Southern India Regional Council of
The Institute of Chartered Accountants of India

Ind AS 110 Consolidated Financial Statements

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Relevant Standards

Consolidation related Standards

Ind AS 110
Deals with 'Consolidated financial statements'

Ind AS 111
Deals with 'Joint Arrangements'

Ind AS 28
Deals with 'Accounting for associates and joint ventures'

Ind AS 112
Deals with 'Disclosures of interests in other entities'

Objective and Scope

Objective

The objective of this Ind AS is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Defines the principle of control, and establishes control as the basis of consolidation;

Sets out the accounting requirements for the preparation of consolidated financial statements; and

Defines an investment entity and sets out an exception to consolidating subsidiaries of an investment entity.

This Ind AS does not deal with the accounting requirements for business combinations and their effect on consolidation, including goodwill arising on a business combination (see Ind AS 103 Business Combinations).

Scope

An entity that is a parent shall present CFS. Following Parents may be Exempted from preparing Consolidated financial statement (CFS):

1. A parent need not present CFS if it meets all the following conditions:

- It is a wholly-owned subsidiary; or a partially-owned subsidiary whose owners including those whose are not otherwise entitled to vote, have been informed and they have not objected for not presenting CFS.
- Equity Instrument or Debt Instrument of the parent are not traded in a public market (Domestic or Foreign stock exchange or over the counter market)
- It did not file, nor is it in the process of listing or issuing any instrument to raise fund from public; **and**
- Its ultimate or any intermediate parent produces CFS that are available for public use and comply with Ind AS.

2. An Entity

- Where post-employment benefit plans or other long-term employee benefit plans to which Ind AS 19, Employee Benefits, applies.

3. An Investment Entity

- Which measures all of its subsidiaries at fair value through profit or loss in accordance with Ind AS 109 (Financial Instruments)

Exclusion to Exemption

- Subsidiary of such entity who provide service to investment entity regarding its investment activity.
- Holding company of Investment co which is not an investment co.

Example

Exemption from preparing consolidated financial statements

Entity X owns the following other entities:

1. 100% interest in entity Y. Entity Y owns 60% interest in entity Z.

2. 80% interest in entity M. Entity M owns 60% interest in entity N.

Entity X is a listed company and prepares Ind AS compliant consolidated financial statements. Entities Y & M do not have their securities publically traded & they are not in the process of issuing securities in public markets. Entity X does not require its subsidiary M to prepare consolidated financial statements. Entity Y is a wholly- owned subsidiary of entity X. Entity Y is not required to prepare consolidated financial statements.

Entity M is not required to prepare consolidated financial statements provided, the non-controlling interest holders have been informed about, and do not object to Entity M presenting consolidated financial statements.

Where local regulations govern the participation of consolidated financial statement

At times local regulations dictate when, and for what periods, an entity must present consolidated or separate financial statements. Local regulations might allow or require an intermediate parent to produce separate financial statements prepared in accordance with Ind AS, instead of consolidated financial statements. Where local regulations permit an entity not to prepare consolidated financial statements, the entity should still consider the exemptions as per Ind AS 110 and determine whether it is exempt from preparing consolidated financial statements.

Key terminology

Consolidated financial statements	• Are the financial statements of a group in which assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.
Parent	• An entity that controls one or more entities.
Subsidiary	• An entity that is controlled by another entity.
Group	• A parent and its subsidiaries.

Key terminology

Non-controlling interest	• Equity in a subsidiary not attributable, directly or indirectly, to a parent.
Power	• Existing rights that give the current ability to direct the relevant activities.
Protective rights	• Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.
Relevant activities	• For the purpose of this Ind AS, relevant activities are activities of the investee that significantly affect the investee’s returns.

Statements prepared under Consolidation Financial statements

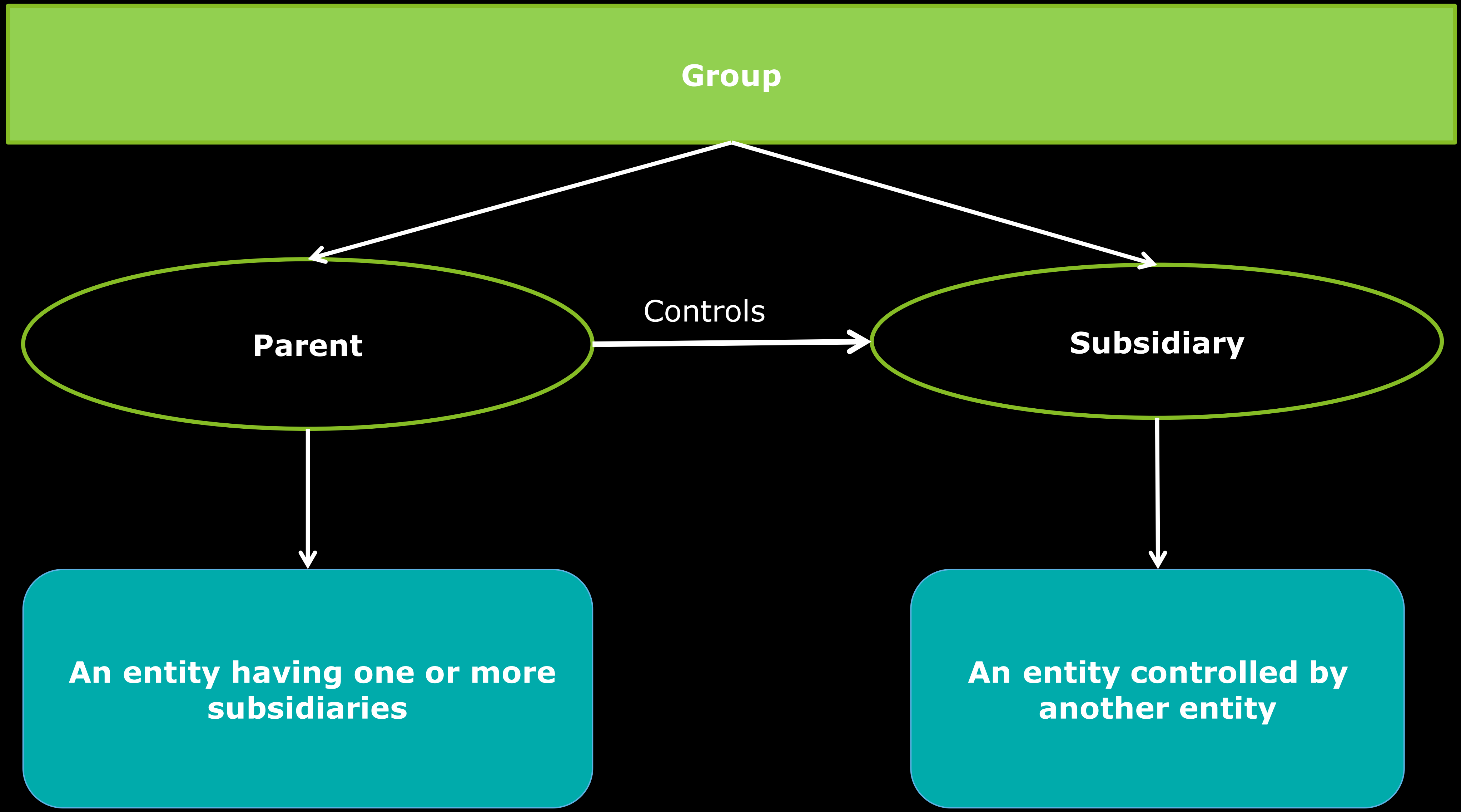
"A company which has a subsidiary on the last day of its accounting period must prepare consolidated financial statements *in addition to* its own individual financial statements."

