- For Net Assets Approach, always consider contingent liabilities and preference capital.
- For Goodwill valuation, always adjust for abnormal and non-recurring items.
- For Market Approach, compute at least three multiples for robustness.
- For DCF, clearly show the terminal value computation.
- For partly paid shares, always compute notional calls and equivalent shares.
- For controlling interest valuation, use Profit Basis for yield value.
- For minority holding valuation, use Dividend Basis for yield value.

F. Frequently Repeated Concepts

- DCF valuation with terminal value — appears almost every attempt.
- Intrinsic value per share with partly paid shares — very common.
- Goodwill valuation using Super Profits method — frequently tested.
- Yield value per share (Profit and Dividend Basis) — regular.
- Fair value per share computation — regular.
- Capital Employed computation with revaluation adjustments — common.
- Market approach with P/E ratio — increasingly important.
- Break-up value and market value for different categories of shares — common.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ Purpose of share valuation
- ☒ Factors affecting valuation
- ☒ Three approaches and their sub-methods
- ☒ DCF model: NOPAT, CF, FCFF, FCFE, Terminal Value
- ☒ Dividend Discount Model
- ☒ Maintainable Profits Basis
- ☒ Yield-Basis Method: Profit and Dividend Basis
- ☒ Fair Value Method
- ☒ Net Assets Approach: Computation format
- ☒ Notional calls and equivalent shares
- ☒ Goodwill: Capitalisation, Super Profits, Annuity
- ☒ Average Maintainable Profit adjustments
- ☒ Average Capital Employed computation
- ☒ Normal Profit and Super Profit computation
- ☒ Market Approach: P/E, P/S, P/CFO
- ☒ Valuation of intangible assets: Cost, Market, Income
- ☒ Break-up value vs Market value
- ☒ Fair value for controlling vs minority interest
- ☒ All ICMAl illustrations with step-by-step solutions
- ☒ Common mistakes to avoid

H. Common Mistakes Students Make

WARNING

- Forgetting to add notional calls for partly paid shares.
- Incorrect equivalent share computation.
- Not adjusting for abnormal and non-recurring items in maintainable profits.
- Incorrect capital employed computation.
- Forgetting to deduct preference dividend from profits.
- Using wrong normal rate of return.
- Not considering contingent liabilities in Net Assets Approach.
- Confusing Profit Basis and Dividend Basis for yield value.
- Incorrect terminal value computation in DCF.
- Forgetting to deduct debt capital from business value in DCF.
- Not computing equivalent shares for different denominations.
- Incorrect treatment of preference shares in capital employed.
- Forgetting to adjust depreciation on revalued assets.
- Not considering income from non-trade investments.
- Incorrect market multiple computation in Market Approach.

I. Memory Tricks and Mnemonics

KEY TAKEAWAY

Approaches: INM → Income, Net Assets, Market

Income Approach: DDMYF → DCF, Dividend, Maintainable, Yield, Fair Value

Goodwill Methods: CSA → Capitalisation, Super Profits, Annuity

Super Profit: ANS → Average Profit – Normal Profit = Super Profit

Net Assets: ALN → Assets – Liabilities = Net Assets

Market Approach: RCV → Relative, Comparator, Value

DCF: NCFT → NOPAT, CF, FCFF, Terminal Value

Yield-Basis: PD → Profit Basis (Majority), Dividend Basis (Minority)

J. Printable PDF Version Content

1 DAY BEFORE EXAM

Module 2 – Printable Quick Notes:

1. DCF: Value = $CF / (k - g)$; FCFF = CF – Capex; NOPAT = EBIT × (1 – t)
2. Dividend Discount: D/Ke or $D/(Ke - g)$
3. Maintainable Profits: Capitalize at Ke
4. Yield-Basis: Profit Basis (majority), Dividend Basis (minority)
5. Fair Value = (Intrinsic + Yield) / 2
6. Net Assets = Total Assets – Total Liabilities
7. Value per share = Net Assets / No. of equity shares
8. Notional calls added for partly paid shares
9. Super Profit = Average Maintainable Profit – Normal Profit
10. Normal Profit = Average Capital Employed × Normal Rate
11. Goodwill = Super Profit / Normal Rate (Capitalisation)
12. Goodwill = Super Profit × Years (Years' Purchase)
13. Goodwill = Super Profit × PV of Annuity (Annuity)
14. Relative = Market Capitalisation / Base Value
15. Value of Equity = Base Value × Comparator

KEY TAKEAWAY

END OF MODULE 2 – VALUATION OF SHARES

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CMA Final Paper 18

Corporate Financial Reporting

MODULE 3

Accounting of Financial Instruments

Complete Revision Handbook with Full ICAI Illustrations, Step-by-Step Solutions,
Formulas, and Exam-Focused Notes

3

IND AS

15%

WEIGHTAGE

10+

ILLUSTRATIONS

40+

FORMULAS

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MODULE 3: Accounting of Financial Instruments

Ind AS 32, Ind AS 107, Ind AS 109 | 15% Weightage | Recognition, Measurement, Presentation & Disclosure

3

IND AS COVERED

15%

EXAM WEIGHTAGE

10+

FULL ILLUSTRATIONS

40+

FORMULAS &
FRAMEWORKS

★ EXAM IMPORTANT

Module 3 carries **15% weightage** in Paper 18. Expect **1–2 full questions (15 marks each)** plus short notes and objective questions. Master the classification of financial assets and liabilities, compound financial instruments, and the three measurement categories under Ind AS 109.

Table of Contents – Module 3

- 1 Ind AS 32 – Financial Instruments: Presentation
- 2 Ind AS 107 – Financial Instruments: Disclosures
- 3 Ind AS 109 – Financial Instruments: Recognition & Measurement
- 4 Classification & Measurement Categories
- 5 Compound Financial Instruments & Embedded Derivatives
- 6 Full ICAI Illustrations with Step-by-Step Solutions
- ★ Module Summary & Mega Revision

Syllabus Coverage Matrix

IND AS	TOPIC	WEIGHTAGE	PRIORITY
Ind AS 32	Financial Instruments: Presentation	4–5%	★★★★★
Ind AS 107	Financial Instruments: Disclosures	3–4%	★★★★★
Ind AS 109	Financial Instruments: Recognition & Measurement	6–8%	★★★★★
Compound Instruments	Convertible Bonds, Preference Shares	3–4%	★★★★★
Embedded Derivatives	Separation Criteria, Accounting	2–3%	★★★★★

Expected Question Types

Practical Problems (15 Marks)

- Compound financial instrument: Split into liability and equity components
- Convertible bonds: Initial recognition, interest expense, conversion
- Redeemable preference shares: Liability vs equity classification
- Amortized cost computation with effective interest rate
- Impairment of financial assets (expected credit loss)
- Classification of financial assets based on business model and SPPI test
- Fair value through OCI vs Fair value through P&L

Short Notes / Theory (5 Marks)

- Financial asset vs Financial liability vs Equity instrument
- Puttable instruments and their classification
- Offsetting of financial assets and liabilities
- Business model test and SPPI test
- Amortized cost vs Fair value measurement
- Expected credit loss model
- Disclosure requirements under Ind AS 107
- Embedded derivatives: Separation criteria



Frequently Tested Concepts

- Compound financial instrument split
- Effective interest rate method
- Amortized cost measurement
- Business model test for classification
- SPPI (Solely Payments of Principal and Interest) test
- Fair value hierarchy for financial instruments
- Expected credit loss (ECL) model
- Offsetting criteria
- Puttable instrument classification
- Convertible bond accounting
- Redeemable preference share accounting
- Disclosure requirements for financial instruments

Ind AS 32 – Financial Instruments: Presentation

1. Chapter Overview

Ind AS 32 establishes principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.

2. Learning Objectives

- Understand the definitions of financial assets, financial liabilities, and equity instruments.
- Apply the classification criteria for financial instruments from the issuer's perspective.
- Understand puttable instruments and their classification.
- Apply the offsetting criteria for financial assets and financial liabilities.

3. Important Definitions

3.1 Financial Asset

DEFINITION

A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

3.2 Financial Liability

DEFINITION

A financial liability is any liability that is:

- (a) a contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

3.3 Equity Instrument

DEFINITION

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. The instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met:

- (a) The instrument includes no contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

3.4 Puttable Instrument

DEFINITION

A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder. Ordinarily it satisfies the conditions of being classified as financial liabilities. Where it entitles the holder a pro rata share of the entity's net assets on liquidation it is classified as equity.

3.5 Fair Value

DEFINITION

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

4. Classification: Liability vs Equity

Financial Instrument Classification

Financial Asset

Financial Liability

Equity Instrument

Cash, Equity of another, Contractual right

Contractual obligation to deliver cash

Residual interest, No obligation to deliver cash

★ EXAM IMPORTANT

Key Classification Principle: The critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer.

5. Offsetting of Financial Assets and Financial Liabilities

A financial asset and a financial liability shall be offset and the net amount presented in the balance sheet when, and only when, an entity:

- (a) currently has a legally enforceable right to set off the recognised amounts; and
- (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

6. Journal Entry Frameworks

ILLUSTRATION

Issue of Financial Liability (e.g., Debentures):

Dr. Bank A/c xxx

To. Financial Liability A/c xxx

ILLUSTRATION

Issue of Equity Instruments (e.g., Equity Shares):

Dr. Bank A/c xxx

To. Equity Share Capital A/c xxx

To. Securities Premium A/c xxx

ILLUSTRATION

Interest on Financial Liability:

Dr. Finance Cost A/c xxx

To. Financial Liability A/c xxx

ILLUSTRATION

Dividend on Equity Instruments:

Dr. Retained Earnings / Dividend Distribution A/c xxx

To. Bank A/c xxx

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 32 in 90 seconds:

- Financial Asset = Cash + Equity of another + Contractual right + Certain contracts
- Financial Liability = Contractual obligation to deliver cash + Certain contracts
- Equity = Residual interest + No obligation to deliver cash
- Puttable instrument → Usually liability; equity if pro rata share on liquidation
- Offsetting → Legally enforceable right + Intention to settle net
- **Mnemonic: FLE** → Financial Asset, Liability, Equity

Ind AS 107 – Financial Instruments: Disclosures

1. Chapter Overview

Ind AS 107 requires entities to provide disclosures in their financial statements that enable users to evaluate: (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.

2. Learning Objectives

- Understand the disclosure requirements for financial instruments.
- Disclose carrying amounts of each category of financial instruments.
- Disclose the nature and extent of risks arising from financial instruments.
- Understand the qualitative and quantitative disclosure requirements.

3. Important Disclosure Requirements

3.1 Carrying Amounts Disclosure

The carrying amounts of each of the following categories, as specified in Ind AS 109, shall be disclosed either in the balance sheet or in the notes:

- (a) financial assets measured at fair value through profit or loss;
- (b) financial liabilities at fair value through profit or loss;
- (c) financial assets measured at amortised cost;
- (d) financial liabilities measured at amortised cost;
- (e) financial assets measured at fair value through other comprehensive income.

3.2 Nature and Extent of Risks

For each type of risk arising from financial instruments, an entity shall disclose:

- (a) the exposures to risk and how they arise;
- (b) its objectives, policies and processes for managing the risk and the methods used to measure the risk; and
- (c) any changes in (a) or (b) from the previous period.

3.3 Qualitative and Quantitative Disclosures

DISCLOSURE TYPE	REQUIREMENTS
Qualitative	Exposures, objectives, policies, processes, methods for managing risks
Quantitative	Summary data about exposure to each risk, concentrations of risk
Credit Risk	Amount of maximum exposure, collateral, credit quality, past due analysis
Liquidity Risk	Maturity analysis for financial liabilities, description of managing liquidity
Market Risk	Sensitivity analysis for each type of market risk

3.4 Fair Value Disclosures

For each class of financial assets and financial liabilities measured at fair value, an entity shall disclose:

- The fair value measurement at the end of the reporting period;
- The level of the fair value hierarchy (Level 1, 2, or 3);
- For Level 3 measurements: reconciliation from opening to closing balances;
- Valuation techniques and inputs used.

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 107 in 60 seconds:

- Objective: Significance of FIs + Nature/extent of risks
- Disclose carrying amounts for each category (FVTPL, Amortized Cost, FVOCI)
- Disclose qualitative + quantitative risk information
- Credit risk: Maximum exposure, collateral, past due
- Liquidity risk: Maturity analysis
- Market risk: Sensitivity analysis
- Fair value: Hierarchy Level 1, 2, 3
- **Mnemonic: SCC** → Significance, Credit, Concentration

CHAPTER 3

Ind AS 109 – Financial Instruments: Recognition & Measurement

1. Chapter Overview

Ind AS 109 establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. It classifies the financial assets and financial liabilities into three categories for recognition and measurement.

2. Learning Objectives

- Understand the initial recognition and measurement of financial instruments.
- Apply the business model test and SPPI test for classification.
- Measure financial assets and liabilities at amortized cost, FVOCI, and FVTPL.
- Apply the effective interest rate method.
- Understand the expected credit loss model.
- Account for embedded derivatives and compound instruments.

3. Important Definitions

DEFINITION

Amortised Cost: The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and adjusted for any loss allowance.

DEFINITION

Effective Interest Rate: The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the gross carrying amount of the financial asset or to the amortised cost of the financial liability.

DEFINITION

Business Model: How an entity manages its financial assets in order to generate cash flows — either by collecting contractual cash flows, selling financial assets, or both.

DEFINITION

SPPI Test: Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

DEFINITION

Expected Credit Loss: The weighted average of credit losses with the respective risks of a default occurring as the weights.

4. Classification of Financial Assets

1. Amortised Cost

- Business model: Hold to collect
- SPPI test: Pass
- Measured at amortised cost
- Interest income in P&L

2. Fair Value through OCI (FVOCI)

- Business model: Hold to collect and sell
- SPPI test: Pass
- Measured at fair value
- Gains/losses in OCI (reclassified on disposal)

3. Fair Value through P&L (FVTPL)

- All other financial assets
- Measured at fair value
- Gains/losses in P&L
- Residual category

4.1 Business Model Test

- **Hold to Collect:** Objective is to collect contractual cash flows. → Amortised Cost (if SPPI pass)
- **Hold to Collect and Sell:** Objective is both collecting contractual cash flows and selling financial assets. → FVOCI (if SPPI pass)
- **Other:** Any other business model. → FVTPL

4.2 SPPI Test

Contractual cash flows that are solely payments of principal and interest on the principal amount outstanding. Interest includes consideration for:

- Time value of money
- Credit risk
- Other basic lending risks and costs
- Profit margin

5. Classification of Financial Liabilities

Financial liabilities are classified as:

- **Amortised Cost:** Default category for most financial liabilities.
- **FVTPL:** If held for trading, or designated as such (fair value option).

6. Initial and Subsequent Measurement

CATEGORY	INITIAL MEASUREMENT	SUBSEQUENT MEASUREMENT	GAINS/LOSSES
Amortised Cost	Fair value + transaction costs	Amortised cost using EIR	P&L (interest, impairment)
FVOCI	Fair value + transaction costs	Fair value	OCI (reclassified on disposal)
FVTPL	Fair value (transaction costs expensed)	Fair value	P&L

7. Effective Interest Rate Method

FORMULA

Amortised Cost = Initial Amount – Principal Repayments ± Cumulative Amortisation – Loss Allowance

FORMULA

Interest Income = Carrying Amount × Effective Interest Rate

FORMULA

Effective Interest Rate = Rate that exactly discounts estimated future cash flows to the gross carrying amount

8. Expected Credit Loss (ECL) Model

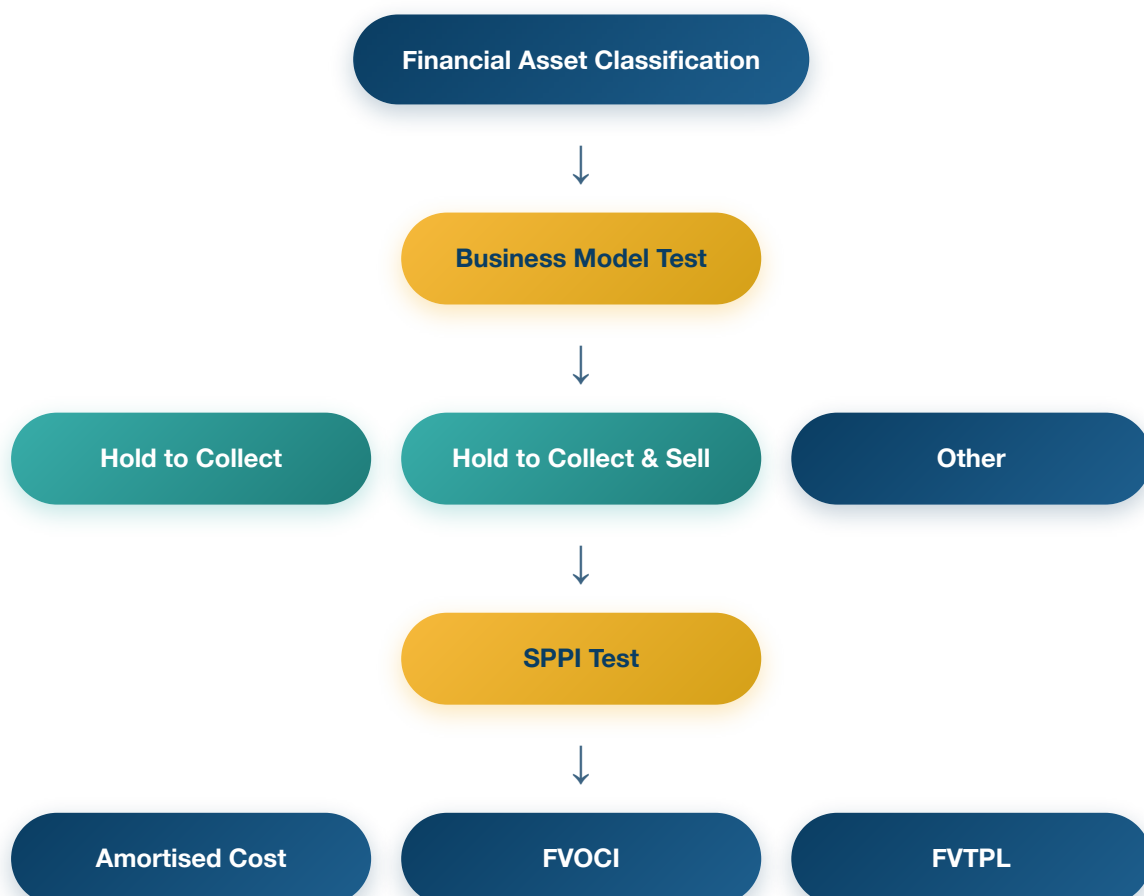
The ECL model applies to:

- Financial assets measured at amortised cost
- Financial assets measured at FVOCI
- Lease receivables
- Contract assets
- Loan commitments and financial guarantee contracts

Three-stage approach:

1. **Stage 1:** No significant increase in credit risk since initial recognition → 12-month ECL
2. **Stage 2:** Significant increase in credit risk → Lifetime ECL
3. **Stage 3:** Credit impaired → Lifetime ECL (interest on net carrying amount)

9. Flowchart Summary



10. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 109 in 90 seconds:

- Classification: Business Model + SPPI Test
- Amortised Cost: Hold to Collect + SPPI Pass
- FVOCI: Hold to Collect & Sell + SPPI Pass
- FVTPL: Residual category
- Initial Measurement: Fair value + transaction costs (except FVTPL)
- Subsequent: Amortised cost (EIR) or Fair value
- ECL: Stage 1 (12-month), Stage 2 (lifetime), Stage 3 (credit impaired)
- **Mnemonic: BSP** → Business Model, SPPI, Presentation

Classification & Measurement Categories

1. Chapter Overview

This chapter provides a detailed analysis of the three measurement categories for financial assets and the two categories for financial liabilities under Ind AS 109. It covers the criteria, measurement principles, and accounting treatment for each category.

2. Financial Assets – Detailed Analysis

2.1 Amortised Cost

Criteria:

- **Business Model:** Hold to collect contractual cash flows
- **SPPI Test:** Contractual cash flows are solely payments of principal and interest

Measurement:

- Initially at fair value + transaction costs
- Subsequently at amortised cost using effective interest rate method
- Subject to impairment under ECL model

Examples:

- Trade receivables
- Loans and advances
- Debt instruments held to maturity

2.2 Fair Value through OCI (FVOCI)

Criteria:

- **Business Model:** Hold to collect and sell
- **SPPI Test:** Pass

Measurement:

- Initially at fair value + transaction costs
- Subsequently at fair value
- Interest income, impairment, and foreign exchange gains/losses in P&L
- Other gains/losses in OCI (reclassified to P&L on derecognition)

Examples:

- Debt instruments held for both collection and sale
- Certain equity investments (irrevocable election)

2.3 Fair Value through P&L (FVTPL)

Criteria:

- All other financial assets not classified as amortised cost or FVOCI
- Held for trading
- Designated as FVTPL (fair value option)

Measurement:

- Initially at fair value (transaction costs expensed)
- Subsequently at fair value
- All gains/losses in P&L

Examples:

- Derivatives
- Equity investments not designated as FVOCI
- Debt instruments not meeting SPPI or business model test

3. Financial Liabilities – Detailed Analysis

Amortised Cost (Default)

- Most financial liabilities are measured at amortised cost
- Initial measurement at fair value minus transaction costs
- Subsequent measurement using effective interest rate method
- Examples: Trade payables, borrowings, debentures

FVTPL

- Held for trading
- Designated as FVTPL (fair value option)
- All gains/losses in P&L

4. Summary Table

CATEGORY	BUSINESS MODEL	SPPI	INITIAL	SUBSEQUENT	GAINS/LOSSES
Amortised Cost	Hold to Collect	Pass	FV + TC	Amortised Cost	P&L (interest, impairment)
FVOCI	Hold to Collect & Sell	Pass	FV + TC	Fair Value	OCI (recycled)
FVTPL	Other	N/A	FV	Fair Value	P&L

5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Classification Categories in 60 seconds:

- Amortised Cost: Hold to Collect + SPPI Pass
- FVOCI: Hold to Collect & Sell + SPPI Pass
- FVTPL: Residual category
- Transaction costs: Capitalise for Amortised Cost & FVOCI; Expense for FVTPL
- EIR method for Amortised Cost
- **Mnemonic: AFF** → Amortised Cost, FVOCI, FVTPL

Compound Financial Instruments & Embedded Derivatives

1. Chapter Overview

A compound financial instrument is a financial instrument that, from the issuer's perspective, contains both a liability and an equity component. Ind AS 32 requires the issuer of such a financial instrument to classify the instrument's component parts separately as financial liabilities, financial assets, or equity instruments. Embedded derivatives are components of a hybrid contract that also includes a non-derivative host contract.

2. Learning Objectives

- Understand the concept of compound financial instruments.
- Apply the split accounting method for compound instruments.
- Account for convertible bonds and redeemable preference shares.
- Identify and account for embedded derivatives.

3. Important Definitions

DEFINITION

Compound Financial Instrument: A financial instrument that, from the issuer's perspective, contains both a liability and an equity component.

DEFINITION

Embedded Derivative: A component of a hybrid contract that also includes a non-derivative host contract — with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

DEFINITION

Hybrid Contract: A contract that contains a host contract and an embedded derivative.

4. Split Accounting for Compound Instruments

The issuer of a compound financial instrument shall classify the instrument's component parts separately as financial liabilities, financial assets, or equity instruments. The split is done as follows:

1. **Determine the liability component:** Measure the fair value of the liability component first (present value of future cash flows discounted at market rate for similar liability without conversion option).
2. **Determine the equity component:** The equity component is the residual amount after deducting the fair value of the liability component from the fair value of the compound instrument as a whole.

FORMULA

Equity Component = Total Proceeds – Fair Value of Liability Component

FORMULA

Liability Component = PV of future cash flows discounted at market rate for similar liability without conversion option

5. Accounting for Convertible Bonds

Initial Recognition:

- Liability component: PV of future interest and principal payments discounted at market rate for similar non-convertible debt.
- Equity component: Residual amount (Total proceeds – Liability component).

Subsequent Measurement:

- Liability component: Amortised cost using effective interest rate method.
- Equity component: Not remeasured.

On Conversion:

- Derecognise liability component.
- Derecognise equity component.
- Recognise equity share capital and securities premium.

6. Accounting for Redeemable Preference Shares

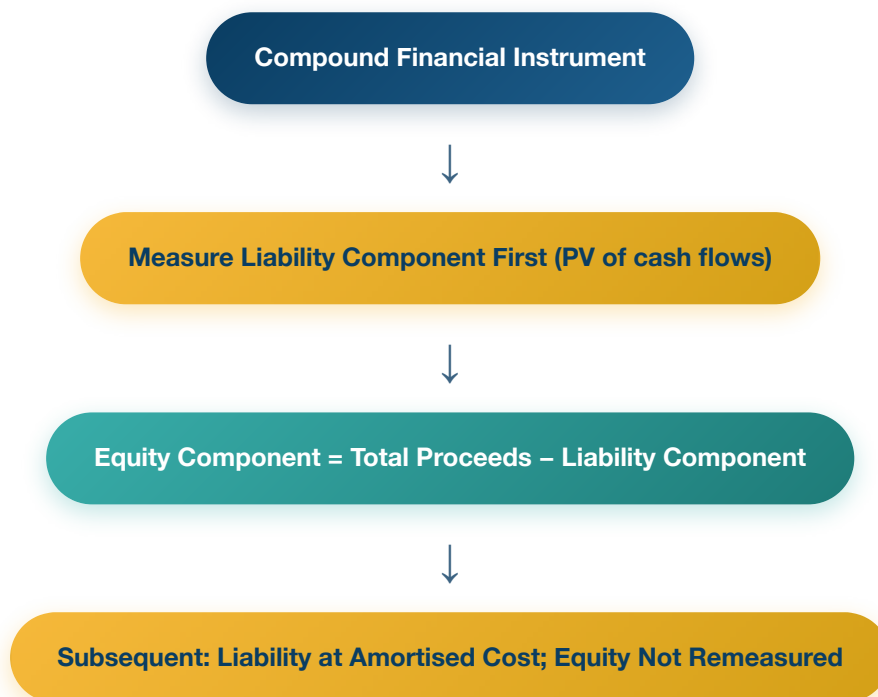
Redeemable preference shares that require mandatory redemption are classified as financial liabilities. The liability component is measured at the present value of future cash flows (dividends + redemption amount). Any residual is equity component (if convertible).

7. Embedded Derivatives

An embedded derivative shall be separated from the host contract and accounted for as a derivative if, and only if:

- (a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;
- (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- (c) the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss.

8. Flowchart Summary



9. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Compound Instruments in 90 seconds:

- Measure liability component FIRST (PV of cash flows at market rate)
- Equity component = Total Proceeds – Liability Component
- Liability subsequent measurement: Amortised cost (EIR)
- Equity component: Not remeasured
- On conversion: Derecognise liability + equity; recognise share capital
- Embedded derivative: Separate if not closely related + derivative definition + not FVTPL
- **Mnemonic: LEA** → Liability first, Equity residual, Amortised cost

CHAPTER 6

Full ICMAI Illustrations with Step-by-Step Solutions

★ EXAM IMPORTANT

This chapter contains all the illustrations from the ICMAI study material for Module 3, presented with complete step-by-step solutions. Practice each illustration thoroughly — they form the foundation for exam problems on financial instruments.

ICMAI Illustration 1 – Convertible Debentures with Embedded Derivative

Question: G Ltd. issued 6% Debenture of total ₹10,00,000 on 01.04.2017 repayable on 31.03.2022. The debenture holders have right to receive equity shares of face value of ₹4,00,000 at maturity as alternative to repayment in cash. The required rate of return is 10%. How the transaction will be recognised, measured and presented in 2017-2018?

COMPLETE SOLUTION

Step 1: Compute Present Value of Liability Component

YEAR	INTEREST (6%)	DCF AT 10%	PRESENT VALUE (₹)
1	60,000	0.909	54,545
2	60,000	0.826	49,587
3	60,000	0.751	45,079
4	60,000	0.683	40,981
5	10,60,000	0.621	6,58,177
Total Liability Component			8,48,369

Step 2: Compute Equity Component

Total Proceeds = ₹10,00,000

Less: Liability Component = ₹8,48,369

Equity Component = ₹1,51,631

Step 3: Finance Cost for 2017-18

Finance Cost = $10\% \times ₹8,48,369 = ₹84,837$

Step 4: Presentation in Balance Sheet (31.03.2018)

Financial Liability (Debenture) = ₹8,48,369 + ₹84,837 - ₹60,000 = **₹8,73,206**

Equity Component (Option to acquire shares) = **₹1,51,631**

Step 5: At Maturity (If Conversion Opted)

PARTICULARS	DR. (₹)	CR. (₹)
Debenture A/c Dr.	10,00,000	
To, Equity Share Capital A/c		4,00,000
To, Security Premium A/c		6,00,000

ICMAI Illustration 2 – Loan with Processing Cost and Impairment

Question: X Ltd. granted a loan to Y Ltd. amounting to ₹40 lakhs repayable in 2 years at ₹46 lakhs. However, due to economic recession after 1 year the repayable amount has been revised at ₹44 lakhs. Effective annual interest rate for such a loan is determined at 6% p.a. The loan processing cost was ₹2 lakhs. X Ltd's accountant suggested to: (i) Charge processing cost to the first year profit and loss A/c. (ii) To credit ₹4 Lakhs as interest income in the second year profit and loss a/c. (iii) To carry loan a/c in the first year balance sheet at ₹40 lakhs. Your advice is solicited.

COMPLETE SOLUTION

Step 1: Processing Cost Treatment

Processing cost should be **added to the carrying value of the loan** (i.e., ₹40 Lakhs + ₹2 Lakhs = ₹42 lakhs), and **not charged to P&L**.

Step 2: Interest Income for Year 1

Interest should be credited to P&L at 6% on ₹42 lakhs = **₹2.52 lakhs**

Step 3: Carrying Amount at End of Year 1

Carrying Amount = ₹42 lakhs + ₹2.52 lakhs = **₹44.52 lakhs**

Step 4: Impairment Loss at End of Year 1

Recoverable Amount = PV of revised repayment = ₹44 lakhs / 1.06 = **₹41.51 Lakhs** (approx)

Impairment Loss = ₹44.52 lakhs – ₹41.51 lakhs = **₹3.01 lakhs**

(To be charged to P&L under Ind AS 36)

Step 5: Year 2 Interest and Final Settlement

Interest in Year 2 = ₹41.51 × 6% = **₹2.49 lakhs**

Carrying amount at end of Year 2 = ₹41.51 + ₹2.49 = **₹44 lakhs** (repaid)

ICMAI Solved Case 1 – Convertible Bonds with Equity Component

Question: Dew Ltd. issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of ₹1,000 per bond, giving total proceeds of ₹20,00,000. Interest is payable annually at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 25,000 ordinary shares of ₹10. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent. The holders of the Debentures elected to convert the Debentures into Equity at maturity. Pass journal entries in the books of Dew Ltd.

COMPLETE SOLUTION

Step 1: Compute Liability Component (PV at 9%)

YEAR	INTEREST & PRINCIPAL (₹)	DCF AT 9%	PRESENT VALUE (₹)
1	1,20,000	0.917	1,10,092
2	1,20,000	0.842	1,01,002
3	1,20,000	0.772	92,662
3	20,00,000	0.772	15,44,367
Liability Component			18,48,122

Step 2: Compute Equity Component

Total Proceeds = ₹20,00,000

Less: Liability Component = ₹18,48,122

Equity Component = ₹1,51,878

Step 3: Amortization Schedule

DATE	PAYMENT 6% (₹)	INTEREST AT 9% (₹)	INCREASE IN LIABILITY (₹)	TOTAL LIABILITY (₹)
01-04-2019	–	–	–	18,48,122
31-03-2020	1,20,000	1,66,331	46,331	18,94,453
31-03-2021	1,20,000	1,70,501	50,501	19,44,954
31-03-2022	1,20,000	1,75,046	55,046	20,00,000

DATE	PARTICULARS	DR. (₹)	CR. (₹)
01-04-2019	Bank Dr.	20,00,000	
	To, Convertible Debenture (liability)		18,48,122
	To, Convertible Debenture (Equity component)		1,51,878
31-03-2020	Interest Expense Dr.	1,66,331	
	To, Bank		1,20,000
	To, Convertible Debenture (liability)		46,331
31-03-2021	Interest Expense Dr.	1,70,501	
	To, Bank		1,20,000
	To, Convertible Debenture (liability)		50,501
31-03-2022	Interest Expense Dr.	1,75,046	
	To, Bank		1,20,000
	To, Convertible Debenture (liability)		55,046
31-03-2022	Convertible Debenture (liability) Dr.	20,00,000	
	Convertible Debenture (Equity component) Dr.	1,51,878	
	To, Equity Share Capital		2,50,000
	To, Securities Premium		19,01,878

ICMAI Solved Case 2 – Redeemable Cumulative Preference Shares

Question: Hill Ltd. issues 4-year 2000 2% redeemable cumulative preference shares of ₹1000 at par to its parent Mountain Ltd. on 01-04-2018. Market rate of interest is 12%. Show journal entries in the books of Mountain Ltd. for all the years.

COMPLETE SOLUTION

Step 1: Compute Loan Component (PV at 12%)

YEAR	DIVIDEND & PRINCIPAL (₹)	DCF AT 12%	PRESENT VALUE (₹)
1	40,000	0.893	35,714
2	40,000	0.797	31,888
3	40,000	0.712	28,471
4	40,000	0.636	25,421
4	20,00,000	0.636	12,71,036
Loan Component			13,92,530

Step 2: Compute Equity Component

Investment = ₹20,00,000

Less: Loan Component = ₹13,92,530

Equity Component = ₹6,07,470

Step 3: Amortization Schedule

YEAR	RECEIPTS @ 2% (₹)	INTEREST @ 12% (₹)	INCREASE IN LOAN (₹)	CARRYING AMOUNT (₹)
0	–	–	–	13,92,530
1	40,000	1,67,104	1,27,104	15,19,634
2	40,000	1,82,356	1,42,356	16,61,990
3	40,000	1,99,439	1,59,439	18,21,429
4	40,000	2,18,571	1,78,571	20,00,000

DATE	PARTICULARS	DR. (₹)	CR. (₹)
01-04-2018	Investment (Equity portion) Dr.	6,07,470	
	Loan Receivable Dr.	13,92,530	
	To, Bank		20,00,000
31-03-2019	Loan Receivable Dr.	1,27,104	
	Bank Dr.	40,000	
	To, Interest Income		1,67,104
31-03-2020	Loan Receivable Dr.	1,42,356	
	Bank Dr.	40,000	
	To, Interest Income		1,82,356
31-03-2021	Loan Receivable Dr.	1,59,439	
	Bank Dr.	40,000	
	To, Interest Income		1,99,439
31-03-2022	Loan Receivable Dr.	1,78,571	
	Bank Dr.	40,000	
	To, Interest Income		2,18,571
31-03-2022	Bank Dr.	20,00,000	
	To, Loan Receivable		20,00,000

ICMAI Comprehensive Problem – Loan with Processing Cost and Impairment

Question: X Ltd. Granted a loan to Y Ltd. amounting to ₹60 lakhs repayable in 2 years at ₹70 lakhs. However, due to economic recession after 1 year the repayable amount has been revised at ₹68 lakhs. Effective annual interest rate for such a loan is determined at 6% pa. The loan processing cost was ₹3 lakhs. X Ltd.'s accountant suggested to: (i) Charge processing cost to the first-year Profit and Loss A/c. (ii) To credit ₹8 Lakhs as interest income in the second-year Profit and Loss A/c. (iii) To carry Loan A/c in the first year balance sheet at ₹60 lakhs. Your advice is solicited.

COMPLETE SOLUTION

Step 1: Processing Cost Treatment

Processing cost should be **added to the carrying value of the loan** (₹60 + ₹3 = ₹63 lakhs), not charged to P&L.

Step 2: Interest Income for Year 1

Interest = 6% × ₹63 lakhs = **₹3.78 lakhs**

Step 3: Carrying Amount at End of Year 1

Carrying Amount = ₹63 + ₹3.78 = **₹66.78 lakhs**

Step 4: Impairment Loss

Recoverable Amount = PV of revised repayment = ₹68 / 1.06 = **₹64.15 lakhs**

Impairment Loss = ₹66.78 – ₹64.15 = **₹2.63 lakhs**

Step 5: Year 2 Interest

Interest = 6% × ₹64.15 = **₹3.85 lakhs**

Carrying amount at end of Year 2 = ₹64.15 + ₹3.85 = ₹68 lakhs (repaid)

KEY TAKEAWAY

Key Takeaways from Module 3 Illustrations:

- Compound financial instruments: Always measure liability component FIRST, then equity as residual.
- Effective interest rate method: Used for amortised cost measurement.
- Processing costs: Added to carrying amount of loan (not expensed).
- Impairment: Recognised when carrying amount exceeds recoverable amount.
- Convertible bonds: Liability + Equity components; equity not remeasured.
- Redeemable preference shares: Liability component measured at PV; equity residual.

MODULE 3 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 3 covers Accounting of Financial Instruments under Ind AS 32 (Presentation), Ind AS 107 (Disclosures), and Ind AS 109 (Recognition & Measurement). This module carries **15% weightage** in Paper 18. Master the classification criteria, compound instrument split, and effective interest rate method.

B. Mega Revision Sheet

IND AS	CORE PRINCIPLE	KEY TREATMENT
Ind AS 32	Presentation: Liability vs Equity	Contractual obligation to deliver cash → Liability; Residual interest → Equity
Ind AS 107	Disclosures: Significance & Risks	Disclose carrying amounts by category; Qualitative + Quantitative risk info
Ind AS 109	Recognition & Measurement	Business Model + SPPI Test → Amortised Cost, FVOCI, or FVTPL
Compound Instruments	Split Accounting	Liability first (PV of cash flows); Equity = Residual
Embedded Derivatives	Separation Criteria	Separate if not closely related + derivative definition + not FVTPL

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA
Amortised Cost	Initial Amount – Principal Repayments $\pm$ Cumulative Amortisation – Loss Allowance
Interest Income (EIR)	Carrying Amount $\times$ Effective Interest Rate
Liability Component	PV of future cash flows discounted at market rate for similar liability
Equity Component	Total Proceeds – Liability Component
Finance Cost	Opening Liability $\times$ Effective Interest Rate
Impairment Loss	Carrying Amount – Recoverable Amount
Expected Credit Loss (12-month)	PD $\times$ LGD $\times$ EAD (for 12 months)
Expected Credit Loss (Lifetime)	PD $\times$ LGD $\times$ EAD (for lifetime)
Fair Value Hierarchy	Level 1 (quoted), Level 2 (observable), Level 3 (unobservable)

D. Top Exam Points – Quick Revision

1. Financial Asset = Cash + Equity of another + Contractual right + Certain contracts.
2. Financial Liability = Contractual obligation to deliver cash + Certain contracts.
3. Equity = Residual interest + No obligation to deliver cash.
4. Puttable instrument → Usually liability; equity if pro rata share on liquidation.
5. Offsetting → Legally enforceable right + Intention to settle net.
6. Ind AS 107 requires disclosure of carrying amounts by category.
7. Disclose qualitative + quantitative risk information.
8. Credit risk: Maximum exposure, collateral, past due analysis.
9. Liquidity risk: Maturity analysis for financial liabilities.
10. Market risk: Sensitivity analysis.
11. Fair value hierarchy: Level 1, 2, 3.
12. Ind AS 109 classifies financial assets into three
50. Sensitivity analysis: Effect of changes in market variables.
51. Fair value: Amount for which asset could be exchanged.
52. Arm's length transaction: Knowledgeable, willing parties.
53. Effective interest rate: Rate that exactly discounts future cash flows.
54. Gross carrying amount: Amortised cost before loss allowance.
55. Loss allowance: Expected credit losses recognised.
56. Credit-impaired: Financial asset with evidence of impairment.
57. 12-month ECL: Portion of lifetime ECL from default within 12 months.
58. Lifetime ECL: ECL from all possible default events over life.
59. Probability of Default (PD): Likelihood of default.
60. Loss Given Default (LGD): Loss if default occurs.
61. Exposure at Default (EAD): Amount outstanding

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly for compound instrument split.
- State the Ind AS reference for each treatment.
- For practical problems, draw tables for amortization schedules.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: Compound instruments, EIR method, Classification.
- Practice at least 5 comprehensive problems on compound instruments.
- Read the question carefully for market rates and conversion terms.
- For compound instruments, always measure liability FIRST.
- For impairment, always compute recoverable amount as higher of FV and VIU.
- For processing costs, add to carrying amount (not expense).
- For convertible bonds, track liability amortization separately.
- For redeemable preference shares, treat as liability if mandatory redemption.

F. Frequently Repeated Concepts

- Compound instrument split (liability + equity) — appears almost every attempt.
- Effective interest rate method — very common.
- Classification of financial assets (Business Model + SPPI) — frequently tested.
- Impairment of financial assets (ECL model) — regular.
- Disclosure requirements under Ind AS 107 — common theory question.
- Embedded derivatives — increasingly important.
- Convertible bonds — comprehensive problem.
- Redeemable preference shares — practical problem.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- | | |
|--|---|
| • ☒ Financial Asset definition | • ☒ Effective Interest Rate method |
| • ☒ Financial Liability definition | • ☒ Expected Credit Loss model |
| • ☒ Equity Instrument definition | • ☒ Compound instrument split |
| • ☒ Puttable instrument | • ☒ Convertible bonds accounting |
| • ☒ Offsetting criteria | • ☒ Redeemable preference shares accounting |
| • ☒ Ind AS 107 disclosure requirements | • ☒ Embedded derivatives |
| • ☒ Business Model Test | • ☒ All ICMAI illustrations with step-by-step solutions |
| • ☒ SPPI Test | • ☒ Common mistakes to avoid |
| • ☒ Amortised Cost measurement | • ☒ Examiner insights |
| • ☒ FVOCI measurement | |
| • ☒ FVTPL measurement | |

H. Common Mistakes Students Make

⚠ WARNING

- Measuring equity component first instead of liability component.
- Forgetting to use market rate for similar non-convertible debt.
- Incorrect amortization schedule for liability component.
- Expensing processing costs instead of adding to carrying amount.
- Not computing impairment loss correctly.
- Confusing FVOCI and FVTPL classification.
- Forgetting SPPI test in classification.
- Incorrect disclosure of financial instruments.
- Not separating embedded derivatives.
- Using wrong effective interest rate.
- Forgetting to remeasure cash-settled liability.
- Not derecognising liability on conversion.
- Treating redeemable preference shares as equity.
- Incorrect treatment of transaction costs.
- Not considering the three-stage ECL model.

