Query No. 22

Subject: Consolidation of financial statements of an associate company which is a section 8 company, under Ind AS framework.[1]

A. Facts of the Case

1. A company (hereinafter referred to as 'the Company') is one of India's leading Defence Public Sector Undertakings, established in 2021 under the Ministry of Defence as part of the restructuring of the erstwhile Ordinance Factory Board. The Company is entrusted with the critical responsibility of manufacturing a wide range of high-quality forgings, castings, steel and non-ferrous components, and other engineering products to support the operational readiness of the Indian Armed Forces.

2. With a strong legacy of expertise and state-of-the-art facilities across multiple production units, the Company plays a vital role in strengthening India's defence manufacturing ecosystem. The Company is committed to delivering precision, reliability, and innovation in every product, thereby contributing to the vision of Atmanirbhar Bharat in defence.

3. During the financial year (F.Y.) 2024-25, the Company invested in *A M Foundation* (AMF), which was established under the Defence Testing Infrastructure Scheme (DTIS) promulgated by the Department of Defence Production. The Company holds *20% shareholding* in this entity (AMF). Accordingly, in terms of Indian Accounting Standard (Ind AS) 28, 'Investments in Associates and Joint Ventures', the entity qualifies as an *associate* of the Company. The AMF is incorporated as a *section 8 company* (not-for-profit entity under the Companies Act, 2013). Apart from this investment, the Company has no other subsidiary, associate, or joint venture. (Emphasis supplied by the querist.)

4. During F.Y. 2024-25, the Company recognised this investment in AMF in its books in accordance with Indian Accounting Standard (Ind AS) 28, 'Investments in Associates and Joint Ventures', applying the equity method (i.e., cost of investment plus the Company's share of the investee's profit).

5. The Statutory auditors have given the qualification on this account as under:

> "During the year the Company has invested in an associate company incorporated as a Section 8 company under Companies Act, 2013 with 20% shareholding. We draw attention to the Statement of Profit and Loss wherein the Company added the share of profit of Rs. 3.68 crore in the financial statements being 20% of the profit share of Section 8 company. However, as per Section 8 of the Companies Act 2013, no profit can directly or indirectly be distributed among any of the members or shareholders as the case may be. Hence, the profit of the Company and investment in associate are overstated to the extent of Rs. 3.68 Crore."

6. In view of the above facts and qualification by the statutory auditor, the querist has sought clarification on the requirement of preparation of Consolidated Financial Statements (CFS) considering the fact that in case profit of section 8 company cannot be appropriated, the Company's CFS will exactly be same as Standalone Financial Statements (SFS) with an additional disclosure regarding section 8 company. The querist is of the view that the additional

[1] Opinion finalised by the Committee on 16.12.2025.

disclosure regarding section 8 company can be given in SFS itself and there is no need for preparation of CFS.

B. Query

7. On the basis of the above, the querist has sought the opinion of the Expert Advisory Committee as to where an investor company holds 20% shareholding in an entity incorporated as a section 8 company (not-for-profit entity under the Companies Act, 2013), thereby classifying it as an 'associate' in terms of Ind AS 28, 'Investments in Associates and Joint Ventures', whether the investor company is required to apply the equity method of accounting in its consolidated financial statements, or whether such investment should be carried *at cost* without recognition of the share of profit/loss of the section 8 company.

Further, if recognition of the share of profit/loss is not permitted in respect of such an associate, then considering that the Company has no other subsidiary, associate, or joint venture apart from this section 8 company, would the preparation of Consolidated Financial Statements (CFS) still be mandatory? Or, in such circumstances, would the preparation of Standalone Financial Statements (SFS) with appropriate disclosure of the investment be considered sufficient compliance with Ind AS and Companies Act, 2013 requirements?

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to the need of application of equity method of accounting for an associate company, which is a section 8 company under the Companies Act, 2013 and recognition of share of profit/loss of associate (being a section 8 company) in the financial statements of the Company. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting in the books of section 8 company, detailed application of Ind AS 28, 'Investments in Associates and Joint Ventures' including application of equity method, etc. The opinion expressed hereinafter is purely from accounting perspective and considering the requirements of Indian Accounting Standards (Ind AS), notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended or revised from time to time; and not from legal perspective, such as, interpretation of Companies Act/Rules, etc.