Consolidated financial statements consist of

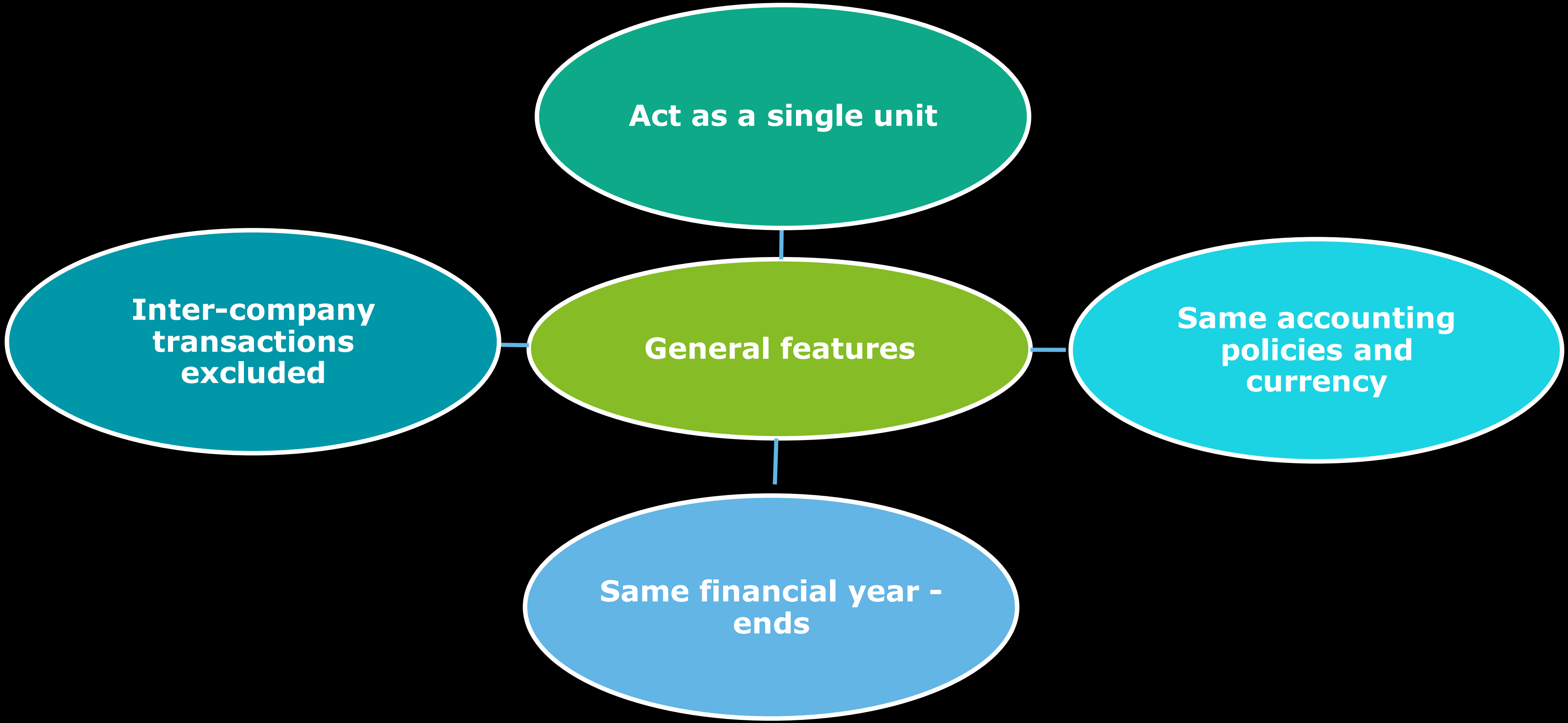
- Consolidated statement of financial position.
- Consolidated statement of comprehensive income.
- Consolidated SOCIE.
- Consolidated statement of cash flows.
- Notes to accounts.

Concept of Group & Control

Concept of a Group



What are the general features of a group?