I. Memory Tricks and Mnemonics

🔑 KEY TAKEAWAY

Ind AS 32: FLE → Financial Asset, Liability, Equity

Ind AS 107: SCC → Significance, Credit, Concentration

Ind AS 109: BSP → Business Model, SPPI, Presentation

Classification: AFF → Amortised Cost, FVOCI, FVTPL

Compound Instrument: LEA → Liability first, Equity residual, Amortised cost

ECL Stages: 1-2-3 → 12-month, Lifetime, Credit Impaired

Business Model: HHS → Hold to Collect, Hold to Collect & Sell, Sell

Effective Interest: EIR → Exactly discounts future cash flows

1 DAY BEFORE EXAM

Module 3 – Printable Quick Notes:

1. Financial Asset = Cash + Equity of another + Contractual right + Certain contracts
2. Financial Liability = Contractual obligation to deliver cash + Certain contracts
3. Equity = Residual interest + No obligation to deliver cash
4. Ind AS 107: Disclose carrying amounts by category + Risks (Credit, Liquidity, Market)
5. Ind AS 109 Classification: Business Model + SPPI Test
6. Amortised Cost: Hold to Collect + SPPI Pass
7. FVOCI: Hold to Collect & Sell + SPPI Pass
8. FVTPL: Residual category
9. Effective Interest Rate: Exactly discounts future cash flows
10. Compound Instrument: Liability first (PV of cash flows); Equity = Residual
11. Embedded Derivative: Separate if not closely related + derivative + not FVTPL
12. ECL: Stage 1 (12-month), Stage 2 (Lifetime), Stage 3 (Credit Impaired)
13. Convertible Bonds: Liability + Equity components
14. Redeemable Preference Shares: Liability if mandatory redemption
15. Transaction Costs: Capitalise for Amortised Cost & FVOCI; Expense for FVTPL

KEY TAKEAWAY

END OF MODULE 3 – ACCOUNTING OF FINANCIAL INSTRUMENTS

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CMA Final Paper 18

Corporate Financial Reporting

MODULE 4

NBFCs – Provisioning Norms, Accounting & Reporting

Complete Revision Handbook with Full ICAI Illustrations, Step-by-Step Solutions,
Formulas, and Exam-Focused Notes

4

ASSET CLASSES

15%

WEIGHTAGE

10+

ILLUSTRATIONS

40+

FORMULAS

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MODULE 4: NBFCs – Provisioning Norms, Accounting & Reporting

Non-Banking Financial Companies | RBI Regulations | Asset Classification | Provisioning | Income Recognition | Disclosures

4

ASSET CLASSES

15%

EXAM WEIGHTAGE

10+

FULL ILLUSTRATIONS

40+

FORMULAS &
FRAMEWORKS

★ EXAM IMPORTANT

Module 4 carries **15% weightage** in Paper 18. Expect **1–2 full questions (15 marks each)** plus short notes and objective questions. Master asset classification, provisioning norms, income recognition principles, and the format of Balance Sheet and Statement of Profit and Loss as per Division III of Schedule III.



Table of Contents – Module 4

- 1 NBFC – Concept & Definition
- 2 Classification of NBFCs
- 3 Regulatory Approach & Prudential Norms
- 4 Asset Classification (Standard, Sub-standard, Doubtful, Loss)
- 5 Provisioning Norms
- 6 Income Recognition Principles

7 Accounting, Reporting & Disclosures

8 Full ICMAI Illustrations with Step-by-Step Solutions

★ Module Summary & Mega Revision

Syllabus Coverage Matrix

TOPIC	SUB-TOPICS	WEIGHTAGE	PRIORITY
NBFC Concept	Definition, RBI Act 1934, Principal Business	2–3%	★★★★★
Classification	Liability Structure, Nature of Activities	3–4%	★★★★★
Regulatory Approach	NBFC-ND, NBFC-ND-SI, NBFC-D, NOF Requirements	3–4%	★★★★★
Asset Classification	Standard, Sub-standard, Doubtful, Loss	4–5%	★★★★★
Provisioning Norms	Standard, Sub-standard, Doubtful, Loss assets; Hire Purchase	4–5%	★★★★★
Income Recognition	NPA, Interest, Dividend, Bonds	3–4%	★★★★★
Accounting & Reporting	Division III Schedule III, Disclosures	3–4%	★★★★★

Expected Question Types

Practical Problems (15 Marks)

- Compute provision against advances given asset classification
- Hire purchase asset provisioning with IRR computation
- Income recognition for NPA and standard assets
- Net Owned Fund (NOF) computation
- CRAR (Capital to Risk Assets Ratio) computation
- Prepare extracts of Balance Sheet and P&L as per Division III
- Comprehensive problem: Asset classification + provisioning + income recognition

Short Notes / Theory (5 Marks)

- Define NBFC as per Sec. 45I(f) of RBI Act, 1934
- Classification of NBFCs
- Regulatory approaches for NBFCs
- Standard, Sub-standard, Doubtful, Loss assets
- Non-Performing Asset (NPA) definition
- Income recognition principles for NBFCs
- Provisioning norms for standard, sub-standard, doubtful, loss assets
- Disclosure requirements under Division III of Schedule III
- Net Owned Fund (NOF) requirements

Frequently Tested Concepts

- Provision computation for standard assets (0.25%/0.40%)
- Provision for sub-standard assets (10%)
- Provision for doubtful assets (20%, 30%, 50%)
- Provision for loss assets (100%)
- Hire purchase asset provisioning
- Non-Performing Asset (NPA) classification
- Income recognition on NPA (cash basis)
- Income from dividends and bonds
- Net Owned Fund (NOF) computation
- CRAR computation
- Division III Schedule III format
- Disclosure requirements for NBFCs

NBFC – Concept & Definition

1. Chapter Overview

The financial sector in any economy consists of several intermediaries, which include the banks, investment intermediaries (viz. mutual funds, hedge funds, pension funds etc.), risk transfer entities (i.e. the insurance companies), information and analysis providers (viz. rating agencies, financial advisers, etc.), investment banks, portfolio managers. All the above-mentioned financial intermediaries, other than the banks, are broadly referred to as Non-Banking Financial Institutions.

Non-Banking Financial Companies (NBFCs), form an integral part of Indian financial system, providing various financial services. In recent times, activities of NBFCs have undergone variety of changes through financial innovation. NBFC initially gets incorporated under Indian Companies Act, 2013 and later on obtains Certificate of Incorporation from RBI.

2. Learning Objectives

- Understand the concept and definition of NBFC.
- Identify what constitutes an NBFC as per RBI Act, 1934.
- Distinguish NBFCs from banks.
- Understand the principal business criteria.

3. Important Definitions

DEFINITION

Non-Banking Financial Company (NBFC): A financial institution which does not meet the legal definition of bank but carries similar activities to that of bank like lending and making investments, i.e. such an institution does not hold a banking license.

DEFINITION

As per Sec. 45I(f) of RBI Act, 1934: A "non-banking financial company" means:

- (i) a financial institution which is a company;
- (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) such other non-banking institution or class of such institutions, as the Bank may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

DEFINITION

Principal Business: A company is considered to be engaged in the business of financial institution if its financial assets constitute more than 50% of total assets (netted off by intangible assets) and income from financial assets constitutes more than 50% of gross income.

4. What NBFCs Do

A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, 2013 which is engaged in the business of:

- loans and advances,
- acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature,
- leasing,
- hire-purchase,
- insurance business,
- chit business.

5. What NBFCs Are NOT

WARNING

However, such a company does not include any institution whose principal business is that of:

- agriculture activity,
- industrial activity,
- purchase or sale of any goods (other than securities),
- providing any services, and
- sale/purchase/construction of immovable property.

6. Residuary Non-Banking Company

DEFINITION

A non-banking institution which is a company and has principal business of receiving deposits, under any scheme or arrangement, in one lump sum or in installments, by way of contributions or in any other manner, is also a non-banking financial company (called a Residuary Non-Banking Company).

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

NBFC Concept in 60 seconds:

- NBFC = Financial institution without banking license
- Sec. 45I(f) of RBI Act, 1934 defines NBFC
- Principal Business: Financial assets > 50% of total assets + Income from financial assets > 50% of gross income
- Activities: Loans, investments, leasing, hire-purchase, insurance, chit
- Excludes: Agriculture, industrial, goods trading, services, real estate
- Residuary NBFC: Receiving deposits under any scheme
- **Mnemonic: 50-50** → 50% assets + 50% income = NBFC

Classification of NBFCs

1. Chapter Overview

NBFCs can be classified on two bases: (A) On the basis of Liability Structure, and (B) On the basis of Nature of Primary Activities Performed. This classification determines the applicable regulatory framework, prudential norms, and reporting requirements.

2. Classification Based on Liability Structure

2.1 Deposit Taking NBFCs (NBFCs-D)

NBFCs-D

- Accept public deposits
- Subject to Capital adequacy norms
- Liquid assets maintenance norms
- Exposure norms (including restrictions on investments in land, building, unquoted shares)
- Asset Liability Management (ALM) discipline
- Reporting requirements
- Must obtain investment grade rating for deposits

2.2 Non-Deposit Taking NBFCs (NBFCs-ND)

NBFCs-ND

- Do not accept public deposits
- Classified into two categories based on asset size:
 - **NBFCs-ND:** Assets < ₹500 crore
 - **NBFCs-ND-SI (Systemically Important):** Assets ≥ ₹500 crore
- NBFCs-ND-SI subject to prudential regulations (CRAR, exposure norms)
- ALM reporting and disclosure norms applicable

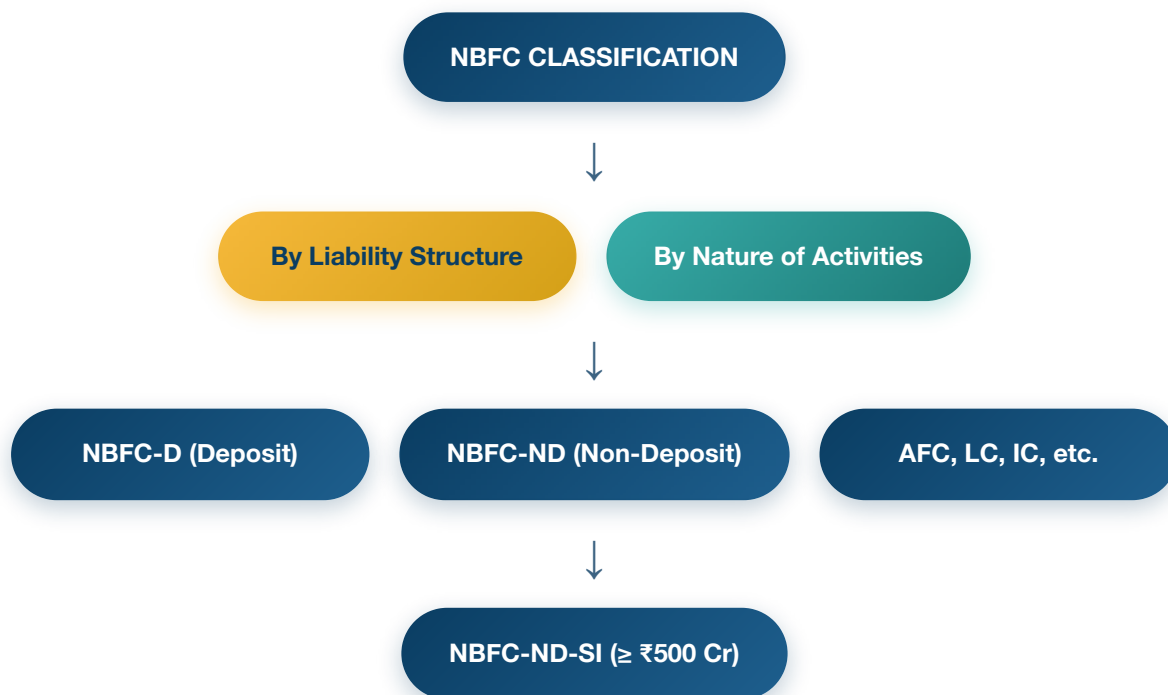
NOTE

Note: NBFCs that are part of a corporate group or are floated by a common set of promoters will not be viewed on a standalone basis. The total assets of NBFCs in a group including deposit taking NBFCs, if any, will be aggregated to determine if such consolidation falls within the asset sizes of the above two categories. For this purpose, Statutory Auditors would be required to certify the asset size of all the NBFCs in the Group.

3. Classification Based on Nature of Primary Activities

TYPE OF NBFC	PRINCIPAL BUSINESS
Asset Finance Company (AFC)	Financing of physical assets supporting productive/economic and general purpose assets
Leasing Company	Leasing of equipments or financing of such activity
Investment Company	Acquisition of securities
Loan Company	Providing finance whether by making loans or advances or otherwise for any activity other than its own (but not AFC)
Infrastructure Finance Company	Financing the acquisition or construction of infrastructure facilities
Infrastructure Debt Fund	Facilitating flow of long term debt into infrastructure projects
Venture Capital Company	Providing start-up capital to new business ventures
NBFC-Factor	Non-deposit taking NBFC engaged in principal business of factoring
NBFC-NOFHC	Non-Operative Financial Holding Company through which promoter/promoter groups set up a new bank

4. Flowchart Summary



5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

NBFC Classification in 60 seconds:

- By Liability: NBFC-D (Deposit) and NBFC-ND (Non-Deposit)
- NBFC-ND: < ₹500 Cr; NBFC-ND-SI: ≥ ₹500 Cr
- By Activities: AFC, Leasing, Investment, Loan, Infrastructure, Venture Capital, Factor, NOFHC
- NBFC-D: Capital adequacy, liquid assets, exposure norms
- NBFC-ND-SI: Prudential regulations, ALM reporting
- Group aggregation applies for classification
- **Mnemonic: DND** → Deposit, Non-Deposit, SI (Systemically Important)

Regulatory Approach & Prudential Norms

1. Chapter Overview

The Reserve Bank of India (RBI) has established a comprehensive regulatory framework for NBFCs based on their deposit acceptance and systemic importance. The regulatory approach differs for NBFCs-ND (assets < ₹500 crore) and NBFCs-ND-SI (assets ≥ ₹500 crore) plus all NBFCs-D.

2. Regulatory Approach for NBFCs-ND (Asset Size < ₹500 Crore)

SITUATION	REGULATORY APPROACH
No Deposits and No Customer Interface	No regulation — neither prudential nor conduct of business
Customer Interface but No Public Funds	Conduct of business regulations only
Public Funds but No Customer Interface	Limited prudential regulations only
Both Public Funds and Customer Interface	Both limited prudential + conduct of business regulations
Registration	Mandatory under Section 45-IA of RBI Act

3. Regulatory Approach for NBFCs-ND-SI (Asset Size ≥ ₹500 Crore)

- Must comply with prudential regulations as applicable to NBFCs-ND-SI even if they have not accessed public funds.
- Conduct of business regulations only if customer interface exists.

4. Net Owned Fund (NOF) Requirements

- Minimum NOF of ₹25 lakhs (historical requirement under Section 45 IA)
- Increased to ₹200 lakhs for all new companies w.e.f. April 21, 1999
- Mandatory to attain minimum NOF of ₹2 crore by end of March 2017
- Milestones: ₹1 crore by March 2016; ₹2 crore by March 2017
- Failure to achieve → RBI initiates process for cancellation of COR

5. Public Funds Definition

DEFINITION

The term 'Public Funds' includes:

- (a) Funds raised directly or indirectly through public deposits;
- (b) Commercial papers;
- (c) Debentures;
- (d) Inter-corporate deposits; and
- (e) Bank finance.

However, the term Public Funds does **not** include funds raised by issue of instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue.

6. Prudential Norms for NBFCs

6.1 For NBFCs-ND (Assets < ₹500 Crores)

- (A) Exempted from requirement of maintaining CRAR
- (B) Exempted from complying with Credit Concentration Norms
- (C) Maintain a leverage ratio (Total Outside Liabilities Owned Funds) of 7 to link Asset Growth with Capital

6.2 For NBFCs-ND-SI (Assets ≥ ₹500 Crore) and all NBFCs-D

Tier 1 Capital Requirements

- Minimum Tier 1 Capital of 10%
- Phased implementation: 8.5% by March 2016; 10% by March 2017

7. Capital to Risk Assets Ratio (CRAR)

FORMULA

CRAR = (Tier 1 Capital + Tier 2 Capital) / Risk Weighted Assets

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Regulatory Approach in 90 seconds:

- NBFC-ND < ₹500 Cr: No CRAR, No Credit Concentration; Leverage Ratio 7
- NBFC-ND-SI ≥ ₹500 Cr: Prudential regulations apply
- NBFC-D: Capital adequacy, liquid assets, exposure norms
- NOF: Minimum ₹2 crore (milestones: ₹1 Cr by Mar 2016, ₹2 Cr by Mar 2017)
- Public Funds: Deposits, CPs, Debentures, ICDs, Bank Finance
- Tier 1 Capital: 10% (8.5% by Mar 2016, 10% by Mar 2017)
- **Mnemonic: NDC** → NOF, Deposit, CRAR

Asset Classification

1. Chapter Overview

Every non-banking financial company shall, after taking into account the degree of well-defined credit weaknesses and extent of dependence on collateral security for realisation, classify its lease/hire purchase assets, loans and advances and any other forms of credit into four classes: Standard, Sub-standard, Doubtful, and Loss assets.

2. Asset Classification Tree

NBFC ASSET CLASSIFICATION

Standard Assets

Sub-standard Assets

Doubtful Assets

Loss Assets

No default, no problem

NPA up to 12/18 months

Sub-standard > 12 months

Identified as loss

3. Standard Asset

DEFINITION

Standard Asset: An asset in respect of which, no default in repayment of principal or payment of interest is perceived and which does not disclose any problem nor carry more than normal risk attached to the business.

4. Sub-Standard Asset

DEFINITION

Sub-standard Asset (Non-Systemically Important NBFC):

- (a) an asset which has been classified as non-performing asset for a period not exceeding 18 months;
- (b) an asset where the terms of the agreement regarding interest and/or principal have been renegotiated or rescheduled or restructured after commencement of operations, until the expiry of one year of satisfactory performance under the renegotiated or rescheduled or restructured terms.

DEFINITION

Sub-standard Asset (Systemically Important NBFC): Similar to above but the period is progressively reduced:

- Not exceeding 16 months for FY ending March 31, 2016
- Not exceeding 14 months for FY ending March 31, 2017
- Not exceeding 12 months for FY ending March 31, 2018 and thereafter

5. Doubtful Asset

DEFINITION

Doubtful Asset (Non-Systemically Important NBFC): A term loan, or a lease asset, or a hire purchase asset, or any other asset, which remains a sub-standard asset for a period exceeding 18 months.

DEFINITION

Doubtful Asset (Systemically Important NBFC): Similar but period progressively reduced:

- Exceeding 18 months for FY ended March 31, 2015
- Exceeding 16 months for FY ended March 31, 2016
- Exceeding 14 months for FY ending March 31, 2017
- Exceeding 12 months for FY ending March 31, 2018 and thereafter

6. Loss Asset

DEFINITION

Loss Asset:

- (a) an asset which has been identified as loss asset by the NBFC or its internal or external auditor or by the RBI during inspection, to the extent it is not written off by the NBFC; and
- (b) an asset which is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security or due to any fraudulent act or omission on the part of the borrower.

7. Non-Performing Asset (NPA)

DEFINITION

Non-Performing Asset (NPA):

- (a) an asset, in respect of which, interest has remained overdue for a period of six months or more;
- (b) a term loan inclusive of unpaid interest, when the instalment is overdue for a period of six months or more or on which interest amount remained overdue for a period of six months or more;
- (c) a demand or call loan, which remained overdue for a period of six months or more from the date of demand or call or on which interest amount remained overdue for a period of six months or more;
- (d) a bill which remains overdue for a period of six months or more;
- (e) the interest in respect of a debt or the income on receivables under the head 'other current assets' in the nature of short term loans/advances, which facility remained overdue for a period of six months or more;
- (f) any dues on account of sale of assets or services rendered or reimbursement of expenses incurred, which remained overdue for a period of six months or more;
- (g) the lease rental and hire purchase instalment, which has become overdue for a period of twelve months or more;
- (h) in respect of loans, advances and other credit facilities (including bills purchased and discounted), the balance outstanding under the credit facilities (including accrued interest) made available to the same borrower/beneficiary when any of the above credit facilities becomes non-performing asset.

NOTE

Harmonisation with Banks (Phased Manner):

Lease Rental and Hire-Purchase Assets:

- Overdue for 9 months as on 31st March 2016
- Overdue for 6 months as on 31st March 2017
- Overdue for 3 months as on 31st March 2018 and onwards

Assets other than Lease Rental and Hire-Purchase:

- Overdue for 5 months as on 31st March 2016
- Overdue for 4 months as on 31st March 2017
- Overdue for 3 months as on 31st March 2018 and onwards

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Asset Classification in 90 seconds:

- Standard: No default, no problem
- Sub-standard: NPA up to 12/18 months
- Doubtful: Sub-standard > 12/18 months
- Loss: Identified as loss, non-recoverable
- NPA: Interest overdue 6 months (3 months for SI from 2018)
- Lease/Hire Purchase: 12 months (3 months for SI from 2018)
- **Mnemonic: SSDL** → Standard, Sub-standard, Doubtful, Loss

Provisioning Norms

1. Chapter Overview

Every NBFC shall, after taking into account the time lag between an account becoming non-performing, its recognition as such, the realisation of the security and the erosion over time in the value of security charged, make provision against sub-standard assets, doubtful assets and loss assets. This chapter covers the provisioning requirements for different classes of assets.

2. Provisioning Matrix – Loans, Advances and Other Credit Facilities

ASSET CLASSIFICATION	PROVISION REQUIREMENT
Standard Assets	0.25% (Non-Systemically Important NBFC) / 0.40% (Systemically Important NBFC and NBFC-D) of outstanding
Sub-standard Assets	10% of total outstanding
Doubtful Assets	100% provision to the extent advance is not covered by realisable value of security + 20% to 50% of secured portion (based on period)
Loss Assets	100% of outstanding (entire asset written off)

2.1 Doubtful Assets – Secured Portion Provisions

PERIOD AS DOUBTFUL	PROVISION ON SECURED PORTION
Up to one year	20%
One to three years	30%
More than three years	50%

2.2 Standard Assets – Phased Increase for SI-NBFCs and NBFC-D

PERIOD	PROVISION ON STANDARD ASSETS
By end of March 2015	0.25%
By end of March 2016	0.30%
By end of March 2017	0.35%
By end of March 2018 and thereafter	0.40%

3. Provisioning for Lease and Hire Purchase Assets

For Hire Purchase Assets: The total dues (overdue and future instalments taken together) as reduced by:

- (a) the finance charges not credited to the profit and loss account and carried forward as unmatured finance charges; and
- (b) the depreciated value of the underlying asset, shall be provided for.

Depreciated Value: Original cost reduced by depreciation at 20% per annum on straight line method. For second hand asset, original cost = actual cost incurred for acquisition.

3.1 Additional Provision for Hire Purchase and Leased Assets

OVERDUE PERIOD	PROVISION ON NET BOOK VALUE
Up to 12 months	Nil
More than 12 months but up to 24 months	10%
More than 24 months but up to 36 months	40%
More than 36 months but up to 48 months	70%
More than 48 months	100%

4. Important Formulae

FORMULA

Provision for Standard Assets = Outstanding × Provision Rate (0.25%/0.40%)

FORMULA

Provision for Sub-standard Assets = Total Outstanding $\times$ 10%

FORMULA

Provision for Doubtful Assets = 100% of Unsecured Portion + (20%/30%/50% of Secured Portion based on period)

FORMULA

Provision for Loss Assets = 100% of Outstanding

FORMULA

Depreciated Value (Hire Purchase) = Original Cost – (20% $\times$ Original Cost $\times$ Number of Years)

FORMULA

Net Book Value (Hire Purchase) = Total Dues – Unmatured Finance Charges – Depreciated Value

5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Provisioning Norms in 90 seconds:

- Standard: 0.25% (NSI) / 0.40% (SI + D)
- Sub-standard: 10%
- Doubtful: 100% unsecured + 20%/30%/50% secured (up to 1 yr / 1-3 yr / >3 yr)
- Loss: 100%
- Hire Purchase: Total Dues – Unmatured Finance Charges – Depreciated Value
- Additional Provision: 10% (12-24m), 40% (24-36m), 70% (36-48m), 100% (>48m)
- Depreciated Value: Cost – 20% SLM per annum
- **Mnemonic: S-S-D-L** → Standard, Sub-standard, Doubtful, Loss

Income Recognition Principles

1. Chapter Overview

Income recognition of NBFCs, irrespective of their categorisation, shall be based on recognised accounting principles. The RBI has prescribed specific principles for recognition of income from various sources including interest, dividends, bonds, and debentures.

2. General Principles

- Income recognition shall be based on recognised accounting principles.
- Accounting Standards and Guidance Notes issued by ICAI shall be followed insofar as they are not inconsistent with RBI Directions.

3. Income from NPA

⚠ WARNING

- Income including interest/discount/hire charges/lease rentals or any other charges on NPA shall be recognised **only when it is actually realised**.
- Any such income recognised before the asset became non-performing and remaining unrealised shall be **reversed**.
- Income recognised before asset becoming NPA should be reversed in the financial year in which such asset becomes NPA.

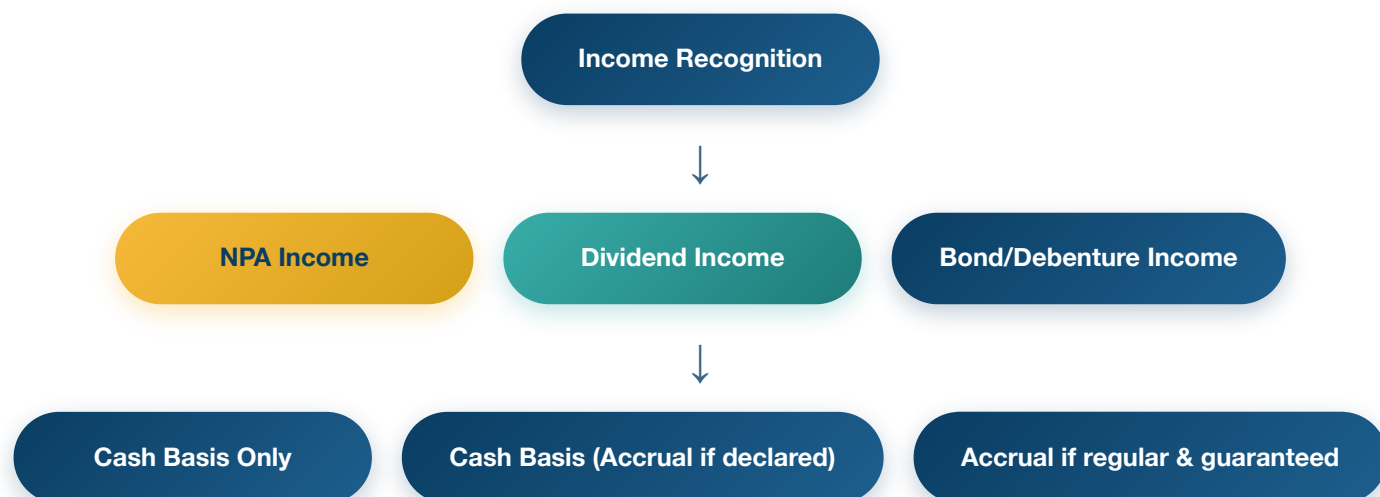
4. Income from Dividends

- NBFCs are required to recognise income from dividends on shares of corporate bodies and units of mutual funds on **cash basis**.
- Exception: If the company has declared the dividend in AGM and right of the company to receive the same has been established, it can be recognised on **accrual basis**.

5. Income from Bonds and Debentures

- Income from bonds and debentures of corporate bodies and from government securities/bonds may be taken into account on **accrual basis** provided it is paid regularly and is not in arrears.
- Income on securities of corporate bodies or public sector undertakings may be taken into account on **accrual basis** provided the payment of interest and repayment of the security has been guaranteed by Central Government.

6. Income Recognition Flowchart



7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Income Recognition in 60 seconds:

- NPA Income: Only when actually realised (cash basis)
- Unrealised income on NPA: Reverse in year asset becomes NPA
- Dividend: Cash basis; accrual if declared in AGM
- Bonds/Debentures: Accrual basis if paid regularly and not in arrears
- Government guaranteed securities: Accrual basis
- **Mnemonic: NDC** → NPA (Cash), Dividend (Cash), Bonds (Accrual)

Accounting, Reporting & Disclosures

1. Chapter Overview

The Ministry of Corporate Affairs (MCA) vide Notification dated 11 October 2018 made amendments in Schedule III inserting Division III for NBFC whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. Further amendment made to Schedule III for NBFC vide Notification dated 24 March 2021 to be effective on and from 01 April 2021.

2. Preparation of Balance Sheet and Profit and Loss Account

- Every NBFC shall prepare its Balance Sheet and Profit and Loss Account as on March 31 every year.
- If extending the date of Balance Sheet, prior approval of RBI is required before approaching ROC.
- Even if extension is granted, proforma Balance Sheet as on March 31 must be furnished to RBI.
- Balance Sheet must be finalised within 3 months from the date to which it pertains.
- Must append particulars in the schedule as set out in Division III of Schedule III.

3. Division III Schedule III – Balance Sheet Format

3.1 Assets – Financial Assets

- (a) Cash and cash equivalents
- (b) Bank Balance other than included in (a) above
- (c) Derivative financial instruments
- (d) Receivables:
 - (I) Trade Receivables
 - (II) Other Receivables
- (e) Loans
- (f) Investments
- (g) Other Financial assets (to be specified)

3.2 Assets – Non-Financial Assets

- (a) Inventories
- (b) Current Tax Assets (Net)
- (c) Deferred Tax Assets (Net)
- (d) Investment Property
- (e) Biological assets other than bearer plants
- (f) Property, Plant and Equipment
- (g) Capital work-in-progress
- (h) Intangible assets under development
- (i) Goodwill
- (j) Other Intangible assets
- (k) Other non-financial assets (to be specified)

3.3 Liabilities – Financial Liabilities

- (a) Derivative financial instruments
- (b) Payables:
 - (I) Trade Payables (MSME + Others)
 - (II) Other Payables (MSME + Others)
- (c) Debt Securities
- (d) Borrowings (Other than Debt Securities)
- (e) Deposits
- (f) Subordinated Liabilities
- (g) Other financial liabilities (to be specified)

3.4 Liabilities – Non-Financial Liabilities and Equity

- (a) Current tax liabilities (Net)
- (b) Provisions
- (c) Deferred tax liabilities (Net)
- (d) Other non-financial liabilities (to be specified)
- (e) Equity Share capital
- (f) Other Equity

4. Division III Schedule III – Statement of Profit and Loss Format

Revenue from Operations

- (i) Interest Income
- (ii) Dividend Income
- (iii) Rental Income
- (iv) Fees and commission Income
- (v) Net gain on fair value changes
- (vi) Net gain on derecognition of financial instruments under amortised cost category
- (vii) Sale of products (including Excise Duty)
- (viii) Sale of services
- (ix) Others (to be specified)
- (I) Total Revenue from operations
- (II) Other Income (to be specified)
- (III) Total Income (I+II)

Expenses

- (i) Finance Costs
- (ii) Fees and commission expense
- (iii) Net loss on fair value changes
- (iv) Net loss on derecognition of financial instruments under amortised cost category
- (v) Impairment on financial instruments
- (vi) Cost of materials consumed
- (vii) Purchases of Stock-in-trade
- (viii) Changes in Inventories
- (ix) Employee Benefits Expenses
- (x) Depreciation, amortization and impairment
- (xi) Others expenses (to be specified)
- (IV) Total Expenses
- (V) Profit/(loss) before exceptional items and tax (III – IV)
- (VI) Exceptional items
- (VII) Profit/(loss) before tax (V – VI)
- (VIII) Tax Expense: Current Tax + Deferred Tax
- (IX) Profit/(loss) for the period from continuing operations (VII – VIII)
- (X) Profit/(loss) from discontinued operations
- (XI) Tax Expense of discontinued operations
- (XII) Profit/(loss) from discontinued operations (After tax) (X – XI)
- (XIII) Profit/(loss) for the period (IX + XII)
- (XIV) Other Comprehensive Income (A + B)
- (XV) Total Comprehensive Income for the period (XIII + XIV)
- (XVI) Earnings per equity share (for continuing operations): Basic & Diluted
- (XVII) Earnings per equity share (for discontinued operations): Basic & Diluted
- (XVIII) Earnings per equity share (for continuing and discontinued operations): Basic & Diluted

5. Key Disclosure Requirements

- Disclosure of provisions created without netting them from income or against value of assets.
- Provisions distinctly indicated under separate heads:
 - (i) Provisions for bad and doubtful debts
 - (ii) Provisions for depreciation in investments
- Provisions shall not be appropriated from general provisions and loss reserves held.
- Provisions shall be debited to the profit and loss account.
- Excess provisions may be written back without adjustment against provisions.

5.1 Additional Disclosures for Systemically Important NBFCs (Asset Size > ₹500 crore)

- Capital to Risk Assets Ratio (CRAR)
- Exposure to real estate sector, both direct and indirect
- Maturity pattern of assets and liabilities

5.2 Trade Receivables Ageing Schedule

PARTICULARS	< 6 MONTHS	6M- 1YR	1-2 YRS	2-3 YRS	> 3 YRS	TOTAL
(i) Undisputed – considered good						
(ii) Undisputed – significant increase in credit risk						
(iii) Undisputed – credit impaired						
(iv) Disputed – considered good						
(v) Disputed – significant increase in credit risk						
(vi) Disputed – credit impaired						

5.3 Loans Disclosure

Loans shall be sub-classified as:

- (i) Bills Purchased and Bills Discounted
- (ii) Loans repayable on Demand
- (iii) Term Loans
- (iv) Leasing
- (v) Factoring
- (vi) Others (to be specified)

Disclose separately:

- Secured by tangible assets
- Secured by intangible assets
- Covered by bank/government guarantees
- Unsecured

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Accounting & Reporting in 90 seconds:

- Division III of Schedule III applies to NBFCs
- Balance Sheet: Financial + Non-Financial Assets/Liabilities
- P&L: Revenue from Operations (Interest, Dividend, Rental, Fees, etc.)
- Provisions: Disclosed separately (Bad debts, Depreciation in investments)
- SI-NBFCs: Disclose CRAR, Real estate exposure, Maturity pattern
- Loans: Sub-classified (Bills, Demand, Term, Leasing, Factoring)
- Trade Receivables: Ageing schedule
- **Mnemonic: FNF** → Financial, Non-Financial, Footnotes

CHAPTER 8

Full ICMAI Illustrations with Step-by-Step Solutions

★ EXAM IMPORTANT

This chapter contains all the illustrations from the ICMAI study material for Module 4, presented with complete step-by-step solutions. Practice each illustration thoroughly — they form the foundation for exam problems on NBFC provisioning and accounting.

ICMAI Illustration 1 – Provision Against Advances

Question: While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

PARTICULARS	₹ LAKHS	PARTICULARS	₹ LAKHS
Standard Assets	8,400	Unsecured Portion of Doubtful Debts	87
Sub-Standard Assets	910	Loss Assets	24
Secured Portions of Doubtful Debts:			
- Up to one year	160		
- One year to three years	70		
- More than three years	20		

Calculate the amount of provision which must be made against the advances.

COMPLETE SOLUTION

Step 1: Identify Applicable Provision Rates

ASSET CLASS	PROVISION RATE
Standard Assets	0.40%
Sub-Standard Assets	10%
Doubtful – Up to 1 year (Secured)	20%
Doubtful – 1 to 3 years (Secured)	30%
Doubtful – More than 3 years (Secured)	50%
Doubtful – Unsecured Portion	100%
Loss Assets	100%

Step 2: Compute Provision for Each Category

PARTICULARS	LOAN (₹ LAKHS)	PROVISION (%)	PROVISION (₹ LAKHS)
Standard Assets	8,400	0.40%	33.60
Sub-Standard Assets	910	10%	91.00
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32.00
- One year to three years	70	30%	21.00
- More than three years	20	50%	10.00
Unsecured Portions of Doubtful Debts	87	100%	87.00
Loss Assets	24	100%	24.00
Total Provision			298.60

Note

Percentage of provision for Standard Asset is 0.40% as per Systemically Important NBFC (Asset Size $\geq$ ₹500 crore) and all NBFCs-D. For Non-Systemically Important NBFC, it would be 0.25%.

ICMAI Illustration 2 – Provision Against Advances (with Loss Assets)

Question: While closing its books of account on March 31 of a financial year, a Non-Banking Finance company has its advances classified as follows:

PARTICULARS	₹ LAKHS
Standard Assets	16,800
Sub-Standard Assets	1,340
Secured Portions of Doubtful Debts:	
- Up to one year	320
- One year to three years	90
- More than three years	30
Unsecured Portions of Doubtful Debts	97
Loss Assets	48

Calculate the amount of provision which must be made against the advances.

COMPLETE SOLUTION

Step 1: Compute Provision for Each Category

PARTICULARS	LOAN (₹ LAKHS)	PROVISION (%)	PROVISION (₹ LAKHS)
Standard Assets	16,800	0.40%	67.20
Sub-Standard Assets	1,340	10%	134.00
Secured Portions of Doubtful Debts:			
- Up to one year	320	20%	64.00
- One year to three years	90	30%	27.00
- More than three years	30	50%	15.00
Unsecured Portions of Doubtful Debts	97	100%	97.00
Loss Assets	48	100%	48.00
Total Provision			452.20

ICMAI Illustration 3 – Provision Against Advances

Question: While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

PARTICULARS	₹ LAKHS
Standard Assets	10,000
Sub-Standard Assets	1,000
Secured Portions of Doubtful Debts:	
- Up to one year	160
- One year to three years	70
- More than three years	20
Unsecured Portions of Doubtful Debts	90
Loss Assets	30

Calculate the amount of provision which must be made against the advances.

COMPLETE SOLUTION

Step 1: Compute Provision for Each Category

PARTICULARS	LOAN (₹ LAKHS)	PROVISION (%)	PROVISION (₹ LAKHS)
Standard Assets	10,000	0.40%	40.00
Sub-Standard Assets	1,000	10%	100.00
Secured Portions of Doubtful Debts:			
- Up to one year	160	20%	32.00
- One year to three years	70	30%	21.00
- More than three years	20	50%	10.00
Unsecured Portions of Doubtful Debts	90	100%	90.00
Loss Assets	30	100%	30.00
Total Provision			323.00

ICMAI Illustration 4 – Hire Purchase Asset Provisioning (Samvedan Ltd.)

Question: Samvedan Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31.3.19. Few machines were sold on hire-purchase basis. The hire purchase price was set as ₹100 lakhs as against cash price of ₹80 lakhs. The amount was payable as ₹20 lakhs down payment and balance in 5 equal installments. The Hirvender collected first installment as on 31.3.20, but could not collect the second installment which was due on 31.3.21. The company was finalizing accounts for the year ending 31.3.21. Till 15.5.21, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10.42%.

Required:

- (i) What should be the principal outstanding on 1.4.20? Should the company recognise finance charge for the year 2020-21 as income?
- (ii) What should be the net book value of assets as on 31.3.21 so far Samvedan Ltd. is concerned as per NBFC prudential norms requirement for provisioning?
- (iii) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

COMPLETE SOLUTION

Step 1: Segregate Instalments into Principal and Interest using IRR @ 10.42%

TIME	OPENING OUTSTANDING (₹ LAKHS)	CASH FLOW (₹ LAKHS)	INTEREST @ 10.42% (₹ LAKHS)	PRINCIPAL REPAYMENT (₹ LAKHS)	CLOSING OUTSTANDING (₹ LAKHS)
31.3.19	80	20	–	20	60
31.3.20	60	16	6.25	9.75	50.25
31.3.21	50.25	16	5.24	10.76	39.49
31.3.22	39.49	16	4.11	11.89	27.60
31.3.23	27.60	16	2.88	13.12	14.48
31.3.24	14.48	16	1.52	14.48	0

Step 2: Principal Outstanding on 01.04.2020

Since the hire-purchaser paid the first installment due on 31.3.20, the notional principal outstanding on 01.04.2020 was ₹50.25 lakhs.

In the year ended 31.3.21, the installment due of ₹16 lakhs has not been received. However, it was due on 31.3.21, i.e., on the Balance Sheet date, and therefore, it will be classified as **Standard Asset**.

Samvedan Ltd. will recognise ₹5.24 lakhs as interest income included in that due installment.

Step 3: Net Book Value of Assets as on 31.3.2020

PARTICULARS	₹ LAKHS
Overdue installment	16.00
Installments not due (₹16 lakhs × 3)	48.00
Total Dues	64.00
Less: Finance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
Net Book Value	55.49
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20%)	(48.00)
Provision as per NBFC prudential norms	7.49

Since the installment of ₹16 lakhs not paid was due on 31.03.2016 only, the asset is classified as **standard asset**. Therefore, no additional provision has been made for it.

Step 4: Amount of Provision

PARTICULARS	₹ LAKHS
Overdue installment	16.00
Installments not due (₹16 lakhs × 3)	48.00
Total Dues	64.00
Less: Finance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
Net Book Value	55.49
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20%)	(48.00)
Provision as per NBFC prudential norms	7.49

Step 5: Net Book Value of Assets as on 31.3.2020

PARTICULARS	₹ LAKHS
Overdue installment	16.00
Installments not due (₹16 lakhs × 3)	48.00
Total Dues	64.00
Less: Finance charge not matured and not credited to P/L A/c [4.11 + 2.88 + 1.52]	(8.51)
Less: Provision as per NBFC prudential norms	(7.49)
Net Book Value of Assets	48.00

ICMAI Comprehensive Problem – Water Ltd. Hire Purchase Provisioning

Question: Water Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31.3.18. Few machines were sold on hire-purchase basis. The HP price was set as ₹200 lakhs as against cash price of ₹160 lakhs. The amount was payable as ₹20 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.3.19, but could not collect the second installment which was due on 31.3.20. The company was finalizing accounts for the year ending 31.3.20. Till 15.5.20, the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 11.32%.

Required:

- What should be the principal outstanding on 1.4.19?
- Should the company recognise finance charge for the year 2019-20 as income?
- What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?
- What should be the net book value of assets as on 31.3.20 so far Water Ltd. is concerned as per NBFC prudential norms requirement for provisioning?