9. At the outset, the Committee notes that the Company has considered AMF (section 8 company) as an 'associate' as it holds 20 % shareholding in it. In this regard, the Committee notes the following requirements of Ind AS 28:

> **"*Significant influence* is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies."**
>
> "5 If an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

6 The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

(a) representation on the board of directors or equivalent governing body of the investee;

(b) participation in policy-making processes, including participation in decisions about dividends or other distributions;

(c) material transactions between the entity and its investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information."

The Committee notes from the requirements of Ind AS 28 that an associate is an entity over which the investor has significant influence, i.e., the power to participate in the financial and operating policy decisions of the investee. Further, if an entity holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Thus, merely holding 20% shares (and thereby holding 20% voting power) does not conclude that the entity is an 'associate' and the same should be determined considering the requirements of Ind AS 28. However, in the absence of detailed information and as the issue of existence of 'significant influence' has neither been raised by the querist and nor objected to by the auditor, the Committee has not examined the aspect related to whether the Company has significant influence on AMF or not and has proceeded on the premise that the Company has significant influence and therefore, AMF is an associate of the Company.

10. With regard to the issue raised regarding application of equity method of accounting and consolidation, the Committee notes that section 129(3) of the Companies Act, 2013 provides as follows:

"(3) Where a company has one or more subsidiaries or *associate companies*, it shall, in addition to financial statements provided under sub-section (2), prepare a consolidated financial statement of the company and of *all* the subsidiaries and *associate companies* in the same form and manner as that of its own and in accordance with applicable accounting standards, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2):

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

Provided further that the Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed."

Further, the manner of consolidation has been laid down in Rule 6 of the Companies (Accounts) Rules, 2014, which states as under:

"**Manner of consolidation of accounts.**

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

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

…"

Division II of Schedule III to the Act

Further, paragraphs 3 and 4 of Part III - General Instructions for the Preparation of Consolidated Financial Statements, contained in Division II of Schedule III to the Act read as under:

"3. *All* subsidiaries, *associates* and joint venture (whether Indian or Foreign) will be covered under consolidated financial statements.

4. An entity shall disclose the list of subsidiaries or associates or joint venture which have not been consolidated in the consolidated financial statement along with the reason of not consolidating."

(Emphasis supplied by the Committee.)

From the above, the Committee notes that as per the provisions of the Act, a company is required to prepare consolidated financial statements of the company and all its associates (even if the company does not have any subsidiary), unless it is exempt from that requirement in accordance with law and applicable Accounting Standards. In this regard, the Committee wishes to clarify that 'consolidation' in the case of associates/joint ventures should be construed to mean financial statements prepared by applying 'equity method' of accounting in accordance with Ind AS 28, 'Investments in Associates and Joint Ventures'. This is also evident from paragraph 7 of Ind AS 27, 'Separate Financial Statements', which states, "Financial statements in which the equity method is applied are not separate financial statements. These may be termed as 'consolidated financial statements'. ..."

11. With regard to exemption from applying equity method, the Committee notes the following requirements from Ind AS 28, 'Investments in Associates and Joint Ventures':

"16 An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 17–19.

Exemptions from applying the equity method

17 An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a parent that is exempt from preparing consolidated financial statements by the scope exception in paragraph 4(a) of Ind AS 110 or if all the following apply:

(a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.

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

(c) The entity 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.

(d) The ultimate or any intermediate parent of the entity produces financial statements available for public use that comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110.

18 When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through profit or loss in accordance with Ind AS 109. … An entity shall make this election separately for each associate or joint venture, at initial recognition of the associate or joint venture…

19 When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109 regardless of whether the venture capital organisation has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation."

From the above, the Committee notes that paragraph 17 of Ind AS 28, inter alia, exempts an entity from applying equity method to its investment in an associate if the entity is a parent that is exempt from preparing consolidated financial statements by scope exception in paragraph 4(a) of Ind AS 110, 'Consolidated Financial Statements', which states as follows:

"4 An entity that is a parent shall present consolidated financial statements. This Ind AS applies to all entities, except as follows:

(a) 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 (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(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 financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with this Ind AS."