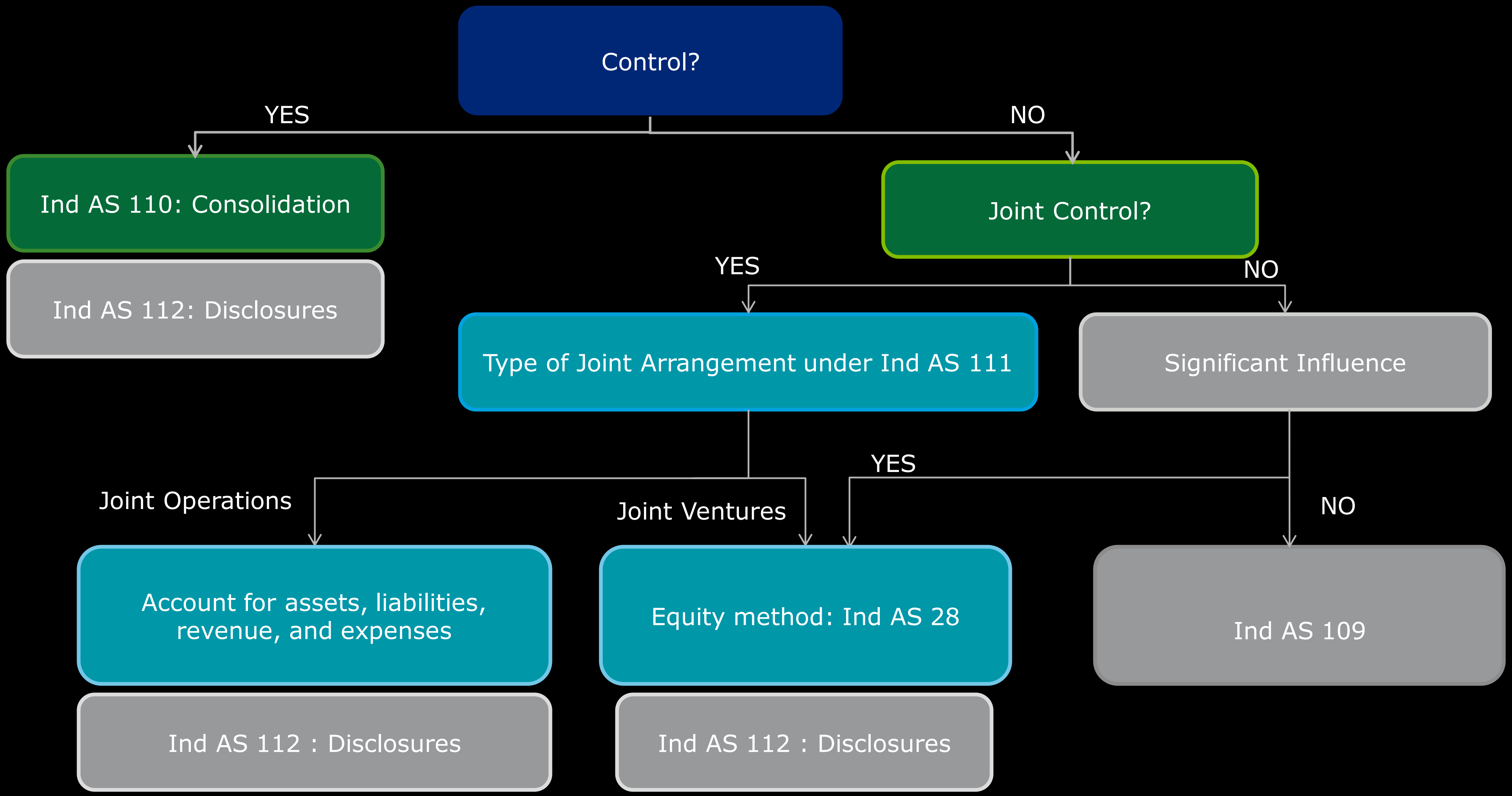


- ❑ Subsidiary with a different financial year should adjust significant events between different dates, which should be no longer than 3 months

(or)

- ❑ Special statements of subsidiary are prepared as at the same date of group.

Interaction between Ind AS 110, 111, 112 and other Ind ASs



Fundamental principle

Ind AS 110

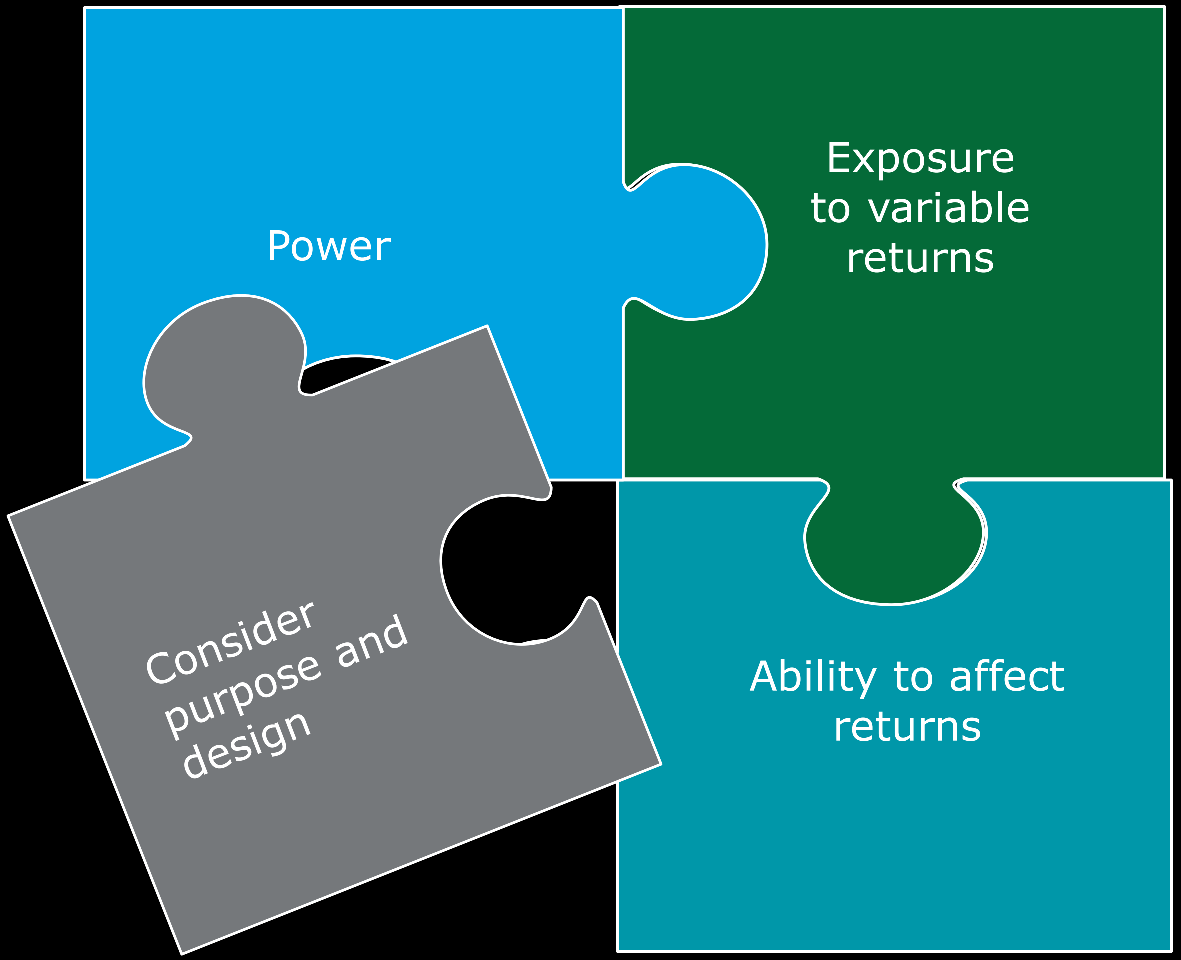
- Consolidation is based on control
- Control may be obtained in various manners, and not solely as a result of the power to direct the financial and operating policies
- Exposure to risks/rewards is one of the factors necessary to the existence of control, but it is never the determining factor