COMPLETE SOLUTION

Step 1: Segregate Instalments using IRR @ 11.32%

Cash Price = ₹160 lakhs; HP Price = ₹200 lakhs; Down Payment = ₹20 lakhs;
Annual Installment = $(200 - 20)/5 = ₹36$ lakhs

TIME	OPENING OUTSTANDING (₹ LAKHS)	CASH FLOW (₹ LAKHS)	INTEREST @ 11.32% (₹ LAKHS)	PRINCIPAL REPAYMENT (₹ LAKHS)	CLOSING OUTSTANDING (₹ LAKHS)
31.3.18	160	20	–	20	140
31.3.19	140	36	15.85	20.15	119.85
31.3.20	119.85	36	13.57	22.43	97.42
31.3.21	97.42	36	11.03	24.97	72.45
31.3.22	72.45	36	8.20	27.80	44.65
31.3.23	44.65	36	5.05	30.95	13.70
31.3.24	13.70	13.70	0	13.70	0

Note: The exact segregation may vary slightly based on precise IRR computation. The principle remains the same.

Step 2: Principal Outstanding on 01.04.2019

Since the hire-purchaser paid the first installment due on 31.3.19, the notional principal outstanding on 01.04.2019 was approximately **₹119.85 lakhs**.

Step 3: Finance Charge Recognition for 2019-20

In the year ended 31.3.20, the installment due of ₹36 lakhs has not been received. However, it was due on 31.3.20, i.e., on the Balance Sheet date, and therefore, it will be classified as **Standard Asset**.

Water Ltd. should recognise approximately ₹13.57 lakhs as interest income included in that due installment as this should be treated as finance charge.

Step 4: Amount of Provision

PARTICULARS	₹ LAKHS
Overdue installment	36.00
Installments not due ($₹36 \text{ lakhs} \times 3$)	108.00
Total Dues	144.00
Less: Finance charge not matured and not credited to P/L A/c $[8.21 + 5.70 + 2.97]$	(16.88)
Net Book Value	127.12
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20% = $160 - 2 \times 32 = 96$)	(96.00)
Provision as per NBFC prudential norms	31.12

Since the installment of ₹36 lakhs not paid, was due on 31.03.2020 only, the asset is classified as **standard asset**. Therefore, no additional provision has been made for it.

Step 5: Net Book Value of Assets as on 31.3.2020

PARTICULARS	₹ LAKHS
Overdue installment	36.00
Installments not due ($₹36 \text{ lakhs} \times 3$)	108.00
Total Dues	144.00
Less: Finance charge not matured and not credited to P/L A/c $[8.21 + 5.70 + 2.97]$	(16.88)
Less: Provision as per NBFC prudential norms	(31.12)
Net Book Value of Assets	96.00

ICMAI Comprehensive Problem – Advances Provisioning

Question: While closing its books of accounts on 31st March, a NBFC has its advances classified as follows:

PARTICULARS	₹ LAKHS
Standard Assets	40,000
Sub-Standard Assets	4,000
Secured Portions of Doubtful Debts:	
- Up to one year	1,000
- One year to three years	600
- More than three years	200
Unsecured Portions of Doubtful Debts	160
Loss Assets	120

Calculate the amount of provision which must be made against the advances.

COMPLETE SOLUTION

Step 1: Compute Provision for Each Category

PARTICULARS	LOAN (₹ LAKHS)	PROVISION (%)	PROVISION (₹ LAKHS)
Standard Assets	40,000	0.40%	160.00
Sub-Standard Assets	4,000	10%	400.00
Secured Portions of Doubtful Debts:			
- Up to one year	1,000	20%	200.00
- One year to three years	600	30%	180.00
- More than three years	200	50%	100.00
Unsecured Portions of Doubtful Debts	160	100%	160.00
Loss Assets	120	100%	120.00
Total Provision			1,320.00

ICMAI Comprehensive Problem – Lake Ltd. Hire Purchase Provisioning

Question: Lake Ltd. is a non-banking finance company. It accepts public deposit and also deals in the hire purchase business. It provides you with the following information regarding major hire purchase deals as on 31.03.2019. Few machines were sold on hire-purchase basis. The hire purchase price was set as ₹80 lakhs as against cash price of ₹65 lakhs. The amount was payable as ₹10 lakhs down payment and balance in 5 equal installments. The Hire-vendor collected first installment as on 31.03.2020, but could not collect the second installment which was due on 31.03.2021. The company was finalizing accounts for the year ending 31.03.2021. Till the date on which the Board of Directors signed the accounts, the second installment was not collected. Presume IRR to be 10%.

Required:

- (a) What should be the principal outstanding on 1.4.20? Should the company recognise finance charge for the year 2020-21 as income?
- (b) What should be the net book value of assets as on 31.3.21 so far Lake Ltd. is concerned as per NBFC prudential norms requirement for provisioning?
- (c) What should be the amount of provision to be made as per prudential norms for NBFC laid down by RBI?

COMPLETE SOLUTION

Step 1: Segregate Instalments using IRR @ 10%

Cash Price = ₹65 lakhs; HP Price = ₹80 lakhs; Down Payment = ₹10 lakhs;
Annual Installment = $(80 - 10)/5 = ₹14$ lakhs

TIME	OPENING OUTSTANDING (₹ LAKHS)	CASH FLOW (₹ LAKHS)	INTEREST @ 10% (₹ LAKHS)	PRINCIPAL REPAYMENT (₹ LAKHS)	CLOSING OUTSTANDING (₹ LAKHS)
31.3.19	65	10	–	10	55
31.3.20	55	14	5.50	8.50	46.50
31.3.21	46.50	14	4.65	9.35	37.15
31.3.22	37.15	14	3.72	10.28	26.87
31.3.23	26.87	14	2.69	11.31	15.56
31.3.24	15.56	15.56	1.56	14.00	1.56

Step 2: Principal Outstanding on 01.04.2020

Since the hire-purchaser paid the first installment due on 31.3.20, the notional principal outstanding on 01.04.2020 was approximately **₹46.50 lakhs**.

Step 3: Finance Charge Recognition for 2020-21

In the year ended 31.3.21, the installment due of ₹14 lakhs has not been received. However, it was due on 31.3.21, i.e., on the Balance Sheet date, and therefore, it will be classified as **Standard Asset**.

Lake Ltd. should recognise approximately ₹4.65 lakhs as interest income included in that due installment.

Step 4: Amount of Provision

PARTICULARS	₹ LAKHS
Overdue installment	14.00
Installments not due (₹14 lakhs × 3)	42.00
Total Dues	56.00
Less: Finance charge not matured [3.72 + 2.69 + 1.56]	(7.97)
Net Book Value	48.03
Less: Depreciated value (Cash Price Less Depreciation for 2 years on SLM @ 20% = 65 – 26 = 39)	(39.00)
Provision as per NBFC prudential norms	9.03

Since the installment of ₹14 lakhs not paid was due on 31.03.2021 only, the asset is classified as **standard asset**.

Step 5: Net Book Value of Assets as on 31.3.2021

PARTICULARS	₹ LAKHS
Overdue installment	14.00
Installments not due (₹14 lakhs × 3)	42.00
Total Dues	56.00
Less: Finance charge not matured [3.72 + 2.69 + 1.56]	(7.97)
Less: Provision as per NBFC prudential norms	(9.03)
Net Book Value of Assets	39.00

KEY TAKEAWAY

Key Takeaways from Module 4 Illustrations:

- Provision for Standard Assets: 0.25% (NSI) / 0.40% (SI + D)
- Provision for Sub-standard Assets: 10%
- Provision for Doubtful Assets: 100% unsecured + 20%/30%/50% secured
- Provision for Loss Assets: 100%
- Hire Purchase Provision = Total Dues – Unmatured Finance Charges – Depreciated Value
- Depreciated Value = Cost – 20% SLM per annum
- Finance charge on overdue installment: Recognised as income if asset is Standard
- NPA classification: Based on overdue period (6 months for loans, 12 months for lease/hire purchase)

MODULE 4 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 4 covers NBFCs – Provisioning Norms, Accounting & Reporting. This module carries **15% weightage** in Paper 18. Master asset classification, provisioning norms, income recognition principles, and the Division III Schedule III format for Balance Sheet and P&L.

B. Mega Revision Sheet

TOPIC	CORE PRINCIPLE	KEY TREATMENT
NBFC Definition	Sec. 45I(f) of RBI Act, 1934	Financial institution without banking license
Classification	Liability Structure + Activities	NBFC-D, NBFC-ND, NBFC-ND-SI, AFC, LC, IC, etc.
Regulatory Approach	Based on asset size and deposit acceptance	NBFC-ND < 500 Cr: No CRAR; NBFC-ND-SI ≥ 500 Cr: Prudential norms
Asset Classification	Standard, Sub-standard, Doubtful, Loss	Based on overdue period and security cover
Provisioning	Based on asset classification	0.40%, 10%, 20-50%, 100%
Income Recognition	NPA: Cash basis; Others: Accrual	NPA income only when realised
Reporting	Division III of Schedule III	Financial + Non-Financial Assets/Liabilities

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA
Provision for Standard Assets	Outstanding $\times$ 0.40% (SI/D) or 0.25% (NSI)
Provision for Sub-standard Assets	Total Outstanding $\times$ 10%
Provision for Doubtful Assets	100% Unsecured + (20%/30%/50% Secured)
Provision for Loss Assets	100% Outstanding
Depreciated Value (HP)	Cost – (20% $\times$ Cost $\times$ Years)
Net Book Value (HP)	Total Dues – Unmatured Finance Charges – Depreciated Value
Net Owned Fund (NOF)	Owned Fund – Investments in shares of subsidiaries/companies
CRAR	(Tier 1 + Tier 2 Capital) / Risk Weighted Assets
Leverage Ratio	Total Outside Liabilities / Owned Funds

D. Top Exam Points – Quick Revision

- NBFC = Financial institution without banking license.
- Sec. 45I(f) of RBI Act, 1934 defines NBFC.
- Principal Business: Financial assets > 50% + Financial income > 50%.
- NBFC-D: Accepts public deposits.
- NBFC-ND: Does not accept public deposits.
- NBFC-ND-SI: Assets $\geq$ ₹500 crore.
- NBFC-ND: Assets < ₹500 crore.
- NOF minimum: ₹2 crore by March 2017.
- Milestones: ₹1 crore by March 2016, ₹2 crore by March 2017.
- Public Funds: Deposits, CPs, Debentures, ICDs, Bank Finance.
- NBFC-ND < 500 Cr: No CRAR, No Credit Concentration, Leverage Ratio 7.
- NBFC-ND-SI $\geq$ 500 Cr: Prudential regulations apply.
- Tier 1 Capital: 10% (8.5% by Mar 2016, 10% by Mar 2017).
- Asset Classification: Standard, Sub-standard,
- Inter-class transfer at book value or market value, whichever is lower.
- Depreciation in each scrip fully provided; appreciation ignored.
- Quoted current investments: Valued at aggregate cost or market value, whichever is lower.
- Unquoted equity shares: Cost or break-up value, whichever is lower.
- Unquoted preference shares: Cost or face value, whichever is lower.
- Unquoted Government securities: Carrying cost.
- Unquoted mutual fund units: Net Asset Value (NAV).
- Commercial papers: Carrying cost.
- Long term investments: As per ICAI Accounting Standards.
- Government securities: Through CSG/L/demat account.
- NBFC-MFIs: No provision for guaranteed portion under CRGFTLIH.
- Standard Asset Provision: 0.25% (NSI) / 0.40%

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly for provisioning computations.
- State the asset classification for each category.
- For hire purchase problems, always show the IRR segregation table.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: Provisioning norms, Asset classification, Income recognition.
- Practice at least 5 comprehensive problems on hire purchase provisioning.
- Read the question carefully for asset size (SI vs NSI) to determine provision rates.
- For NPA classification, always check the overdue period.
- For doubtful assets, always separate secured and unsecured portions.
- For standard assets, check whether NBFC is SI or NSI for correct provision rate.
- For hire purchase, compute depreciated value using SLM @ 20%.
- For finance charges, always use IRR for segregation.

F. Frequently Repeated Concepts

- Provision computation for standard, sub-standard, doubtful, loss assets — appears almost every attempt.
- Hire purchase asset provisioning — very common.
- Income recognition for NPA — frequently tested.
- Asset classification — regular.
- NOF computation — common theory question.
- CRAR computation — increasingly important.
- Division III Schedule III format — comprehensive problem.
- Disclosure requirements for NBFCs — common theory question.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ NBFC definition as per Sec. 45I(f)
- ☒ Principal Business criteria
- ☒ Classification of NBFCs
- ☒ Regulatory approaches for NBFCs
- ☒ Net Owned Fund requirements
- ☒ Public Funds definition
- ☒ Prudential norms for NBFCs-ND
- ☒ Prudential norms for NBFCs-ND-SI and NBFCs-D
- ☒ Asset classification (Standard, Sub-standard, Doubtful, Loss)
- ☒ NPA definition and classification
- ☒ Provisioning norms for all asset classes
- ☒ Hire purchase asset provisioning
- ☒ Income recognition principles
- ☒ Division III Schedule III format
- ☒ Balance Sheet and P&L format for NBFCs
- ☒ Disclosure requirements
- ☒ All ICMAI illustrations with step-by-step solutions
- ☒ Common mistakes to avoid
- ☒ Examiner insights
- ☒ Memory tricks and mnemonics

H. Common Mistakes Students Make

WARNING

- Using wrong provision rate for standard assets (0.25% vs 0.40%).
- Forgetting to separate secured and unsecured portions of doubtful assets.
- Not computing depreciated value correctly for hire purchase.
- Forgetting to deduct unmatured finance charges.
- Incorrect NPA classification based on overdue period.
- Recognising income on NPA on accrual basis.
- Not reversing unrealised income on NPA.
- Incorrect IRR computation for hire purchase.
- Not considering the correct asset size (SI vs NSI).
- Forgetting additional provision for overdue hire purchase assets.
- Incorrect net book value computation.
- Not classifying loss assets correctly.
- Incorrect disclosure of provisions.
- Not following Division III Schedule III format.
- Forgetting to disclose CRAR, real estate exposure, maturity pattern for SI-NBFCs.

I. Memory Tricks and Mnemonics

KEY TAKEAWAY

NBFC Concept: 50-50 → 50% assets + 50% income = NBFC

Classification: DND → Deposit, Non-Deposit, SI (Systemically Important)

Regulatory: NDC → NOF, Deposit, CRAR

Asset Classification: SSDL → Standard, Sub-standard, Doubtful, Loss

Provisioning: S-S-D-L → 0.40%, 10%, 20-50%, 100%

Income Recognition: NDC → NPA (Cash), Dividend (Cash), Bonds (Accrual)

Reporting: FNF → Financial, Non-Financial, Footnotes

Doubtful Secured: 2-3-5 → 20%, 30%, 50%

Hire Purchase: DUF → Dues – Unmatured – Finance Charges

J. Printable PDF Version Content

1 DAY BEFORE EXAM

Module 4 – Printable Quick Notes:

1. NBFC = Financial institution without banking license (Sec. 45I(f) RBI Act, 1934)
2. Principal Business: Financial assets > 50% + Financial income > 50%
3. Classification: NBFC-D (Deposit) and NBFC-ND (Non-Deposit)
4. NBFC-ND < ₹500 Cr; NBFC-ND-SI ≥ ₹500 Cr
5. NOF minimum: ₹2 crore by March 2017
6. Asset Classification: Standard, Sub-standard, Doubtful, Loss
7. NPA: Interest overdue 6 months (3 months for SI from 2018)
8. Provision: Standard 0.40%, Sub-standard 10%, Doubtful 20-50%, Loss 100%
9. Hire Purchase: Total Dues – Unmatured Finance Charges – Depreciated Value
10. Depreciated Value: Cost – 20% SLM per annum
11. Income Recognition: NPA on cash basis; Dividend cash; Bonds accrual
12. Division III of Schedule III for NBFC financial statements
13. SI-NBFCs: Disclose CRAR, Real estate exposure, Maturity pattern
14. Loans: Sub-classified (Bills, Demand, Term, Leasing, Factoring)
15. Trade Receivables: Ageing schedule

 KEY TAKEAWAY

**END OF MODULE 4 – NBFCs: PROVISIONING NORMS, ACCOUNTING &
REPORTING**

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PREMIUM REVISION SERIES

CMA Final Paper 18

Corporate Financial Reporting

MODULE 5

Accounting for Business Combination & Restructuring

Complete Revision Handbook with Full ICAI Illustrations, Step-by-Step Solutions,
Formulas, and Exam-Focused Notes

20%
WEIGHTAGE

12
SUB-TOPICS

20+
ILLUSTRATIONS

50+
FORMULAS

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MODULE 5: Accounting for Business Combination & Restructuring

Ind AS 103 | Acquisition Method | Pooling of Interest | Reverse Acquisition | Internal Reconstruction | 20% Weightage

20%

EXAM WEIGHTAGE

12

SUB-TOPICS

20+

FULL ILLUSTRATIONS

50+

FORMULAS &
FRAMEWORKS

★ EXAM IMPORTANT

Module 5 carries **20% weightage** in Paper 18 — one of the highest weightage modules. Expect **2–3 full questions (15 marks each)** plus short notes and objective questions. Master the Acquisition Method, Pooling of Interest Method, Reverse Acquisition, and Internal Reconstruction.

Table of Contents – Module 5

- 1 Introduction to Ind AS 103
- 2 Accounting for Business Combination (Basic Level)
- 3 Absorptions, Amalgamations, External Reconstruction
- 4 Detailed Discussion on Business Combination
- 5 Business Combination Achieved in Stages
- 6 Reverse Acquisition
- 7 Purchase/Sale of NCI not Resulting in Loss of Control

8 Sale of Holding Resulting in Loss of Control

9 Business Combination under Common Control

10 Disclosures

11 Difference between Ind AS 103 and AS 14

12 Internal Reconstruction (Capital Reduction)

13 Full ICAI Illustrations with Step-by-Step Solutions

★ Module Summary & Mega Revision

Syllabus Coverage Matrix

TOPIC	SUB-TOPICS	WEIGHTAGE	PRIORITY
Introduction	Objective, Scope, Definitions, Acquisition Method	3–4%	★★★★★
Basic Business Combination	Takeover, 100% Subsidiary, NCI at Fair Value/Proportionate	4–5%	★★★★★
Absorption/Amalgamation	Absorption, Amalgamation, External Reconstruction	3–4%	★★★★★
Detailed Discussion	Identifying Acquirer, Acquisition Date, Recognition & Measurement	3–4%	★★★★★
Step Acquisition	Previously Held Interest, Remeasurement	2–3%	★★★★★
Reverse Acquisition	Legal Acquirer vs Accounting Acquirer	2–3%	★★★★★
NCI Purchase/Sale	Equity Transaction, No Goodwill Adjustment	2–3%	★★★★★
Loss of Control	Derecognition, Fair Value of Retained Interest	2–3%	★★★★★
Common Control	Pooling of Interest Method, Appendix C	3–4%	★★★★★
Disclosures	Nature and Financial Effects of Business Combination	1–2%	★★★★★
Ind AS 103 vs AS 14	Scope, Method, Goodwill, NCI, Common Control	1–2%	★★★★
Internal Reconstruction	Capital Reduction, Journal Entries, Balance Sheet	3–4%	★★★★★

Practical Problems (15 Marks)

- Compute Goodwill/Gain on Bargain Purchase under Acquisition Method
- Journal entries for Business Combination in consolidated and separate set
- NCI computation at fair value and proportionate net asset value
- Step acquisition: Remeasurement of previously held interest
- Reverse acquisition: Legal vs accounting acquirer
- Purchase/sale of NCI without loss of control
- Business Combination under Common Control: Pooling of Interest Method
- Internal Reconstruction: Capital reduction scheme with journal entries
- Chain holding: Parent → Subsidiary → Sub-subsidiary

Short Notes / Theory (5 Marks)

- Define Business Combination and Business Combination under Common Control
- Acquisition Method vs Pooling of Interest Method
- Identifying the Acquirer
- Non-Controlling Interest (NCI)
- Reverse Acquisition
- Contingent Consideration
- Contingent Liability in Business Combination
- Gain on Bargain Purchase
- Chain Holding
- Internal Reconstruction: Ways of Capital Reduction
- Difference between Ind AS 103 and AS 14

Frequently Tested Concepts

- Goodwill computation: $\text{Consideration} + \text{NCI} + \text{FV of previously held interest} - \text{Net Assets}$
- NCI at fair value vs proportionate net asset value
- Gain on Bargain Purchase → OCI (Capital Reserve)
- Pooling of Interest: Carry values, no fair value adjustments
- Reverse Acquisition: Legal acquiree = Accounting acquirer
- Step Acquisition: Remeasure previously held interest at fair value
- Purchase of NCI: Equity transaction, no goodwill adjustment
- Sale of NCI: Equity transaction, gain/loss to Other Equity
- Loss of Control: Derecognise assets/liabilities; FV of retained interest
- Chain Holding: Group share computation
- Internal Reconstruction: Capital Reduction Account
- Demerger: Business Combination under Common Control

Introduction to Ind AS 103

1. Chapter Overview

In Ind AS 103, Business Combination is dealt with. Two new terms are used in Ind AS 103: Business Combination and Business Combination under Common Control. All the events and arrangements meant by the extant and popular terms such as mergers, acquisitions, absorptions, amalgamations, external reconstruction, de-merger and reverse merger are now accommodated within these two new terms. Only events and arrangements meant by extant and popular terms like internal reconstruction, financial restructuring or capital reduction are continuing with the same terminology as Ind AS has not intervened on such events.

2. Learning Objectives

- Understand the objective and scope of Ind AS 103.
- Distinguish between Business Combination and Business Combination under Common Control.
- Understand the Acquisition Method and Pooling of Interest Method.
- Identify the Acquirer and Acquisition Date.

3. Important Definitions

DEFINITION

Business Combination: A transaction or other event in which an acquirer obtains control of one or more businesses.

DEFINITION

Acquiree: The business or businesses that the acquirer obtains control of in a business combination.

DEFINITION

Acquirer: The entity that obtains control of the acquiree.

DEFINITION

Acquisition Date: The date on which the acquirer obtains control of the acquiree.

DEFINITION

Non-Controlling Interest (NCI): The equity in a subsidiary (acquiree) not attributable, directly or indirectly, to a parent (acquirer).

DEFINITION

Contingent Consideration: Usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met.

DEFINITION

Goodwill: An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

DEFINITION

Gain on Bargain Purchase: The excess of net assets acquired over the consideration transferred plus NCI.

4. Objective of Ind AS 103

The objective of this Indian Accounting Standard (Ind AS) is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects. To accomplish that, this Ind AS establishes principles and requirements for how the acquirer:

- (a) recognises and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- (b) recognises and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and
- (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

5. Two Types of Business Combinations

BUSINESS COMBINATION

Business Combination (Ind AS 103)

Business Combination under Common Control (Appendix C)

Acquisition Method

Pooling of Interest Method

Fair Value Measurement

Carrying Amount Measurement

6. Accounting Treatment Based on Existence of Acquiree

When after business combination, acquiree continues to exist:

- Recorded in the books of the acquirer in two sets:
 - (I) Stand-alone set (Separate Financial Statements) — Ind AS 109 applies (Investment in shares)
 - (II) Consolidated set — Ind AS 103 Acquisition Method applies

When after business combination, acquiree ceases to exist:

- Recorded in the books of the acquirer in one set only — in its stand-alone accounts (also called individual set).

7. Journal Entry Framework

ILLUSTRATION

In Stand-Alone Set (Acquirer's Books) — Investment in Shares:

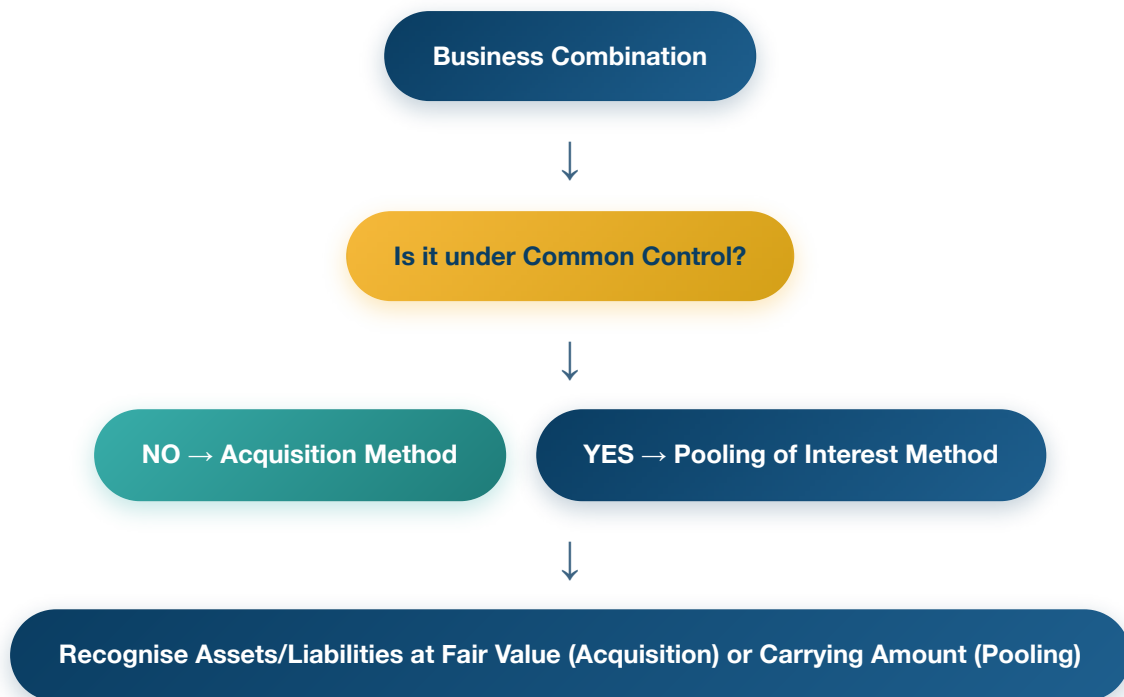
Dr. Investment in shares in the Acquiree xxx
To. Consideration xxx

ILLUSTRATION

In Consolidated Set (Acquirer's Books) — Acquisition Method:

Dr. Identified Assets of Acquiree xxx
Dr. Goodwill (if any) xxx
To. Consideration xxx
To. Identified Liabilities xxx
To. Non-controlling Interest xxx
To. Previously-held equity interest in Acquiree xxx
To. Gain from a bargain purchase (if any) xxx

8. Flowchart Summary



9. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 103 Introduction in 60 seconds:

- Business Combination = Acquirer obtains control of Acquiree
- Two types: Business Combination + Business Combination under Common Control
- Business Combination → Acquisition Method (Fair Value)
- Common Control → Pooling of Interest Method (Carrying Amount)
- Acquiree continues → Two sets (Separate + Consolidated)
- Acquiree ceases → One set (Stand-alone)
- **Mnemonic: BCA** → Business Combination → Acquisition Method

Accounting for Business Combination (Basic Level)

1. Chapter Overview

This chapter covers the basic accounting for business combinations under Ind AS 103 using the Acquisition Method. It covers three scenarios: (a) Takeover where acquiree ceases to exist, (b) 100% Subsidiary where acquiree continues to exist, and (c) Partial Subsidiary with Non-Controlling Interest (NCI) measured at fair value or proportionate net asset value.

2. Important Formulae

FORMULA

Goodwill = Fair Value of Consideration + NCI + Fair Value of Previously Held Interest – Fair Value of Net Identifiable Assets

FORMULA

Gain on Bargain Purchase = Fair Value of Net Identifiable Assets – (Consideration + NCI + FV of Previously Held Interest)

FORMULA

NCI at Fair Value = Consideration × (NCI Share / Parent Share)

FORMULA

NCI at Proportionate Net Asset Value = NCI % × Fair Value of Net Identifiable Assets

FORMULA

Net Identifiable Assets = Fair Value of Assets Acquired – Fair Value of Liabilities Assumed

3. Scenario 1: Takeover (Acquiree Ceases to Exist)

ICAI ILLUSTRATION

ICAI Illustration 1(a) – Takeover

Question: A Ltd. takes over B Ltd. for ₹12,60,000. Fair Value (FV) of B's net assets at time of acquisition amounts ₹11,80,000. Calculate Goodwill and pass Journal Entries in the books of A Ltd.

COMPLETE SOLUTION

Step 1: Identify the Acquirer and Acquiree

A Ltd. = Acquirer; B Ltd. = Acquiree. B Ltd. ceases to exist after takeover.

Step 2: Compute Goodwill

Purchase consideration = ₹12,60,000

Fair Value of Net Assets = ₹11,80,000

Goodwill = ₹12,60,000 – ₹11,80,000 = ₹80,000

PARTICULARS	DR. (₹)	CR. (₹)
Net Assets A/c Dr.	11,80,000	
Goodwill A/c Dr.	80,000	
To, Consideration A/c		12,60,000

In books of B Ltd.: All accounts would be closed through Realisation Account.

4. Scenario 2: 100% Subsidiary (Acquiree Continues to Exist)

ICMAI ILLUSTRATION

ICMAI Illustration 1(b) – 100% Subsidiary

Question: A Ltd. acquires 100% shares of B Ltd. for ₹12,60,000. Fair Value of B Ltd.'s net assets at time of acquisition amounts ₹11,80,000. Calculate Goodwill and pass Journal Entries in the books of A Ltd. and B Ltd.

COMPLETE SOLUTION

Step 1: Compute Goodwill

Purchase consideration = ₹12,60,000

Fair Value of Net Assets = ₹11,80,000

Goodwill = ₹12,60,000 – ₹11,80,000 = ₹80,000

PARTICULARS	DR. (₹)	CR. (₹)
Journal in Consolidated Set of A Ltd.		
Net Assets A/c Dr.	11,80,000	
Goodwill A/c Dr.	80,000	
To, Consideration A/c		12,60,000
Journal in Separate Set of A Ltd.		
Investment in B Ltd. A/c Dr.	12,60,000	
To, Consideration A/c		12,60,000
<i>In books of B Ltd.: No accounting.</i>		

In books of B Ltd.: No accounting.

5. Scenario 3: NCI at Fair Value

ICAI ILLUSTRATION

ICMAI Illustration 1(c) – Non-Controlling Interest at Fair Value

Question: A Ltd. acquires 80% shares of B Ltd. for ₹12,80,000. Fair Value of B Ltd.'s net assets at time of acquisition amounts ₹14,80,000. Non-Controlling Interests are recognized at fair value. Calculate Goodwill and pass Journal Entries.

COMPLETE SOLUTION

Step 1: Compute NCI at Fair Value

Purchase consideration = ₹12,80,000 (for 80%)

NCI = Purchase consideration × (NCI Share / Acquirer Share)

= ₹12,80,000 × (20/80) = **₹3,20,000**

Step 2: Compute Goodwill

Consideration = ₹12,80,000

Add: NCI = ₹3,20,000

Total = ₹16,00,000

Less: Fair Value of Net Assets = ₹14,80,000

Goodwill = ₹1,20,000

PARTICULARS	DR. (₹)	CR. (₹)
-------------	---------	---------

Journal in Consolidated Set of A Ltd.

Net Assets A/c Dr.	14,80,000	
Goodwill A/c Dr.	1,20,000	
To, Consideration A/c		12,80,000
To, NCI A/c		3,20,000

Journal in Separate Set of A Ltd.

Investment in B Ltd. A/c Dr.	12,80,000	
To, Consideration A/c		12,80,000

6. Gain on Bargain Purchase

ICAI ILLUSTRATION

ICMAI Illustration 5 – Gain on Bargain Purchase

Question: On 1 January 2021 M Ltd. acquires 80 per cent of the equity interests of P Ltd. by issue of equity shares of paid-up value of ₹100 Lakhs (market value ₹240 Lakhs). The identifiable assets are measured at ₹380 Lakhs and the liabilities assumed are measured at ₹60 Lakhs. Non-controlling Interest is measured at proportionate net asset value. Pass journal.

COMPLETE SOLUTION

Step 1: Compute Net Identifiable Assets

Identifiable Assets = ₹380 Lakhs

Less: Liabilities Assumed = ₹60 Lakhs

Net Identifiable Assets = ₹320 Lakhs

Step 2: Compute NCI at Proportionate Net Asset Value

NCI = 20% × ₹320 = **₹64 Lakhs**

Step 3: Compute Gain on Bargain Purchase

Consideration = ₹240 Lakhs

Add: NCI = ₹64 Lakhs

Total = ₹304 Lakhs

Less: Net Identifiable Assets = ₹320 Lakhs

Gain on Bargain Purchase = ₹16 Lakhs

PARTICULARS	DR. (₹ LAKHS)	CR. (₹ LAKHS)
Identifiable Assets Acquired A/c Dr.	380	
To, Consideration A/c		240
To, Liabilities assumed A/c		60
To, Non-controlling Interest in P Ltd. A/c		64
To, Gain on the Bargain Purchase A/c		16

Note: The gain on bargain purchase will be recognised in other comprehensive income and accumulated in other equity as capital reserve.

7. NCI at Fair Value (Illustration 4)

ICAI ILLUSTRATION

ICMAI Illustration 4 – NCI at Fair Value

Question: Z Ltd. acquired a 60% interest in P Ltd. on January 1, 2021. Z paid ₹960 Lakhs in cash for their interest in P Ltd. The fair value of P Ltd.'s assets is ₹2,400 Lakhs, and the fair value of its liabilities is ₹900 Lakhs. Provide the journal entry for the acquisition using Ind AS, assuming that Z Ltd. does not wish to report the NCI at fair value.

COMPLETE SOLUTION

Step 1: Compute Fair Value of Net Assets

FV of Assets = ₹2,400 Lakhs

Less: FV of Liabilities = ₹900 Lakhs

FV of Net Assets = ₹1,500 Lakhs

Step 2: Compute NCI at Proportionate Net Asset Value

$\text{NCI} = 40\% \times ₹1,500 = \text{₹600 Lakhs}$

Step 3: Compute Goodwill

Consideration = ₹960 Lakhs

Add: NCI = ₹600 Lakhs

Total = ₹1,560 Lakhs

Less: Net Assets = ₹1,500 Lakhs

Goodwill = ₹60 Lakhs

PARTICULARS	DR. (₹ LAKHS)	CR. (₹ LAKHS)
Assets A/c Dr.	2,400	
Goodwill A/c Dr.	60	
To, Consideration A/c		960
To, Acquired liabilities A/c		900
To, Non-controlling interests A/c		600
Consideration A/c Dr.	960	
To, Cash		960

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Basic Business Combination in 90 seconds:

- $\text{Goodwill} = \text{Consideration} + \text{NCI} + \text{FV of Previously Held Interest} - \text{Net Assets}$
- $\text{NCI at Fair Value} = \text{Consideration} \times (\text{NCI Share} / \text{Parent Share})$
- $\text{NCI at Proportionate} = \text{NCI \%} \times \text{Net Assets}$
- $\text{Gain on Bargain Purchase} = \text{Net Assets} - (\text{Consideration} + \text{NCI})$
- Bargain Purchase Gain → OCI (Capital Reserve)
- Takeover → One set (Stand-alone)
- Subsidiary → Two sets (Separate + Consolidated)
- **Mnemonic: GNC** → Goodwill, NCI, Consideration

Absorptions, Amalgamations, External Reconstruction

1. Chapter Overview

For Absorption, Amalgamation and External Reconstruction, no consolidated set of accounts is required even for companies complying with Ind AS. The Acquirer company will account for the transactions following Ind AS 103 and Ind AS 103 Appendix C for preparing individual (stand-alone) financial statements.

2. Key Distinctions

EVENT	DESCRIPTION	METHOD
Absorption	One company absorbs another; absorbed company ceases to exist	Acquisition Method (Ind AS 103)
Amalgamation	Two or more companies combine into a new company	Acquisition Method or Pooling (if common control)
External Reconstruction	New company takes over the business of an existing company	Pooling of Interest (if common control)

3. Full ICMAI Illustrations

ICMAI ILLUSTRATION

ICMAI Illustration 6 – Absorption

Question: On March 31, 201X, A Ltd absorbed B Ltd. A Ltd. issued 60,000 equity shares (₹10 par value) that were trading at ₹25 on March 31. The book value of B's net assets was ₹12,00,000, Equity Share Capital ₹5,00,000 and Other Equity ₹7,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at ₹13,00,000. Show journal entries complying Ind AS.

COMPLETE SOLUTION

Step 1: Compute Consideration

$$\text{Consideration} = 60,000 \times ₹25 = ₹15,00,000$$

Step 2: Compute Goodwill

$$\text{Goodwill} = ₹15,00,000 - ₹13,00,000 = ₹2,00,000$$

PARTICULARS	DR. (₹)	CR. (₹)
Net Assets A/c Dr.	13,00,000	
Goodwill A/c Dr.	2,00,000	
To, Consideration A/c		15,00,000
Consideration A/c Dr.	15,00,000	
To, Equity Share Capital A/c		6,00,000
To, Security Premium A/c		9,00,000

ICMAI Illustration 7 – Amalgamation (Common Control)

Question: On March 31, 201X, A Ltd and B Ltd. were amalgamated into C Ltd., control of the businesses lying with the same parties as before. C Ltd. issued 80,000 equity shares to A Ltd. and 75,000 equity shares to B Ltd. at the nominal value of ₹10 per share. The book value of A Ltd.'s net assets was ₹12,00,000, Equity Share Capital ₹5,00,000 and Other Equity ₹7,00,000 on March 31. The fair value of net assets of A Ltd. was assessed at ₹16,00,000. The book value of B Ltd.'s net assets was ₹10,00,000, Equity share capital ₹4,00,000 and Other Equity ₹6,00,000 on March 31. The fair value of net assets of B Ltd. was assessed at ₹15,00,000. Show journal entries complying Ind AS.

COMPLETE SOLUTION

Analysis

It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C. Pooling of Interest method applies. Consideration is measured at nominal value of shares. Net assets and Other Equity of the transferor company will be carried at book value.

Step 1: Compute Consideration

Consideration to A Ltd. = $80,000 \times ₹10 = ₹8,00,000$

Consideration to B Ltd. = $75,000 \times ₹10 = ₹7,50,000$

Total Consideration = ₹15,50,000

Step 2: Other Equity

Other Equity of A Ltd. and B Ltd. = $₹7,00,000 + ₹6,00,000 = ₹13,00,000$

Step 3: Total Net Assets

Net assets = $₹12,00,000 + ₹10,00,000 = ₹22,00,000$

Step 4: Compute Goodwill

Goodwill = Consideration + Other Equity – Net Assets

= $₹15,50,000 + ₹13,00,000 - ₹22,00,000 = ₹6,50,000$

PARTICULARS	DR. (₹)	CR. (₹)
Net Assets of A Ltd. A/c Dr.	12,00,000	
Net Assets of B Ltd. A/c Dr.	10,00,000	
Goodwill A/c Dr.	6,50,000	
To, Consideration A/c		15,50,000
To, Other Equity A/c		13,00,000
Consideration A/c Dr.	15,50,000	
To, Equity Share Capital A/c		15,50,000

ICMAI Illustration 8 – External Reconstruction (Common Control)

Question: On March 31, 201X, A Ltd externally reconstructed into B Ltd. B Ltd. issued 80,000 equity shares at the nominal value of ₹10 per share. The book value of A Ltd.'s net assets was ₹12,00,000 on March 31. The fair value of net assets was assessed at ₹15,00,000. Show journal entries complying Ind AS.

COMPLETE SOLUTION

Analysis

It is a transaction of Business Combination Under Common Control under Ind AS 103 Appendix C. Pooling of Interest method applies.

Step 1: Compute Consideration

$$\text{Consideration} = 80,000 \times ₹10 = ₹8,00,000$$

Step 2: Compute Goodwill

$$\begin{aligned} \text{Goodwill} &= \text{Consideration} + \text{Other Equity} - \text{Net Assets} \\ &= ₹8,00,000 + ₹6,00,000 - ₹12,00,000 = ₹2,00,000 \end{aligned}$$

PARTICULARS	DR. (₹)	CR. (₹)
Net Assets A/c Dr.	12,00,000	
Goodwill A/c Dr.	2,00,000	
To, Consideration A/c		8,00,000
To, Other Equity A/c		6,00,000
Consideration A/c Dr.	8,00,000	
To, Equity Share Capital A/c		8,00,000

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Absorption/Amalgamation in 60 seconds:

- Absorption: One company absorbs another → Acquisition Method
- Amalgamation: New company formed → Acquisition or Pooling
- External Reconstruction: New company takes over → Pooling (if common control)
- Common Control → Pooling of Interest Method
- Consideration measured at nominal value for Pooling
- Net assets at carrying amount for Pooling
- **Mnemonic: AAER** → Absorption, Amalgamation, External Reconstruction

Detailed Discussion on Business Combination

1. Chapter Overview

In business combination, control of the business of Acquiree is obtained by the Acquirer. Control of business can be obtained by: (a) acquiring assets and assuming liabilities, (b) by acquisition of shares, or (c) by other legal process. An entity shall account for each business combination by applying the Acquisition Method.

2. Applying the Acquisition Method

1. Identifying the acquirer;
2. Determining the acquisition date;
3. Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
4. Recognising and measuring goodwill or a gain from a bargain purchase.

3. Identifying the Acquirer

The guidance in Ind AS 110 shall be used to identify the acquirer — the entity that obtains control of another entity, i.e., the acquiree. When it is not clear from Ind AS 110, the following factors should be considered under Ind AS 103 (Appendix B):

- **B14:** In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.
- **B15:** In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests.
- **Other factors:**
 - (a) Relative voting rights in the combined entity
 - (b) Existence of a large minority voting interest
 - (c) Composition of the governing body
 - (d) Composition of senior management
 - (e) Terms of exchange of equity interests
 - (f) Relative size of combining entities

4. Determining the Acquisition Date

DEFINITION

Acquisition Date: It is the date on which the acquirer obtains control of the acquiree, i.e., legally transfers the consideration, acquires the assets and assumes the liability of the acquiree.

5. Consideration Transferred

- Measured at fair value, calculated as the sum of the acquisition-date fair values of:
 - Assets transferred by the acquirer
 - Liabilities incurred by the acquirer to former owners of the acquiree
 - Equity interests issued by the acquirer
- Contingent consideration, if any, should also be measured at fair value at acquisition date.

6. Contingent Consideration

ICMAI ILLUSTRATION

ICMAI Illustration 11 – Contingent Consideration

Question: D Ltd. has acquired 100% of the equity of F Ltd. on March 31, 2021. The purchase consideration comprises of an immediate payment of ₹10 lakhs and two further payments of ₹1.21 lakhs if the Return on Equity exceeds 20% in each of the subsequent two financial years. A discount rate of 10% is used. Compute the value of total consideration at the acquisition date.