From the above, the Committee notes that no specific exemption is available under the Companies Act or Indian Accounting Standards from consolidation or application of equity method of accounting on the basis that the associate company is a not-for-profit organisation or a section 8 company. As per the requirements of Ind AS 28, an entity with significant influence over an investee shall account for its investment in an associate in its consolidated financial statements using the equity method except when that investment qualifies for exemption in accordance with paragraphs 17–19 of Ind AS 28. However, in the absence of detailed information and as neither the querist nor the auditor has raised the issue with regard to the exemptions available in paragraphs 17-19 of Ind AS 28, the Committee has not examined the exemptions available under paragraphs 17-19 of Ind AS 28.

12. With regard to the prohibition on distribution of profits of a section 8 company (directly or indirectly) among any of its shareholders or members, the Committee notes the following paragraphs from Ind AS 28 and Basis for Conclusions (BC) to International Accounting Standard (IAS) 28 (which is corresponding international standard to Ind AS 28), issued by the International Accounting Standards Board (IASB):

"10 Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. The investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see Ind AS 1, *Presentation of Financial Statements*).

11 The recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate or a joint venture because the distributions received may bear little relation to the performance of the associate or joint venture. Because the investor has joint control of, or significant influence over, the investee, the investor has an interest in the associate's or joint venture's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of the profit or loss of such an investee. As a result, application of the equity method provides more informative reporting of the investor's net assets and profit or loss."

"BCZ18 The Board decided not to exempt an entity from applying the equity method for accounting for its investments in joint ventures or associates when severe long-term restrictions impaired a joint venture or an associate's ability to transfer funds to the investor. It did so because such circumstances may not preclude the entity's joint control of, or significant influence over, the joint venture or the associate. The Board decided that an entity should, when assessing its ability to exercise joint control of, or significant influence over, an investee, consider restrictions on the transfer of funds from the joint venture or from the associate to the entity. In themselves, such restrictions do not preclude the existence of joint control or significant influence."

From the above, the Committee notes that an investor should apply the equity method even if there are severe long-term restrictions on transferring funds from an associate as such restrictions do not preclude the existence of significant influence. However, an entity should, when assessing its ability to exercise significant influence over, an investee, consider such restrictions on the transfer of funds from the investee to the entity.

Accordingly, in the extant case, the Committee is of the view that solely the existence of prohibition/restriction on distribution of profits by AMF in itself does not preclude the Company from having significant influence over AMF; however, the Company, while assessing its ability to exercise significant influence over AMF (section 8 company), should consider restrictions or prohibitions on transfer of funds by section 8 company. Further, since in the extant case, there is significant influence (as is presumed in paragraph 9 above), the Company should consolidate the financial statements of AMF (section 8 company) using equity method, as per the requirements of paragraphs 10 and 11 of Ind AS 28. In case, on the basis of afore-mentioned assessment, it is concluded that there is no significant influence, the question of consolidation shall not arise.

13. The Committee also notes the following requirements from Ind AS 1, 'Presentation of Financial Statements' and Division II of Schedule III to the Companies Act, 2013:

Ind AS 1

"Balance Sheet

Information to be presented in the balance sheet

54 The balance sheet shall include line items that present the following amounts:

(a) …

….

(e) investments accounted for using the equity method;

…"

55 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 54), headings and subtotals in the balance sheet when such presentation is relevant to an understanding of the entity's financial position.

55A When an entity presents subtotals in accordance with paragraph 55, those subtotals shall:

…

(b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;

…”

Statement of Profit and Loss

…

“**82 In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:**

…

(c) share of the profit or loss of associates and joint ventures accounted for using the equity method;

…”

“85 An entity shall present additional line items (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the statement of profit and loss, when such presentation is relevant to an understanding of the entity’s financial performance.