Ind AS 110 requires extensive use of judgment
(Ind AS 112 requires disclosure of areas of judgment)

Definition of Control

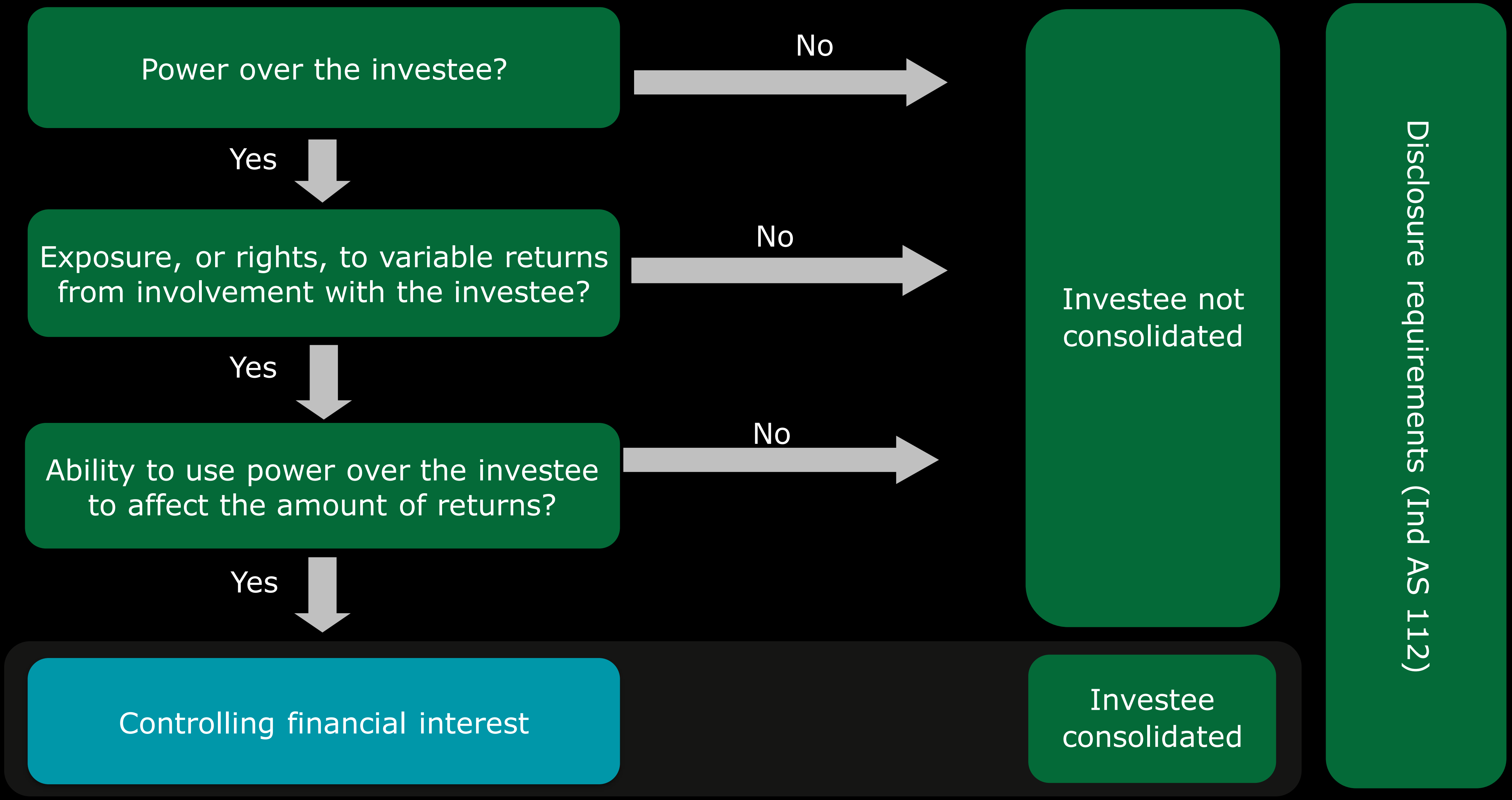
An investor controls an investee when **it is exposed, or has rights to, variable returns** from its involvement with the investee and has the **ability to affect** those returns through its **power over the investee**

Need to apply professional judgment!



Assessment of Control

Ind AS 110 consolidation decision process:

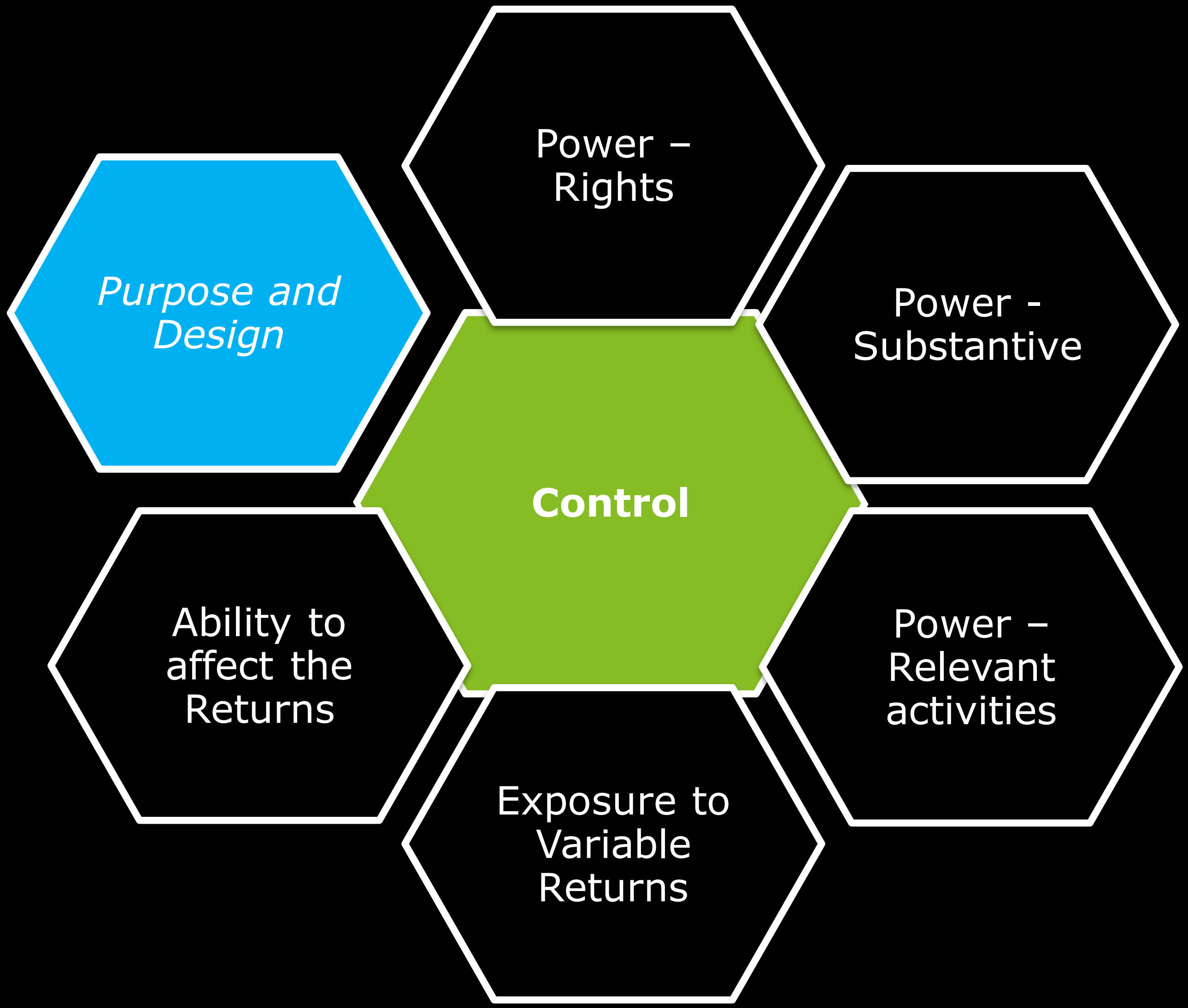


Consideration while assessing control

Some or all of the following factors may assist to determine whether investor controls investee:-

1. Purpose and design of the investee.
2. What the relevant activities of Investee are and how decisions about those activities are made.
3. Whether the rights of the investor give it the current ability to direct the relevant activities.
4. Investor has exposure, or rights, to variable returns from an investee.
5. Investor has ability to use its power over the investee to affect the amount of the its return.

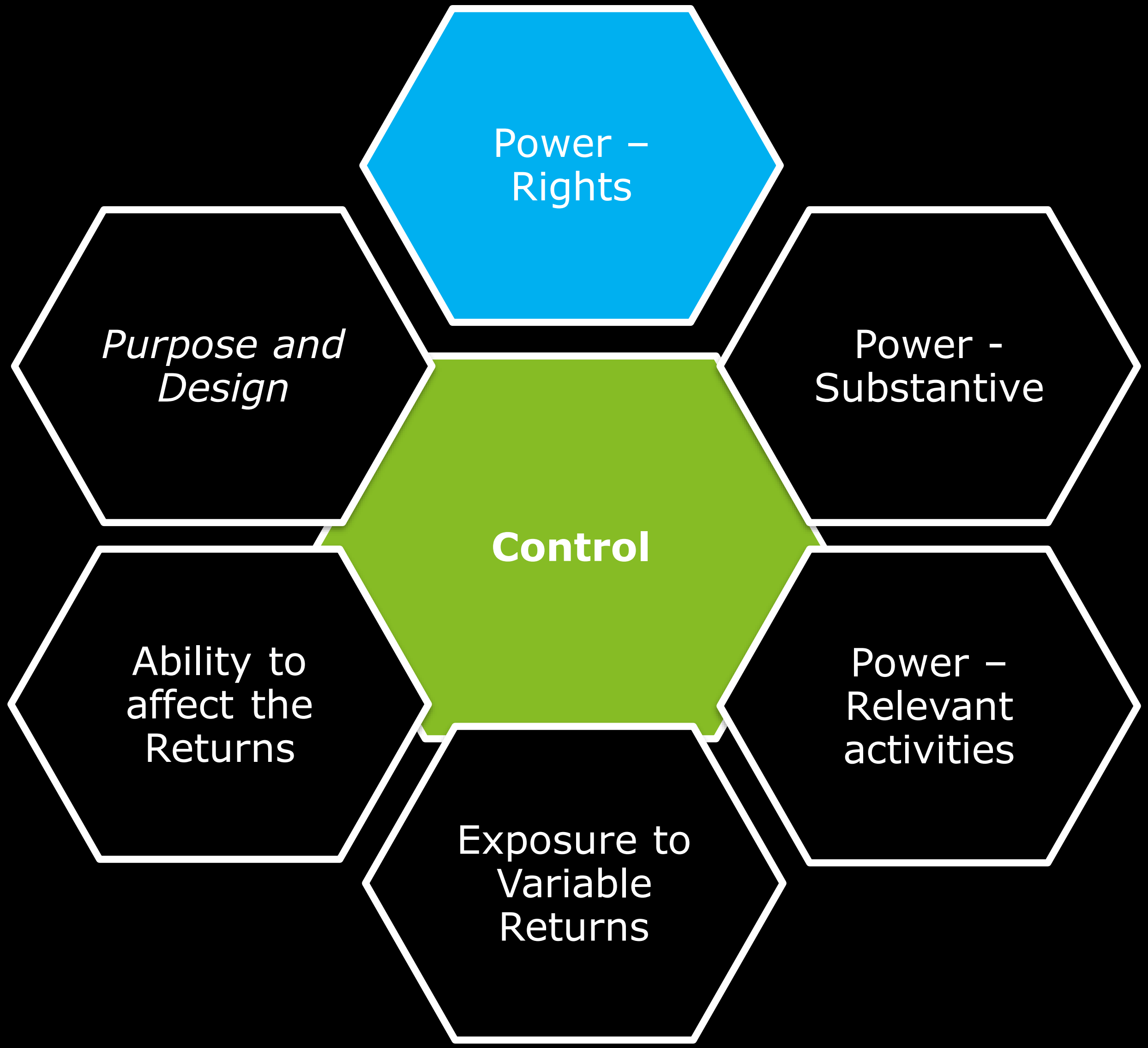
Control Assessment – Purpose and Design



Assess the **purpose and design** of the investee in order:

- ✓ to identify the <u>relevant activities</u>
- ✓ <u>how decisions</u> about the relevant activities are made
- ✓ who has the <u>current ability to direct</u> those activities and
- ✓ <u>who receives returns</u> from those activities.