COMPLETE SOLUTION

Step 1: Compute Fair Value of Contingent Consideration

Payment 1: ₹1.21 / (1.1) = ₹1.10 lakhs

Payment 2: ₹1.21 / (1.1)² = ₹1.00 lakhs

Fair Value of Contingent Consideration = ₹2.10 lakhs

Step 2: Compute Total Consideration

Immediate Payment = ₹10.00 lakhs

Add: Contingent Consideration = ₹2.10 lakhs

Total Purchase Consideration = ₹12.10 lakhs

7. Contingent Liability

ICAI ILLUSTRATION

ICAI Illustration 13 – Contingent Liability

Question: Z Ltd. acquired C Ltd. on April 1, 2021. For a lawsuit contingency C Ltd. has a present obligation as on April 1, 2021 and the fair value of the obligation can be reliably measured as ₹50,000. As of the acquisition date it is not believed that an outflow of cash or other assets will be required to settle this matter. What amount should be recorded by Z Ltd. under Ind AS for this contingent liability of C Ltd.?

COMPLETE SOLUTION

Analysis

Contingent liabilities of the Acquiree are recognized as of the acquisition date if there is a present obligation (even if it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, contrary to Ind AS 37) and the fair value of the obligation can be measured reliably.

Conclusion

A liability of ₹50,000 would be recorded by Z Ltd.

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Detailed BC in 60 seconds:

- Acquisition Method: Identify Acquirer → Acquisition Date → Recognise Assets/Liabilities → Goodwill
- Acquirer: Entity obtaining control
- Acquisition Date: Date of obtaining control
- Consideration: Fair value of assets transferred, liabilities incurred, equity issued
- Contingent Consideration: Fair value at acquisition date
- Contingent Liability: Recognised if present obligation + fair value measurable
- **Mnemonic: IARC** → Identify, Acquire, Recognise, Consideration

Business Combination Achieved in Stages

1. Chapter Overview

An acquirer sometimes obtains control of an acquiree in which it already held an equity interest. For example, Entity A holds a 35% non-controlling equity interest in Entity B. On that date, Entity A purchases an additional 40% interest in Entity B, which gives it control of Entity B. This is a business combination achieved in stages or a step acquisition.

2. Accounting Treatment

- In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at the acquisition-date fair value.
- Recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate.

3. Full ICMAI Illustration

ICMAI ILLUSTRATION

ICMAI Illustration 9 – Step Acquisition

Question: Entity A acquired 35% of Entity B on 01-04-2019 for ₹35,000. On 31-03-2020, fair value of shares of Entity B is ₹42,000, thus ₹7,000 reported under OCI in 2019-20. On 01-07-2020 Entity A further acquired 40% stake in Entity B. Consideration paid is ₹60,000. Entity A identifies the net assets of Entity B at fair value of ₹1,20,000 at the acquisition date, value 35% shares at ₹45,000. NCI is valued at proportionate net assets. Show workings and Journal entries.

COMPLETE SOLUTION

Step 1: Compute Gain on Disposal of 35% Investment

Fair Value at acquisition date = ₹45,000

Less: Carried Value = ₹42,000

Gain on disposal = ₹3,000

Step 2: Transfer OCI to P&L

Gain previously reported in OCI = ₹42,000 – ₹35,000 = ₹7,000

Total transfer to P&L = ₹3,000 + ₹7,000 = ₹10,000

Step 3: Compute Goodwill

Fair Value of consideration given for controlling interest = ₹60,000

Add: NCI (25% × ₹1,20,000) = ₹30,000

Add: Fair Value of previously-held interest = ₹45,000

Total = ₹1,35,000

Less: Fair value of net assets of acquiree = ₹1,20,000

Goodwill = ₹15,000

PARTICULARS	DR. (₹)	CR. (₹)
Investment A/c Dr.	3,000	
OCI A/c Dr.	7,000	
To, Profit and Loss A/c		10,000
Net Assets A/c Dr.	1,20,000	
Goodwill A/c Dr.	15,000	
To, Consideration A/c		60,000
To, Investment A/c		45,000
To, NCI A/c		30,000

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Step Acquisition in 60 seconds:

- Previously held interest: Remeasure at fair value at acquisition date
- Gain/loss → P&L or OCI as appropriate
- Goodwill = Consideration + NCI + FV of Previously Held Interest – Net Assets
- Transfer OCI to P&L on acquisition date
- **Mnemonic: PRE** → Previously held interest Remeasured at fair value

Reverse Acquisition

1. Chapter Overview

A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition.

2. Key Concept

REVERSE ACQUISITION

Legal Acquirer

Legal Acquiree

Accounting Acquiree

Accounting Acquirer

3. Full ICAI Illustrations

ICAI ILLUSTRATION

ICAI Illustration 15 – Reverse Acquisition (Basic)

Question: Suppose, Entity A acquires 80% shares of Entity B and satisfies the consideration by issue of three shares of Entity A for every share of Entity B. Market price of ₹10 share of Entity A is ₹25. Balance Sheets: A has Net Assets ₹30,000 and 1000 shares; B has Net Assets ₹20,000 and 750 shares. Is it a reverse acquisition?

COMPLETE SOLUTION

Analysis

$80\% \text{ of } 750 = 600$ shares of Entity B are acquired and Entity A issues $600 \times 3 = 1800$ shares to Entity B.

Now, shareholders of Entity A hold 1000 shares and shareholders of Entity B hold 1800 shares.

Effectively, the group is controlled by Entity B.

This is a case of reverse acquisition.

Accounting Treatment

Accounting will be done in books of Entity A (legal acquirer), but it would be assumed that Entity B is the accounting acquirer. Assets and liabilities of Entity A would be identified and effective consideration would be calculated.

ICMAI Illustration 16 – Reverse Acquisition (Detailed)

Question: Reverse Acquisition takes place as H Ltd. acquires 100% equity shares of S Ltd on 31.03.2021. From the following data pass journal entries and prepare consolidated and separate Balance Sheet in the books of H Ltd.

PARTICULARS	H LTD. (₹ LAKHS)	S LTD. (₹ LAKHS)
Non-current Assets	2,000	3,000
Current Assets	1,000	1,000
Total	3,000	4,000
Equity Share Capital (H: 100 shares; S: 80 shares)	1,000	800
Other Equity	500	1,600
Non-current Liabilities	700	1,200
Current Liabilities	800	400
Total	3,000	4,000

H Ltd. and S Ltd. shares are quoted at ₹20 and ₹50 respectively on 31.03.2021. H Ltd. issues shares in exchange ratio based on quoted price. Fair Value of Net asset of H ₹2,400, S ₹3,200.

COMPLETE SOLUTION

Step 1: Determine Exchange Ratio

H Ltd. issues 2.5 shares for every one share of S Ltd. (50/20).
Thus 200 shares (80×2.5) of H Ltd. are issued to owners of S Ltd.
Owners of S Ltd. become 2/3rd owner of the group (200 out of total 300 shares).

It is a reverse acquisition.

Step 2: Determine Effective Consideration

Effective consideration from the viewpoint of accounting acquirer S Ltd. is the fair value of 100 shares held by H = $20 \times ₹100 = ₹2,000$

Step 3: Compute Goodwill

Net Assets of H identified = $₹(2,400 + 1,000 - 700 - 800) = ₹1,900$

Consideration transferred = ₹2,000

Goodwill = ₹2,000 - ₹1,900 = ₹100 Lakhs

PARTICULARS	DR. (₹ LAKHS)	CR. (₹ LAKHS)
Non-Current Assets A/c Dr.	2,400	
Current Assets A/c Dr.	1,000	
Goodwill A/c Dr.	100	
To, Non-current Liabilities A/c		700
To, Current Liabilities A/c		800
To, Consideration A/c		2,000
Consideration A/c Dr.	2,000	
To, Equity Share Capital A/c		2,000

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Reverse Acquisition in 60 seconds:

- Legal Acquirer = Accounting Acquiree
- Legal Acquiree = Accounting Acquirer
- Effective Consideration = FV of shares held by legal acquirer's owners
- Assets/Liabilities of legal acquiree: Recognised at Fair Value
- Assets/Liabilities of legal acquirer: Recognised at Carrying Amount
- Goodwill = Effective Consideration + NCI – Net Assets of Legal Acquirer
- **Mnemonic: LAA** → Legal Acquirer = Accounting Acquiree

Purchase/Sale of NCI not Resulting in Loss of Control

1. Chapter Overview

When there is an increase in parent's ownership interest by purchase of a part/full of non-controlling interest, it is an Equity Transaction (transaction with owner in the capacity of owner). Any profit or loss on the transaction will be transferred to Other Equity of the Parent in consolidated accounting. Goodwill will not be affected for the change of stake retaining control.

2. Accounting Treatment

- **Purchase of NCI:** Debit NCI for acquisition of additional stake; difference between NCI and payment → Other Equity (debit for loss, credit for gain).
- **Sale of NCI:** Credit NCI for sale of a part of holding; difference between NCI and sale proceeds → Other Equity (debit for loss, credit for gain).
- Goodwill will not be affected for the change of stake retaining control.

3. Full ICMAl Illustration

ICMAl ILLUSTRATION

ICMAI Illustration 10 – Purchase/Sale of NCI

Question: On 01.04.2020 Gold Ltd. acquired 75% share of Coal Ltd. at ₹10,80,000, when the fair value of its net assets was ₹10,00,000. During 01.4.2020 to 31-3-2021 Coal Ltd made TCI ₹2,00,000. On 31.3.2021 Gold Ltd. (a) sold (b) purchased 15% holding to/from outsiders at ₹2,20,000. Pass journal entries for sale/purchase of partial holding retaining control. NCI is valued at (i) Proportionate net asset value; (ii) fair value.

COMPLETE SOLUTION

(a) Sale of 15% holding

NCI at Proportionate Net Asset Value:

Carrying amount of 15% holding = $15\% \times ₹10,80,000 + 15\% \text{ of TCI} = 15\% \times ₹10,80,000 + 15\% \times ₹2,00,000 = ₹1,62,000 + ₹30,000 = ₹1,92,000$

Sale price = ₹2,20,000

Gain credited to Other Equity = ₹2,20,000 - ₹1,92,000 = ₹28,000

PARTICULARS	DR. (₹)	CR. (₹)
Bank A/c Dr.	2,20,000	
To, NCI		1,92,000
To, Other Equity		28,000

(b) Purchase of 15% from outsiders

(i) NCI at Proportionate Net Asset Value:

15% holding = $15\% \times ₹(10,00,000 + 2,00,000) = ₹1,80,000$

Purchase price = ₹2,20,000

Loss debited to Other Equity = ₹2,20,000 - ₹1,80,000 = ₹40,000

PARTICULARS	DR. (₹)	CR. (₹)
NCI A/c Dr.	1,80,000	
Other Equity A/c Dr.	40,000	
To, Bank A/c		2,20,000

(ii) NCI at Fair Value:

Carrying amount of 15% holding = $(15\%/75\%) \times ₹10,80,000 + 15\% \text{ of } ₹2,00,000 = ₹2,16,000 + ₹30,000 = ₹2,46,000$

Purchase price = ₹2,20,000

Gain credited to Other Equity = ₹2,46,000 - ₹2,20,000 = ₹26,000

PARTICULARS	DR. (₹)	CR. (₹)
NCI A/c Dr.	2,46,000	
To, Other Equity		26,000
To, Bank		2,20,000

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

NCI Purchase/Sale in 60 seconds:

- Equity Transaction (transaction with owner in capacity of owner)
- No goodwill adjustment
- Profit/loss → Other Equity
- Purchase: Dr. NCI; difference to Other Equity
- Sale: Cr. NCI; difference to Other Equity
- **Mnemonic: ETO** → Equity Transaction → Other Equity

CHAPTER 8

Sale of Holding Resulting in Loss of Control

1. Chapter Overview

If a parent loses control of a subsidiary, it shall derecognise the assets and liabilities of the subsidiary, recognise the fair value of consideration received, and account for any retained interest at fair value.

2. Accounting Treatment

If a parent loses control of a subsidiary, it shall:

- (a) derecognise:
 - (i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and
 - (ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost.
- (b) recognise:
 - (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control.

3. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Loss of Control in 60 seconds:

- Derecognise assets and liabilities of subsidiary
- Derecognise NCI
- Recognise fair value of consideration received
- Recognise any retained interest at fair value
- Gain/loss → P&L
- **Mnemonic: DRC** → Derecognise, Recognise, Consideration

Business Combination under Common Control (Appendix C of Ind AS 103)

1. Chapter Overview

If in a business combination all the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory, it is a business combination under common control. Appendix C of Ind AS 103 deals with accounting for combination of entities or businesses under common control.

2. Pooling of Interest Method

Business combinations involving entities or businesses under common control shall be accounted for using the Pooling of Interest Method.

The pooling of interest method is considered to involve the following:

1. The assets and liabilities of the combining entities are reflected at their carrying amounts.
2. No adjustments are made to reflect fair values, or recognize any new assets or liabilities.
3. The equity share capital will be recorded at nominal value only. Consideration in excess of equity share capital will be recorded as goodwill (Capital reserve in case of deficiency).
4. The other equity of the transferor shall be carried by the transferee in the same form in which they appeared in the financial statements of the transferor.

3. Full ICMAI Illustrations

ICMAI ILLUSTRATION

ICMAI Illustration 18 – Demerger (Business Combination under Common Control)

Question: Z Ltd has two divisions X and Y. On 31.03.2021 the division-wise extract of the balance sheet was:

PARTICULARS	X (₹ CRORES)	Y (₹ CRORES)	TOTAL (₹ CRORES)
PPE	350	600	950
Prov. for Depr.	(300)	(400)	(700)
Current assets	300	400	700
Total	350	600	950
Equity share capital (₹10 per share)	50	—	50
Other Equity	250	(150)	100
Borrowing	—	360	360
Current Liabilities	50	390	440
Total	350	600	950

Q Ltd, a new company is formed to take over division Y by issue of 1 crore equity shares of ₹10 at a premium of ₹15 per share to (i) the shareholders of Z Ltd (ii) to Z Ltd. Pass journal entries and prepare balance sheet after reconstruction in the books of both Z Ltd and Q Ltd.

COMPLETE SOLUTION

Analysis

As the control of division Y was with the shareholders of Z Ltd before the demerger and after division Y is taken over by Q Ltd the control of Q Ltd is still lying with the same shareholders of Z Ltd, this is a transaction identified as business combination under common control, where the transferee is Q Ltd. and the transferor is Z Ltd. Pooling of interest is the method of accounting to be applied.

(a) When shares are issued to shareholders of Z Ltd

Journal in the books of Z Ltd.

PARTICULARS	DR. (₹ CRORES)	CR. (₹ CRORES)
Borrowing A/c Dr.	360	
Current Liabilities A/c Dr.	390	
Provision for Depn. A/c Dr.	400	
To, PPE A/c		600
To, Current Assets A/c		400
To, Other Equity A/c		150

Balance Sheet of Z Ltd. after reconstruction

PARTICULARS	AMOUNT (₹ CRORES)
PPE	50
Current Assets	300
Total Assets	350
Equity Share Capital	50
Other Equity	250
Current Liabilities	50
Total	350

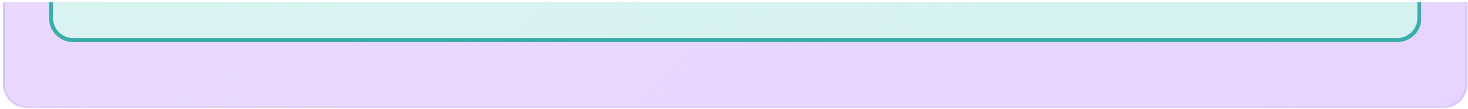
Journal in the books of Q Ltd.

PARTICULARS	DR. (₹ CRORES)	CR. (₹ CRORES)
PPE A/c Dr.	200	
Current Assets A/c Dr.	400	
Other Equity A/c Dr.	150	
Goodwill A/c Dr.	10	
To, Borrowing A/c		360
To, Current Liabilities A/c		390
To, Consideration A/c		10
Consideration A/c Dr.	10	
To, Equity Share Capital A/c		10

Balance Sheet of Q Ltd.

PARTICULARS	AMOUNT (₹ CRORES)
PPE	200
Goodwill	10
Current Assets	400
Total Assets	610
Equity Share Capital	10
Other Equity	(150)
Borrowings	360
Current Liabilities	390
Total	610

Goodwill is the excess of the amount recorded as share capital issued over the share capital of the transferor. Here Y Division share capital is Zero. Hence, Goodwill = ₹(10 - 0) crore = ₹10 crore.



ICMAI Illustration 19 – Amalgamation (Business Combination under Common Control)

Question: DA Ltd. and TA Ltd. were amalgamated to form a new company DATA Ltd. on 31.03.2021 who issued requisite number of equity shares of ₹10 to take over the businesses of DA and TA. The abstract of balance sheets of the companies on 31.03.2021:

PARTICULARS	DA LTD. (₹ LAKHS)	TA LTD. (₹ LAKHS)	DATA LTD. (₹ LAKHS)
PPE	7,500	8,000	15,500
Financial Assets	800	500	1,300
Current Assets	4,700	6,500	11,200
Equity Share Capital	6,000	8,000	14,000
Other Equity	3,000	3,000	6,000
Borrowings	2,000	3,000	5,000
Current Liabilities	2,000	1,000	3,000

Pass journal entries in the books of DA, TA and DATA Ltd. and show balance sheet abstract after merger.

COMPLETE SOLUTION

Analysis

The combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination. It is a business combination under common control, and pooling of interest method of accounting is to be followed.

WN 1: Carrying amount after merger

PARTICULARS	DA LTD.	TA LTD.	DATA LTD.
PPE	7,500	8,000	15,500
Financial Assets	800	500	1,300
Current Assets	4,700	6,500	11,200
Equity Share Capital	6,000	8,000	14,000
Other Equity	3,000	3,000	6,000
Borrowings	2,000	3,000	5,000
Current Liabilities	2,000	1,000	3,000

WN 2: Purchase consideration

PARTICULARS	DA LTD.	TA LTD.	DATA LTD.
Equity Share Capital	6,000	8,000	14,000
Other Equity	3,000	3,000	6,000
Equity	9,000	11,000	20,000
Share	9/20	11/20	20/20
Purchase consideration	$(9/20) \times 14,000 = 6,300$	$(11/20) \times 14,000 = 7,700$	14,000

Journal in the books of transferor company DA Ltd.

PARTICULARS	DR. (₹)	CR. (₹)
Current Liabilities A/c Dr.	2,000	
Borrowings A/c Dr.	2,000	
Realisation A/c Dr.	9,000	
To, PPE A/c		7,500
To, Current Assets A/c		4,700
To, Financial Assets A/c		800
Shares in DATA Ltd. A/c Dr.	6,300	
To, Realisation A/c		6,300
Equity Shareholders A/c Dr.	2,700	
To, Realisation A/c		2,700
Equity Share Capital A/c Dr.	6,000	
Other Equity A/c Dr.	3,000	
To, Equity Shareholders A/c		9,000
Equity Shareholders A/c Dr.	6,300	
To, Shares in DATA Ltd. A/c		6,300

Journal in the books of Transferee company DATA Ltd.

PARTICULARS	DR. (₹)	CR. (₹)
PPE A/c Dr.	15,500	
Current Assets A/c Dr.	11,200	
Financial Assets A/c Dr.	1,300	
To, Consideration A/c		14,000
To, Borrowings A/c		5,000
To, Current Liabilities A/c		3,000
To, Other Equity		6,000
Consideration A/c Dr.	14,000	
To, Equity Share Capital A/c		14,000

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Common Control in 90 seconds:

- Same party controls before and after → Common Control
- Pooling of Interest Method applies
- Assets/Liabilities at carrying amounts
- No fair value adjustments
- Equity Share Capital at nominal value
- Other Equity carried in same form
- Difference → Goodwill (or Capital Reserve)
- **Mnemonic: PCC** → Pooling, Carrying, Capital

Disclosures

1. Chapter Overview

An acquirer should disclose information that enables users to evaluate the nature and financial effect of business combinations that were affected.

2. Disclosure Requirements

- (a) The name and a description of the acquiree.
- (b) The acquisition date.
- (c) The percentage of voting equity interests acquired.
- (d) The primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- (e) A qualitative description of the factors that make up the goodwill recognised.
- (f) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
 - (i) cash;
 - (ii) other tangible or intangible assets, including a business or subsidiary of the acquirer;
 - (iii) liabilities incurred; and
 - (iv) equity interests of the acquirer
- (g) Information for contingent consideration arrangements.
- (h) Information for each contingent liability recognised.
- (i) The amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless impracticable. If impracticable, fact must be disclosed.

3. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Disclosures in 60 seconds:

- Name and description of acquiree
- Acquisition date
- Percentage of voting equity interests acquired
- Primary reasons for combination
- Goodwill description
- Fair value of consideration transferred
- Contingent consideration arrangements
- Contingent liability recognised
- Acquiree's profit/loss since acquisition
- **Mnemonic: NADP** → Name, Acquisition, Date, Percentage

Difference between Ind AS 103 and AS 14

1. Comparative Analysis

ASPECT	IND AS 103	AS 14
Scope	Wider scope than AS 14	Narrower scope
Method of Accounting	Acquisition Method for every business combination (except common control)	Two methods: Pooling of Interest Method and Purchase Method
Recognition & Measurement	Acquired identifiable assets, liabilities and NCI at fair value	Allows choice of Book value, agreed value or Fair Value
Goodwill	Not amortised; tested for annual impairment	Amortised over a period not exceeding 5 years
Non-Controlling Interest	Provides for accounting of NCI	Does not provide for NCI
Consolidated Financial Statements	Recording for consolidated financial statements provided	Not provided
Common Control Transactions	Appendix C deals with accounting for common control transactions (Pooling of Interest Method)	Does not prescribe any common control transactions
Contingent Consideration	Recognises contingent consideration	Does not recognise contingent consideration
Reverse Acquisitions	Deals with reverse acquisitions	Does not deal with reverse acquisitions

2. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Ind AS 103 vs AS 14 in 60 seconds:

- Ind AS 103: Acquisition Method only; AS 14: Pooling + Purchase
- Ind AS 103: Fair Value; AS 14: Book/Agreed/Fair Value
- Ind AS 103: No amortisation; AS 14: Amortise over 5 years
- Ind AS 103: NCI; AS 14: No NCI
- Ind AS 103: Common Control (Appendix C); AS 14: No Common Control
- Ind AS 103: Contingent Consideration; AS 14: No
- Ind AS 103: Reverse Acquisition; AS 14: No
- **Mnemonic: AFNC** → Acquisition, Fair Value, No amortisation, Common Control

Internal Reconstruction (Capital Reduction)

1. Chapter Overview

The Act does not prescribe the manner in which the reduction of capital is to be effected nor is there any limitation on the power of the Tribunal to confirm the reduction, except that it must be satisfied that every creditor of the company has either consented to the said reduction or they have been paid off or their interest has been secured.

2. Ways of Reduction of Share Capital

1. In respect of share capital not paid-up, extinguishing or reducing the liability on any of its shares.
2. Cancel any paid-up share capital, which is lost, or is not represented by available assets.
3. Pay off the paid-up share capital, which is in excess of the needs of the company.

Paid-up share capital for the purpose of capital reduction would include securities premium and capital redemption reserve.

3. Steps in Internal Reconstruction

1. **Ascertain total amounts to be written off:** Total debit balance of P&L A/c, fictitious assets like goodwill, preliminary expenses, discount on shares/debentures, fall in value of assets, increase in liabilities, arrears of dividends on cumulative preference shares.
2. **Determine who bears the loss:** If net assets > preference share capital, entire loss borne by equity shareholders. If net assets < preference share capital, preference shareholders also accept sacrifice.
3. **Payment of arrears of dividend:** May be settled by issue of deposit certificates (preferable to shares as it doesn't upset voting power and can be redeemed later).
4. **Creditors and debenture holders:** Affected only if total assets insufficient to cover liabilities. May accept sacrifice or reduced payment.

4. Full ICMAI Illustration

ICMAI ILLUSTRATION

ICMAI Illustration 21 – Internal Reconstruction (Hopefull Ltd.)

Question: The following is the Balance Sheet as at 31st March, 2017 of Hopefull Ltd.

LIABILITIES	₹	ASSETS	₹
8,500 Equity Shares of ₹100 each fully paid up	8,50,000	Fixed Assets (including goodwill of ₹1,00,000)	11,80,000
4,000 Cumulative Preference Shares of ₹100 each fully paid up	4,00,000	Investments	40,000
Securities Premium	20,000	Stock in Trade	2,75,000
General Reserve	60,000	Trade Debtors	1,50,000
Trade Creditors	3,80,000	Bank Balances	65,000
Total	17,10,000	Total	17,10,000

Contingent liability: Preference Dividends in arrears ₹60,000.

The Board of Directors decided upon the following scheme of reconstruction, which was duly approved by all concerned and put into effect from 1st April, 2017:

- (i) The Preference Shares are to be converted into 12% unsecured debentures of ₹100 each with regard to 70% of the dues (including arrears of dividends) and for the balance Equity Shares of ₹50 paid up would be issued. The authorized Capital permitted the issue of additional shares.
- (ii) Equity Shares would be reduced to share of ₹50 each paid up.
- (iii) Since goodwill has no value, the same is to be written off fully.
- (iv) The market value of investments are to be reflected at ₹60,000.
- (v) Obsolete items in Stock of ₹75,000 are to be written off. Bad Debts to the extent of 5% of the total debtors would be provided for. Fixed assets to be written down by ₹1,80,000.
- (vi) The company carried on trading for six months upto 30th September 2017, and made a net profit of ₹1,00,000 after writing off depreciation at 25% p.a. on the revised value of fixed assets.
- (vii) The half yearly working resulted in an increase of Sundry Debtors by ₹80,000, stock by ₹70,000 and Cash by ₹50,000.

COMPLETE SOLUTION

Step 1: Compute Total Amount to be Written Off

PARTICULARS	₹
Goodwill (to be written off)	1,00,000
Fixed Assets (to be written down)	1,80,000
Obsolete Stock	75,000
Bad Debts (5% of ₹1,50,000)	7,500
Preference Dividend Arrears	60,000
Investments (to be reduced to ₹60,000)	(40,000)
Total Amount to be Written Off	3,42,500

Step 2: Determine Who Bears the Loss

Net Assets available (excluding preference capital) = ₹17,10,000 – ₹4,00,000 – ₹3,80,000 = ₹9,30,000

Preference Share Capital = ₹4,00,000

Net Assets > Preference Share Capital, so entire loss borne by equity shareholders.

Step 3: Capital Reduction Account

PARTICULARS	₹
To, Goodwill A/c	1,00,000
To, Fixed Assets A/c	1,80,000
To, Stock A/c	75,000
To, Provision for Doubtful Debts A/c	7,500
To, Investments A/c	22,500
To, Capital Reserve A/c (Balancing figure)	1,00,000
Total	4,85,000
By, Equity Share Capital A/c (Reduction)	4,25,000
By, Capital Reduction A/c (Balance)	60,000
Total	4,85,000

Journal Entries

PARTICULARS	DR. (₹)	CR. (₹)
Cumulative Preference Share Capital A/c Dr.	4,00,000	
Capital Reduction A/c Dr.	60,000	
To, Cumulative Preference Shareholders A/c		4,60,000
Cumulative Preference Shareholders A/c Dr.	4,60,000	
To, 12% Unsecured Debentures A/c (70% of ₹4,60,000)		3,22,000
To, Equity Share Capital A/c (2,760 shares of ₹50)		1,38,000
Equity Share Capital A/c Dr.	4,25,000	
To, Capital Reduction A/c		4,25,000
Capital Reduction A/c Dr.	4,85,000	
To, Goodwill A/c		1,00,000
To, Fixed Assets A/c		1,80,000
To, Stock A/c		75,000
To, Provision for Doubtful Debts A/c		7,500
To, Investments A/c		22,500
To, Capital Reserve A/c		1,00,000

5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Internal Reconstruction in 90 seconds:

- Capital Reduction Scheme under Companies Act, 2013
- Ways: Reduce unpaid capital, Cancel lost capital, Pay off excess capital
- Step 1: Ascertain total amount to be written off
- Step 2: Determine who bears the loss (equity first, then preference)
- Step 3: Arrears of dividend → Deposit Certificates
- Step 4: Creditors affected only if assets insufficient
- Capital Reduction A/c: Debit all write-offs, Credit capital reduction
- Balance → Capital Reserve
- **Mnemonic: CWC** → Cancel, Write off, Capital Reserve

Full ICMAI Illustrations with Step-by-Step Solutions

★ EXAM IMPORTANT

This chapter contains comprehensive illustrations from the ICMAI study material for Module 5. Practice each illustration thoroughly — they form the foundation for exam problems on business combination.

ICMAI Illustration 2(a) – P Ltd Acquires Q Ltd (Takeover)

Question: On March 31, 2021, P Ltd acquired Q Ltd. by issue of 3,00,000 equity shares (₹10) that were trading at ₹16 on March 31. The summarized Balance Sheets:

PARTICULARS	P LTD. (BOOK VALUE)	Q LTD. (BOOK VALUE)	P LTD. (MARKET VALUE)	Q LTD. (MARKET VALUE)
Net Assets	80,00,000	42,00,000	1,10,00,000	45,00,000
Equity Share Capital	60,00,000	25,00,000		
Other Equity	20,00,000	17,00,000		

Show acquisition journal entry under Ind AS 103 and summarized balance sheet after business combination. Also show the necessary accounting in the books of the Acquiree.

COMPLETE SOLUTION

Step 1: Compute Purchase Consideration

Purchase Consideration = 3,00,000 × ₹16 = **₹48,00,000**

Step 2: Compute Goodwill

FV of Net Assets = ₹45,00,000

Goodwill = ₹48,00,000 – ₹45,00,000 = **₹3,00,000**

PARTICULARS	DR. (₹)	CR. (₹)
Net Assets A/c Dr.	45,00,000	
Goodwill A/c Dr.	3,00,000	
To, Consideration A/c		48,00,000
Consideration A/c Dr.	48,00,000	
To, Equity Share Capital A/c		30,00,000
To, Security Premium A/c		18,00,000

Summarized Individual Balance Sheet of P Ltd. (Post-acquisition)

PARTICULARS	₹
Net Assets: Carrying amount of Acquirer P Ltd.	80,00,000
Fair Value of Acquiree Q Ltd.	45,00,000
Goodwill	3,00,000
Total Net Assets	1,28,00,000
Equity Share Capital (60,00,000 + 30,00,000)	90,00,000
Other Equity (20,00,000 + 18,00,000)	38,00,000
Total Equity	1,28,00,000

ICMAI Illustration 2(b) – 100% Subsidiary

Question: On March 31, 2021, P Ltd acquired 100% shares of Q Ltd. P Ltd. issued 3,00,000 equity shares (₹10) that were trading at ₹16 on March 31. The summarized Balance Sheets are the same as above. Show acquisition journal entry under Ind AS 103 and summarized balance sheet after business combination.

COMPLETE SOLUTION

Step 1: Compute Purchase Consideration

$$\text{Purchase Consideration} = 3,00,000 \times ₹16 = ₹48,00,000$$

Step 2: Compute Goodwill

$$\text{FV of Net Assets} = ₹45,00,000$$

$$\text{Goodwill} = ₹48,00,000 - ₹45,00,000 = ₹3,00,000$$

PARTICULARS	DR. (₹)	CR. (₹)
Journal in Consolidated Set of P Ltd.		
Net Assets A/c Dr.	45,00,000	
Goodwill A/c Dr.	3,00,000	
To, Consideration A/c		48,00,000
Consideration A/c Dr.	48,00,000	
To, Equity Share Capital A/c		30,00,000
To, Security Premium A/c		18,00,000
Journal in Separate Set of P Ltd.		
Investment in Shares of Q Ltd. A/c Dr.	48,00,000	
To, Equity Share Capital A/c		30,00,000
To, Security Premium A/c		18,00,000

Summarized Consolidated Balance Sheet of P Ltd. and Q Ltd. (Post-acquisition)

PARTICULARS	₹
Net Assets: Carrying amount of Acquirer P	80,00,000
Fair Value of Acquiree Q	45,00,000
Goodwill	3,00,000
Total Net Assets	1,28,00,000
Equity Share Capital (60,00,000 + 30,00,000)	90,00,000
Other Equity (20,00,000 + 18,00,000)	38,00,000
Total Equity	1,28,00,000

ICMAI Illustration 12 – NCI and Goodwill (Fair Value vs Proportionate)

Question: C Ltd. acquires 60% share in D Ltd. for cash payment of ₹2,00,000. The fair value of non-controlling interest is ₹1,00,000. This amount was determined with reference of market price of D's ordinary shares before the acquisition date. Calculate NCI and goodwill following: (i) Fair Value approach (ii) Proportionate shares of identified net asset in acquire approach, when on the acquisition date, the aggregate value of D's identifiable net assets is: (a) ₹2,40,000; (b) ₹3,30,000.

COMPLETE SOLUTION

PARTICULARS	(IA) ₹	(IB) ₹	(IIA) ₹	(IIB) ₹
Consideration	2,00,000	2,00,000	2,00,000	2,00,000
NCI	1,00,000	1,00,000	96,000*	1,32,000**
Net Assets	2,40,000	3,30,000	2,40,000	3,30,000
Goodwill (1+2-3)	60,000	–	56,000	2,000
Gain on Bargain Purchase (3-1-2)	–	30,000	–	–

* $40\% \times ₹2,40,000 = ₹96,000$

** $40\% \times ₹3,30,000 = ₹1,32,000$

Note: Under Ind AS 103, Goodwill is not amortised but tested for annual impairment in accordance with Ind AS 36.

ICMAI Illustration 14 – Comprehensive Problem (Associate → Subsidiary → NCI Change)

Question: P Ltd. acquired 25% shares of S Ltd. on 01.04.2019 in cash. P Ltd. further acquired on 01.04.2020 45% shares of B Ltd. payable by issue of 30,000 shares of ₹10 (market price ₹15). On that date Debentures of S Ltd. were exchanged for 10% Debenture of P Ltd. A contingent consideration is also payable, fair value of which at 01.04.2020 was estimated at ₹45,000. P Ltd. paid transaction cost ₹20,000. Non-Controlling Interest is recognized at fair value.

FAIR VALUES	01.04.2019 (₹)	01.04.2020 (₹)	31.03.2021 (₹)
PPE	3,80,000	4,00,000	4,50,000
Current Assets	4,00,000	4,20,000	4,30,000
Creditors	30,000	36,000	40,000

On 31.03.2021 P Ltd. further purchased 20% shares in S Ltd. at ₹2,50,000 in cash. Profits made by S Ltd. during 2020-21 amounted to ₹80,000.

COMPLETE SOLUTION

Explanation 1: 01.04.2020 – Acquisition of 25% shares (Associate)

Cost of Acquisition = ₹2,30,000 – ₹16,000 (post-acquisition profits) =
₹2,14,000

Journal in Consolidated and Separate Set: Dr. Investment in shares of S Ltd. ₹2,14,000; To Cash ₹2,14,000

Explanation 2: 01.04.2021 – Further acquisition of 45% shares (Subsidiary)

WN 1: Net Identified Assets at Fair Value as at 01.04.2021

PPE = ₹4,00,000; Current Assets = ₹4,20,000; Less: Creditors = ₹36,000;
Less: Debenture = ₹10,000

Net Identified Assets = ₹7,74,000

WN 2: Calculation of Consideration

Issue of Shares (30,000 × ₹15) = ₹4,50,000

Contingent Consideration = ₹45,000

Total Consideration = ₹4,95,000

WN 3: Calculation of NCI

Share of NCI = 100 – 70 = 30%

NCI at Fair Value = (30/45) × ₹4,95,000 = **₹3,30,000**

WN 4: Fair Value of previously held interest

Fair Value for 25% interest = (25/45) × ₹4,95,000 = ₹2,75,000

Less: Carried Value = ₹2,30,000

Profit on Revaluation through P&L = ₹45,000

WN 5: Calculation of Goodwill

Consideration = ₹4,95,000

Fair value of previously held shares = ₹2,75,000

NCI = ₹3,30,000

Total = ₹11,00,000

Less: Net Identified Assets at fair value = ₹7,74,000

Goodwill = ₹3,26,000

ICMAI Illustration 20 – Chain Holding

Question: Pass journal entries for business combination in the books of P Ltd. from the following particulars:

PARTICULARS	P (₹ LAKHS)	Q (₹ LAKHS)	R (₹ LAKHS)
PPE	400	500	320
Inventory	250	80	60
Trade Receivables	280	120	200
Bills Receivables	70	50	—
Cash and Bank	180	50	60
Equity Share Cap (₹10)	450	500	300
Other Equity	260	160	120
Trade Payables	300	300	200
Bills Payables	100	90	70

P Ltd. acquired 80% shares of Q Ltd. at a consideration of ₹480 and Q Ltd. acquired 75% shares of R Ltd. at a consideration of ₹300 on 01-04-2021. NCI is measured at fair value. Fair value as at acquisition: PPE: P=700, Q=600, R=400; Inventory: P=240, Q=80, R=60; Trade Receivables: P=250, Q=120, R=180; Bills Receivables: P=70, Q=50; Trade Payables: P=300, Q=300, R=170; Bills Payables: P=100, Q=90, R=70.

COMPLETE SOLUTION

Step 1: Share of Parent and NCI

Share of P in Q = 80%; NCI in Q = 20%

Share of Q in R = 75%

Share of Group in R = 80% × 75% = 60%

NCI in R = 40%

Step 2: Net Assets on Acquisition at Fair Value

PARTICULARS	Q (₹ LAKHS)	R (₹ LAKHS)	TOTAL (₹ LAKHS)
PPE	600	400	1,000
Inventory	80	60	140
Trade Receivables	120	180	300
Cash and Bank	50	60	110
Bills Receivables	70	50	120
Total Assets	920	750	1,670
Trade Payables	300	170	470
Bills Payables	90	70	160
Total Liabilities	390	240	630
Net Assets at fair value	530	510	1,040

Step 3: NCI at Fair Value

NCI of R = 300 × 40%/75% = ₹160 Lakhs

NCI of Q = 480 × 20%/80% = ₹120 Lakhs

Less: Included in NCI of R (20% of 300) = (₹60 Lakhs)

Total NCI = ₹220 Lakhs

Step 4: Goodwill / Bargain Purchase

Net Assets = ₹1,040 Lakhs

Consideration = ₹480 Lakhs (Q) + ₹240 Lakhs (80% of R's ₹300)

NCI = ₹220 Lakhs

Gain on Bargain Purchase = ₹1,040 - (₹480 + ₹240 + ₹220) = ₹340 Lakhs

PARTICULARS	DR. (₹ LAKHS)	CR. (₹ LAKHS)
PPE Dr.	1,000	
Inventory Dr.	140	
Trade Receivables Dr.	300	
Bills Receivables Dr.	120	
Cash and Bank Dr.	110	
To, Consideration		480
To, Trade Payables		470
To, Bills Payables		160
To, NCI		220
To, Capital Reserve (Gain on Bargain Purchase)		340

KEY TAKEAWAY

Key Takeaways from Module 5 Illustrations:

- Goodwill = Consideration + NCI + FV of Previously Held Interest – Net Assets
- NCI at Fair Value = Consideration × (NCI Share / Parent Share)
- NCI at Proportionate = NCI % × Net Assets
- Gain on Bargain Purchase → OCI (Capital Reserve)
- Common Control → Pooling of Interest Method (Carrying Amount)
- Reverse Acquisition: Legal Acquiree = Accounting Acquirer
- Step Acquisition: Remeasure previously held interest at fair value
- NCI Purchase/Sale: Equity Transaction → Other Equity
- Internal Reconstruction: Capital Reduction Account → Capital Reserve

MODULE 5 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 5 covers Accounting for Business Combination and Restructuring under Ind AS 103. This module carries **20% weightage** in Paper 18 — one of the highest. Master the Acquisition Method, Pooling of Interest Method, Reverse Acquisition, Step Acquisition, and Internal Reconstruction.

B. Mega Revision Sheet

TOPIC	CORE PRINCIPLE	KEY TREATMENT
Business Combination	Acquirer obtains control of Acquiree	Acquisition Method (Fair Value)
Common Control	Same party controls before and after	Pooling of Interest Method (Carrying Amount)
Goodwill	Excess of consideration + NCI over net assets	Consideration + NCI + FV of PHI – Net Assets
Gain on Bargain Purchase	Excess of net assets over consideration + NCI	Net Assets – (Consideration + NCI) → OCI
NCI at Fair Value	Based on consideration paid for parent's share	Consideration × (NCI Share / Parent Share)
NCI at Proportionate	Based on net asset value	NCI % × Net Assets
Step Acquisition	Previously held interest remeasured	FV at acquisition date → Gain/loss to P&L/OCI
Reverse Acquisition	Legal acquirer = Accounting acquiree	Legal acquiree = Accounting acquirer
NCI Purchase/Sale	Equity transaction	No goodwill adjustment → Other Equity
Loss of Control	Derecognise assets/liabilities	FV of retained interest → P&L
Internal Reconstruction	Capital reduction scheme	Write off losses → Capital Reduction A/c

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA
Goodwill	$\text{Consideration} + \text{NCI} + \text{FV of Previously Held Interest} - \text{Net Assets}$
Gain on Bargain Purchase	$\text{Net Assets} - (\text{Consideration} + \text{NCI} + \text{FV of PHI})$
NCI at Fair Value	$\text{Consideration} \times (\text{NCI Share} / \text{Parent Share})$
NCI at Proportionate	$\text{NCI \%} \times \text{Fair Value of Net Assets}$
Net Identifiable Assets	$\text{Fair Value of Assets} - \text{Fair Value of Liabilities}$
Consideration (Pooling)	Nominal Value of Shares Issued
Goodwill (Pooling)	$\text{Consideration} + \text{Other Equity} - \text{Net Assets (Carrying Amount)}$
Gain on Step Acquisition	$\text{FV of Previously Held Interest} - \text{Carried Value}$
Effective Consideration (Reverse)	$\text{Number of Shares of Accounting Acquiree} \times \text{Market Price}$
Equity Transaction (NCI)	Difference between NCI and Consideration → Other Equity

D. Top Exam Points – Quick Revision

1. Ind AS 103 deals with Business Combination.
2. Two types: Business Combination and Business Combination under Common Control.
3. Business Combination → Acquisition Method (Fair Value).
4. Common Control → Pooling of Interest Method (Carrying Amount).
5. Acquiree = Business whose control is obtained.
6. Acquirer = Entity that obtains control.
7. Acquisition Date = Date of obtaining control.
8. NCI = Equity not attributable to parent.
9. Goodwill = Consideration + NCI + FV of PHI – Net Assets.
10. Gain on Bargain Purchase = Net Assets – (Consideration + NCI).
11. Gain on Bargain Purchase → OCI (Capital Reserve).
12. NCI at Fair Value = Consideration $\times$ (NCI Share / Parent Share).
13. NCI at Proportionate = NCI % $\times$ Net Assets.
14. Takeover: Acquiree ceases → One set (Stand-
52. Capital Reduction A/c: Debit all write-offs.
53. Capital Reduction A/c: Credit capital reduction.
54. Balance → Capital Reserve.
55. Chain Holding: Parent → Subsidiary → Sub-
subsidiary.
56. Chain Holding: Group share = Parent % $\times$
Subsidiary %.
57. Chain Holding: NCI computation adjusted for
cross-holdings.
58. Cross-Holding: Prohibited under Companies Act,
2013.
59. Demerger: Business Combination under
Common Control.
60. Demerger: Pooling of Interest Method.
61. Absorption: One company absorbs another.
62. Amalgamation: New company formed.
63. External Reconstruction: New company takes
over.
64. Reverse Acquisition: Legal vs Accounting.
65. Reverse Acquisition: Public entity acquires
private entity.