85A When an entity presents subtotals in accordance with paragraph 85, those subtotals shall:

…

(b) be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable;

…”

Division II of Schedule III to the Companies Act, 2013

Illustrative Consolidated Financial Statements

…

Consolidated Statement of Profit and Loss for the year ended _______

	Particulars	**Note No.**	**Figures for the current reporting period**	**Figures for the previous reporting period**
…	…			
	Total expenses (VI)			
VII	Profit/(loss) before share of profit/(loss) of an associate / a joint venture and exceptional items (V - VI)			

VIII	Share of profit/(loss) of an associate/a joint venture			
…	…			

From the above, the Committee notes that as per the requirements of Ind AS 1, investments accounted for using the equity method are to be presented as separate line items. Further, Ind AS 1 requires that the Company shall present additional line items, headings, and subtotals in the balance sheet and statement of profit and loss, when such presentation is relevant to an understanding of the entity's financial position and performance and the same should be labelled in a clear and understandable manner. Thus, in the extant case, in the consolidated balance sheet, while presenting the investments in AMF (which is accounted for using equity method) as a separate line item, the Company can additionally include the share of profit (which is generally referred to as 'surplus' in case of section 8 company as it has to prepare income and expenditure account as per the requirements of Companies Act, 2013) from AMF in the inner column or as a sub-head and label the same in a manner so as to make the users of financial statements clearly understand that these are the share of surplus from a section 8 company on which there are prohibitions regarding distribution of surplus. The Committee further notes that Schedule III to the Companies Act, 2013 and Ind AS 1 require that in the statement of profit and loss, the Company's share of profit or loss from associates should be presented as a separate line item. Therefore, in the extant case, while presenting such share of surplus from AMF (a section 8 company), the share of surplus should be labelled and presented in a manner that the users are informed that these surplus are not distributable as dividends.

Further, with regard to the disclosures to be made, the Committee notes following paragraphs from Ind AS 112, 'Disclosure of Interests in Other Entities':

"21 An entity shall disclose:

(a) for each joint arrangement and associate that is material to the reporting entity:

…

(ii) the nature of the entity's relationship with the joint arrangement or associate (by, for example, describing the nature of the activities of the joint arrangement or associate and whether they are strategic to the entity's activities).

…

22 An entity shall also disclose:

(a) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements, regulatory requirements or contractual arrangements between investors with joint control of or significant influence over a joint venture or an associate) on the ability of joint ventures or associates to transfer funds to the entity in the form of cash dividends, or to repay loans or advances made by the entity.

…"

From the above, the Committee is of the view that in the extant case, the Company should disclose the nature of its relationship with its associate (AMF), by describing the nature of the activities of the associate (e.g., that the activities are not-for-profit in nature) and whether those activities are strategic to the Company's activities; the nature and extent of any significant restrictions resulting from the regulatory requirements on the ability of associate to transfer funds to the Company in the form of dividends etc. In addition, other disclosure requirements as prescribed under other Ind ASs and Schedule III to the Companies Act, 2013 should also be considered and complied with.

D. Opinion

14. On the basis of the above, the Committee is of the view that solely the existence of prohibition on distribution of profits by AMF in itself does not preclude the Company from having significant influence over AMF; however, the Company, while assessing its ability to exercise significant influence over AMF (section 8 company), should consider restrictions or prohibitions on transfer of funds by section 8 company. Further, since in the extant case, there is significant influence (as is presumed in paragraph 9 above), the Company should consolidate the financial statements of AMF (section 8 company) using equity method, as per the requirements of paragraphs 10 and 11 of Ind AS 28, as discussed in paragraphs 10 to 12 above.

Furthermore, in the extant case, while presenting the investment in AMF as a separate line item in the balance sheet, the Company can additionally include the share of surplus from AMF in the inner column or as a sub-head and label the same in a manner so as to make the users of financial statements clearly understand that these are the share of surplus from a section 8 company on which there are prohibitions regarding distribution. Similarly, in the statement of profit and loss, while presenting share of surplus from AMF (a section 8 company), as a separate line item, the share of surplus should be labelled and presented in a manner that the users are informed that these surplus are not distributable as dividends, as discussed in paragraph 13 above. Also, considering the requirements of Ind AS 112, the Company should disclose the nature of its relationship with its associate (AMF), by describing the nature of the activities of the associate (e.g., that the activities are not-for-profit in nature) and whether those activities are strategic to the Company's activities; the nature and extent of any significant restrictions resulting from the regulatory requirements on the ability of associate to transfer funds to the Company in the form of dividends etc. In addition, other disclosure requirements as prescribed under other Ind ASs and Schedule III to the Companies Act, 2013 should also be considered and complied with.

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