Control Assessment – Power (Rights)



- ✓ **Power arises from rights**
- ✓ Assessing power can be **straight forward** in some cases – **voting rights**
- ✓ Can be **complex** in some cases requiring other factors to be considered - **contractual arrangements**.
  - Voting rights, **potential** voting rights
  - **Contractual** rights
  - **Majority rights** at the board and shareholder level
  - Consider **all options** to acquire shares
  - **De facto power**

Control Assessment – Power (Rights)

Does "de facto power" exist?

a. Voting rights:

- Number of voting rights held by the investor
- Relative size of the investor's holding
- Dispersion of other parties

b. Potential voting rights

c. Rights from other contractual arrangements

Step 1: Is a + b + c conclusive?

Yes

Conclude:
De facto power does exist OR does not exist

No

Step 2: Go to d.

d. Other facts and circumstances e.g. past voting patterns, other

If it is still not clear – investor does not control investee

Control Assessment – Power (Rights)

De facto power – other facts and circumstances

1. Practical ability to direct relevant activities unilaterally?	• Investor can appoint/approve investee's KMP who have the ability to direct relevant activities • Investor can direct investee to enter into/veto changes to significant transactions for benefit of investor • Investor can dominate nominations process • Investee's KMP or majority of its board are related parties of investor
2. Special relationship with the investee?	• Investee's KMP who have the ability to direct relevant activities are current/previous employees of investor • Investee's operations are dependent on investor • Significant portion of investee's activities involve or are conducted on behalf of investor
3. Large exposure/ rights to variable returns?	• Greater this is, greater the investor's incentive to obtain rights to give it power

Greater weight is given to 1 over 2 + 3

Control Assessment – Power (Rights)

De-facto power: Examples					
Ex.	**Largest single investor**	**Other investors**	**Other facts**	**Is Step 1 conclusive of power *?**	**Does largest investor have power?**
1	48%	• 1000s • No 1 holds >1% of votes	No voting arrangements	**Yes**	**Yes**
2	**45%**	• **2 investors @26% each** • **3 investors @1% each**	**No other arrangements affecting decision-making**	**Yes**	**No**
3	**45%**	• **11 investors @5% each**	**No voting arrangements**	**No**	**Depends on other facts & circumstances**

Control Assessment – Power over a legal entity?

Does investor have power over a legal entity ?

Yes → **Assess control at legal entity level**

No →

Does investor have power only over specified assets (i.e. a silo)?

1. Are specified assets the only source of payment for specified liabilities, or specified other interests in, the investee?

Yes

2. Do parties, other than those with the specified liability, have no rights/obligations relating to the specified assets or to residual cash flows from those assets?

Yes

3. Can none of the returns from specified assets be used by the remaining investee and none of the liabilities are payable from assets of the remaining investee?

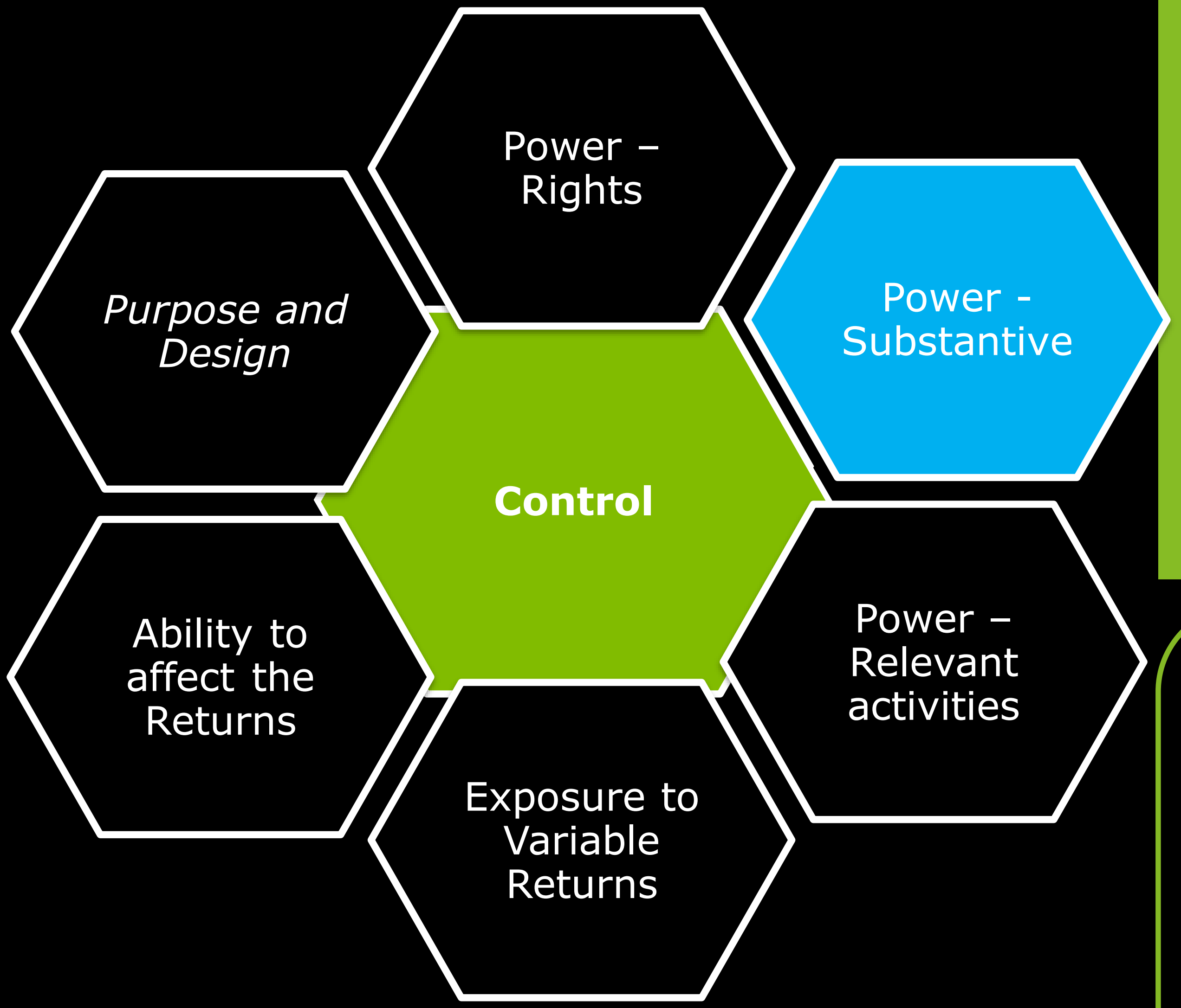
Yes

4. In substance, are all assets, liabilities and equity "ring-fenced" from the overall investee?

Yes

Assess control at silo level

Control Assessment – Power (substantive)



- ✓ **Practical ability** to exercise the rights
- ✓ **Current ability** to direct relevant activities
- ✓ **Barriers** to exercise voting rights
- ✓ **Potential rights substantive** if ability to exercise when decisions on relevant activities are made
- ✓ Investors having **only protective rights cannot have power** over the investee.