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly for goodwill computation.
- State the method used (Acquisition vs Pooling) explicitly.
- For practical problems, draw tables for computation.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: Goodwill, NCI, Common Control, Internal Reconstruction.
- Practice at least 10 comprehensive problems covering all scenarios.
- Read the question carefully for common control vs non-common control.
- For common control, always use carrying amounts (not fair values).
- For step acquisition, always remeasure previously held interest.
- For reverse acquisition, always identify legal vs accounting acquirer.
- For NCI purchase/sale, never adjust goodwill.
- For internal reconstruction, always show Capital Reduction Account.

F. Frequently Repeated Concepts

- Goodwill computation under Acquisition Method — appears almost every attempt.
- NCI at fair value vs proportionate — very common.
- Gain on Bargain Purchase — frequently tested.
- Pooling of Interest Method — regular.
- Reverse Acquisition — increasingly important.
- Step Acquisition — common.
- Internal Reconstruction — comprehensive problem.
- Ind AS 103 vs AS 14 — common theory question.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ Objective and scope of Ind AS 103
- ☒ Definitions: Acquirer, Acquiree, Acquisition Date, NCI
- ☒ Acquisition Method: Steps
- ☒ Identifying the Acquirer
- ☒ Determining Acquisition Date
- ☒ Consideration Transferred
- ☒ Contingent Consideration
- ☒ Contingent Liability
- ☒ Goodwill computation
- ☒ Gain on Bargain Purchase
- ☒ NCI at Fair Value
- ☒ NCI at Proportionate
- ☒ Takeover accounting
- ☒ 100% Subsidiary accounting
- ☒ Partial Subsidiary accounting
- ☒ Absorption, Amalgamation, External Reconstruction
- ☒ Step Acquisition
- ☒ Reverse Acquisition
- ☒ NCI Purchase/Sale
- ☒ Loss of Control
- ☒ Common Control (Pooling of Interest)
- ☒ Chain Holding
- ☒ Demerger
- ☒ Disclosures
- ☒ Ind AS 103 vs AS 14
- ☒ Internal Reconstruction
- ☒ Capital Reduction Account
- ☒ All ICMAI illustrations
- ☒ Common mistakes to avoid
- ☒ Examiner insights
- ☒ Memory tricks and mnemonics

H. Common Mistakes Students Make

⚠ WARNING

- Using fair values for Common Control transactions (should be carrying amounts).
- Forgetting to add NCI in goodwill computation.
- Incorrect NCI computation (fair value vs proportionate).
- Not remeasuring previously held interest in step acquisition.
- Forgetting to transfer OCI to P&L in step acquisition.
- Incorrect identification of acquirer in reverse acquisition.
- Adjusting goodwill for NCI purchase/sale (should not be adjusted).
- Not derecognising assets/liabilities on loss of control.
- Incorrect computation of gain on bargain purchase.
- Not recognising contingent consideration at fair value.
- Incorrect treatment of contingent liability.
- Not considering common control in amalgamation.
- Incorrect journal entries for absorption/amalgamation.
- Not computing chain holding group share correctly.
- Incorrect internal reconstruction entries.
- Not transferring balance to Capital Reserve.

I. Memory Tricks and Mnemonics

🔑 KEY TAKEAWAY

Business Combination: BCA → Business Combination → Acquisition Method

Common Control: PCC → Pooling, Carrying, Capital

Goodwill: GNC → Goodwill = Consideration + NCI – Net Assets

NCI Fair Value: NCI-FV → Consideration × (NCI Share / Parent Share)

Step Acquisition: PRE → Previously held interest Remeasured at fair value

Reverse Acquisition: LAA → Legal Acquirer = Accounting Acquiree

NCI Purchase/Sale: ETO → Equity Transaction → Other Equity

Loss of Control: DRC → Derecognise, Recognise, Consideration

Internal Reconstruction: CWC → Cancel, Write off, Capital Reserve

Ind AS 103 vs AS 14: AFNC → Acquisition, Fair Value, No amortisation, Common Control

1 DAY BEFORE EXAM

Module 5 – Printable Quick Notes:

1. Business Combination = Acquirer obtains control of Acquiree
2. Two types: Business Combination (Acquisition Method) and Common Control (Pooling)
3. Goodwill = Consideration + NCI + FV of PHI – Net Assets
4. Gain on Bargain Purchase = Net Assets – (Consideration + NCI) → OCI
5. NCI at Fair Value = Consideration × (NCI Share / Parent Share)
6. NCI at Proportionate = NCI % × Net Assets
7. Common Control → Pooling of Interest Method (Carrying Amount)
8. Pooling: No fair value adjustments; Other Equity carried forward
9. Step Acquisition: Previously held interest remeasured at fair value
10. Reverse Acquisition: Legal Acquirer = Accounting Acquiree
11. NCI Purchase/Sale: Equity Transaction → Other Equity
12. Loss of Control: Derecognise assets/liabilities; FV of retained interest
13. Internal Reconstruction: Capital Reduction Account → Capital Reserve
14. Disclosures: Name, date, percentage, reasons, goodwill, consideration
15. Ind AS 103 vs AS 14: Method, Goodwill, NCI, Common Control, Contingent Consideration, Reverse Acquisition

KEY TAKEAWAY

END OF MODULE 5 – ACCOUNTING FOR BUSINESS COMBINATION & RESTRUCTURING

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Corporate Financial Reporting

MODULE 6

Consolidated & Separate Financial Statements

Complete Revision Handbook with Full ICMAI Illustrations, Step-by-Step Solutions,
Formulas, and Exam-Focused Notes

20%

WEIGHTAGE

9

SUB-TOPICS

20+

ILLUSTRATIONS

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MODULE 6: Consolidated & Separate Financial Statements

Ind AS 27, 28, 110, 111, 112 | Control, Joint Control, Significant Influence | 20% Weightage

20%

EXAM WEIGHTAGE

5

IND AS COVERED

20+

FULL ILLUSTRATIONS

50+

FORMULAS &
FRAMEWORKS

★ EXAM IMPORTANT

Module 6 carries **20% weightage** in Paper 18. Expect **2–3 full questions (15 marks each)** plus short notes and objective questions. Master the concepts of Control, Joint Control, Significant Influence, Consolidation Procedure, NCI, Goodwill, and Equity Method.

Table of Contents – Module 6

- 1 Introduction to Consolidation
- 2 Concept of Significant Influence, Joint Control & Control
- 3 Consolidation Procedure for Associates, JVs & Subsidiaries
- 4 Measurement of Fair Value, NCI, Goodwill & Consolidated Other Equity
- 5 Accounting at Acquisition Date – Introductory Examples
- 6 Accounting at Subsequent Reporting Date – Introductory Examples
- 7 Advanced Level Discussion (Chain Holding, Cross Holding, Inter-company)
- 8 Accounting and Reporting of Joint Operation

9 Disclosures (Ind AS 112)

10 Full ICMAI Illustrations with Step-by-Step Solutions

★ Module Summary & Mega Revision

Syllabus Coverage Matrix

TOPIC	SUB-TOPICS	WEIGHTAGE	PRIORITY
Introduction	Group, Parent, Subsidiary, Ind AS 110, 27	3–4%	★★★★★
Control Concepts	Significant Influence, Joint Control, Control	4–5%	★★★★★
Consolidation Procedure	Associates, JVs, Subsidiaries	4–5%	★★★★★
Measurement	Fair Value, NCI, Goodwill, Consolidated Other Equity	4–5%	★★★★★
Acquisition Date	Separate & Consolidated FS at acquisition	3–4%	★★★★★
Subsequent Date	Separate & Consolidated FS at subsequent date	3–4%	★★★★★
Advanced Level	Chain Holding, Cross Holding, Inter-company	3–4%	★★★★★
Joint Operation	Accounting and Reporting	2–3%	★★★★★
Disclosures	Ind AS 112 Requirements	1–2%	★★★★★

Practical Problems (15 Marks)

- Prepare Consolidated Balance Sheet at acquisition date
- Prepare Consolidated Balance Sheet at subsequent reporting date
- Compute NCI at fair value and proportionate net asset value
- Compute Goodwill / Gain on Bargain Purchase
- Prepare Consolidated Other Equity
- Equity Method for Associates and Joint Ventures
- Chain Holding: Parent → Subsidiary → Sub-subsidiary
- Inter-company adjustments (inventory, receivables, payables)
- Dividend treatment in consolidated accounts
- Step acquisition / Loss of control

Short Notes / Theory (5 Marks)

- Define Group, Parent, Subsidiary, Associate, Joint Venture
- Significant Influence: Concept and Indicators
- Joint Control and Joint Arrangements
- Control: Power, Exposure to Variable Returns, Ability to Affect Returns
- Equity Method of Accounting
- Separate Financial Statements (Ind AS 27)
- Consolidation Procedure (Ind AS 110)
- Non-Controlling Interest (NCI)
- Goodwill and Gain on Bargain Purchase
- Joint Operation vs Joint Venture
- Disclosure requirements under Ind AS 112



Frequently Tested Concepts

- Control assessment (power + variable returns + ability to affect)
- Significant influence (20% or more voting power)
- Joint control (unanimous consent)
- Consolidation procedure (combining assets/liabilities)
- NCI computation at fair value vs proportionate
- Goodwill computation at acquisition
- Consolidated Other Equity computation
- Equity Method for Associates/JVs
- Chain Holding (Group share computation)
- Inter-company elimination adjustments
- Dividend treatment in consolidation
- Disclosures under Ind AS 112

Introduction to Consolidation

1. Chapter Overview

A group consists of a parent and its subsidiaries. A parent is an entity that controls one or more entities. A subsidiary is an entity that is controlled by another entity. Purchase of equity shares is the most common way by which an investor company (parent) acquires control in the investee company (called subsidiary). Accounting for consolidated financial statements (as per Ind AS 110) is made at the reporting date by combining assets and liabilities of parent and subsidiaries, measuring non-controlling interest [Ind AS 110] and recognizing goodwill [Ind AS 103].

2. Learning Objectives

- Understand the concept of a group, parent, and subsidiary.
- Distinguish between Consolidated Financial Statements and Separate Financial Statements.
- Understand the applicability of Ind AS 27, 28, 110, 111, and 112.
- Know when consolidation is required and when it is exempted.

3. Important Definitions

DEFINITION

Group: A parent and its subsidiaries.

DEFINITION

Parent: An entity that controls one or more entities.

DEFINITION

Subsidiary: An entity that is controlled by another entity.

DEFINITION

Consolidated Financial Statements: The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

DEFINITION

Separate Financial Statements: Those presented by a parent (i.e., an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or at a value based on Ind AS 109.

DEFINITION

Associate: An entity over which the investor has significant influence.

DEFINITION

Joint Venture: A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

4. Applicable Ind AS

IND AS	TITLE	APPLICABILITY
Ind AS 110	Consolidated Financial Statements	Parent with Subsidiaries
Ind AS 27	Separate Financial Statements	Parent/Investor preparing separate FS
Ind AS 28	Investments in Associates and Joint Ventures	Investor with Significant Influence or Joint Control
Ind AS 111	Joint Arrangements	Parties to Joint Arrangement
Ind AS 112	Disclosure of Interests in Other Entities	Entities with interests in subsidiaries, associates, JVs

5. When Consolidation is Required

Consolidated financial statements are required to be prepared by an Ind AS complied company if it holds shares in the investee company:

- Entailing 20% or more voting rights having significant influence over the investee company (called Associate as per Ind AS 28).
- Entailing joint control over the investee company (called a Joint Venture as per Ind AS 28).
- Entailing control over investee company (called subsidiary company as per Ind AS 110).

No consolidation is required otherwise (i.e., for holding shares in investee not falling under above three clauses) and the investor company prepares only individual/standalone financial statements.

6. Exemptions from Consolidation

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

- (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- (ii) its debt or equity instruments are not traded in a public market;
- (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
- (iv) its ultimate or any intermediate parent produces consolidated financial statements that are available for public use and comply with Ind ASs.

7. Investment Entity

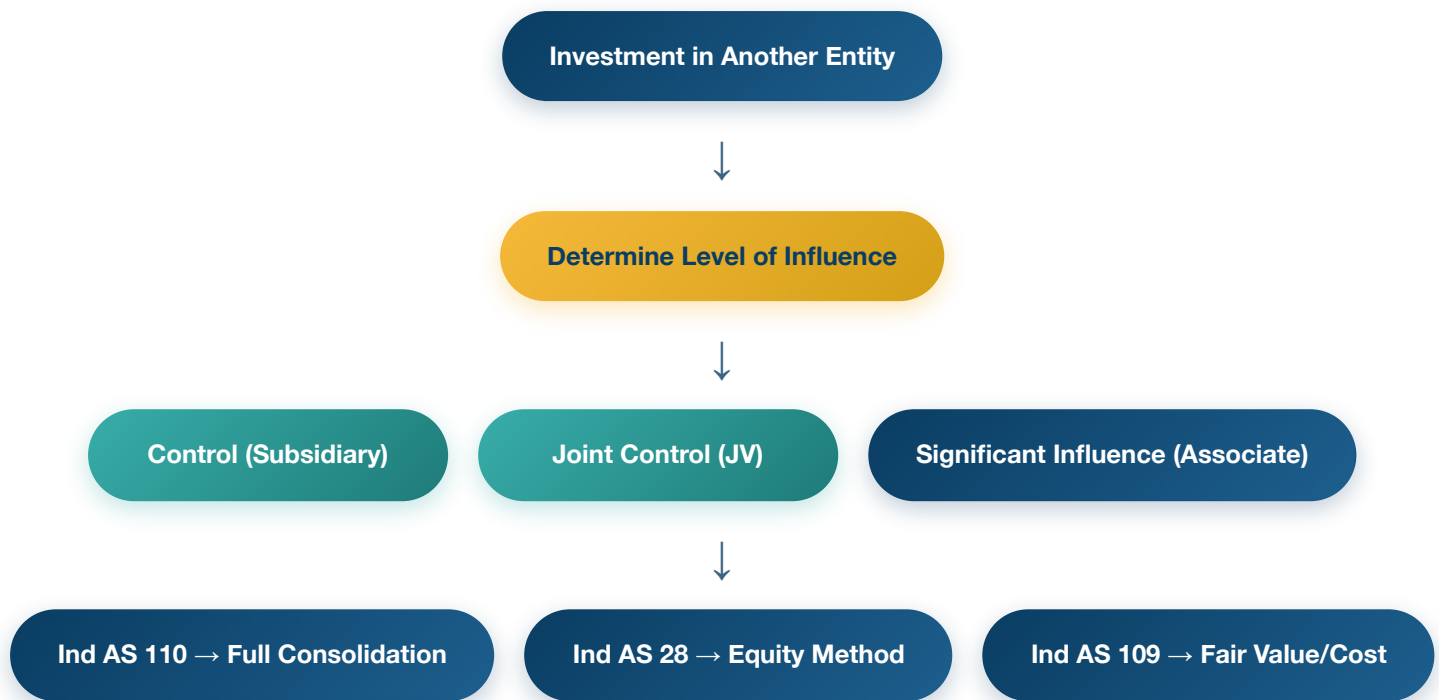
DEFINITION

Investment Entity: An entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity shall not consolidate its subsidiaries or apply Ind AS 103 when it obtains control of another entity. Instead, it shall measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

8. Flowchart Summary



9. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Introduction to Consolidation in 60 seconds:

- Group = Parent + Subsidiaries
- Parent = Controls one or more entities
- Subsidiary = Controlled by another entity
- Consolidated FS = Parent + Subsidiaries as single economic entity
- Separate FS = At cost or Ind AS 109
- Ind AS 110 → Consolidation (Control)
- Ind AS 28 → Equity Method (Significant Influence / Joint Control)
- Ind AS 27 → Separate FS
- **Mnemonic: PSC** → Parent, Subsidiary, Consolidation

Concept of Significant Influence, Joint Control & Control

1. Chapter Overview

Ind AS 110 defines control as the basis for consolidation. Ind AS 28 defines significant influence and joint control. Understanding these concepts is essential for determining the appropriate accounting treatment for investments in other entities.

2. Control (Ind AS 110)

DEFINITION

Control: An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

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

- (a) **Power** over the investee;
- (b) **Exposure, or rights, to variable returns** from its involvement with the investee; and
- (c) **The ability to use its power** over the investee to affect the amount of the investor's returns.

2.1 Power

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e., the activities that significantly affect the investee's returns. Power arises from rights. Sometimes, power can be assessed straightforward from the voting rights through shareholdings. In other cases, the assessment will be more complex when power results from one or more contractual arrangements.

2.2 Control Assessment Cases

ICAI ILLUSTRATION

ICAI Case 1 – Dominant Voting Interest

Question: An investor acquires 45 per cent of the voting rights of an investee. The remaining voting rights are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. Has investor power over the investee?

SOLUTION

In this case, on the basis of the absolute size of its holding and the relative size and arrangements of the other shareholdings, it appears that the investor has a **sufficiently dominant voting interest** to conclude that the investor has power over the investee.

ICAI ILLUSTRATION

ICAI Case 2 – 40% with 12 Other Investors at 5% Each

Question: Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights of the investee. Has A power over the investee?

SOLUTION

In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are **not conclusive** in determining whether the investor has rights sufficient to give it power. Additional evidence is needed. If it is not clear that the investor has power, the investor **does not control** the investee.

ICMAI Case 3 – 40% with Contractual Right to Appoint Management

Question: Investor A holds 40 per cent of the voting rights of an investee and twelve other investors each hold 5 per cent of the voting rights. A shareholder agreement grants investor A the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. To change the agreement, a two-thirds majority vote of the shareholders is required. Has A power over the investee?

SOLUTION

In this case, investor A concludes that the absolute size of the investor's holding and the relative size of the other shareholdings alone are not conclusive. However, investor A determines that its **contractual right to appoint, remove and set the remuneration of management** is sufficient to conclude that it has power over the investee.

ICMAI Case 4 – 45% with Two Other Investors at 26% Each

Question: Investor A holds 45 per cent of the voting rights of an investee. Two other investors each hold 26 per cent of the voting rights. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. Has A power over the investee?

SOLUTION

In this case, the size of investor A's voting interest and its size relative to the other shareholdings are **not sufficient** to conclude that investor A has power. Only two other investors would need to co-operate to be able to prevent investor A from directing the relevant activities of the investee.

3. Significant Influence (Ind AS 28)

DEFINITION

Significant Influence: The power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

- If an entity holds, directly or indirectly, 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence.
- Conversely, if the entity holds less than 20 per cent of the voting power, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated.

4. Joint Control (Ind AS 111 & 28)

DEFINITION

Joint Control: The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

DEFINITION

Joint Arrangement: An arrangement of which two or more parties have joint control.

JOINT ARRANGEMENT

Joint Operation

Joint Venture

Rights to Assets, Obligations for Liabilities

Rights to Net Assets

5. Concept Mapping

Control

- Power over investee
- Exposure to variable returns
- Ability to affect returns
- → Consolidation (Ind AS 110)

Joint Control

- Contractually agreed sharing of control
- Unanimous consent required
- → Joint Operation or Joint Venture
- → Equity Method (Ind AS 28)

Significant Influence

- Power to participate in financial/operating policies
- Not control or joint control

- 20% or more voting power presumption
- → Equity Method (Ind AS 28)

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Control Concepts in 90 seconds:

- Control = Power + Variable Returns + Ability to Affect
- Power = Existing rights to direct relevant activities
- Significant Influence = Power to participate in policies (20%+ presumption)
- Joint Control = Contractually agreed sharing; unanimous consent
- Joint Operation = Rights to assets, obligations for liabilities
- Joint Venture = Rights to net assets
- **Mnemonic: CSP** → Control, Significant Influence, Power

Consolidation Procedure for Associates, JVs & Subsidiaries

1. Chapter Overview

Consolidated financial statements are required to be prepared as per Ind AS 28 under Equity Method when investor company has significant influence or joint control over the investee company (associate or joint venture). When investor company has control over the investee company (subsidiary), consolidated financial statements are required to be prepared as per Ind AS 110.

2. Equity Method (Ind AS 28)

Under Equity Method of consolidation:

- No assets or liabilities of the investee are recognised.
- Investment account is recognised at cost plus share of investor in post-acquisition profits (both profit or loss and other comprehensive income) in the investee.
- The investor's profit or loss includes its share of the investee's profit or loss.
- The investor's other comprehensive income includes its share of the investee's other comprehensive income.

3. Full Consolidation (Ind AS 110)

When investor company has control over the investee company (subsidiary), consolidated financial statements are required to be prepared on the reporting date as per Ind AS 110:

- By combining the book value of assets and liabilities of parent with the fair value of assets and liabilities of the subsidiary plus post-acquisition changes in their book value.
- By recognising non-controlling interest at acquisition date value plus post-acquisition share in total comprehensive income of the subsidiary.
- By recognising goodwill or gains from bargain purchase at acquisition date as per Ind AS 103.
- By recognising parent's share in post-acquisition profits of the subsidiary company in the consolidated Other Equity.
- No investment account is recognised for holding shares in the subsidiary.

4. Consolidation Procedure Comparison

ASPECT	SUBSIDIARY (IND AS 110)	ASSOCIATE/JV (IND AS 28)
Method	Full Consolidation (Line-by-line)	Equity Method
Assets/Liabilities	Combined at Fair Value + Post-acquisition changes	Not recognised
Investment Account	Not recognised (eliminated)	Recognised at cost + share of post-acquisition profits
NCI	Recognised separately	Not applicable
Goodwill	Recognised at acquisition date	Included in investment cost
Other Equity	Parent's share of post-acquisition profits added	Investor's share of post-acquisition profits added

5. Illustration – Investment in Associate

ICAI ILLUSTRATION

ICMAI Illustration 1 – Investment in Associate (20% Shares)

Question: Company P Ltd. (a listed company) acquires 20% shares (entitling 20% voting power and significant influence) in company Q Ltd. on 1.4.2020 at a cost of ₹46,000, paid by cash. During the financial year 2020-2021, Q made profits of ₹20,000 and other comprehensive income of ₹10,000.

- (a) Whether for the investment in shares of Q, P requires preparation of consolidated financial statements and separate financial statements?
- (b) Pass the journal entries in books of P at the time of acquisition.
- (c) Show the relevant accounting treatment at the end of the year in (i) consolidated and (ii) separate financial statements of P.

COMPLETE SOLUTION

(a) Requirement of Consolidated and Separate Financial Statements

P Ltd. requires preparation of consolidated financial statements because it has investment in Associate Q Ltd. Ind AS 28 requires that accounting for investment in associate and in joint venture should be made under equity method in the consolidated financial statement. Q is an Associate because P has significant influence in Q by virtue of its 20% voting power through holding of 20% shares in Q. Ind AS 28 also requires P the investor company to prepare separate financial statement as per Ind AS 27.

(b) Journal Entry at Acquisition (Both Consolidated and Separate Set)

PARTICULARS	DR. (₹)	CR. (₹)
Investment A/c Dr.	46,000	
To, Cash A/c		46,000

(c) Accounting Treatment at Year End

(i) Consolidated Accounts (Equity Method):

Change in investee's net assets = ₹20,000 + ₹10,000 = ₹30,000

Share of P = 20% of ₹30,000 = ₹6,000

Investor's Profit or loss includes 20% of ₹20,000 = ₹4,000

Other comprehensive income includes 20% of ₹10,000 = ₹2,000

PARTICULARS	DR. (₹)	CR. (₹)
Investment A/c Dr.	6,000	
To, Profit and Loss A/c		4,000
To, Other Comprehensive Income A/c		2,000

(ii) Separate Financial Statements:

Investment is valued at cost at ₹46,000 or at a value as per Ind AS 109.

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Consolidation Procedure in 60 seconds:

- Subsidiary → Full Consolidation (Ind AS 110)
- Associate/JV → Equity Method (Ind AS 28)
- Equity Method: Investment at cost + share of post-acquisition profits
- Full Consolidation: Combine assets/liabilities; recognise NCI + Goodwill
- No investment account in full consolidation
- **Mnemonic: FCE** → Full Consolidation, Equity Method

CHAPTER 4

Measurement of Fair Value, NCI, Goodwill & Consolidated Other Equity

1. Chapter Overview

This chapter covers the measurement principles for consolidated financial statements including fair value of net assets, non-controlling interest (NCI), goodwill/gain on bargain purchase, and consolidated other equity. It also covers the measurement of investments under the equity method.

2. Key Formulae

FORMULA

Goodwill = Consideration + NCI + Fair Value of Previously Held Interest – Fair Value of Net Identifiable Assets

FORMULA

Gain on Bargain Purchase = Fair Value of Net Identifiable Assets – (Consideration + NCI + FV of Previously Held Interest)

FORMULA

NCI at Fair Value = Consideration × (NCI Share / Parent Share)

FORMULA

NCI at Proportionate Net Asset Value = NCI % × Fair Value of Net Identifiable Assets

FORMULA

Consolidated Other Equity = Parent's Other Equity + Parent's Share of Post-acquisition Profits of Subsidiary

FORMULA

NCI at Reporting Date = NCI at Acquisition + NCI Share of Post-acquisition TCI – Dividend Payable to NCI

FORMULA

Equity Method Investment = Cost + Share of Post-acquisition Profits (P&L and OCI)

3. Measurement at Acquisition Date

At the acquisition date, the acquirer recognises and measures:

- (a) Identifiable assets acquired and liabilities assumed at their fair values;
- (b) Non-controlling interest at either fair value or proportionate share of identifiable net assets;
- (c) Goodwill or gain on bargain purchase.

4. Measurement at Subsequent Reporting Date

For consolidation at subsequent reporting date:

- Post-acquisition changes in assets and liabilities of the subsidiary are considered.
- No change is made to Goodwill/Gain on Bargain Purchase.
- NCI at reporting date = NCI at acquisition + share of NCI in post-acquisition total comprehensive income.
- Parent's share in post-acquisition profits is added to Consolidated Other Equity.

5. Treatment of Current Items

NOTE

For current items (inventory, receivables, payables), the revaluation profit or loss on the acquisition date (difference between fair value and book value) is reverted through post-acquisition retained earnings, and thus the book values of parent and subsidiaries are combined for consolidation.

Example: Unsold stocks of S on acquisition date had carrying amount ₹1,000 and Fair Value ₹1,200. After one year, on the reporting date, stock is fully sold at ₹1,300. S's post-acquisition profits amounting to ₹300 (₹1,300 – ₹1,000) should be reduced by ₹200 for consolidation as this ₹200 has already been considered as revaluation profit at the time of acquisition.

6. Dividend Treatment

- When dividend is declared by the subsidiary company, it appears as a deduction from Profit and Loss of subsidiary and as a current liability in subsidiary's balance sheet.
- In the books of the parent company, the dividend receivable is shown as current asset and credited to Profit and Loss (if from post-acquisition profit) or Investment A/c (if from pre-acquisition profits).
- If pre-acquisition dividend is wrongly credited to parent's Profit and Loss, both Investment A/c and parent's Profit and Loss are reduced by the share of parent in pre-acquisition dividend.
- Goodwill is not adjusted for any declaration of dividend by the subsidiary.

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Measurement in Consolidation in 90 seconds:

- $\text{Goodwill} = \text{Consideration} + \text{NCI} + \text{FV of PHI} - \text{Net Assets}$
- $\text{NCI at Fair Value} = \text{Consideration} \times (\text{NCI Share} / \text{Parent Share})$
- $\text{NCI at Proportionate} = \text{NCI \%} \times \text{Net Assets}$
- $\text{Consolidated Other Equity} = \text{Parent's OE} + \text{Parent's Share of Post-acq. Profits}$
- $\text{NCI at Reporting Date} = \text{NCI at Acquisition} + \text{NCI Share of Post-acq. TCI}$
- Current items: Revaluation profit/loss reverted to retained earnings
- Goodwill not adjusted for dividend
- **Mnemonic: GNC** → Goodwill, NCI, Consolidated Other Equity

Accounting at Acquisition Date – Introductory Examples

1. Chapter Overview

This chapter provides introductory examples of accounting in Consolidated Financial Statements and Separate Financial Statements at the acquisition date. It covers investment in associates, subsidiaries, and NCI measurement.

2. Full ICMAl Illustration – Company P Ltd. and Q Ltd.

ICMAl ILLUSTRATION

ICMAI Illustration 3 – P Ltd. Acquires 60% of Q Ltd.

Question: Company P Ltd. (a listed company) acquires 60% shares in company Q Ltd. on 01.04.17 at a cost of (₹ in Lakhs) 138, paid by issue of shares of ₹10 at par. The abstract of balance sheets of Q (along with fair values at the acquisition date) and P at the beginning and at the end of the year are as follows:

PARTICULARS	Q LTD. 1-4-2021 BOOK VALUE	Q LTD. 1-4-2021 FAIR VALUE	Q LTD. 31-3-2022 BOOK VALUE	P LTD. 1-4-2021	P LTD. 31-3-2022
PPE	175	200	190	276	300
Investment in Q				138	138
Other Non-current Financial Assets	80	60	70	100	120
Inventories	45	48	50	68	80
Total Assets	300	310	582	638	
Equity Share Capital	130		130	338	338
Other Equity	80		90	120	150
Borrowings	60		60	64	80
Trade Payables	30		28	26	44

COMPLETE SOLUTION

Step 1: Analysis of Net Assets of Q Ltd. at Fair Value

ITEMS	ON 1.4.21 BOOK VALUE	ON 1.4.21 FAIR VALUE	PROFIT FOR REVERSAL OF CHANGE IN CURRENT ITEMS	CHANGE IN BOOK VALUE POST ACQUISITION
PPE	175	200	–	190–175 = 15
Inventories	45	48	–3	50–45 = 5
Non-current Financial Assets	80	60	–	70–80 = –10
Borrowings	60	60	–	64–60 = 4
Trade Payables	30	28	–2	–
Net Assets at Fair Value		220		

Step 2: NCI at Acquisition

Fair Value of Consideration transferred = ₹138

NCI recognized at Fair Value = $40\% \times ₹138 / 60\% = ₹92$

Step 3: Goodwill

Goodwill = Consideration + NCI – Fair Value of Identifiable Net Assets
= ₹138 + ₹92 – ₹220 = **₹10 Lakhs**

Step 4: Balance Sheet Data of Q Ltd. (Adjusted)

PARTICULARS	1.4.2021 FAIR VALUE	REVERSAL OF CHANGE IN CURRENT ITEMS	CHANGE IN BK VALUE CARRIED TO SUBSEQUENT B/S	ADJUSTED B/S ON 31.3.18
PPE	200	–	+15	215
Inventories	48	–3	5	50
Financial Assets	60	–	–10	50
Borrowings	60	–	4	64
Trade Payables	(28)	–2	–	(30)

Step 5: NCI at Reporting Date

NCI at acquisition = ₹92

Share of NCI in post-acquisition TCI = $40\% \times 5 = ₹2$

Total NCI at year end = ₹94

Step 6: Other Equity of P Ltd.

Other Equity of P at end of year = ₹150

Share of post-acquisition TCI of Q = $60\% \times 5 = ₹3$

Consolidated Other Equity = ₹153

Abstract of Consolidated Balance Sheet of P Ltd. and its subsidiary Q Ltd. as at 31.3.22

PARTICULARS	WORKING	₹ LAKHS
PPE	300+215	515
Goodwill	10	10
Financial Assets	120+50	170
Inventories	80+50	130
Total Assets		825
Equity Share Capital		338
Other Equity	153	153
NCI	94	94
Borrowings	100+64	164
Trade Payables	50+26	76
Total Equity and Liabilities		825

3. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Acquisition Date in 60 seconds:

- Goodwill = Consideration + NCI – Net Assets
- NCI at Fair Value = Consideration × (NCI Share / Parent Share)
- Adjust subsidiary's book values for fair value differences
- Revert revaluation profit/loss on current items to retained earnings
- Consolidated Other Equity = Parent's OE + Parent's share of post-acq. profits
- NCI at Reporting = NCI at acquisition + NCI share of post-acq. TCI
- **Mnemonic: GNA** → Goodwill, NCI, Adjusted Net Assets

CHAPTER 6

Accounting at Subsequent Reporting Date – Introductory Examples

1. Chapter Overview

This chapter covers the preparation of Consolidated Financial Statements at subsequent reporting dates, including post-acquisition changes in assets and liabilities, NCI, and consolidated other equity.

2. Full ICMAl Illustration – P Ltd. and S Ltd.

ICMAl ILLUSTRATION

ICMAI Illustration 4 – P Ltd. Acquires 80% of S Ltd.

Question: Company P Ltd. (P) acquires 80% shares of company S Ltd. (S) on 1.10.2020 by issue of equity shares at total Fair Value of ₹440 Lakhs, total paid up value ₹100 Lakhs. Non-Controlling Interest (NCI) should be measured at proportionate Net Assets. The total comprehensive income of P and S in the year ending on 31.3.2021 amounted to ₹120 Lakhs and ₹140 Lakhs respectively. The extracts from balance sheets at book values and at fair values at the date of acquisition and at 31.03.2021 are stated below:

PARTICULARS	ON 1.10.2020 P	ON 1.10.2020 S	ON 1.10.2020 FV OF S	ON 31.3.2021 P	ON 31.3.2021 S
PPE	680	440	700	720	500
Investment in Shares of Q		440			
Current Assets	420	360	320	500	400
Total Assets	1,100	800		1,660	900
Current Liability	300	200	200	340	220
Noncurrent Liability	300	300	300	320	310
Total Liabilities	600	500		660	530
Net Assets at Fair Value			520		

Equity structure: P Ltd. Equity Share Capital: 01.04.2020: ₹200 Lakhs, 31.03.2021: ₹300 Lakhs; Other Equity: 01.04.2020: ₹240 Lakhs, 31.03.2021: ₹700 Lakhs. S Ltd. Equity Share Capital: 01.04.2020: ₹100 Lakhs, 31.03.2021: ₹100 Lakhs; Other Equity: 01.04.2020: ₹130 Lakhs, 31.03.2021: ₹270 Lakhs.

COMPLETE SOLUTION

Step 1: Analysis of Profits of S

PARTICULARS	PRE- ACQUISITION	POST- ACQUISITION
Other Equity on 01.04.2020	130	
Revaluation Profit/Loss (260-40)	220	
Profits during the year (140) – 50% pre, 50% post	70	70
Revaluation loss on Current Asset reverted		40
Other Equity on 01.10.2020	420	110
Share of P 80%		88
Share of NCI 20%		22

Step 2: Net Assets of S at Fair Value

Equity Share Capital = ₹100 Lakhs

Other Equity on 01.10.2020 = ₹420 Lakhs

Net Assets = ₹520 Lakhs

Step 3: NCI at Acquisition

NCI = 20% × ₹520 = **₹104 Lakhs**

Step 4: Goodwill

Goodwill = Consideration + NCI – Net Assets

= ₹440 + ₹104 – ₹520 = **₹24 Lakhs**

Consolidated Balance Sheet of P Ltd. and its subsidiary S Ltd. as on 01.10.2020

PARTICULARS	WORKINGS	₹ LAKHS
PPE	680 + 700	1,380
Goodwill	24	24
Current Assets	420 + 320	740
Total Assets		2,144
Equity Share Capital	200 + 100	300
Other Equity	240 + 60 + 340	640
NCI	104	104
Noncurrent Liability	300 + 300	600
Current Liability	300 + 200	500
Total Equity and Liabilities		2,144

Consolidated Balance Sheet of P Ltd. and its subsidiary S Ltd. as on 31.03.2021

PARTICULARS	WORKINGS	₹ LAKHS
PPE	720 + 500 + 260	1,480
Goodwill	24	24
Current Assets	500 + 400 – 40 + 40	900
Total Assets		2,404
Equity Share Capital	300	300
Other Equity	700 + 88	788
NCI	104 + 22	126
Noncurrent Liability	320 + 310	630
Current Liability	340 + 220	560
Total Equity and Liabilities		2,404

3. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Subsequent Date in 90 seconds:

- Adjust subsidiary's book values for fair value differences
- Revert revaluation profit/loss on current items to retained earnings
- $\text{NCI at Reporting} = \text{NCI at Acquisition} + \text{NCI Share of Post-acq. TCI}$
- $\text{Consolidated Other Equity} = \text{Parent's OE} + \text{Parent's Share of Post-acq. Profits}$
- Goodwill remains unchanged at acquisition date value
- **Mnemonic: NCO** → NCI, Consolidated Other Equity

CHAPTER 7

Advanced Level Discussion (Chain Holding, Cross Holding, Inter-company)

1. Chapter Overview

This chapter covers advanced consolidation topics including chain holding, cross holding, inter-company investments, and other relevant matters. These topics are frequently tested in the CMA Final examination.

2. Chain Holding

DEFINITION

Chain Holding: Refers to the transaction of business combination where a parent is acquiring control of its subsidiary (intermediate parent) which in turn is acquiring control of another company (sub-subsidiary).

In separate set of accounts of the Acquirer (parent), there will be no additional treatment for chain holding. But in the consolidated set of accounts of the Acquirer:

- Net assets of the subsidiary (which is intermediate parent also) and the net assets of the sub-subsidiary are recognised at fair value.
- Non-controlling interest of the subsidiary and the sub-subsidiary are recognised.

ICMAI Illustration 20 – Chain Holding

Question: Pass journal entries for business combination in the books of P Ltd. from the following particulars:

PARTICULARS	P (₹ LAKHS)	Q (₹ LAKHS)	R (₹ LAKHS)
PPE	400	500	320
Inventory	250	80	60
Trade Receivables	280	120	200
Bills Receivables	70	50	—
Cash and Bank	180	50	60
Equity Share Cap (₹10)	450	500	300
Other Equity	260	160	120
Trade Payables	300	300	200
Bills Payables	100	90	70

P Ltd. acquired 80% shares of Q Ltd. at a consideration of ₹480 and Q Ltd. acquired 75% shares of R Ltd. at a consideration of ₹300 on 01-04-2021. NCI is measured at fair value. Fair value as at acquisition: PPE: P=700, Q=600, R=400; Inventory: P=240, Q=80, R=60; Trade Receivables: P=250, Q=120, R=180; Bills Receivables: P=70, Q=50; Trade Payables: P=300, Q=300, R=170; Bills Payables: P=100, Q=90, R=70.

COMPLETE SOLUTION

Step 1: Share of Parent and NCI

Share of P in Q = 80%; NCI in Q = 20%

Share of Q in R = 75%

Share of Group in R = 80% × 75% = 60%

NCI in R = 40%

Step 2: Net Assets on Acquisition at Fair Value

PARTICULARS	Q (₹ LAKHS)	R (₹ LAKHS)	TOTAL (₹ LAKHS)
PPE	600	400	1,000
Inventory	80	60	140
Trade Receivables	120	180	300
Cash and Bank	50	60	110
Bills Receivables	70	50	120
Total Assets	920	750	1,670
Trade Payables	300	170	470
Bills Payables	90	70	160
Total Liabilities	390	240	630
Net Assets at fair value	530	510	1,040

Step 3: NCI at Fair Value

NCI of R = 300 × 40%/75% = ₹160 Lakhs

NCI of Q = 480 × 20%/80% = ₹120 Lakhs

Less: Included in NCI of R (20% of 300) = (₹60 Lakhs)

Total NCI = ₹220 Lakhs

Step 4: Goodwill / Bargain Purchase

Net Assets = ₹1,040 Lakhs

Consideration = ₹480 Lakhs (Q) + ₹240 Lakhs (80% of R's ₹300)

NCI = ₹220 Lakhs

Gain on Bargain Purchase = ₹1,040 – (₹480 + ₹240 + ₹220) = ₹340 Lakhs

PARTICULARS	DR. (₹ LAKHS)	CR. (₹ LAKHS)
PPE Dr.	1,000	
Inventory Dr.	140	
Trade Receivables Dr.	300	
Bills Receivables Dr.	120	
Cash and Bank Dr.	110	
To, Consideration		480
To, Trade Payables		470
To, Bills Payables		160
To, NCI		220
To, Capital Reserve (Gain on Bargain Purchase)		340

3. Inter-company Adjustments

- **Inter-company debts:** Fully set off.
- **Inter-company investments in equity:** Not permitted vide Section 19 of the Companies Act, 2013.
- **Unrealised profits in inventory:** Adjusted for unrealised profit on inter-company holding of inventory.

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Advanced Level in 60 seconds:

- Chain Holding: Group Share = Parent % × Subsidiary %
- NCI adjusted for cross-holdings
- Inter-company debts: Fully set off
- Unrealised profit in inventory: Eliminated
- No inter-company equity investment (Section 19)
- **Mnemonic: CHI** → Chain Holding, Inter-company

Accounting and Reporting of Joint Operation

1. Chapter Overview

Ind AS 111 establishes principles for financial reporting by entities that have an interest in arrangements that are controlled jointly (i.e., joint arrangements). A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

2. Key Concepts

DEFINITION

Joint Operation: A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators.

DEFINITION

Joint Venture: A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers.

3. Financial Statements of Parties to a Joint Operation

A joint operator shall recognise in relation to its interest in a joint operation:

- (a) its assets, including its share of any assets held jointly;
- (b) its liabilities, including its share of any liabilities incurred jointly;
- (c) its revenue from the sale of its share of the output arising from the joint operation;
- (d) its share of the revenue from the sale of the output by the joint operation; and
- (e) its expenses, including its share of any expenses incurred jointly.

4. Financial Statements of Parties to a Joint Venture

- A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with Ind AS 28.
- A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with Ind AS 109, unless it has significant influence over the joint venture.

5. Illustration – Joint Arrangement Classification

ICAI ILLUSTRATION

ICAI Illustration 14 – Joint Arrangement Classification

Question: Assume that two parties structure a joint arrangement in an incorporated entity. Each party has a 50 per cent ownership interest in the incorporated entity. The incorporation enables the separation of the entity from its owners and as a consequence the assets and liabilities held in the entity are the assets and liabilities of the incorporated entity. In such a case, what is the classification of the joint arrangement?

SOLUTION

The assessment of the rights and obligations conferred upon the parties by the legal form of the separate vehicle indicates that the parties have rights to the net assets of the arrangement and the joint arrangement is classified as **Joint Venture**.