Note on Potential voting rights : An investor may hold any instrument (such as share warrants, share call options, debt or equity instruments) issued by an associate and terms of the instrument is that a holder will get an equity rights on the expiry of the term i.e., they are convertible into ordinary shares, to give the entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (ie potential voting rights). **Only an existing right** will be considered for determining the Significant influence. Any potential voting rights that will arise in future will not be considered while determining Significant influence.

Control Assessment – (Substantive Rights)

Are rights substantive?

1. Does holder have the practical ability to exercise the right?

No

Are there barriers that prevent holder from exercising?

No

When exercising requires >1 party to agree or when the rights are held by more than one party, is mechanism in place to give parties practical ability to exercise?

Yes

Would holder of rights benefit from exercise?

Yes

Rights are not substantive

No

2. Are the rights exercisable when decisions about relevant activities need to be made?

Yes

Yes

3. Are there substantive rights held by others that can prevent the investor from controlling (approval/blockage votes) and these rights are not merely protective?

No

Rights are substantive

Control Assessment – Example (Substantive Rights)

Facts

- The investee has annual shareholder meetings at which decisions to direct the relevant activities are made.
- The next scheduled meeting is in 8 months.

- Shareholders that individually or collectively hold at least 5% of the voting rights can call a special meeting to change the existing policies over the relevant activities, but such notice requires at least 30 days.

- Policies over the relevant activities can be changed only at special or scheduled shareholders‘ meetings, e.g., the approval of material sales of assets, acquiring or disposing of significant investments.

Does each of the following scenarios give the investor substantive rights?

a) An investor holds a majority of the voting rights in the investee.

b) An investor is a party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is 25 days.

c) An investor is a party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is 6 months.

Control Assessment – Example (Substantive Rights)- contd.

a) An investor holds a majority of the voting rights in the investee.

b) An investor is a party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is 25 days.

c) An investor is a party to a forward contract to acquire the majority of shares in the investee. The forward contract's settlement date is 6 months.

Yes, the investor's voting rights are substantive because the investor is able to make decisions about the relevant activities.

Yes, the investor's forward contract is a substantive right that gives the investor the current ability to direct the relevant activities even before the forward contract is settled (being 25 days < 30 days)

No, the investor's forward contract is not a substantive right because the existing shareholders have the current ability to direct the relevant activities since they can change the existing policies before the forward contract is settled (being 30 days < 6 months)

Control Assessment – Example (Substantive Rights)

- A, B and C own 60%, 20% and 20%, respectively in D.
- Decisions on the relevant activities of D are based on majority at shareholders' meetings subject to supplementary right.
- B and C have a supplementary right at shareholders' meetings if either disagrees with proposals regarding relevant activities made by A.
- If B or C exercises its supplementary rights, proposals can only be approved by shareholders holding at least 75% of the voting rights.

Solution

- A does not have control of Entity D because
- The supplementary rights held by B and C are not merely protective rights.
- The supplementary rights not only protect the interests of B and C but also give them the ability to prevent 'A' from making unilateral decisions over the relevant activities of D.

Control Assessment – Example (Substantive Rights)

Potential voting rights – Examples

Example 1

	Voting rights
A	70%
B	30%
B- fixed price option	35%

- B-option is deeply out of $$$, expected to remain so for 2 year-term
- A is directing relevant activities

Are potential voting rights substantive*?	**Not substantive**
Do they give B power?	**Potential voting rights do *not* give B power**

Example 2

	Voting rights
A	33%
B	33%
C	33%
B-Convertible debt	27%

- Conversion price is out of the $$$ (not deeply)
- B’s business is closely related to investee’s and B would benefit from synergies if it converts

Are potential voting rights substantive*?	**Substantive**
Do they give B power?	**Potential *voting* rights give B power**

* Holder has practical ability to exercise/convert potential voting rights.

Control Assessment – Example (Power)

Example 1

Entity E has four shareholders – Entity A, Entity B, Entity C and Entity D. Entity A owns 40 per cent of the ordinary shares of Entity E while each of the other shareholders owns 20 per cent.

The relevant activities of Entity E are directed by its board of directors comprised of six directors: three appointed by Entity A, and one each appointed by Entity B, Entity C and Entity D.

Separately, Entities A and B have entered a contractual arrangement that requires the director appointed by Entity B to vote in the same way as the directors appointed by Entity A.

Absent other factors, the fact that the contractual arrangement effectively gives Entity A a majority of votes at board meetings in relation to the relevant activities provides Entity A with power over Entity E, even though Entity A does not hold a majority of the voting rights in Entity E.

Control Assessment – Example (Power)

Example 2

Entity E has four shareholders – Entity A, Entity B, Entity C and Entity D.Entity A owns 40 per cent of the ordinary shares of Entity E while each of the other shareholders owns 20 per cent.

The relevant activities of Entity E are directed by its board of directors comprised of six directors: three appointed by Entity A, and one each appointed by Entity B, Entity C and Entity D.

In order to avoid deadlock in board deliberations, the shareholders have entered into an agreement to the effect that one of the directors appointed by Entity A acts as the chairman of the board and has an additional casting vote at board meetings.

The shareholders' agreement effectively gives Entity A a majority of votes at board meetings in relation to the relevant activities. Absent other factors, this provides Entity A with power over Entity E, even though Entity A does not hold a majority of the voting rights in Entity E

Control Assessment – Example (Power)

Example 3

- An investor acquires 48 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. When assessing the proportion of voting rights to acquire, on the basis of the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control. In this case, on the basis of the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power.

Control Assessment – Example (Power)

Example 4

- 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. 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. 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. 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. The fact that investor A might not have exercised this right or the likelihood of investor A exercising its right to select, appoint or remove management shall not be considered when assessing whether investor A has power.

Control Assessment – Example (Power)

Example 5

- 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 of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent. There are no other arrangements that affect decision-making. In this case, the size of investor A’s voting interest and its size relative to the other shareholdings are sufficient to conclude that investor A does not have 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.

Control Assessment – Example (Power)

Example 6

- An investee's only business activity, as specified in its founding documents, is to purchase receivables and service them on a day-to-day basis for its investors. The servicing on a day-today basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable the investee automatically puts the receivable to an investor as agreed separately in a put agreement between the investor and the investee. The only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee's returns—the activities before default are predetermined and amount only to collecting cash flows as they fall due and passing them on to investors. Therefore, only the investor's right to manage the assets upon default should be considered when assessing the overall activities of the investee that significantly affect the investee's returns.