However, if parties modify the features of the corporation through their contractual arrangement so that each has an interest in the assets of the incorporated entity and each is liable for the liabilities of the incorporated entity in a specified proportion, such contractual modifications to the features of a corporation can cause the joint arrangement to be a **Joint Operation**.

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Joint Operation in 60 seconds:

- Joint Operation: Rights to assets, obligations for liabilities
- Joint Venture: Rights to net assets
- Joint Operator: Recognise share of assets, liabilities, revenue, expenses
- Joint Venturer: Equity Method (Ind AS 28)
- No joint control: Ind AS 109 (unless significant influence)
- **Mnemonic: JOA** → Joint Operation, Assets, Liabilities

Disclosures (Ind AS 112)

1. Chapter Overview

Ind AS 112 requires an entity to disclose information that enables users of its financial statements to evaluate: (a) the nature of, and risks associated with, its interests in other entities; and (b) the effects of those interests on its financial position, financial performance and cash flows.

2. Key Disclosure Requirements

An entity shall disclose:

- (a) the significant judgements and assumptions it has made in determining:
 - (i) the nature of its interest in another entity or arrangement;
 - (ii) the type of joint arrangement in which it has an interest;
 - (iii) that it meets the definition of an investment entity, if applicable; and
- (b) information about its interests in:
 - (i) subsidiaries;
 - (ii) arrangements and associates; and
 - (iii) structured entities that are not controlled by the entity.

3. Examples of Significant Judgements and Assumptions

An entity shall disclose, for example, significant judgements and assumptions made in determining that:

- (a) it does not control another entity even though it holds more than half of the voting rights of the other entity.
- (b) it controls another entity even though it holds less than half of the voting rights of the other entity.
- (c) it is an agent or a principal.
- (d) it does not have significant influence even though it holds 20 per cent or more of the voting rights of another entity.
- (e) it has significant influence even though it holds less than 20 per cent of the voting rights of another entity.

4. Disclosures about Interests in Subsidiaries

An entity shall disclose information that enables users of its consolidated financial statements:

- (a) to understand:
 - (i) the composition of the group; and
 - (ii) the interest that non-controlling interests have in the group's activities and cash flows; and
- (b) to evaluate:
 - (i) the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;
 - (ii) the nature of, and changes in, the risks associated with its interests in consolidated structured entities;
 - (iii) the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control; and
 - (iv) the consequences of losing control of a subsidiary during the reporting period.

5. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Disclosures in 60 seconds:

- Ind AS 112: Nature of, and risks associated with, interests in other entities
- Disclose significant judgements and assumptions
- Disclose interests in subsidiaries, associates, JVs
- Disclose non-controlling interests
- Disclose significant restrictions
- Disclose risks associated with interests
- **Mnemonic: SIR** → Subsidiaries, Interests, Risks

Full ICMAI Illustrations with Step-by-Step Solutions

★ EXAM IMPORTANT

This chapter contains comprehensive illustrations from the ICMAI study material for Module 6. Practice each illustration thoroughly — they form the foundation for exam problems on consolidation.

ICMAI Illustration 5 – D Co. Ltd Acquires 60% of G Co. Ltd (Dividend Treatment)

Question: D Co. Ltd acquired 60% shares of G Co. Ltd. on 1st October 2020. The Retained Earnings balance of G on 01.04.2020 was ₹5,000. G declared dividend for 2020-2021 ₹6,000 (accounted in books of G but not accounted in books of D). The abstracts from balance sheets of D and G as at 31.03.2021 are:

PARTICULARS	D (₹)	G (₹)
PPE	60,000	30,000
Investments: Shares in G	24,000	
Current Assets	20,000	16,000
Total Assets	1,04,000	46,000
Equity Shares	50,000	25,000
Other Equity (Retained Earnings)	25,000	11,000
Current Liabilities	29,000	10,000
Total Equity and Liabilities	1,04,000	46,000

Required: Separate and Consolidated Balance Sheet as at 31.03.2021.

COMPLETE SOLUTION

Step 1: Share of Parent and NCI

Share of D = 60%; NCI = 40%

Step 2: Pre-acquisition Profits of G

PARTICULARS	PRE (₹)	POST (₹)
Retained Earnings on 01.04.2020	5,000	
Retained Earnings on 31.03.2021	11,000	
Add: Dividend declared	6,000	
Earnings before dividend	17,000	
Less: Opening balance	(5,000)	
Profits during the year	12,000	
Pre-acquisition (50%)	6,000	
Post-acquisition (50%)		6,000
Total	11,000	6,000

Step 3: FV of Net Assets Identified

Equity Shares = ₹25,000

Pre-acquisition Profits = ₹11,000

Net Assets = ₹36,000

Step 4: Goodwill

Purchase consideration = ₹24,000

NCI (FV) at acquisition $(40/60) \times ₹24,000 = ₹16,000$

Total = ₹40,000

Less: Net Assets identified = ₹36,000

Goodwill = ₹4,000

Step 5: NCI at Reporting Date

NCI at acquisition = ₹16,000

Add: Share of Post-acquisition profit $40\% \times ₹6,000 = ₹2,400$

Less: Dividends payable to NCI $40\% \times ₹6,000 = (₹2,400)$

NCI at reporting date = ₹16,000

Step 6: Consolidated Other Equity

Other equity of D = ₹25,000

Share of post-acquisition profit of G ($60\% \times ₹6,000$) = ₹3,600

Consolidated Other Equity = ₹28,600

Consolidated Balance Sheet as at 31.03.2021

PARTICULARS	SEPARATE (₹)	CONSOLIDATED (₹)
PPE	60,000	$60,000 + 30,000 = 90,000$
Investment ($24,000 - 1,800$)	22,200	—
Goodwill	—	4,000
Current Assets ($20,000 + 3,600$)	23,600	$20,000 + 16,000 = 36,000$
Total	1,05,800	1,30,000
Equity Share Capital	50,000	50,000
Consolidated Other Equity	26,800	28,600
NCI	—	16,000
Current Liabilities ($29,000 + 6,400$)	29,000	35,400
Total	1,05,800	1,30,000

ICMAI Illustration 6 – Multiple Investment Scenarios

Question: Company P Ltd. (a listed company) invests in shares of company Q Ltd. on 01.04.2020 at a cost of ₹66,000, paid by cash. During the financial year 2020-2021, Q made profits of ₹20,000 and other comprehensive income of ₹10,000. The following alternative scenarios are presented:

- I. Investment entails 25% voting power and significant influence over Q.
- II. P does have joint control of Q, a joint venture.
- III. Investment entails significant influence over Q, which is a Joint Venture and P does not have joint control of Q.
- IV. P does not have significant influence over Q.
- V. P does not have joint control of or significant influence over Q, which is a joint venture.

For each of the cases I, II, III, IV and V: (a) State whether P requires preparation of consolidated financial statements and separate financial statements. (b) Pass the journal entries in books of P at the time of purchase of shares. (c) Show the relevant accounting treatment at the end of the year for (i) consolidated financial statements, (ii) separate financial statements, and (iii) Individual financial statements of P.

COMPLETE SOLUTION

(a) Requirement of Consolidated and Separate Financial Statements

In cases I, II and III, P Ltd. requires preparation of consolidated financial statements for its investment in Q Ltd.

In case I, Q is an Associate because P has significant influence in Q by virtue of its 25% voting power. In case II, Q is a joint venture in which P has joint control. In case III, Q is a joint venture in which P does not have joint control, but has significant influence. For each of the above cases, Ind AS 28 requires that accounting for investment in associate or in joint venture (having joint control or significant influence) should be made under equity method in the consolidated financial statement. Ind AS 28 also requires P the investor company to prepare separate financial statement as per Ind AS 27. For cases IV and V, P requires preparation of Individual financial statements.

(b) Journal Entry on 01.04.2020 for cases I, II and III

PARTICULARS	DR. (₹)	CR. (₹)
Investment A/c Dr.	66,000	
To, Cash A/c		66,000

Journal Entry for cases IV and V: As per Ind AS 109 for Individual financial statements.

(c) Journal Entry on 31-03-2018 for cases I, II and III

(i) For Consolidated Accounts (Equity Method):

Change in investee's Net Assets = ₹20,000 + ₹10,000 = ₹30,000

Share of P = 25% of ₹30,000 = ₹7,500

Investor's Profit or loss includes 25% of ₹20,000 = ₹5,000

Other comprehensive income includes 25% of ₹10,000 = ₹2,500

PARTICULARS	DR. (₹)	CR. (₹)
Investment A/c Dr.	7,500	
To, Profit and Loss A/c		5,000
To, Other Comprehensive Income A/c		2,500

(ii) **Separate Financial Statements:** Investment is valued at cost at ₹66,000 or at a value as per Ind AS 109.

For cases IV and V: Investment shall be valued as per Ind AS 109 in Individual financial statements. There will be no consolidated and no separate financial statement.

ICMAI Illustration 7 – P Ltd. and S Ltd. (Fair Value Adjustments)

Question: The financial data of the companies P and S at 31.03.2020 and at 31.03.2021 are stated below. (₹ in Lakhs)

PARTICULARS	ON 31.03.2020 S (INDIVIDUAL B/S)	ON 31.03.2020 FAIR VALUE OF S	P (SEPARATE B/S)	S (INDIVIDUAL B/S)
PPE	480	700	750	500
Investment in S (60% shares acquired on 01.04.2020 by issue of Equity)			480	
CA	350	300	540	400
Total	830	1,000	1,770	900
Equity	300		1,070	360
Non-current Liability	300	310	360	330
Current Liability	230	200	340	210

Prepare Consolidated Balance Sheet.

COMPLETE SOLUTION

Step 1: Purchase Consideration = ₹480

Step 2: Fair Value of Net Identified Assets at Acquisition Date

PARTICULARS	FAIR VALUE OF S (₹)	REVALUATION PROFITS (LOSS) NON-CURRENT	REVALUATION PROFITS (LOSS) CURRENT
PPE	700	220	
CA	300		(50)
Noncurrent Liability	310	(10)	
Current Liability	200		30
Net Assets	490		

Step 3: Post-acquisition TCI of S

Equity on 31.03.2021 = ₹360

Less: Equity on 31.03.2020 = ₹300

TCI Post-Acquisition = ₹60

Add: Reversal of Revaluation loss on Current items = ₹20

Adjusted Post-acquisition TCI = ₹80

Share of Parent (60% × ₹80) = ₹48

Share of NCI (40% × ₹80) = ₹32

Step 4: NCI at Proportionate Net Assets at Acquisition Date

NCI = 40% × ₹490 = ₹196

Add: Share of NCI in post-acquisition TCI = ₹32

NCI at reporting date = ₹228

Step 5: Goodwill

Goodwill = Consideration + NCI at acquisition – Net Assets

= ₹480 + ₹196 – ₹490 = **₹186**

Step 6: Consolidated Equity

Equity of P = ₹1,070

Share of P in Post-acquisition TCI of S = ₹48

Consolidated Equity = ₹1,118

Consolidated Balance Sheet of P and S on 31.03.2021

PARTICULARS	BOOK VALUE	ADJUSTMENT ON NON- CURRENT ITEMS	CONSOLIDATED
PPE	750 + 500	+220	1,470
Goodwill	186		186
CA	540 + 400	[revaluation loss 50]	940
Total Assets			2,596
Equity			1,118
NCI			228
Noncurrent Liability	360 + 330	+10	700
Current Liability	340 + 210	[revaluation gain 30]	550
Total Equity and Liability			2,596

ICMAI Illustration 8 – Sky Ltd. Acquires 60% of Cloud Ltd.

Question: Company Sky Ltd. (a listed company) acquires 60% shares in company Cloud Ltd. on 01.04.2020 at a cost of ₹1,50,000, paid by issue of shares of ₹10 (Market Price ₹25). The abstract of balance sheets of Cloud (along with fair values at the acquisition date) and Sky at the end of the year 2019-2020 and 2020-2021 are as follows:

PARTICULARS	CLOUD 31.03.2020 BOOK VALUE	CLOUD 31.03.2020 FAIR VALUE	CLOUD 31.03.2021 BOOK VALUE	SKY 31.03.2020	SKY 31.03.2021
PPE	1,94,000	2,10,000	2,06,000	2,80,000	3,00,000
Investment in Q				1,50,000	
Inventories	45,000	54,000	58,000	74,000	80,000
Financial Assets	88,000	50,000	98,000	1,00,000	1,20,000
Total Assets	3,27,000	3,62,000	4,54,000	6,50,000	
Equity Share Capital	1,50,000		1,50,000	2,00,000	2,60,000
Other Equity	87,000		1,17,000	1,20,000	2,40,000
Borrowings	60,000	60,000	64,000	90,000	1,00,000
Trade Payables	30,000	25,000	31,000	44,000	50,000
Total	3,27,000	3,62,000	4,54,000	6,50,000	

COMPLETE SOLUTION

Step 1: Assets and Liabilities of Cloud Recognized at Fair Value

PARTICULARS	01.04.2020 FAIR VALUE (₹)
PPE	2,10,000
Inventories	54,000
Financial Assets	50,000
Total	3,14,000
Borrowings	60,000
Trade Payables	25,000
Total	85,000
Net Assets at Fair Value	2,29,000

Step 2: NCI at Fair Value

$$\text{NCI} = 40\% \times ₹1,50,000 / 60\% = ₹1,00,000$$

Step 3: Goodwill

$$\begin{aligned} \text{Goodwill} &= \text{Consideration} + \text{NCI} - \text{Fair Value of Net Assets} \\ &= ₹1,50,000 + ₹1,00,000 - ₹2,29,000 = ₹21,000 \end{aligned}$$

PARTICULARS	DR. (₹)	CR. (₹)
PPE A/c Dr.	2,10,000	
Inventories A/c Dr.	54,000	
Financial Assets A/c Dr.	50,000	
Goodwill A/c Dr.	21,000	
To, Consideration A/c		1,50,000
To, NCI A/c		1,00,000
To, Borrowings A/c		60,000
To, Trade Payables A/c		25,000
Consideration A/c Dr.	1,50,000	
To, Equity Share Capital A/c		60,000
To, Security Premium A/c		90,000

ICMAI Illustration 12 – Consolidated Balance Sheet of P, Q, R Group

Question: Prepare Consolidated Balance Sheet (CBS) of a group of P Ltd., Q Ltd. and R Ltd. for which the abstracts of Balance sheets on 31.03.2021 are given below. (₹ in Lakhs)

PARTICULARS	P	Q	R
PPE	400	500	320
Investment in Q (80%)	480		
Investment in R (75%)		300	
Inventory	250	80	60
Trade Receivables	280	120	200
Bills Receivables	70	50	
Cash and Bank	180	50	60
Total Assets	1,660	1,050	690
Equity Share Cap (₹10)	600	500	300
Other Equity	460	160	120
Trade Payables	500	250	200
Dividend Payable		50	
Bills Payables	100	90	70
Total	1,660	1,050	690

Control was acquired on 01.10.2020 when fair value of PPE was in excess of carrying amount by Q: 50 and R: 30. On 01.04.2020 the balances of Other Equity were Q: 100 and R: 50. NCI is measured at fair value. Inventory of Q included 16 purchased from R at cost plus 33.33%. Bills Receivables of R includes 30 from P and Bills Receivables of R includes 40 from Q.

COMPLETE SOLUTION

Step 1: Share of Parent and NCI

Share of P in Q = 80%

Share of Q in R = 75%

Share of Group in R = $80\% \times 75\% = 60\%$

NCI in R = 40%

Step 2: Analysis of Profits

PARTICULARS	P	Q	R
Other Equity at the yearend + dividend payable	460	210	120
Other Equity at the beginning		100	50
Profits during the year		110	70
Pre-acquisition upto 30.09.2020		55	35
Post-acquisition Profits		55	35
Share from Q = $80\% \times 55$	44		
Share from R = $60\% \times 35$	21		
Total	525		
Less: Unrealised Profits in inter-company Inventory = $16 \times 1/4$	(4)		
Other Equity	521		

Step 3: Net Assets on Acquisition

PARTICULARS	Q (₹)	R (₹)
Share Cap	500	300
Other Equity on 01.04.2020	100	50
Revaluation	50	30
Add Profits	55	35
Net Assets	705	415

Step 4: NCI on 01-10-2020

$$\text{NCI} - Q = 480 \times 20\%/80\% = ₹120$$

$$\text{NCI} - R = 300 \times 40\%/75\% = ₹160$$

Step 5: Goodwill / Bargain Purchase

PARTICULARS	Q (₹)	R (₹)	CONSOLIDATED (₹)
Net Assets (a)	705	415	
Consideration (b)	480	240*	
NCI on acquisition at fair value (c)	120	160	
Gain on Bargain Purchase a – (b + c)	105	15	
Net amount to Other Equity			120

$$* 80\% \times ₹300$$

Step 6: Consolidated Other Equity

$$= \text{Other Equity} + \text{Net Gains on Bargain Purchase}$$

$$= ₹521 + ₹120 = ₹641 \text{ Lakhs}$$

Step 7: NCI on 31.03.2021

PARTICULARS	Q (₹)	R (₹)
NCI on acquisition	120	160
Post acquisition profit: Q: $55 \times 20\%$; R: $35 \times 40\%$	11	14
Less: NCI share in investment in R = $20\% \times 300$	(60)	
Less: Dividend payable	(10)	
NCI on Reporting date	61	174

ASSETS	WORKINGS	₹
Non-Current: PPE	$400 + 500 + 320 + 50 + 30$	1,300
Current Assets: Inventory	$250 + 80 + 60 - 4$	386
Trade Receivables	$280 + 120 + 200$	600
Bills Receivables	$70 + 50 - 30 - 40$	50
Cash and Bank	$180 + 50 + 60$	290
Total Assets		2,626
Equity Share Cap		600
Other Equity		641
NCI of Q		61
NCI of R		174
Trade Payables	$500 + 250 + 200$	950
Dividend Payable		10
Bills Payables	$100 + 90 + 70 - 30 - 40$	190
Total		2,626

KEY TAKEAWAY

Key Takeaways from Module 6 Illustrations:

- $\text{Goodwill} = \text{Consideration} + \text{NCI} + \text{FV of PHI} - \text{Net Assets}$
- $\text{NCI at Fair Value} = \text{Consideration} \times (\text{NCI Share} / \text{Parent Share})$
- $\text{NCI at Proportionate} = \text{NCI \%} \times \text{Net Assets}$
- $\text{Consolidated Other Equity} = \text{Parent's OE} + \text{Parent's Share of Post-acq. Profits}$
- $\text{NCI at Reporting} = \text{NCI at Acquisition} + \text{NCI Share of Post-acq. TCI}$
- Chain Holding: $\text{Group Share} = \text{Parent \%} \times \text{Subsidiary \%}$
- Inter-company adjustments: Eliminate unrealised profits, set off debts
- Equity Method for Associates/JVs: $\text{Investment} + \text{Share of Post-acq. Profits}$
- Dividend treatment: Pre-acquisition dividend reduces Investment; Post-acquisition dividend is income

MODULE 6 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 6 covers Consolidated and Separate Financial Statements under Ind AS 27, 28, 110, 111, and 112. This module carries **20% weightage** in Paper 18 — one of the highest. Master the concepts of Control, Joint Control, Significant Influence, Consolidation Procedure, NCI, Goodwill, Equity Method, and Chain Holding.

B. Mega Revision Sheet

IND AS	CORE PRINCIPLE	KEY TREATMENT
Ind AS 110	Consolidated Financial Statements	Full consolidation for subsidiaries (Control)
Ind AS 27	Separate Financial Statements	At cost or Ind AS 109
Ind AS 28	Investments in Associates and JVs	Equity Method for significant influence / joint control
Ind AS 111	Joint Arrangements	Joint Operation vs Joint Venture
Ind AS 112	Disclosure of Interests in Other Entities	Significant judgements, risks, NCI

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA
Goodwill	Consideration + NCI + FV of PHI – Net Assets
Gain on Bargain Purchase	Net Assets – (Consideration + NCI + FV of PHI)
NCI at Fair Value	Consideration $\times$ (NCI Share / Parent Share)
NCI at Proportionate	NCI % $\times$ Fair Value of Net Assets
Consolidated Other Equity	Parent's OE + Parent's Share of Post-acq. Profits
NCI at Reporting Date	NCI at Acquisition + NCI Share of Post-acq. TCI – Dividend Payable
Equity Method Investment	Cost + Share of Post-acq. Profits (P&L + OCI)
Chain Holding Group Share	Parent % $\times$ Subsidiary %
NCI in Chain Holding	100% – Group Share %

D. Top Exam Points – Quick Revision

- Group = Parent + Subsidiaries.
- Parent = Controls one or more entities.
- Subsidiary = Controlled by another entity.
- Consolidated FS = Parent + Subsidiaries as single economic entity.
- Separate FS = At cost or Ind AS 109.
- Ind AS 110 → Full Consolidation for Control.
- Ind AS 28 → Equity Method for Significant Influence / Joint Control.
- Ind AS 27 → Separate FS.
- Ind AS 111 → Joint Arrangements.
- Ind AS 112 → Disclosures.
- Control = Power + Variable Returns + Ability to Affect.
- Power = Existing rights to direct relevant activities.
- Significant Influence = Power to participate in policies (20%+ presumption).
- Joint Control = Contractually agreed sharing; unanimous consent.
- Joint Operation = Rights to assets, obligations produces Ind AS FS.
- Control assessment: Dominant voting interest.
- Control assessment: Contractual rights.
- Control assessment: Relative size of holdings.
- NCI measurement: Fair value or proportionate net assets.
- NCI at fair value: Based on consideration paid for parent's share.
- NCI at proportionate: Based on net asset value.
- Post-acquisition TCI: Profit or loss + OCI.
- Current items: Revaluation profit/loss reverted to retained earnings.
- Non-current items: Revaluation profit/loss carried forward.
- Goodwill: Not amortised; tested for impairment annually.
- Goodwill: Not adjusted for dividend.
- Consolidated Other Equity: Parent's OE + Parent's share of post-acq. profits.
- NCI at Reporting: NCI at acquisition + NCI share of post-acq. TCI – Dividend payable.

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly for consolidation.
- State the method used (Full Consolidation vs Equity Method) explicitly.
- For practical problems, draw tables for computation.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: Goodwill, NCI, Consolidated Other Equity, Chain Holding.
- Practice at least 10 comprehensive problems covering all scenarios.
- Read the question carefully for pre-acquisition vs post-acquisition profits.
- For current items, always revert revaluation profit/loss to retained earnings.
- For non-current items, carry forward revaluation profit/loss.
- For chain holding, always compute group share first.
- For inter-company adjustments, always eliminate unrealised profits.
- For dividend treatment, always distinguish pre-acquisition and post-acquisition.

F. Frequently Repeated Concepts

- Consolidated Balance Sheet preparation at acquisition date — appears almost every attempt.
- NCI at fair value vs proportionate — very common.
- Goodwill computation — frequently tested.
- Consolidated Other Equity computation — regular.
- Chain Holding — increasingly important.
- Inter-company adjustments — common.
- Equity Method for Associates — comprehensive problem.
- Disclosure requirements under Ind AS 112 — common theory question.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ Group, Parent, Subsidiary definitions
- ☒ Consolidated vs Separate Financial Statements
- ☒ Ind AS 110, 27, 28, 111, 112
- ☒ Control: Power, Variable Returns, Ability to Affect
- ☒ Significant Influence (20% presumption)
- ☒ Joint Control (unanimous consent)
- ☒ Joint Operation vs Joint Venture
- ☒ Consolidation Procedure (Full Consolidation)
- ☒ Equity Method (Associates/JVs)
- ☒ Goodwill computation
- ☒ Gain on Bargain Purchase
- ☒ NCI at Fair Value
- ☒ NCI at Proportionate
- ☒ Consolidated Other Equity
- ☒ NCI at Reporting Date
- ☒ Measurement at Acquisition Date
- ☒ Measurement at Subsequent Date
- ☒ Chain Holding
- ☒ Inter-company adjustments
- ☒ Dividend treatment
- ☒ Joint Operation accounting
- ☒ Disclosures under Ind AS 112
- ☒ All ICMAI illustrations
- ☒ Common mistakes to avoid
- ☒ Examiner insights
- ☒ Memory tricks and mnemonics
- ☒ Formula sheet
- ☒ Top exam points
- ☒ Frequently repeated concepts
- ☒ Final revision checklist

H. Common Mistakes Students Make

⚠ WARNING

- Confusing pre-acquisition and post-acquisition profits.
- Incorrect NCI computation (fair value vs proportionate).
- Not reverting revaluation profit/loss on current items to retained earnings.
- Forgetting to eliminate unrealised profit in inter-company inventory.
- Not setting off inter-company debts.
- Incorrect chain holding group share computation.
- Not adjusting NCI for cross-holdings.
- Incorrect treatment of pre-acquisition dividend.
- Adjusting goodwill for dividend.
- Not computing consolidated other equity correctly.
- Incorrect NCI at reporting date.
- Not considering post-acquisition TCI in NCI.
- Not considering post-acquisition profits in Consolidated Other Equity.
- Using wrong accounting policy for consolidation.
- Not eliminating intra-group transactions.

I. Memory Tricks and Mnemonics

🔑 KEY TAKEAWAY

Introduction: PSC → Parent, Subsidiary, Consolidation

Control: CSP → Control, Significant Influence, Power

Consolidation: FCE → Full Consolidation, Equity Method

Measurement: GNC → Goodwill, NCI, Consolidated Other Equity

Advanced: CHI → Chain Holding, Inter-company

Joint Operation: JOA → Joint Operation, Assets, Liabilities

Disclosures: SIR → Subsidiaries, Interests, Risks

Goodwill: GNC → Goodwill = Consideration + NCI – Net Assets

1 DAY BEFORE EXAM

Module 6 – Printable Quick Notes:

1. Group = Parent + Subsidiaries; Parent controls; Subsidiary controlled
2. Ind AS 110 → Full Consolidation (Control); Ind AS 28 → Equity Method (Significant Influence/Joint Control)
3. Control = Power + Variable Returns + Ability to Affect
4. Significant Influence = 20%+ presumption; Joint Control = Unanimous consent
5. Goodwill = Consideration + NCI + FV of PHI – Net Assets
6. NCI at Fair Value = Consideration $\times$ (NCI Share / Parent Share)
7. NCI at Proportionate = NCI % $\times$ Net Assets
8. Consolidated Other Equity = Parent's OE + Parent's Share of Post-acq. Profits
9. NCI at Reporting = NCI at Acquisition + NCI Share of Post-acq. TCI
10. Chain Holding: Group Share = Parent % $\times$ Subsidiary %
11. Inter-company adjustments: Eliminate unrealised profits, set off debts
12. Dividend: Pre-acquisition → Reduce Investment; Post-acquisition → Income
13. Joint Operation: Recognise share of assets, liabilities, revenue, expenses
14. Joint Venture: Equity Method (Ind AS 28)
15. Disclosures: Significant judgements, risks, NCI (Ind AS 112)

KEY TAKEAWAY

END OF MODULE 6 – CONSOLIDATED & SEPARATE FINANCIAL STATEMENTS

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MODULE 7: Recent Developments in Financial Reporting

4P Bottom Line | Sustainability | BRSR | Integrated Reporting | CSR | ESG | HR Reporting | Value Added | EVA & MVA | XBRL | Earnings Call

10%

EXAM WEIGHTAGE

11

SUB-TOPICS

10+

FULL ILLUSTRATIONS

40+

FORMULAS &
FRAMEWORKS

★ EXAM IMPORTANT

Module 7 carries **10% weightage** in Paper 18. Expect **1 full question (15 marks)** plus short notes and objective questions. This module is highly scoring with mostly theory and formula-based problems. Master Value Added Statement, EVA, MVA, and Integrated Reporting.

Table of Contents – Module 7

- 1 4P Bottom Line Reporting
- 2 Sustainability Reporting and GRI
- 3 Business Responsibility and Sustainability Report (BRSR)
- 4 Integrated Reporting
- 5 Corporate Social Responsibility Reporting in India
- 6 Environmental, Social and Governance (ESG)
- 7 Human Resource Reporting

8 Value Added Statement

9 Economic Value Added and Market Value Added

10 Reporting through XBRL

11 Quarterly Earnings Call Management

★ Module Summary & Mega Revision

Syllabus Coverage Matrix

TOPIC	SUB-TOPICS	WEIGHTAGE	PRIORITY
4P Bottom Line	Triple Bottom Line, Quadruple Bottom Line, Benefits	1–2%	★★★★★
Sustainability & GRI	Sustainability Reporting, GRI Framework, Materiality	1–2%	★★★★★
BRSR	SEBI BRR, Nine Principles, NVG, ESG Mapping	1–2%	★★★★★
Integrated Reporting	IIRC Framework, Six Capitals, Value Creation Process	2–3%	★★★★★★
CSR Reporting	Section 135, Schedule VII, CSR Rules, Accounting	1–2%	★★★★★★
ESG	Environmental, Social, Governance Criteria, Evolution in India	1–2%	★★★★★
HR Reporting	Types of HR Reports, Metrics	1–2%	★★★★★
Value Added Statement	Generation, Distribution, Format, Uses	2–3%	★★★★★★
EVA & MVA	Economic Value Added, Market Value Added, Computation	2–3%	★★★★★★
XBRL	Concepts, Taxonomy, Features, Benefits, Adoption	1–2%	★★★★★
Earnings Call	Structure, Importance, Frequency, Q&A	1–2%	★★★★★

Practical Problems (15 Marks)

- Prepare Value Added Statement from given financial data
- Compute Economic Value Added (EVA) and Market Value Added (MVA)
- Compute Value Added per employee, per rupee of capital, etc.
- Integrated Reporting: Value Creation Process with Six Capitals
- CSR Accounting: Journal Entries and Disclosure
- ESG Criteria Identification
- XBRL: Taxonomy and Tagging Concepts

Short Notes / Theory (5 Marks)

- Triple Bottom Line vs Quadruple Bottom Line
- Sustainability Reporting and GRI
- Business Responsibility and Sustainability Report (BRSR)
- Integrated Reporting: Objectives and Six Capitals
- Corporate Social Responsibility in India: Section 135, Schedule VII
- ESG Reporting: Criteria and Evolution in India
- Human Resource Reporting: Types and Metrics
- Value Added Statement: Format and Uses
- Economic Value Added vs Market Value Added
- XBRL: Features and Benefits
- Earnings Call Management: Structure and Importance

Frequently Tested Concepts

- 4P Bottom Line: Profit, People, Planet, Purpose
- Sustainability Reporting: Economic, Environmental, Social
- GRI: Materiality, Framework, Standards
- BRSR: Nine Principles of NVG
- Integrated Reporting: Six Capitals
- Value Creation Process: Inputs → Business Model → Outputs → Outcomes
- CSR: Applicability, Committee, Spending, Reporting
- ESG: Environmental, Social, Governance Criteria
- Value Added Statement: Generation + Distribution
- $EVA = NOPAT - (WACC \times Invested\ Capital)$
- $MVA = Market\ Value - Invested\ Capital$
- XBRL: Taxonomy, Tagging, Benefits
- Earnings Call: Safe Harbour, Presentation, Q&A

4P Bottom Line Reporting

1. Chapter Overview

4P Bottom Line or Quadruple Bottom Line (QBL) reporting is an extension of 3P Bottom Line or Triple Bottom Line (TBL) reporting. The phrase "triple bottom line" was first coined in 1994 by John Elkington, the founder of a British consultancy called 'Sustain Ability'. He further articulated the concept in his 1997 book 'Cannibals with Forks: The Triple Bottom Line of 21st Century Business'.

2. Learning Objectives

- Understand the concept of Triple Bottom Line and Quadruple Bottom Line.
- Identify the four dimensions of 4P Bottom Line.
- Understand the benefits of 4P Bottom Line Reporting.
- Know the key challenges in implementation.

3. Important Definitions

DEFINITION

Triple Bottom Line (TBL): A concept that incorporates three dimensions of performance: social, environmental, and economic/financial.

DEFINITION

Quadruple Bottom Line (QBL): A concept that requires an organisation to measure and report on four dimensions: social, environmental, economic/financial, and spiritual performance.

DEFINITION

Bottom Line: In traditional accounting, the "bottom line" refers to either the "operating result", which is usually recorded at the very last line of the income statement.

4. The 4P Bottom Line

4P BOTTOM LINE (QBL)

Profit (Economic)

People (Social)

Planet (Environmental)

Purpose (Spiritual)

The 4P Bottom Line consists of four dimensions:

1. **Profit (Economic):** The first bottom line is the bottom line of the "income statement" (traditional measure of operating result).
2. **People (Social):** The second bottom line is that of an organisation's "people account" (a measure of how socially responsible an organisation has been throughout its operations).
3. **Planet (Environmental):** The third bottom line is that of the organisation's "planet account" (which measures how environmentally responsible the company has been).
4. **Purpose (Spiritual):** The fourth bottom line lifts business activities to a sacred form. It relates business with happiness of stakeholders. That is when the question of why one is doing business becomes relevant.

5. Benefits of 4P Bottom Line Reporting

Reputation & Brand

- Enhancement of reputation and brand
- Protect and enhance corporate reputation
- Effective communication with stakeholders

Social License

- Securing a social license to operate
- Informal community and stakeholder support
- Open and honest communication

Employees

- Attraction and retention of high calibre employees
- Positioning as 'employer of choice'
- Enhance employee loyalty

Investors

- Improved access to investor market
- Socially responsible investment
- Shareholder activism

Suppliers

- Establish position as preferred supplier
- Differentiated position in market place
- Effectively communicating with stakeholders

Risk & Cost

- Reduced risk profile
- Identification of potential cost savings
- Increased scope for innovation

6. Key Challenges for Implementation

- Awareness of relevant issues associated with QBL reporting
- Understanding stakeholder requirements
- Aligning QBL reporting with objectives and risks
- Determining and measuring performance indicators

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

4P Bottom Line in 60 seconds:

- Triple Bottom Line: People, Planet, Profit
- Quadruple Bottom Line: Profit, People, Planet, Purpose
- 4P = Economic, Social, Environmental, Spiritual
- Benefits: Reputation, Social License, Employees, Investors, Suppliers, Risk, Cost
- Challenges: Awareness, Stakeholder requirements, Alignment, Performance indicators
- **Mnemonic: 4P** → Profit, People, Planet, Purpose

CHAPTER 2

Sustainability Reporting and Global Reporting Initiative (GRI)

1. Chapter Overview

In the modern era, sustainability has often been considered as a goal of every kind of organisation, be it business, non-profit organisation or government. Sustainability is a balancing act where business decisions take into account the impact they may have on the various aspects of sustainability including the economic viability of the business. The growth of this broader "world sustainability" viewpoint can be seen in the number of companies that have begun reporting on more than just financial operations.

2. Learning Objectives

- Understand the concept of sustainability and sustainable development.
- Identify the three pillars of sustainability.
- Understand the Global Reporting Initiative (GRI) framework.
- Know the benefits of sustainability reporting.

3. Important Definitions

DEFINITION

Sustainability Reporting: An organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development.

DEFINITION

Sustainable Development: Development that meets the needs of the present without compromising the ability of future generations to meet their own needs. (Brundtland 1987)

DEFINITION

Global Reporting Initiative (GRI): The best-known framework for voluntary reporting of environmental and social performance by business and other organizations worldwide. Guidance and standards of GRI are the most widely used framework of sustainability reporting.

4. Three Pillars of Sustainability

THREE PILLARS OF SUSTAINABILITY

People (Social)

Planet (Environmental)

Profit (Economic)

Social Sustainability

Environmental Sustainability

Economic Sustainability

- **Social Sustainability:** Activities focus on maintaining mutually beneficial relationships with employees, customers and the community. These activities often have benefits in terms of positive profile and customer and community support.
- **Environmental Sustainability:** Activities focus on the impact of resource usage, hazardous substances, waste and emissions on the physical environment. These activities may have a direct benefit for a business by reducing costs.
- **Economic Sustainability:** Activities focus on business efficiency, productivity and profit.

5. GRI Framework

As per GRI, "materiality" is a key principle for reporting. Materiality is achieved when a report covers topics which "can reasonably be considered important for reflecting the organization's economic, environmental, and social impacts, or influencing the decisions of stakeholders."

6. Benefits of Sustainability Reporting

Internal Benefits

- Increased understanding of risks and opportunities
- Enhanced link between financial and non-financial performance
- More focus on long term management strategy
- Streamlining processes, reducing costs
- Benchmarking and assessing sustainability performance

External Benefits

- Mitigating negative environmental, social and governance impacts
- Improving reputation and brand loyalty
- Enhanced perception on organisation's value
- Financial returns and competitiveness benefits

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Sustainability Reporting in 60 seconds:

- Sustainability = Balancing economic, social, environmental factors
- Three Pillars: People, Planet, Profit
- GRI = Global Reporting Initiative (most widely used framework)
- Materiality = Key principle for reporting
- Benefits: Internal (risks, costs, strategy) + External (reputation, brand, value)
- **Mnemonic: PPP** → People, Planet, Profit

Business Responsibility and Sustainability Report (BRSR)

1. Chapter Overview

In 2012, the Securities Exchange Board of India (SEBI) passed a circular amongst the top 100 companies based on market capitalisation, making it mandatory for firms to report their environmental, social and governance initiatives. This report, Business Responsibility Report (BRR), has to be filed as part of their annual reports based on nine principles of National Voluntary Guidelines (NVG). At the time of introduction, only the top-100 BSE-listed firms were required to present BRRs as part of annual reports. In 2016, after signing a memorandum of understanding (MoU) with Global Reporting Initiative, the mandate was extended to top-500 BSE listed companies.

2. Learning Objectives

- Understand the context and regulatory requirements of BRSR.
- Identify the nine principles of National Voluntary Guidelines (NVG).
- Understand the format of Business Responsibility Report.
- Know the alignment of BRSR with ESG pillars.

3. Nine Principles of NVG

1. **Principle 1:** Businesses should conduct and govern themselves with Ethics, Transparency and Accountability.
2. **Principle 2:** Businesses should provide goods and services that are safe and contribute to sustainability throughout their life cycle.
3. **Principle 3:** Businesses should promote the wellbeing of all employees.
4. **Principle 4:** Businesses should respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized.
5. **Principle 5:** Businesses should respect and promote human rights.
6. **Principle 6:** Businesses should respect, protect, and make efforts to restore the Environment.
7. **Principle 7:** Businesses, when engaged in influencing public and regulatory policy, should do so in a responsible manner.
8. **Principle 8:** Businesses should support inclusive growth and equitable development.
9. **Principle 9:** Businesses should engage with and provide value to their customers and consumers in a responsible manner.

4. BRSR Format (Five Sections)

- **Section A:** General information about the company
- **Section B:** Financial details of the company
 - Paid up Capital (INR)
 - Total Turnover (INR)
 - Total profit after taxes (INR)
 - Total Spending on Corporate Social Responsibility (CSR) as percentage of profit after tax (%)
 - List of activities in which expenditure in 4 above has been incurred
- **Section C:** Other details (subsidiaries, participation in BR initiatives)
- **Section D:** BR information (Director responsible, Principle-wise policies)
- **Section E:** Principle-wise performance (Nine Principles)

5. Alignment of BRSR KPIs with ESG Pillars

ENVIRONMENTAL	SOCIAL	GOVERNANCE
Energy and GHG Emissions	Employee Well-Being	Anti-corruption and anti-bribery policies
Solid Waste management	Health and Safety of Workers	Conflict Management Process
Water Consumption and Withdrawal	Trainings	Retention Policies
3R Practices	Human Rights	Remuneration Policies
Sustainable Sourcing	Social Impact Assessment	Stakeholder Engagement
Extended Producer Responsibility (EPR)	Gender Equality	
Life Cycle Assessments (LCA)	CSR Activities and details of beneficiaries	

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

BRSR in 90 seconds:

- SEBI introduced BRR in 2012 (top 100 companies)
- Extended to top 500 in 2016; top 1000 in 2019
- BRSR introduced in May 2021
- Nine Principles of NVG
- Five Sections: A (General), B (Financial), C (Other), D (BR Info), E (Performance)
- Aligned with ESG pillars
- **Mnemonic: NINE** → Nine Principles of NVG

Integrated Reporting

1. Chapter Overview

Corporate Reporting has come a long way over the years. The multiple corporate reporting frameworks including corporate environmental reporting, corporate social responsibility reporting have evolved to report various corporate efforts to meet stakeholders' expectation. In this context, Integrated Reporting is increasingly gaining popularity. The primary purpose of an integrated report is to explain to providers of financial capital how an organization creates, preserves or erodes value over time.

2. Learning Objectives

- Understand the concept and objectives of Integrated Reporting.
- Identify the Six Capitals in the IR Framework.
- Understand the Value Creation Process.
- Know the Guiding Principles of Integrated Reporting.

3. Important Definitions

DEFINITION

Integrated Report: A concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation, preservation or erosion of value over the short, medium and long term.

DEFINITION

Integrated Reporting: A process, founded on integrated thinking, which results in a periodic integrated report highlighting value creation.

DEFINITION

Capitals: Various resources (financial, manufactured, intellectual, human, social and relationship, and natural) used by an organization to create value.

4. Objectives of Integrated Reporting

- (a) To improve the quality of information available to providers of financial capital to enable a more efficient and productive allocation of capital.
- (b) To promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time.
- (c) To enhance accountability and stewardship for the broad base of capitals and promote understanding of their interdependencies.
- (d) To support integrated thinking, decision-making and actions that focus on the creation of value over the short, medium and long term.

5. Six Capitals

SIX CAPITALS

Financial Capital

Manufactured Capital

Intellectual Capital

Human Capital

Social & Relationship Capital

Natural Capital

- **Financial Capital:** Pool of funds available to an organization (debt and equity finance).
- **Manufactured Capital:** Human-created, production-oriented equipment and tools.
- **Intellectual Capital:** Organizational, knowledge-based intangibles (patents, copyrights, tacit knowledge, systems, procedures).
- **Human Capital:** People's competencies, capabilities and experience, and their motivations to innovate.
- **Social and Relationship Capital:** Institutions and relationships within and between communities, groups of stakeholders and other networks.
- **Natural Capital:** All renewable and non-renewable environmental resources and processes.

6. Value Creation Process



7. Guiding Principles of Integrated Reporting

- a. Strategic focus and future orientation
- b. Connectivity of information
- c. Stakeholder relationships
- d. Materiality
- e. Conciseness
- f. Reliability and completeness
- g. Consistency and comparability

8. Integrated Reporting in India

- SEBI issued circular no. SEBI/HO/CFD/CMD/CIR/P/2017/10 dated 6th February, 2017, to introduce Integrated Reporting on a voluntary basis for top 500 companies who are required to prepare Business Responsibility Report (BRR).
- In India, Integrated Reports are not yet mandatory.
- 75 companies from BSE 500 group, 23 Nifty 50 companies and 16 Sensex companies are currently publishing integrated reports.
- The combined market capitalisation of the companies adopting integrated reporting in India is more than \$1 trillion.

9. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Integrated Reporting in 90 seconds:

- IR = Concise communication about value creation over time
- IIRC Framework (launched December 2013)
- Six Capitals: Financial, Manufactured, Intellectual, Human, Social & Relationship, Natural
- Value Creation Process: External Environment → Purpose → Governance → Risk → Strategy → Business Model → Performance
- Guiding Principles: Strategic focus, Connectivity, Stakeholder, Materiality, Conciseness, Reliability, Consistency
- **Mnemonic: FM-IHSN** → Six Capitals

Corporate Social Responsibility (CSR) Reporting in India

1. Chapter Overview

A business organisation is a part of the society. It procures its resources from the society and hence, in turn has responsibilities towards the wellbeing of the society. Corporate Social Responsibility (CSR) is the commitment of an organisation towards this responsibility of the society. In India, traditionally, regulators' effort to bring CSR under the ambit of a well-defined regulatory structure was never whole hearted. The Companies Act, 2013 has only introduced the idea of CSR to the forefront.

2. Learning Objectives

- Understand the concept and definition of CSR.
- Know the legal framework for CSR in India.
- Understand the applicability of CSR regulation.
- Know the permissible CSR activities under Schedule VII.
- Understand accounting for CSR transactions.
- Know the CSR reporting requirements.

3. Important Definitions

DEFINITION

Corporate Social Responsibility (CSR) (WBCSD): The continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large.

DEFINITION

CSR (UNIDO): A management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders.

4. Legal Framework for CSR in India

- (a) Section 135 of Companies Act 2013;
- (b) Schedule VII of Companies Act 2013; and
- (c) Companies (Corporate Social Responsibility Policy) Rules 2014.

5. Applicability of CSR Regulation

As per Section 135(1) read with Companies (Corporate Social Responsibility Policy) Rules 2014, every company including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its branch office or project office in India, having:

- net worth of rupees five hundred crore or more, or
- turnover of rupees one thousand crore or more, or
- a net profit of rupees five crore or more

during three immediately preceding financial years shall come under the ambit of CSR regulation and shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more Directors, out of which at least one director shall be an independent director.

6. Role of CSR Committee and Board

CSR Committee (Section 135(3)):

- Formulate and recommend to Board: CSR Policy, amount of expenditure
- Monitor the CSR Policy of the company from time to time

Board of Directors:

- Disclose composition of CSR Committee in Board's report [Section 135(2)]
- Approve CSR Policy and disclose contents in report and website [Section 135(4)(a)]
- Ensure activities in CSR Policy are undertaken [Section 135(4)(b)]
- Ensure at least 2% of average net profits of last 3 financial years is spent [Section 135(5)]

7. Permissible CSR Activities (Schedule VII)

- a. Eradicating extreme hunger and poverty;
- b. Promotion of education;
- c. Promoting gender equality and empowering women;
- d. Reducing child mortality and improving maternal health;
- e. Combating HIV, AIDS, malaria and other diseases;
- f. Ensuring environmental sustainability;
- g. Employment enhancing vocational skills;
- h. Social business projects;
- i. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;
- j. Such other matters as may be prescribed.

8. Quantum of CSR Spending

- At least 2% of average net profits of last 3 financial years.
- **Overspent:** Can be set off against requirement for 3 succeeding financial years (excluding surplus arising from CSR activities).
- **Unspent (ongoing project):** Transfer to Unspent Corporate Social Responsibility Account within 30 days from end of financial year. Spend within 3 financial years from date of transfer, failing which transfer to Fund specified in Schedule VII.
- **Unspent (not ongoing):** Transfer to Fund specified in Schedule VII within 6 months of expiry of financial year.
- Administrative overheads shall not exceed 5% of total CSR expenditure.

9. Accounting for CSR Transactions

TRANSACTION	ACCOUNTING ENTRY
CSR expenditure incurred in cash	CSR Expenditure A/c Dr. To Cash/Bank A/c
CSR expenditure incurred in kind	CSR Expenditure A/c Dr. To Purchase/Cost of goods consumed A/c
Unspent CSR expenditure (not ongoing)	CSR Expenditure A/c Dr. To Cash/Purchase/Cost of goods To CSR to be Deposited in Fund A/c
Unspent CSR expenditure (ongoing)	CSR Expenditure A/c Dr. To Cash/Purchase/Cost of goods To CSR to be Spent on Ongoing project A/c
Excess spent CSR expenditure	CSR Expenditure A/c Dr. CSR Pre-Spent A/c Dr. To Cash/Purchase/Cost of goods

10. CSR Reporting

The Board's Report of a company covered under these rules pertaining to any financial year shall include an annual report on CSR containing particulars specified in Annexure I or Annexure II, as applicable.

Annexure I includes:

1. Brief outline of CSR Policy
2. Composition of CSR Committee
3. Average net profit for last 3 financial years
4. Prescribed CSR Expenditure (2% of amount in item 3)
5. Details of CSR spent during the financial year
6. Reasons for not spending the amount (if applicable)
7. Responsibility statement of CSR Committee

11. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

CSR in 90 seconds:

- CSR = Commitment to contribute to economic development while improving quality of life
- Legal Framework: Section 135 + Schedule VII + CSR Rules 2014
- Applicability: Net worth $\geq$ ₹500 Cr OR Turnover $\geq$ ₹1000 Cr OR Net Profit $\geq$ ₹5 Cr
- CSR Committee: 3 or more Directors (at least 1 independent)
- Spend: At least 2% of average net profits of last 3 financial years
- Administrative Overheads: Max 5% of total CSR expenditure
- Overspent: Set off for 3 succeeding financial years
- Unspent (ongoing): Transfer to Unspent CSR Account within 30 days
- Unspent (not ongoing): Transfer to Schedule VII Fund within 6 months
- **Mnemonic: 2% CSR** → 2% of average net profits

Environmental, Social and Governance (ESG)

1. Chapter Overview

In today's competitive world, corporate organizations with a transparent and fair image receive added attention from various stakeholders. Especially, investors are increasingly applying various nonfinancial factors as part of their analysis process to identify material risks and growth opportunities. In this process, corporates are being judged on three important aspects namely, economic, environmental and social aspects. Thus, ESG reporting has become immensely important.

2. Learning Objectives

- Understand the concept and importance of ESG reporting.
- Identify the three criteria of ESG.
- Understand the evolution of ESG reporting in India.
- Know the alignment of BRSR with ESG pillars.

3. Important Definitions

DEFINITION

ESG Reporting: The disclosure of data covering the company's operations in three areas: environmental, social and corporate governance.

4. Importance of ESG Reporting

- a. ESG risks and opportunities have potential impact on shareholder's value.
- b. Most investors wish to integrate the business with environment and society to generate sustainable profits.
- c. ESG Reporting analyses how the business operations of the company impact the environment.
- d. ESG Reporting analyses how a company manages relationships with its stakeholders.
- e. ESG reporting highlights on various dimensions of corporate governance.

5. ESG Criteria

Environmental

- Conservation of the natural world
- Climate change and carbon emissions
- Air and water pollution

Social

- Customer satisfaction
- Data protection and privacy
- Gender and diversity

- Biodiversity
- Deforestation
- Energy efficiency
- Waste management
- Water scarcity

- Employee engagement
- Community relations
- Human rights
- Labor standards

Governance

- Board composition
- Audit committee structure
- Bribery and corruption
- Executive compensation
- Lobbying
- Political contributions
- Whistle blower schemes

6. Evolution of ESG Reporting in India

YEAR	REPORTING POLICIES
2009	National Voluntary Guidelines (NVG) were issued by Ministry of Corporate Affairs (MCA) on Corporate Social Responsibility Reporting
2012	Business Responsibility Report (BRR) - SEBI mandated top 100 listed companies by Market Capitalization to file BRR along with Annual Report based on NVG
2014	Corporate Social Responsibility (CSR) Reporting was mandated and rules came into force
2015	Filing BRR was extended to the top 500 listed companies by Market Capitalization
2017	SEBI Circular advised to file Integrated Report - may be adopted on a voluntary basis from FY 2017-18 for top 500 listed companies
2019	National Guidelines on Responsible Business Conduct (NGRBC) were released in March 2019. It is a set of nine principles to guide the corporates for ESG reporting.
2019	SEBI extended the BRR requirement to the top 1000 listed companies by Market Capitalization from FY 2019-20
2021	SEBI issued circulars on Introduction of BRSR in May 10, 2021 (Pr. No. 18/2021) – Initiative towards ensuring investors' access to standardized disclosures on ESG Parameters

7. Extinction Accounting

Scientists declare that we have now entered the sixth mass extinction on planet earth, that they identify is a direct result of human – and corporate – activity. In this context, a new concept, extinction accounting is gaining popularity.

Extinction Accounting: An attempt by companies to report on and evaluate the absence of specific species. It is intended as a means of reporting on biodiversity-related risks which creates an awareness of the importance of managing biodiversity loss.

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

ESG in 90 seconds:

- ESG = Environmental, Social, Governance
- Environmental: Climate change, pollution, biodiversity, energy efficiency
- Social: Customer satisfaction, data protection, diversity, human rights
- Governance: Board composition, audit, bribery, executive compensation
- Evolution in India: NVG (2009) → BRR (2012) → CSR (2014) → NGRBC (2019) → BRSR (2021)
- Extinction Accounting: Reporting on biodiversity-related risks
- **Mnemonic: ESG** → Environmental, Social, Governance

Human Resource Reporting

1. Chapter Overview

Human Resources report is an analytical tool for displaying human resources-related facts, insights, and metrics to improve workforce performance, recruiting procedures, and other important HR operations. By using HR-driven metrics, management can spot trends, identify inefficiencies, capitalise on strengths, and turn-around weaknesses.

2. Learning Objectives

- Understand the concept of Human Resource Reporting.
- Identify the different types of HR reports.
- Know the key metrics tracked in each type of report.

3. Types of HR Reports

3.1 Employee Information Reports

Employee Information Reports provide all information on employees' data factors, such as:

- Employee headcount
- Employee turnover rates
- Diversity
- Revenue per employee
- Employee satisfaction percentage
- Employee engagement percentage
- Average employee tenure

3.2 Recruitment Reports

The following are some important metrics to track in recruitment reports:

- Number of candidates evaluated in a period
- Rate of offer declination
- Reasons for offer rejection
- Total number of interviews
- Duration of the interview
- Top channels for candidate sourcing
- Active job postings by location, department, and other criteria
- Candidates from the talent pool and their behaviour patterns

3.3 Performance Management Reports

It's critical to keep track of employees' goals, skillsets, feedback, and other information. Performance reports provide a logical starting point for appraising staff.

Some of the parameters for measuring performance:

- Employee evaluations
- Time to productivity
- The number of hours worked and revenue
- Employee objectives and performance, as well as their improvements
- Peer reviews, etc.

3.4 Compensation Reports

The finance team is in charge of majority of the compensation provided to employees. Payroll, on the other hand, is the responsibility of the HR department. To better understand compensation, keep track of:

- Salary reports
- Appraisal reports
- Paid time off reports
- Overtime compensation and dues reports
- Shift compensation
- Deductions
- Financial reports based on each filter or criteria

3.5 Terminations Budget/Analysis

This report contains the list of all employees who have been terminated from employment within a defined date range.

3.6 Equal Employment Opportunity Reports

Equal employment opportunity is a pivotal concept for employees and employers alike. It ensures that the employment in an organization is not biased towards a specific gender, race or age group.

3.7 Workplace Safety Reports

It includes Employee Grievance Reports, compensation reports and safety reports.

4. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

HR Reporting in 60 seconds:

- HR Report = Analytical tool for HR metrics
- Types: Employee Information, Recruitment, Performance, Compensation, Terminations, EEO, Safety
- Employee Information: Headcount, Turnover, Diversity, Revenue per employee
- Recruitment: Offer declination, Interview duration, Top channels
- Performance: Evaluations, Time to productivity, Peer reviews
- **Mnemonic: ERPCTES** → Employee, Recruitment, Performance, Compensation, Termination, EEO, Safety

Value Added Statement

1. Chapter Overview

'Value-Added' is a basic and important measurement to judge the performance of an enterprise. It indicates the net value or wealth created by the manufacturer during a specified period. No enterprise can survive or grow, if it fails to generate wealth. An enterprise may exist without making profit, but cannot survive without adding value. Value added is a more meaningful measure of corporate performance than conventional measures based on traditional financial accounting.

2. Learning Objectives

- Understand the concept of Value Added.
- Prepare a Value Added Statement.
- Identify the uses of Value Added Statement.
- Compute productivity measures using Value Added.

3. Important Definitions

DEFINITION

Value Added: The net value or wealth created by the manufacturer during a specified period. It is the excess of turnover plus income from services over the cost of bought-in material and cost of services.

DEFINITION

Value Added Statement: A financial statement that shows how much value (wealth) has been created by an enterprise through the utilisation of its capacity, capital, manpower, and other resources, and how it is then allocated among different stakeholders within an accounting period.

4. Format of Value Added Statement

PARTICULARS	₹	₹
Creation of Value Added		
(a) Sales (including sales tax and excise duty but net of rebate, commission, returns, discounts and goods for self-consumption)		xxx
(b) Income from services (e.g., royalty, dividend and interest, rent received etc.)		xxx
(c) Cost of bought-in materials (consumption of raw materials, consumables, packing materials, stationery, fuel and oil, electricity, repairs etc.)		(xxx)
(d) Cost of bought-in services (e.g., audit fees, insurance, rent paid, travelling expenses, advertisement, postage and telegram, subscriptions, other expenses)		(xxx)
Added Value Created [(a)+(b) – (c) – (d)]		xxx
Distribution of Value Added		
(a) To Employees (e.g., wages and salaries, director's fees, contribution to P.F, ESI etc.)	xxx	
(b) To Government (e.g., duties and taxes)	xxx	
(c) To Providers of Capital (e.g., Interest and Dividend)	xxx	
(d) Retained Earnings (e.g., depreciation and retained profit)	xxx	
Disposal of Value Added [(a)+(b)+(c)+(d)]		xxx

5. Uses of Value Added Statement

- a. Value added is an alternative performance measure to profit.
- b. Useful productivity measures can be devised using corporate value added:
 - i. Value added per rupee of capital employed
 - ii. Value added per rupee of sales
 - iii. Value added per rupee of labour cost
 - iv. Value added per employee
 - v. Value added per labour hour or machine hour
- c. Resource allocation decisions may be based upon value added.
- d. The value added reporting is found useful by many companies for explaining company results to employees.

6. Full ICMAI Illustration

ICMAI ILLUSTRATION

ICMAI Illustration 1 – Preparation of Value Added Statement

Question: The following are the balances in the account statements of X Ltd. for the year ended 31st March, 2005:

PARTICULARS	₹ ('000)
Turnover	4,600
Plant and machinery net	2,160
Loss on sale of machinery	150
Depreciation on plant and machinery	400
Dividends to ordinary shareholders	292
Debtors	390
Creditors	254
Total stock of all materials, WIP and finished goods: Opening stock	320
Closing stock	400
Raw materials purchased	1,250
Cash at bank	196
Printing and stationery	44
Auditor's remuneration	56
Retained profits (opening balance)	1,998
Retained profits for the year	576
Rent, rates and taxes	330
Other expenses	170
Ordinary share capital issued	3,000
Interest on borrowings	80
Income-tax for the year	552
Wages and salaries	654
Employees state insurance	70
P.F. contribution	56

Prepare a Value Added Statement for the company for the year 2021-22.

COMPLETE SOLUTION

Value Added Statement for the year ended on 31.03.2022

PARTICULARS	₹ ('000)	₹ ('000)
Generation of Value Added		
Turnover		4,600
Add: Increase in Stock of raw materials, WIP and FG		80
Total		4,680
Less: Cost of bought-in materials and services		
Raw materials purchased	1,250	
Printing and Stationery	44	
Auditor's remuneration	56	
Rent, rates and taxes	330	
Other expenses	170	1,850
Total Value Added		2,830
Distribution of Value Added		
To Employees		
Wages and salaries	654	
Employees state insurance	70	
P.F. contribution	56	780
To Government		
Income-tax for the year		552
To Providers of Capital		
Interest on borrowings	80	
Dividends	292	372

PARTICULARS	₹ ('000)	₹ ('000)
Re-invested in Business		
Depreciation on plant and machinery	400	
Retained profit for the year	576	976
Loss on sale of machinery	150	
Total Disposal of Added Value		2,830

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Value Added Statement in 60 seconds:

- Value Added = Sales + Income from Services – Cost of Bought-in Materials and Services
- Two Parts: Generation + Distribution
- Distribution: Employees, Government, Providers of Capital, Retained Earnings
- Uses: Performance measure, Productivity measures, Resource allocation, Employee communication
- Productivity: VA per employee, VA per rupee of capital, VA per rupee of labour cost
- **Mnemonic: GDEL** → Generation, Distribution, Employees, Lenders

Economic Value Added and Market Value Added

1. Chapter Overview

Economic Value Added (EVA) is a performance measure developed by Stern Stewart & Co. to find the true economic profit generated by a company. It is also called "economic profit," and provides a measurement of a company's economic success (or failure) over a period of time. Market Value Added (MVA), on the other hand, is simply the difference between the current total market value of a company and the capital contributed by investors.

2. Learning Objectives

- Understand the concept of Economic Value Added (EVA).
- Compute EVA using NOPAT, WACC, and Invested Capital.
- Understand the concept of Market Value Added (MVA).
- Distinguish between EVA and MVA.

3. Important Definitions

DEFINITION

Economic Value Added (EVA): The measure of economic profits after charging both cost of debt and cost of equity capital. $EVA = NOPAT - (WACC \times \text{Invested Capital})$.

DEFINITION

Market Value Added (MVA): The difference between the current total market value of a company and the capital contributed by investors (including both shareholders and debtholders).

4. Important Formulae

FORMULA

$$EVA = NOPAT - (WACC \times \text{Invested Capital})$$

FORMULA

$$NOPAT = EBIT \times (1 - t)$$

FORMULA

$$\text{WACC} = (W_e \times K_e) + (W_d \times K_d)$$

FORMULA

$$\text{MVA} = \text{Market Value of Company} - \text{Capital Contributed by Investors}$$

FORMULA

$$\text{Invested Capital} = \text{Total Debt} + \text{Total Equity (or Total Assets} - \text{Non-interest Bearing Liabilities)}$$

5. EVA Illustration

ICAI ILLUSTRATION

ICAI Illustration – EVA Computation

Question: B Ltd. had 2021 net after-tax operating profits of ₹5,00,000 and invested capital of ₹50 lakhs at an average cost of 9%. Compute EVA.

COMPLETE SOLUTION

Step 1: Compute EVA

$$\text{NOPAT} = ₹5,00,000$$

$$\text{Invested Capital} = ₹50,00,000$$

$$\text{WACC} = 9\%$$

$$\text{EVA} = \text{NOPAT} - (\text{WACC} \times \text{Invested Capital})$$

$$= ₹5,00,000 - (9\% \times ₹50,00,000)$$

$$= ₹5,00,000 - ₹4,50,000$$

$$\text{EVA} = ₹50,000$$

This ₹50,000 represents an amount equal to 1% of B Ltd.'s invested capital, providing 1% real growth during the year.

6. MVA Concept

Market value added (MVA) is simply the difference between the current total market value of a company and the capital contributed by investors (including both shareholders and debtholders). It is typically used for companies that are larger and publicly-traded.

- MVA is not a performance metric like EVA but instead is a wealth metric, measuring the surplus value a company has generated in reflection of its future performance.
- As a company performs well over time, investors will likely bid up the prices of those shares in expectation of future earnings, causing the company's market value to rise.
- MVA measures the difference between the company's market value and the capital contributed by investors represents the excess price tag the market assigns to the company as a result of its expected future operating successes.

7. Comparison: EVA vs MVA

ASPECT	EVA	MVA
Type	Performance Metric	Wealth Metric
Focus	True economic profit	Surplus value generated
Formula	$\text{NOPAT} - (\text{WACC} \times \text{Invested Capital})$	$\text{Market Value} - \text{Invested Capital}$
Application	All companies	Larger, publicly-traded companies
Measurement	Internal performance	External market perception
Developed by	Stern Stewart & Co.	—

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

EVA & MVA in 60 seconds:

- $\text{EVA} = \text{NOPAT} - (\text{WACC} \times \text{Invested Capital})$
- $\text{NOPAT} = \text{EBIT} \times (1 - t)$
- $\text{WACC} = (\text{We} \times \text{Ke}) + (\text{Wd} \times \text{Kd})$
- EVA = Performance Metric (true economic profit)
- MVA = Market Value – Capital Contributed (Wealth Metric)
- MVA = Surplus value company has generated
- **Mnemonic: EVA-NWI** → NOPAT, WACC, Invested Capital

Reporting through XBRL (eXtensible Business Reporting Language)

1. Chapter Overview

XBRL stands for 'eXtensible Business Reporting Language'. XBRL is the open international standard for digital business reporting. It is one of a family of "XML" languages which is becoming a standard means of communicating information between businesses and on the internet. The basic idea behind XBRL is that instead of treating financial information as a block of text or numeric items, a unique electronically readable tag is attached to each individual financial term.

2. Learning Objectives

- Understand the concept and meaning of XBRL.
- Know the four terminologies of XBRL.
- Understand important XBRL-related concepts (XML, Taxonomy).
- Know the features and benefits of XBRL reporting.
- Understand XBRL adoption in India.

3. Important Definitions

DEFINITION

XBRL (eXtensible Business Reporting Language): A standardised language for communication in electronic form to express, report or file financial information by companies under the Companies Act, 2013.

DEFINITION

XML (eXtensible Markup Language): A markup language for documents containing structured information. It defines a set of rules for encoding documents in a format that is both human-readable and machine-readable.

DEFINITION

Taxonomy: In XBRL, an electronic dictionary for reporting the business data as approved by the Central Government in respect of any documents or forms.

4. Meaning of XBRL Terminologies

- **(a) Extensible:** The user can extend the application of a particular business data beyond its original intended purpose. This is achieved by adding tags which are both human and machine readable.
- **(b) Business:** This platform is relevant to any type of business transaction. XBRL focus is on describing the financial statements for all kinds of entities.
- **(c) Reporting:** The intention behind promoting the use of XBRL is to have all companies report their financial statements in a consolidated manner using the specified formats.
- **(d) Language:** XBRL is based on 'eXtensible Markup Language' (XML). It prescribes the manner in which the data can be "marked-up" or "tagged" to make it more meaningful to human readers as well as to computer-based systems.

5. Important XBRL Related Concepts

XML

- XML stands for 'eXtensible Markup Language'.
- It is a markup language for documents containing structured information.
- XML defines a set of rules for encoding documents in a format that is both human-readable and machine-readable.
- XBRL is XML-based and therefore is expected to be widely available in software applications.

Taxonomy

- Taxonomies are the reporting-area specific hierarchical dictionaries used by the XBRL community.
- They define the specific tags that are used for individual items of data (such as "net profit"), their attributes and their interrelationships.
- Different taxonomies will be required for different business reporting purposes.

6. Features of XBRL Reporting

Clear Definitions

- Creation of reusable, authoritative definitions (taxonomies)
- Capture meaning contained in reporting terms
- Relationships between terms

Testable Business Rules

- Prevent poor quality information
- Identify questionable information
- Creation of ratios, aggregations

Multi-lingual Support

- Concept definitions in multiple languages
- Translations by third parties
- Display reports in different languages

Strong Software Support

- Wide range of software from vendors
- Stakeholders can work with the standard

7. Benefits of XBRL Reporting

- **1. Automated Data Processing:** Data can be exchanged and processed automatically by software.
- **2. More accurate and efficient:** Comprehensive definitions and accurate data tags.
- **3. Data Review:** Software can automatically validate data electronically received.
- **4. Improved reporting quality:** Increased data integrity and uniformity.
- **5. Interchangeable:** Information is interchangeable between different information systems.
- **6. Cost and time savings:** Reduces time and cost of filing, receiving, storing, validating and auditing.
- **7. Tagging of transactions:** Unique tags associated with reported facts.

8. Users of XBRL

- 1. Companies
- 2. Not-for-profit Organisations
- 3. Accountants
- 4. Analysts
- 5. Investors
- 6. Regulatory Authorities
- 7. Government agencies
- 8. Tax authorities
- 9. Statistical and monetary policy authorities
- 10. Specialist Data Providers

9. Adoption of XBRL in India

- **MCA:** Mandated submission of XBRL in 2011. Applicable to:
 - (i) All companies listed in India and their subsidiaries;
 - (ii) All companies having a paid up capital of ₹5 crore and above; or
 - (iii) All companies having turnover of ₹100 crore or above (excluding power and banking companies, insurance companies, NBFCs and overseas subsidiaries).
- **RBI:** XBRL implementation for Basel II reporting norms for banks.
- **SEBI:** SEBI Unified Platform for Electronic Reporting and Dissemination (SUPER-D) for listed companies, Mutual Funds and other intermediaries.
- **BSE:** First stock exchange in India to introduce and implement XBRL based reporting.

10. Companies Exempt from XBRL Reporting

- (i) Banking companies
- (ii) Insurance companies
- (iii) Non-Banking Financial companies

Power Sector Companies are excluded from exemption list (2017 amendment) — now required to file XBRL.

11. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

XBRL in 90 seconds:

- XBRL = eXtensible Business Reporting Language
- Based on XML (eXtensible Markup Language)
- Taxonomy = Electronic dictionary for reporting business data
- Features: Clear Definitions, Testable Rules, Multi-lingual, Software Support
- Benefits: Automated, Accurate, Data Review, Quality, Interchangeable, Cost savings
- MCA mandated XBRL in 2011
- Exempt: Banking, Insurance, NBFCs
- **Mnemonic: XBRL-XML** → XBRL based on XML

Quarterly Earnings Call Management

1. Chapter Overview

An earnings call (also known as Earnings Conference Call) is a conference call (typically held in the form of a teleconference or a webcast) during which the management of a company announces and discusses the financial results of a company for a given quarter or a year. The calls are usually preceded or accompanied by a press release containing a summary of the financial results. Typical participants are investors, equity analysts, and business journalists.

2. Learning Objectives

- Understand the concept of an earnings call.
- Know the frequency and timing of earnings calls.
- Understand the structure of an earnings call.
- Know the importance of earnings calls.

3. Important Definitions

DEFINITION

Earnings Call: A conference call during which the management of a company announces and discusses the financial results of a company for a given quarter or a year.

4. Frequency and Timing

- Earnings calls are not legally mandated. So, a company may not actually have any earnings call.
- The culture is more prevalent in western countries and slowly becoming popular in India as well.
- According to the National Investor Relations Institute, USA, 92% of companies represented by their members conduct earnings calls.
- In India also, most of the large publicly listed companies organise earnings conference calls.
- There is no general requirement for how far in advance notice of a call must be given.
- The schedule of the call (along with the link of the meet) is generally posted by the company in the Investor Relations section of their website.

5. Structure of an Earnings Call

1. Safe Harbour Statement



2. Presentation and Discussion of Financial Results



3. Question and Answer Session

1. Safe Harbour Statement

- A typical earnings call starts with the safe harbour statement made by the company's management.
- The safe harbour statement generally warns the participants of the earnings presentation that the discussion of financial results may include forward-looking statements.
- The estimates of results based on the forward-looking statements may substantially differ from the actual results.

2. Presentation and Discussion of Financial Results

- After the safe harbour statement, the managers take over the call.
- Generally, a company is represented by C-level executives.
- The two key executives that are always present are the Chief Executive Officer (CEO) and Chief Financial Officer (CFO).
- The executives present and discuss the financial results for the given reporting period (quarter or year).
- The managers provide an overview of the company's upcoming goals and milestones, as well as discuss how the plans will impact the future financial performance of the company.

3. Question and Answer Session

- The final section of the earnings call is reserved for the Q&A session.
- During this session, investors, analysts, and other participants in the call have an opportunity to ask the management questions regarding the presented financial results.
- The representatives of the management answer the questions based on the data available with them.
- However, they may decline or defer their answers for certain questions.

6. Importance of Earnings Call

- Earnings calls are considered one of the key resources for investors and equity analysts.
- The information provided during earnings calls can be incorporated into the fundamental analysis of a company.
- Analysts can combine the information obtained during the event with the information presented in the management, discussion, and analysis (MD&A) section of the company's reports.
- The importance of earnings calls is acknowledged by the fact that investors frequently plan their trades close to the date of an upcoming conference.
- Equity analysts use the information provided during such events to update their earnings estimates.
- Due to this importance to the investors and analysts, now-a-days earnings calls are recognised as an important tool for corporate reporting.

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Earnings Call in 60 seconds:

- Earnings Call = Conference call to announce and discuss financial results
- Structure: Safe Harbour Statement → Presentation → Q&A Session
- Safe Harbour: Warns about forward-looking statements
- Participants: CEO, CFO, Investors, Analysts, Journalists
- Importance: Fundamental analysis, Trade planning, Earnings estimates
- Not legally mandated; 92% of US companies conduct
- **Mnemonic: SPQ** → Safe Harbour, Presentation, Q&A

MODULE 7 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 7 covers Recent Developments in Financial Reporting. This module carries **10% weightage** in Paper 18. This module is highly scoring with mostly theory and formula-based problems. Master Value Added Statement, EVA, MVA, Integrated Reporting, CSR, ESG, and XBRL.

B. Mega Revision Sheet

TOPIC	CORE PRINCIPLE	KEY TREATMENT
4P Bottom Line	Quadruple Bottom Line	Profit, People, Planet, Purpose
Sustainability & GRI	Economic, Social, Environmental	GRI Framework, Materiality
BRSR	Nine Principles of NVG	Five Sections, ESG Alignment
Integrated Reporting	Value Creation over Time	Six Capitals, Guiding Principles
CSR	Section 135, Schedule VII	2% of average net profits
ESG	Environmental, Social, Governance	Criteria, Evolution in India
HR Reporting	HR Metrics and Analytics	Employee, Recruitment, Performance
Value Added	Wealth Creation and Distribution	Generation + Distribution
EVA & MVA	Economic Profit / Wealth Metric	$EVA = NOPAT - (WACC \times IC)$
XBRL	Digital Business Reporting	XML-based, Taxonomy
Earnings Call	Management Discussion	Safe Harbour, Presentation, Q&A

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA
Value Added	$\text{Sales} + \text{Income from Services} - \text{Cost of Bought-in Materials and Services}$
Value Added per Employee	$\text{Value Added} / \text{Number of Employees}$
Value Added per Rupee of Capital	$\text{Value Added} / \text{Capital Employed}$
Value Added per Rupee of Sales	$\text{Value Added} / \text{Sales}$
Value Added per Rupee of Labour Cost	$\text{Value Added} / \text{Labour Cost}$
EVA	$\text{NOPAT} - (\text{WACC} \times \text{Invested Capital})$
NOPAT	$\text{EBIT} \times (1 - t)$
WACC	$(W_e \times K_e) + (W_d \times K_d)$
MVA	$\text{Market Value of Company} - \text{Capital Contributed}$
CSR Spending	2% of Average Net Profits of Last 3 Financial Years

D. Top Exam Points – Quick Revision

1. 4P Bottom Line = Profit, People, Planet, Purpose.
2. Triple Bottom Line = People, Planet, Profit.
3. Quadruple Bottom Line = TBL + Purpose (Spiritual).
4. Bottom Line = Operating result (last line of income statement).
5. Sustainability = Economic, Environmental, Social.
6. Sustainable Development = Meeting present needs without compromising future.
7. GRI = Global Reporting Initiative (most widely used framework).
8. Materiality = Key principle for GRI reporting.
9. BRSR = Business Responsibility and Sustainability Report.
10. SEBI introduced BRR in 2012 for top 100 companies.
11. BRR extended to top 500 in 2016; top 1000 in 2019.
12. BRSR introduced in May 2021.
53. XBRL Features: Clear Definitions, Testable Rules, Multi-lingual, Software Support.
54. XBRL Benefits: Automated, Accurate, Data Review, Quality, Interchangeable, Cost savings.
55. MCA mandated XBRL in 2011.
56. XBRL Exempt: Banking, Insurance, NBFCs.
57. Power Sector Companies included from 2017.
58. Earnings Call = Conference call to announce financial results.
59. Earnings Call Structure: Safe Harbour → Presentation → Q&A.
60. Safe Harbour = Warns about forward-looking statements.
61. Key Executives: CEO and CFO.
62. Earnings Call not legally mandated.
63. 92% of US companies conduct earnings calls.
64. Earnings Calls important for fundamental analysis.
65. Earnings Calls used to update earnings estimates.
66. Integrated Reporting in India: Voluntary for top

E. Examiner Insights

★ EXAM IMPORTANT

- Always show workings clearly for Value Added, EVA, and MVA computations.
- State the formula used for each computation explicitly.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Focus on high-weightage topics: Value Added Statement, EVA, MVA, Integrated Reporting.
- Practice at least 5 comprehensive problems on Value Added Statement.
- Read the question carefully for adjustments like "ignore tax", "assume fair value equals book value", etc.
- For Integrated Reporting, always mention the Six Capitals.
- For CSR, always mention Section 135, Schedule VII, and CSR Rules 2014.
- For ESG, always mention the three criteria.
- For XBRL, always mention XML and Taxonomy.
- For Earnings Call, always mention the three-part structure.

F. Frequently Repeated Concepts

- Value Added Statement preparation — appears almost every attempt.
- EVA computation — very common.
- MVA computation — frequently tested.
- Integrated Reporting Six Capitals — regular.
- CSR applicability and spending — common theory question.
- ESG criteria — increasingly important.
- XBRL features and benefits — regular.
- Earnings Call structure — common.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ 4P Bottom Line (Profit, People, Planet, Purpose)
- ☒ Triple Bottom Line (People, Planet, Profit)
- ☒ Sustainability Reporting (Economic, Social, Environmental)
- ☒ GRI Framework and Materiality
- ☒ BRSR: Nine Principles, Five Sections
- ☒ Integrated Reporting: Six Capitals, Value Creation Process
- ☒ Guiding Principles of Integrated Reporting
- ☒ CSR: Section 135, Schedule VII, CSR Rules 2014
- ☒ CSR: Applicability, Committee, Spending, Reporting
- ☒ ESG: Environmental, Social, Governance Criteria
- ☒ ESG: Evolution in India
- ☒ HR Reporting: Types and Metrics
- ☒ Value Added Statement: Generation and Distribution
- ☒ Value Added: Productivity Measures
- ☒ EVA: NOPAT – $(WACC \times \text{Invested Capital})$
- ☒ MVA: Market Value – Capital Contributed
- ☒ XBRL: Concepts, Features, Benefits
- ☒ XBRL: Adoption in India
- ☒ Earnings Call: Structure and Importance
- ☒ All ICMAI illustrations
- ☒ Common mistakes to avoid
- ☒ Examiner insights
- ☒ Memory tricks and mnemonics
- ☒ Formula sheet
- ☒ Top exam points
- ☒ Frequently repeated concepts
- ☒ Final revision checklist
- ☒ Printable PDF version content

H. Common Mistakes Students Make

⚠ WARNING

- Confusing 3P Bottom Line with 4P Bottom Line.
- Forgetting Purpose (Spiritual) in 4P Bottom Line.
- Not mentioning GRI Framework in Sustainability Reporting.
- Forgetting the Nine Principles of NVG in BRSR.
- Not mentioning Six Capitals in Integrated Reporting.
- Forgetting Section 135 in CSR.
- Not computing CSR spending correctly (2% of average net profits).
- Confusing EVA and MVA.
- Not computing NOPAT correctly.
- Not computing WACC correctly.
- Not mentioning XML in XBRL.
- Forgetting Taxonomy in XBRL.
- Not mentioning Safe Harbour Statement in Earnings Call.
- Incorrect Value Added computation.
- Not distinguishing Generation and Distribution in Value Added Statement.

I. Memory Tricks and Mnemonics

🔑 KEY TAKEAWAY

4P Bottom Line: PPPP → Profit, People, Planet, Purpose

Triple Bottom Line: PPP → People, Planet, Profit

Sustainability: ESE → Economic, Social, Environmental

BRSR: NINE → Nine Principles of NVG

Integrated Reporting: FM-IHSN → Six Capitals

CSR: 2% CSR → 2% of average net profits

ESG: ESG → Environmental, Social, Governance

Value Added: GDEL → Generation, Distribution, Employees, Lenders

EVA: EVA-NWI → NOPAT, WACC, Invested Capital

XBRL: XBRL-XML → XBRL based on XML

Earnings Call: SPQ → Safe Harbour, Presentation, Q&A

1 DAY BEFORE EXAM

Module 7 – Printable Quick Notes:

1. 4P Bottom Line = Profit, People, Planet, Purpose
2. Triple Bottom Line = People, Planet, Profit
3. Sustainability = Economic, Social, Environmental
4. GRI = Global Reporting Initiative (Materiality)
5. BRSR = Nine Principles of NVG; Five Sections
6. Integrated Reporting = Six Capitals; Value Creation Process
7. CSR = Section 135 + Schedule VII + CSR Rules 2014; 2% of average net profits
8. ESG = Environmental, Social, Governance
9. Value Added = Sales + Income from Services – Bought-in Materials and Services
10. Value Added Statement = Generation + Distribution
11. EVA = NOPAT – (WACC × Invested Capital)
12. NOPAT = EBIT × (1 – t)
13. WACC = (We × Ke) + (Wd × Kd)
14. MVA = Market Value – Capital Contributed
15. XBRL = eXtensible Business Reporting Language (based on XML)
16. Earnings Call = Safe Harbour → Presentation → Q&A

KEY TAKEAWAY

END OF MODULE 7 – RECENT DEVELOPMENTS IN FINANCIAL REPORTING

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Corporate Financial Reporting

MODULE 8

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10%

WEIGHTAGE

5

SUB-TOPICS

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STANDARDS

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MODULE 8: Government Accounting in India

General Principles | C&AG Role | PAC Role | GASAB Standards | IGAS | IGFRS | Government Accounting & Reporting | 10% Weightage

10%

EXAM WEIGHTAGE

5

SUB-TOPICS

10+

STANDARDS

40+

EXAM POINTS

★ EXAM IMPORTANT

Module 8 carries **10% weightage** in Paper 18. Expect **1 full question (15 marks)** or short notes and objective questions. This module is primarily theory-based. Master the differences between Government Accounting and Commercial Accounting, the role of C&AG, PAC, GASAB, and the various IGAS/IGFRS standards.

Table of Contents – Module 8

- 1 General Principles and Comparison with Commercial Accounting
- 2 Role of Comptroller and Auditor General of India
- 3 Role of Public Accounts Committee, Review of Accounts
- 4 Government Accounting Standards issued by GASAB
- 5 Government Accounting and Reporting
- 6 IGAS Standards – Detailed Coverage
- 7 IGFRS Standards – Accrual Based



Syllabus Coverage Matrix

TOPIC	SUB-TOPICS	WEIGHTAGE	PRIORITY
General Principles	Features, Objectives, Comparison with Commercial Accounting	2–3%	★★★★★
C&AG Role	Functions, Duties, Powers, Audit	2–3%	★★★★★
PAC Role	Constitution, Functions, Review of Accounts	1–2%	★★★★★
GASAB	Structure, Responsibilities, Standards	1–2%	★★★★★
IGAS	IGAS 1, 2, 3, 7, 9, 10	2–3%	★★★★★
IGFRS	IGFRS 1, 2, 3, 4, 5	1–2%	★★★★★
Accounting & Reporting	Consolidated Fund, Contingency Fund, Public Account	1–2%	★★★★★

Expected Question Types

Practical Problems (15 Marks)

- Compare Government Accounting with Commercial Accounting
- Explain the role and functions of C&AG
- Explain the role and functions of PAC
- Describe GASAB structure and responsibilities
- Explain IGAS 1, 2, 3 standards with disclosure requirements
- Explain IGFRS 1-5 standards
- Describe the three funds – Consolidated Fund, Contingency Fund, Public Account

Short Notes / Theory (5 Marks)

- Define Government Accounting
- Features of Government Accounting
- Objectives of Government Accounting
- Differences between Government Accounting and Commercial Accounting
- Role of C&AG in audit of Government Companies
- Composition and functions of PAC
- Structure and responsibilities of GASAB
- IGAS 1: Guarantees given by Governments
- IGAS 2: Accounting and Classification of Grants-in-Aid
- IGAS 3: Loans and Advances made by Governments
- IGFRS 1: Presentation of Financial Statements
- IGFRS 2: Property, Plant & Equipment
- IGFRS 3: Revenue from Government Exchange Transactions
- IGFRS 4: Inventories
- IGFRS 5: Contingent Liabilities and Contingent Assets

Frequently Tested Concepts

- Government Accounting vs Commercial Accounting (differences)
- Features of Government Accounting
- Objectives of Government Accounting
- General Principles of Government Accounting
- Role of C&AG (Article 148-151)
- C&AG Duties, Powers and Conditions of Service Act, 1971
- Public Accounts Committee (PAC) – Constitution and Functions
- GASAB – Structure and Responsibilities
- IGAS 1, 2, 3 – Guarantees, Grants-in-Aid, Loans
- IGFRS 1-5 – Accrual Based Standards
- Consolidated Fund, Contingency Fund, Public Account
- Review of Accounts of Government Companies

CHAPTER 1

General Principles and Comparison with Commercial Accounting

1. Chapter Overview

Accounting is the process of recording, classifying and summarizing the financial transactions and communicating the results of its operations and also the financial position to its stake-holders. Government accounting refers to the system of financial accounting that is applicable to government, its departments, offices and institutions. The accounting system that is put to use in government offices or institutions for the purpose of recording and reporting the financial transactions is referred to as government accounting. It is also referred to as Public Finance Accounting.

2. Learning Objectives

- Understand the concept and definition of Government Accounting.
- Identify the features of Government Accounting.
- Know the objectives of Government Accounting.
- Understand the general principles of Government Accounting.
- Distinguish between Government Accounting and Commercial Accounting.

3. Important Definitions

DEFINITION

Government Accounting (Oshisami and Dean): The process of recording, analyzing, classifying, summarizing, communicating, and interpreting information about government in aggregate and in detail, reflecting all transactions involving the receipts, transfer, and disposition of government funds and property.

DEFINITION

Government Accounting: An accounting system used in government institutions for the purpose of recording, classifying, summarizing and communicating the financial information regarding the collection and utilization of public funds and properties.

4. Features of Government Accounting

Specific System

- A specific accounting system followed by government in its departments, offices and

Public Funds Utilisation

- Reveals how public funds and properties have been used

institutions

- Not done for revealing profit and loss

Government Regulations

- Maintained according to government rules and regulations
- Financial policies provide the system

Double Entry System

- Based on principles and assumptions of double entry system
- Every transaction recorded showing double effects

Budget Heads

- All expenses classified into different budget heads
- Expenditures made only on approved budget heads

Budgetary Regulation

- No government office can make expenditure more than allocated budget
- Government accounting is regulated by budget

Mode of Transaction

- All government transactions performed through banks

Fund-based Accounting

- Employment of separate funds
- Segregate specially dedicated resources

Auditing

- Audited by recognized department of government
- Prevent misuse and misappropriation of public funds

5. Objectives of Government Accounting

1. To record financial transactions of revenues and expenditure relating to the government organizations.
2. To provide reliable financial data and information about the operation of public fund.
3. To record the expenditures as per the appropriate Act, Rules, and legal provisions as set by the government.
4. To avoid the excess expenditures beyond the limit of the budget approved by the government.
5. To help in the preparation of various financial statements and reports.
6. To facilitate the auditing by the concerned government department.
7. To prevent misappropriation of government properties by maintaining the systematic records of cash and store items.
8. To facilitate for estimating the annual budget by providing historical financial data of government and expenditures.

6. General Principles of Government Accounting

1. **Classification of Expenditures:** Government Expenditures are classified under Sectors, major heads, minor heads, sub-heads and detailed heads of account.
2. **Based on Budget:** Government accounting is based on the annual budget of the government. Government determines: (a) whether it will be justified in curtailing or expanding its activities; and (b) whether it can and should increase or decrease taxation accordingly.
3. **End Products:** The end products are the monthly accounts and the annual accounts. Monthly accounts serve day-to-day administration; annual accounts present a fair and correct view of financial stewardship.
4. **Period of Accounts:** Annual accounts of central, state and union territory government shall record transactions which take place during financial year running from 1st April to 31st March.
5. **Cash Basis of Accounting:** With the exception of book adjustments authorized by C&AG, transactions in government accounts represent actual cash receipt and disbursement during a financial year.
6. **Form of Accounts:** The accounts of Government are kept in three parts namely, Consolidated Fund, Contingency Fund and Public Account.

7. Comparison: Government Accounting vs Commercial Accounting

ASPECT	GOVERNMENT ACCOUNTING	COMMERCIAL ACCOUNTING
Meaning	Accounting system applied in government departments, offices and institutions	Accounting system applied by non-government organizations
Objective	Recording and reporting the utilisation and position of public funds	Knowing profit or loss for a period and disclosing financial position
Scope	More elaborate than commercial accounts	Less elaborate
Budget	Directly influenced by government budgeting system	Does not follow government budgeting system
Basis	Cash basis	Cash basis, accrual basis, or hybrid basis
Level of Accounting	Central level and operating level accounting	No provision of central and operating level
Rules and Provisions	Strictly maintained by financial rules and provisions set by government	Follows applicable rules and GAAP
Information	Provides information about receipts, deposit, transfer and utilisation of public funds	Provides information about operating result and financial position
Auditing	Audited by Auditor General Office	Audited by professional auditor

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

General Principles in 90 seconds:

- Government Accounting = Public Finance Accounting
- Features: Specific system, Public funds, Government regulations, Double entry, Budget heads, Budgetary regulation, Bank transactions, Fund-based, Auditing
- Objectives: Record transactions, Provide data, Follow rules, Avoid excess, Prepare statements, Facilitate audit, Prevent misappropriation, Estimate budget
- Principles: Classification, Budget-based, Monthly/Annual accounts, April-March, Cash basis, Three funds
- **Mnemonic: SPGBBBAF** → Features of Government Accounting

Role of Comptroller and Auditor General of India

1. Chapter Overview

The Comptroller and Auditor General (C&AG) of India is an authority, established by the Constitution under Article 148, who audits all receipts and expenditure of the Government of India and the state governments, including those of bodies and authorities substantially financed by the government. The CAG is also the external auditor of Government-owned corporations and conducts supplementary audit of government companies.

2. Learning Objectives

- Understand the constitutional basis of the C&AG office.
- Know the duties, powers, and functions of the C&AG.
- Understand the role of C&AG in audit of government companies.
- Know the reporting requirements of the C&AG.

3. Important Definitions

DEFINITION

Comptroller and Auditor General (C&AG): An authority established by the Constitution under Article 148, who audits all receipts and expenditure of the Government of India and the state governments. The CAG is the guardian or care-taker of the national purse.

DEFINITION

Tenure: Appointed by the President of India for a tenure of 6 years.

4. Constitutional Provisions

- Articles 148 to 151 of the Indian constitution create and regulate the office of Comptroller and Auditor General of India.
- The office of the Comptroller and Auditor General is considered as "pivotal" to the control of entire financial system of the country.
- Dr. B. R. Ambedkar felt that the Comptroller and Auditor General of India shall be the most important officer under the constitution of India.
- The Government of India Act of 1935 made the Auditor General of India irremovable except "in like manner and on like grounds as a judge of the Federal Court."

5. Role, Function and Duties of C&AG

The role, function and duties of the CAG are elaborated by the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 (56 of 1971). An amendment of this act in 1976 has relieved him from preparing the accounts of the government. As per Sec. 10 of the said Act:

1. Compile Accounts

- Compiling accounts of Union and each State from initial and subsidiary accounts rendered to audit and accounts offices
- Keeping such accounts in relation to any matters

2. Prepare and Submit Accounts

- Prepare accounts showing annual receipts and disbursements for Union, each State and Union Territory
- Submit to President, Governor, or Administrator
- On or before dates determined with concurrence of Government

3. Give Information and Assistance

- Give information to Union/State Governments
- Render assistance in preparation of annual financial statements

4. General Provisions – Audit

- Audit all expenditure from Consolidated Fund
- Ascertain moneys legally available and applicable
- Audit all transactions relating to Contingency Funds and Public Accounts
- Audit trading, manufacturing, profit and loss accounts

5. Audit of Bodies Substantially Financed

- Audit receipts and expenditure of bodies substantially financed from Union or State Revenues
- With previous approval of President/Governor/Administrator
- Where grants or loans are not less than rupees one crore

6. Functions in Case of Grants or Loans

- Scrutinise procedures by which sanctioning authority satisfies itself
- Right of access to books and accounts
- After giving reasonable previous notice

7. Audit of Receipts

- Audit all receipts payable into Consolidated Fund

8. Audit of Stores and Stock

- Authority to audit and report on accounts of stores and stock

- Satisfy himself that rules and procedures secure effective check
- On assessment, collection and proper allocation of revenue

- Kept in any office or department of Union or State

9. Powers of C&AG

- Place as he may appoint for inspection
- Put questions or make observations
- Call for information required for preparation of account or report

10. Audit of Government Companies

- Duties and powers in relation to audit of Government companies
- In accordance with provisions of Companies Act, 1956 (now 2013)
- Audit of corporations established by law made by Parliament

11. Laying of Reports

- Reports submitted to Government or Governments concerned
- Central Government lays before each House of Parliament
- State Government lays before Legislature of State

12. Audit of Certain Authorities

- Where audit not entrusted by law made by Parliament
- If requested by President, Governor or Administrator
- On terms and conditions as agreed

6. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

C&AG Role in 90 seconds:

- C&AG = Comptroller and Auditor General of India
- Established under Article 148 of Constitution
- Appointed by President for 6 years
- Guardian of national purse
- Duties, Powers and Conditions of Service Act, 1971
- Functions: Compile accounts, Prepare and submit, Give information, Audit, Report
- Audit of Government Companies under Companies Act, 2013
- Reports laid before Parliament/Legislature
- **Mnemonic: CPAAR** → Compile, Prepare, Assist, Audit, Report

Role of Public Accounts Committee, Review of Accounts

1. Chapter Overview

The Public Accounts Committee (P.A.C.) is a committee of selected members of Parliament, constituted by the Parliament of India. In the Indian parliamentary form of governance, the legislature has the power to ensure "that the appropriated money is spent economically, judiciously and for the purpose for which it was sanctioned". Even though the Comptroller and Auditor General of India (C&AG) is to audit the accounts of the government and to ensure the propriety of the money spent, yet its report is further examined by the special committee of the parliament, known as Public Account Committee.

2. Learning Objectives

- Understand the constitution and composition of PAC.
- Know the role and functions of PAC.
- Understand the review of accounts process.
- Know the role of PAC regarding C&AG reports, unauthorized expenditures, and public corporations.

3. Important Definitions

DEFINITION

Public Accounts Committee (PAC): A committee of selected members of Parliament, constituted by the Parliament of India, entrusted with the responsibility of examining the accounts of the Government.

4. Constitution of PAC

- First set up in India in 1921 under the Montague Chelmsford Reforms.
- Formed every year with a strength of not more than 22 members.
- 15 members from Lok Sabha (elected by Lok Sabha every year from amongst its members according to the principle of proportional representation by means of single transferable vote).
- 7 members from Rajya Sabha (elected by that House in like manner).
- Term of office of the members is one year.
- Chairman appointed by the Speaker of Lok Sabha from amongst its members of Lok Sabha.
- Since 1967, the chairman of the committee is selected from the opposition. Earlier, it was headed by a member of the ruling party.
- A Minister is not eligible to be elected as a member of the Committee. If a member after his election to the Committee is appointed a Minister, he ceases to be a member of the Committee from the date of such appointment.

5. Role of Public Accounts Committee

1. Examination of C&AG Report

- Chief function is to examine the audit report of C&AG after it is laid in the Parliament
- C&AG assists the Committee during the course of investigation

2. Unauthorized/Excess Expenditures

- Satisfy itself that expenditures were authorized by Parliament
- Expenditures under any head has not crossed limits of parliamentary authorization
- Bring to notice instances of unauthorized expenditures

3. Spending of Money by Ministries

- Ensures ministries spend money in accordance with parliamentary grants
- Brings to notice instances of extravagance, loss, infructuous expenditure
- Lack of financial integrity in public services
- Cannot question policies of government; only concerns with execution of policy on financial aspects

4. Scrutinizing Audit Reports of Public Corporations

- New dimension to the function of P.A.C.
- Responsibility of scrutinizing the audit report of public corporations

5. Scrutinising Working Process

- Scrutinize the process of working of ministries and public corporations
- Points out weaknesses and shortcomings of the administration
- Criticisms of P.A.C. draw national attention
- Instrument of financial control and administrative control

6. Review of Accounts

The accounts of Government Companies set up under the provisions of the Companies Act (including Government Insurance Companies and deemed Government Companies) are audited by the Comptroller and Auditor General of India (C&AG) under the provisions of Section 143 of the Companies Act, 2013. Under these provisions, the C&AG:

- (i) shall appoint statutory auditor of a Government company,
- (ii) may conduct supplementary or test audit of accounts of a Government Company, and
- (iii) may comment upon the report of the statutory auditor. In addition he issues directions to the statutory auditors regarding the manner in which the accounts of a Government Company are to be audited.

The accounts certified by the Statutory Auditors (Chartered Accountants) appointed by the Central Government on the advice of the CAG under the Companies Act, 2013 are subjected to supplementary or test audit by officers of the CAG and CAG gives his comments or supplements the report of the Statutory Auditors. The Companies Act, 2013 empowers the CAG to issue directions to the Statutory Auditors on the manner in which the Company's accounts shall be audited.

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

PAC Role in 60 seconds:

- PAC = Public Accounts Committee
- First set up in 1921 under Montague Chelmsford Reforms
- Strength: 22 members (15 Lok Sabha + 7 Rajya Sabha)
- Chairman from opposition since 1967
- Minister not eligible
- Functions: Examine C&AG report, Check unauthorized expenditure, Scrutinize spending, Audit public corporations
- Review of Accounts: C&AG appoints statutory auditor, conducts supplementary audit, comments on report
- **Mnemonic:** PAC → Public Accounts Committee

Government Accounting Standards issued by GASAB

1. Chapter Overview

The accounting systems, the world over, are being revisited with an emphasis on transition from rule to principle based standards and migration from cash to accrual based system of accounting. The GASAB, as a nodal advisory body in India, is taking similar action to formulate and improve standards of government accounting and financial reporting and enhance accountability mechanisms.

2. Learning Objectives

- Understand the constitution and structure of GASAB.
- Know the responsibilities of GASAB.
- Understand the two types of standards developed by GASAB: IGAS and IGFRS.
- Know the list of IGAS and IGFRS standards.

3. Important Definitions

DEFINITION

GASAB: Government Accounting Standards Advisory Board, constituted by the Comptroller and Auditor General of India (C&AG) with the support of Government of India through a notification dated August 12, 2002.

DEFINITION

Mission: To formulate and recommend Indian Government Accounting Standards (IGASs) for cash system of accounting and Indian Government Financial Reporting Standards (IGFRS) for accrual system of accounting.

4. Structure of GASAB

The Board has high level representation from the important accounting heads in Government, Ministry of Finance, Department of Post, Finance Secretaries of states, RBI and heads of premier accounting & research organizations. The board consists of the following members:

1. Deputy Comptroller and Auditor General (Government Accounts) as Chairperson
2. Financial Commissioner, Railways
3. Member (Finance) Telecom Commission, Department of Telecom
4. Secretary, Department of Post
5. Controller General of Defence Accounts
6. Controller General of Accounts
7. Additional / Joint Secretary (Budget), Ministry of Finance, Government of India
8. Deputy Governor, Reserve Bank of India, or his nominee
9. Principal Secretary (Finance) of four States, by rotation
10. Director General, National Council of Applied Economic Research (NCAER), New Delhi
11. President, Institute of Chartered Accountants of India (ICAI), or his nominee
12. President, Institute of Cost and Works Accountants of India, or his nominee
13. Principal Director in GASAB, as Member secretary

5. Responsibilities of GASAB

1. To formulate and improve standard of Government accounting and financial reporting in order to enhance accountability mechanisms.
2. To formulate and propose standards that improve the usefulness of financial reports based on the needs of the users.
3. To keep the standards current and reflect change in the Governmental environment.
4. To provide guidance on implementation of standards.
5. To consider significant areas of accounting and financial reporting that can be improved through the standard setting process.
6. To improve the common understanding of the nature and purpose of information contained in the financial reports.

6. Types of Standards

GASAB STANDARDS

IGAS (Cash System)

IGFRS (Accrual System)

IGAS 1, 2, 3, 7, 9, 10

IGFRS 1, 2, 3, 4, 5

7. List of IGAS Standards

IGAS	TITLE	STATUS
IGAS 1	Guarantees given by Governments: Disclosure Requirements	Notified
IGAS 2	Accounting and Classification of Grants-in-aid	Notified
IGAS 3	Loans and Advances made by Governments	Notified
IGAS 7	Foreign Currency Transactions and Loss/Gain by Exchange Rate Variations	Under consideration
IGAS 9	Government Investments in Equity	Under consideration
IGAS 10	Public Debt and Other Liabilities of Governments: Disclosure Requirements	Under consideration

8. List of IGFRS Standards

IGFRS	TITLE
IGFRS 1	Presentation of Financial Statements
IGFRS 2	Property, Plant & Equipment
IGFRS 3	Revenue from Government Exchange Transactions
IGFRS 4	Inventories
IGFRS 5	Contingent Liabilities (other than guarantees) and Contingent Assets: Disclosure Requirements

9. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

GASAB in 90 seconds:

- GASAB = Government Accounting Standards Advisory Board
- Constituted by C&AG on August 12, 2002
- Chairperson: Deputy C&AG (Government Accounts)
- Responsibilities: Formulate standards, Improve usefulness, Keep current, Provide guidance
- IGAS: Cash system (IGAS 1, 2, 3, 7, 9, 10)
- IGFRS: Accrual system (IGFRS 1, 2, 3, 4, 5)
- **Mnemonic: GASAB** → Government Accounting Standards Advisory Board

Government Accounting and Reporting

1. Chapter Overview

Controller General of Accounts (CGA) is the apex accounting body in the Government of India. It is the principal Accounts Adviser to the Government of India and is responsible for establishing and maintaining a technically sound management accounting system. The accounts of the Civil Ministries are compiled and maintained by the Pay and Accounts Offices, the basic accounting units.

2. Learning Objectives

- Understand the role of Controller General of Accounts (CGA).
- Know the features of Government Accounting in India.
- Understand the three funds: Consolidated Fund, Contingency Fund, Public Account.
- Know the role of CGA in Government Accounting and Information Technology.

3. Important Definitions

DEFINITION

Controller General of Accounts (CGA): The apex accounting body in the Government of India. It is the principal Accounts Adviser to the Government of India and is responsible for establishing and maintaining a technically sound management accounting system.

4. Role of CGA

- Consolidating monthly accounts of the Government of India and reporting on the fiscal deficit is the primary responsibility of the CGA.
- The monthly accounts are compiled in the CGA office and a monthly review indicating flow of expenditure, revenue collection, internal and external borrowing and fiscal deficit is prepared for Minister of Finance.
- A summary of the monthly accounts is also placed on the web.
- He prepares a critical analysis of expenditures, revenues, borrowings and the deficit for the Finance Minister every month.
- He also prepares annual Appropriation Accounts and Union Finance Accounts for presentation to the parliament.
- Ministries/Departments approach the CGA for advice on accounting procedures for new schemes, programmes or activities.
- The advice of the CGA is binding on the Ministries/Departments.

5. Features of Government Accounting in India

- All transactions are classified on a six tier functional classification with Major Heads representing a broad function of the Government at the top and an object head representing the activity at the bottom.
- The intermediate levels represent sub-functions, programmes, schemes and sub-schemes.
- The functional classification is applicable to receipts as well as payments.
- Expenditure of Government is divided into Plan and Non-Plan.
- Distinction is made between expenditure subject to vote of legislature and the rest which is charged upon the Consolidated Fund of India.
- Budget is on an annual basis; accounts have to conform to it.
- Accounts are maintained on cash basis. Only actual receipts realised and payments made during the year are recorded.
- Article of the Constitution provides for creation of a Consolidated Fund of India, Contingency Fund and Public Account.

6. Three Funds of Government Accounts

1. Consolidated Fund of India

- Constituted under Article 266 (1) of the Constitution.
- All revenues received by Government (taxes, non-tax revenues) credited into this fund.
- All loans raised by Government (internal and external debt) credited into this fund.
- All expenditure incurred from this fund.
- No amount can be withdrawn without authorization from Parliament.
- Largest of all three funds.

2. Public Accounts of India

- Constituted under Article 266 (2) of the Constitution.
- Transactions relate to debt other than those included in Consolidated Fund.
- Transactions under Debt, Deposits and Advances.
- Government incurs a liability to repay or has a claim to recover.
- Receipts do not constitute normal receipts of Government.
- Parliamentary authorization for payments not required.

3. Contingency Fund of India

- Set up under Article 267 of the Constitution.
- Records transactions connected with Contingency.
- Held on behalf of President by Secretary to Government of India, Ministry of Finance.
- Corpus of this fund is ₹500 crores.
- Advances made for meeting unforeseen expenditure.

- Resumed to the Fund to the full extent as soon as Parliament authorizes additional expenditure.
- Acts like an imprest account of Government of India.

7. Government Accounting & Information Technology

In a continuous effort towards improving the efficiency and the quality of the services rendered by the Department, Information Technology has been introduced at almost all levels of operations. At the three levels, software packages are used:

- **GAINS:** Government Accounting Information System (at CGA level)
- **CONTACT:** Controller's Accounts (at Principal Accounts Offices)
- **IMPROVE:** Integrated Multimodule Processor for Voucher Entries (at field Pay and Accounts Offices)

The monthly accounts are now published on the Web on the last day of the month following the month of account.

8. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

Government Accounting & Reporting in 90 seconds:

- CGA = Controller General of Accounts (apex accounting body)
- Role: Consolidate monthly accounts, Report fiscal deficit, Prepare annual accounts
- Features: Six tier classification, Plan/Non-Plan, Vote/Charged, Cash basis
- Three Funds: Consolidated Fund (Art 266(1)), Public Account (Art 266(2)), Contingency Fund (Art 267)
- IT Systems: GAINS, CONTACT, IMPROVE
- **Mnemonic: CPC** → Consolidated, Public, Contingency

IGAS Standards – Detailed Coverage

1. IGAS 1 – Guarantees Given by Governments: Disclosure Requirements

Introduction: The Union Government and the State Governments give Guarantees for repayment of borrowings within such limits as may be fixed upon the security of the Consolidated Fund of India or of the State, as the case may be, in terms of articles 292 and 293 of the Constitution.

Objective: To set out disclosure norms in respect of Guarantees given by the Union, the State Governments and Union Territory Governments (with legislature) in their respective Financial Statements to ensure uniform and complete disclosure of such Guarantees.

Scope: Applies to preparation of the Statement of Guarantees for inclusion and presentation in the Financial Statements of the Governments.

Important Definitions:

- **Accounting Authority:** Authority which prepares the Financial Statements of the Government.
- **Authority in the Government:** Tracking (monitoring) unit or Authority for Guarantees and in its absence, the Ministry or Department of Finance.
- **Automatic Debit Mechanism:** Arrangement whereby Government's cash balance is affected on a specified date or on occurrence of specified events to meet certain obligations arising out of Guarantees given by it.
- **Financial Statements:** Annual Finance Accounts of the Governments.
- **Guarantee:** An accessory contract, by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person.
- **Structured Payment Arrangement:** Arrangement whereby Government agrees to transfer funds to the designated account in case the beneficiary entity fails to ensure availability of adequate funds for servicing the debts.

Disclosure: The Financial Statements of the Union Government, the State Governments and the Union Territory Governments (with legislature) shall disclose:

- Maximum amount for which Guarantees have been given during the year, additions and deletions, and Guarantees outstanding at the beginning and end of the year;
- Amount of Guarantees invoked and discharged or not discharged during the year;
- Details of Guarantee commission or fee and its realisation; and
- Other material details.

Effective Date: Effective for Financial Statements covering periods beginning on or after 1.4.2010.

2. IGAS 2 – Accounting and Classification of Grants-in-Aid

Introduction: Grants-in-aid are payments in the nature of assistance, donations or contributions made by one government to another government, body, institution or individual. Grants-in-aid are given for specified purpose of supporting an institution including construction of assets.

Objective: To prescribe the principles for accounting and classification of Grants-in-aid in the Financial Statements of Government both as a grantor as well as a grantee; and to prescribe practical solutions to remove any difficulties experienced in adherence to appropriate principles.

Scope: Applies to the Union Government and the State Governments in accounting and classification of Grants-in-aid received or given by them. Encompasses cases of Pass-Through Grants.

Important Definitions:

- **Grants-in-aid:** Payments, transfers of funds, in cash or in kind, in the nature of donations or contributions by one government (grantor) to another government, body, institution or individual (grantee).
- **Local Bodies:** Includes Panchayati Raj Institutions and Urban Local Bodies.
- **Pass-Through Grants:** Grants-in-aid given by the Union Government to the State Governments for transfer to an ultimate grantee.

Recognition:

- Grants-in-aid in cash shall be recognised in the books of the grantor at the time cash disbursements take place. In the books of the grantee at the time cash receipts take place.
- Grants-in-aid in kind shall be recognised in the books of the grantor at the time of their receipt by the grantee. In the books of the grantee at the time of their receipt by the grantee.

Disclosure: Financial Statements of the grantor shall disclose the details of total funds released as Grants-in-aid and funds allocated for creation of capital assets by the grantee during the financial year, in the form of an Appendix to the Financial Statements.

Effective Date: Effective for the Financial Statements covering periods beginning from 1.4.2011.

3. IGAS 3 – Loans and Advances Made by Government

Introduction: The Government of India has been empowered under proviso (2) of Article 293 of the Constitution of India to make loans to the States. The Union Government has been providing financial assistance to the State Governments, a substantial portion of which is in the form of loans.

Objective: To lay down the norms for Recognition, Measurement, Valuation and Reporting in respect of Loans and Advances made by the Union and the State Governments in their respective Financial Statements to ensure complete, accurate, realistic and uniform accounting practices.

Scope: Applies to Loans and Advances given by the Government for incorporation and presentation in the Financial Statements of the Government. Applies only to government accounts being maintained on a cash basis.

Important Definitions:

- **Advances:** Loans made to Government servants.
- **Carrying Amount:** Net amount which the debtor owes the creditor at any point of time.
- **Cash Basis of Accounting:** Accounting transactions represent actual cash receipts and disbursements.
- **Charged and Voted Loans and Advances:** All loans to State Governments and a part of the same to Union Territory Governments made by the Union Government are 'charged' loans whereas all other loans and advances are 'voted' loans and advances.
- **Loans:** Assistance by the Governments by providing money, goods or services directly or indirectly to the beneficiary entities which entails a contractual right to receive back equivalent moneys along with interest thereon.
- **Write-off:** When a competent authority remits or writes off any loan owing to its irrecoverability or otherwise.

Recognition:

- A loan shall be recognized by the disbursing entity as an asset from the date the money is actually disbursed and not from the date of sanction.
- If a loan is disbursed in installments, then each installment shall be treated as a separate loan.
- The loans converted into equity shall be treated as conversion and shall lead to a reduction in the outstanding loan amount.
- The debt assumption due to invocation of guarantees shall be treated as disbursement of loan.

Measurement and Valuation: Historical Cost measurement shall be the basis for accounting and reporting on loans and advances made by Governments.

Disclosure: Financial Statements of the Union and State Governments shall disclose the Carrying Amount of loans and advances at the beginning and end of the accounting period showing additional disbursements and repayments or write-offs. An additional column shall reflect the amount of interest in arrears.

Effective Date: Effective for the Financial Statements covering periods beginning from 1.4.2011.

4. IGAS 7 – Foreign Currency Transactions and Loss/Gain by Exchange Rate Variation

Introduction: Government Accounting Rules, 1990 require that the accounts of the Government shall be maintained in Indian currency. All transactions of the Union and State Governments taking place in other countries are passed periodically by the Indian Embassies/Missions to India and brought to account finally in the Indian books after they have been converted into rupees.

Objective: To provide accounting and disclosure requirements of foreign currency transactions and financial effects of exchange rate variations in terms of loss or gain in the financial statements.

Scope: Applies to accounting and disclosure for transactions in foreign currencies; accounting and disclosure for financial effects of exchange variations; and disclosure of foreign currency external debts.

Treatment of Loss or Gain:

- All losses or gains by exchange rate variation in respect of Government transactions in foreign currencies shall be recognised as revenue loss or gain.
- Loss or gain arising out of transactions for acquisition of Special Drawing Rights at the International Monetary Fund shall be reported in the financial statements.
- Exchange difference may arise out of Government's financing activities like borrowing of loans denominated in foreign currencies and issuing of rupees securities.

Disclosure: Financial statements shall disclose rates of exchange adopted internally by the Government for different types of foreign currency transactions.

5. IGAS 9 – Government Investments in Equity

Introduction: The Union Government, State Governments, and Governments of Union Territories with Legislatures make investments in entities like Government companies, Statutory Corporations, other Joint Stock Companies and Cooperative Banks/Societies etc.

Objective: To lay down the norms for recognition, measurement, and reporting of investments of the Government in the Financial Statements so that the financial statements provide a true and fair view of investments of the Government.

Scope: Applies to investments made in different investee entities by the Government. Applies only to Government accounts being maintained on cash basis.

Important Definitions:

- **Bonus Shares:** Shares issued free of cost to the shareholders by an investee entity by capitalising its reserves and/or the security premiums.
- **Disinvestment/Divestment/Retirement of Government Equity:** Sale or transfer of equity shares by the Government.
- **Government Investment in Equity:** Includes investment in equity shares obtained by the Government on payment of cash or in exchange of any other asset; exercise of a right granted by the investee; issuance of bonus shares; reinvestment of dividends; or conversion of loans into equity.
- **Historical Cost:** Cost of acquisition of equity shares.
- **Right Shares:** Allotment of shares on the issue of fresh capital by an investee entity to which a shareholder is entitled.

Recognition: An investment in equity shall be recognised by the Government as an asset from the date on which the investment details are entered in the books of the entity.

Measurement: The method of initial measurement is the historical cost of the investment. Historical cost of Bonus shares is nil. Historical cost of equity shares acquired on conversion of loans is the amount of the loan outstanding against which such shares are allotted.

Disclosure: Financial Statements shall disclose the amount of investments at the beginning and at the end of the accounting period showing additional investments, disinvestments or retirement/write down of capital/transfer of share.

6. IGAS 10 – Public Debt and Other Liabilities of Governments: Disclosure Requirements

Introduction: In terms of Article 292 of the Constitution, the executive power of the Union extends to borrowing upon the security of the Consolidated Fund of India within such limits as may from time to time be fixed by Parliament by Law.

Objective: To lay down the principles for identification, measurement and disclosure of public debt and other obligation of Union and the State Governments including Union Territories with legislatures in their respective financial statements.

Scope: Applies to the financial statements prepared by the Union and State Governments and Union Territories with legislature. Covers "other obligations" as defined. Does not include guarantees and other contingent liabilities.

Important Definitions:

- **Public Debt:** Includes internal and external debts of the Central Government, State Governments and Government of the Union Territory with legislature.
- **Other Obligations:** Net outcome of the receipt and payment transactions arising in the public account. Does not include transactions categorized as Remittances, Suspense and Miscellaneous and Cash Balance.
- **Face Value:** Contract value of the Public Debt or other obligations.

Measurement & Valuation: Public Debt and Other Obligations incurred by Governments shall be accounted and reported on the basis of Face Value. For reporting external debt, changes in Balance at the end of the Accounting Period arising from variations in the rate of exchange shall also be reported.

Disclosure: Financial statements shall disclose opening balance, additions, discharges, closing balance and net change in rupee terms with respect to internal debt, external debt and other obligations.

7. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

IGAS Standards in 90 seconds:

- IGAS 1: Guarantees given by Governments – Disclosure Requirements
- IGAS 2: Accounting and Classification of Grants-in-aid
- IGAS 3: Loans and Advances made by Governments
- IGAS 7: Foreign Currency Transactions and Loss/Gain
- IGAS 9: Government Investments in Equity
- IGAS 10: Public Debt and Other Liabilities
- **Mnemonic: GGLFIP** → Guarantees, Grants, Loans, Foreign, Investments, Public Debt

IGFRS Standards – Accrual Based

1. Chapter Overview

The standards being developed for accrual system of accounting in the Government are called the Indian Government Financial Reporting Standards (IGFRS). These standards have been developed to address the issues related with the existing cash system of accounting and its migration to the accrual system of accounting in future.

2. Learning Objectives

- Understand the concept and purpose of IGFRS.
- Know the various IGFRS standards.
- Understand the scope and application of each IGFRS.

3. List of IGFRS Standards

IGFRS	TITLE	CORE PRINCIPLE
IGFRS 1	Presentation of Financial Statements	Overall requirement for presentation, structure and minimum content
IGFRS 2	Property, Plant & Equipment	Recognition, measurement, depreciation and impairment
IGFRS 3	Revenue from Government Exchange Transactions	Recognition and measurement under accrual basis
IGFRS 4	Inventories	Cost determination, expense recognition, write-down to NRV
IGFRS 5	Contingent Liabilities and Contingent Assets: Disclosure Requirements	Disclosure principles for contingent liabilities and assets

4. IGFRS 1 – Presentation of Financial Statements

IGFRS 1 has prescribed the manner of presentation of financial statements by Government entities that follow accrual basis of accounting. It sets out overall requirement for the presentation of financial statements, guidance for their structure and minimum requirements for the content of financial statements presented under the accrual basis of accounting.

5. IFRS 2 – Property, Plant & Equipment

This standard has prescribed the accounting treatment for property, plant and equipment (PPE) so that users of financial statements can obtain information regarding an entity's investment in its property, plant and equipment and any changes in such investment. The principal issues in accounting for PPE are:

- The timing of recognition of the assets
- The determination of their carrying amounts
- The depreciation charges and impairment losses to be recognised in relation to them

This standard aims at categorising assets according to their nature and also aims to provide for depreciation of assets, taking into account their usage over the life of the assets. The Accounting Standard is essentially an adaptation to Indian requirements of International Public Sector Accounting Standard (IPSAS 17) issued by IFAC on Property, Plant and Equipment.

6. IFRS 3 – Revenue from Government Exchange Transactions

This Standard lays down the principles to be followed for recognition and measurement of revenue from exchange transactions by government entities under accrual basis of accounting, wherein transactions and other events are recognised when they occur (and not only when cash or its equivalent is received or paid).

7. IFRS 4 – Inventories

This standard has prescribed the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard provides guidance on:

- The determination of cost and its subsequent recognition as an expense
- Any write-down to net realizable value
- The cost formulas that are used to assign costs to inventories

This Standard aims at using accrual principles of accounting for inventories – both at the stage of charging as expense and depicting the closing stock in the financial statements at the end of the reporting period. The Accounting Standard has derived inputs from Indian Accounting Standards (Ind AS 2), IPSAS 12 and IAS 2.

8. IGFRS 5 – Contingent Liabilities and Contingent Assets: Disclosure Requirements

This standard has laid down the principles for disclosure requirements of Contingent Liabilities (other than guarantees) and Contingent Assets for both the Union and the State Governments including Union Territories with Legislatures, in their respective Financial Statements in order to ensure uniform and appropriate disclosure of such liabilities and assets. It also ensures consistency with international best practices leading to transparency and improved quality of disclosure in the financial reports of Governments.

An important objective of the IGFRS is to ensure that Governments portray the risks associated with contingent liabilities and contingent assets in a transparent manner. The purpose of this standard is to provide for disclosure requirements of contingent liabilities (other than guarantees) and contingent assets of Governments in the financial Statements.

9. 1-Day Before Exam Revision Sheet

1 DAY BEFORE EXAM

IGFRS in 90 seconds:

- IGFRS = Indian Government Financial Reporting Standards
- Accrual based standards for Government
- IGFRS 1: Presentation of Financial Statements
- IGFRS 2: Property, Plant & Equipment (adapted from IPSAS 17)
- IGFRS 3: Revenue from Government Exchange Transactions
- IGFRS 4: Inventories (inputs from Ind AS 2, IPSAS 12, IAS 2)
- IGFRS 5: Contingent Liabilities and Contingent Assets
- **Mnemonic: PPRIC** → Presentation, PPE, Revenue, Inventories, Contingent

MODULE 8 SUMMARY & MEGA REVISION

Complete Revision Sheet | Formula Sheet | Top Exam Points | Examiner Insights

A. Module Summary

KEY TAKEAWAY

Module 8 covers Government Accounting in India. This module carries **10% weightage** in Paper 18. It is primarily theory-based with some practical aspects. Master the differences between Government Accounting and Commercial Accounting, the role of C&AG, PAC, GASAB, and the various IGAS/IGFRS standards.

B. Mega Revision Sheet

TOPIC	CORE PRINCIPLE	KEY POINTS
General Principles	Government Accounting System	Features, Objectives, Comparison with Commercial Accounting
C&AG	Constitutional Authority (Article 148)	Audit, Compile Accounts, Report to Parliament
PAC	Parliamentary Committee (1921)	Examine C&AG Reports, Ensure Financial Control
GASAB	Advisory Board (2002)	Formulate IGAS and IGFRS Standards
IGAS	Cash System Standards	IGAS 1, 2, 3, 7, 9, 10
IGFRS	Accrual System Standards	IGFRS 1, 2, 3, 4, 5
Three Funds	Consolidated, Public, Contingency	Article 266(1), 266(2), 267

C. Formula Sheet – Quick Reference

CONCEPT	FORMULA/KEY POINT
Consolidated Fund	Article 266(1) – All revenues, loans, expenditure
Public Account	Article 266(2) – Debt, Deposits, Advances
Contingency Fund	Article 267 – Corpus ₹500 crores
IGAS 1	Guarantees given by Governments – Disclosure
IGAS 2	Grants-in-aid – Accounting and Classification
IGAS 3	Loans and Advances – Historical Cost
IGFRS 1	Presentation of Financial Statements
IGFRS 2	Property, Plant & Equipment
IGFRS 3	Revenue from Government Exchange Transactions
IGFRS 4	Inventories
IGFRS 5	Contingent Liabilities and Contingent Assets

D. Top Exam Points – Quick Revision

1. Government Accounting = Public Finance Accounting.
2. Features: Specific system, Public funds, Government regulations, Double entry.
3. Objectives: Record, Provide data, Follow rules, Avoid excess, Prepare statements.
4. Principles: Classification, Budget-based, Monthly/Annual accounts, April-March, Cash basis.
5. Government Accounting vs Commercial Accounting: Objective, Scope, Budget, Basis.
6. C&AG = Comptroller and Auditor General of India.
7. C&AG established under Article 148 of Constitution.
8. C&AG appointed by President for 6 years.
9. C&AG = Guardian of national purse.
10. Duties, Powers and Conditions of Service Act, 1971.
11. C&AG functions: Compile accounts, Prepare and submit. Give information. Audit. Report.
51. Contingency Fund: Unforeseen expenditure, imprest account.
52. Government Accounting: Six tier functional classification.
53. Government Accounting: Plan and Non-Plan expenditure.
54. Government Accounting: Vote and Charged expenditure.
55. Government Accounting: Cash basis.
56. IT Systems: GAINS, CONTACT, IMPROVE.
57. GAINS = Government Accounting Information System.
58. CONTACT = Controller's Accounts.
59. IMPROVE = Integrated Multimodule Processor for Voucher Entries.
60. Monthly accounts published on Web on last day of following month.
61. Financial Statements of Government: Annual Finance Accounts.
62. Financial Statements of Government: Monthly accounts and annual accounts.

E. Examiner Insights

★ EXAM IMPORTANT

- Always mention constitutional articles (148, 266, 267) for C&AG, Funds.
- For C&AG questions, mention the Duties, Powers and Conditions of Service Act, 1971.
- For PAC questions, mention 1921, Montague Chelmsford Reforms, 22 members.
- For GASAB questions, mention August 12, 2002, Chairperson, and standards.
- For IGAS questions, mention the specific standard number and title.
- For IGFRS questions, mention the specific standard number and title.
- For comparison questions, use a table format with clear headings.
- For theory questions, use bullet points and headings.
- Time management: Allocate 1.8 minutes per mark.
- Read the question carefully for "explain", "discuss", "compare", "list".

F. Frequently Repeated Concepts

- Government Accounting vs Commercial Accounting (differences) — appears almost every attempt.
- Features of Government Accounting — very common.

- Objectives of Government Accounting — frequently tested.
- Role and functions of C&AG — regular.
- Constitution and functions of PAC — common theory question.
- GASAB structure and responsibilities — increasingly important.
- IGAS 1, 2, 3 standards — regular.
- IGFRS standards — common.
- Three funds — frequently tested.

G. Final Revision Checklist

1 DAY BEFORE EXAM

- ☒ Government Accounting definition
- ☒ Features of Government Accounting
- ☒ Objectives of Government Accounting
- ☒ General Principles of Government Accounting
- ☒ Comparison: Government vs Commercial Accounting
- ☒ C&AG – Constitutional provisions
- ☒ C&AG – Duties, Powers and Functions
- ☒ C&AG – Audit of Government Companies
- ☒ PAC – Constitution and Composition
- ☒ PAC – Role and Functions
- ☒ Review of Accounts
- ☒ GASAB – Structure
- ☒ GASAB – Responsibilities
- ☒ IGAS 1 – Guarantees
- ☒ IGAS 2 – Grants-in-aid
- ☒ IGAS 3 – Loans and Advances
- ☒ IGAS 7 – Foreign Currency
- ☒ IGAS 9 – Investments in Equity
- ☒ IGAS 10 – Public Debt
- ☒ IGFRS 1 – Presentation
- ☒ IGFRS 2 – PPE
- ☒ IGFRS 3 – Revenue
- ☒ IGFRS 4 – Inventories
- ☒ IGFRS 5 – Contingent Liabilities
- ☒ Three Funds of Government Accounts
- ☒ CGA – Role and Functions
- ☒ IT Systems – GAINS, CONTACT, IMPROVE
- ☒ Common mistakes to avoid
- ☒ Examiner insights
- ☒ Memory tricks and mnemonics
- ☒ Formula sheet
- ☒ Top exam points
- ☒ Frequently repeated concepts
- ☒ Final revision checklist
- ☒ Printable PDF version content

H. Common Mistakes Students Make

⚠ WARNING

- Confusing Government Accounting with Commercial Accounting.
- Forgetting to mention the constitutional articles (148, 266, 267).
- Not mentioning the Duties, Powers and Conditions of Service Act, 1971.
- Not mentioning Montague Chelmsford Reforms for PAC.
- Not mentioning August 12, 2002 for GASAB.
- Confusing IGAS and IGFRS.
- Not mentioning the specific standard numbers and titles.
- Forgetting the three funds and their constitutional articles.
- Not mentioning the corpus of Contingency Fund (₹500 crores).
- Not mentioning CGA as apex accounting body.
- Not mentioning IT systems (GAINS, CONTACT, IMPROVE).
- Incorrect comparison between Government and Commercial Accounting.

I. Memory Tricks and Mnemonics

🔑 KEY TAKEAWAY

Government Accounting Features: SPGBBBAF → Specific, Public, Government, Budget, Budgetary, Bank, Auditing, Fund-based

C&AG Functions: CPAAR → Compile, Prepare, Assist, Audit, Report

PAC: PAC → Public Accounts Committee

GASAB: GASAB → Government Accounting Standards Advisory Board

IGAS: GGLFIP → Guarantees, Grants, Loans, Foreign, Investments, Public Debt

IGFRS: PPRIC → Presentation, PPE, Revenue, Inventories, Contingent

Three Funds: CPC → Consolidated, Public, Contingency

CGA: CGA → Controller General of Accounts

IT Systems: GCI → GAINS, CONTACT, IMPROVE

1 DAY BEFORE EXAM

Module 8 – Printable Quick Notes:

1. Government Accounting = Public Finance Accounting; Cash basis; Three funds
2. Features: Specific system, Public funds, Government regulations, Double entry, Budget heads
3. Comparison: Government vs Commercial Accounting (Objective, Scope, Budget, Basis, Audit)
4. C&AG: Article 148; Appointed by President for 6 years; Guardian of national purse
5. C&AG: Duties, Powers and Conditions of Service Act, 1971
6. PAC: 1921 Montague Chelmsford Reforms; 22 members (15 LS + 7 RS)
7. GASAB: August 12, 2002; Chairperson: Deputy C&AG (Government Accounts)
8. IGAS: Cash system standards (1, 2, 3, 7, 9, 10)
9. IGFRS: Accrual system standards (1, 2, 3, 4, 5)
10. Consolidated Fund: Article 266(1); Public Account: Article 266(2); Contingency Fund: Article 267
11. CGA: Apex accounting body; Consolidates monthly accounts; GAINS, CONTACT, IMPROVE

KEY TAKEAWAY

END OF MODULE 8 – GOVERNMENT ACCOUNTING IN INDIA

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