- In this example, the design of the investee ensures that the investor has decision-making authority over the activities that significantly affect the returns at the only time that such decision-making authority is required. The terms of the put agreement are integral to the overall transaction and the establishment of the investee. Therefore, the terms of the put agreement together with the founding documents of the investee lead to the conclusion that the investor has power over the investee even though the investor takes ownership of the receivables only upon default and manages the defaulted receivables outside the legal boundaries of the investee.

Control Assessment – Example (Power)

Example 7

- Investor A holds 70 per cent of the voting rights of an investee. Investor B has 30 per cent of the voting rights of the investee as well as an option to acquire half of investor A's voting rights. The option is exercisable for the next two years at a fixed price that is deeply out of the money (and is expected to remain so for that two-year period). Investor A has been exercising its votes and is actively directing the relevant activities of the investee. In such a case, investor A is likely to meet the power criterion because it appears to have the current ability to direct the relevant activities. Although investor B has currently exercisable options to purchase additional voting rights (that, if exercised, would give it a majority of the voting rights in the investee), the terms and conditions associated with those options are such that the options are not considered substantive.

Control Assessment – Example (Power)

Example 8

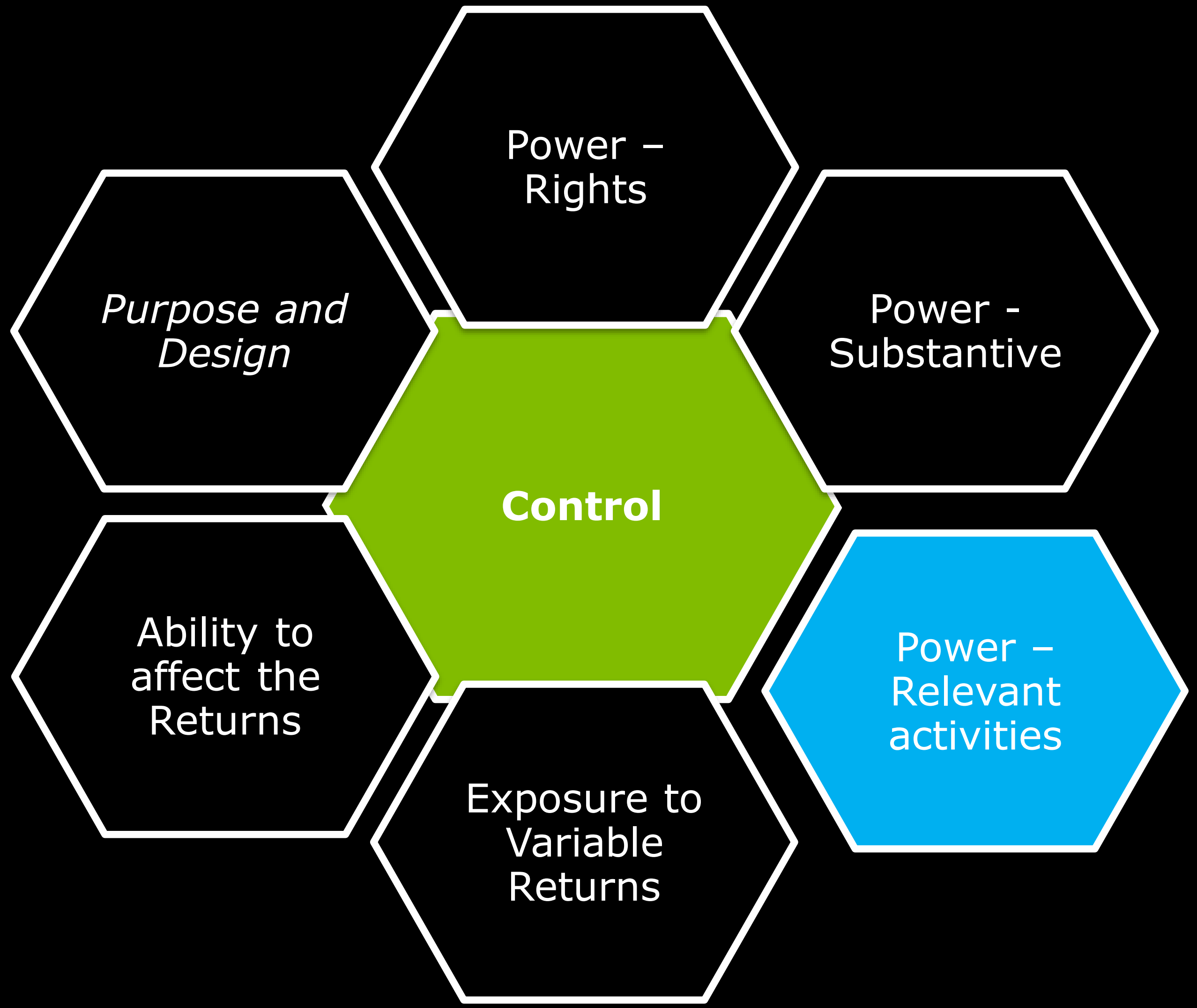
- An investor holds 35 per cent of the voting rights of an investee. Three other shareholders each hold 5 per cent of the voting rights of the investee. The remaining voting rights are held by numerous other shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has arrangements to consult any of the others or make collective decisions. Decisions about the relevant activities of the investee require the approval of a majority of votes cast at relevant shareholders' meetings—75 per cent of the voting rights of the investee have been cast at recent relevant shareholders' meetings. In this case, the active participation of the other shareholders at recent shareholders' meetings indicates that the investor would not have the practical ability to direct the relevant activities unilaterally, regardless of whether the investor has directed the relevant activities because a sufficient number of other shareholders voted in the same way as the investor.

Control Assessment – Example (Power)

Example 9

- Investor A and two other investors each hold a third of the voting rights of an investee. The investee’s business activity is closely related to investor A. In addition to its equity instruments, investor A also holds debt instruments that are convertible into ordinary shares of the investee at any time for a fixed price that is out of the money (but not deeply out of the money). If the debt were converted, investor A would hold 60 per cent of the voting rights of the investee. Investor A would benefit from realizing synergies if the debt instruments were converted into ordinary shares. Investor A has power over the investee because it holds voting rights of the investee together with substantive potential voting rights that give it the current ability to direct the relevant activities.

Control Assessment – Power (Relevant Activities)



- ✓ Activities that **significantly affect the investee's returns**
- ✓ How **decisions** over these activities are made
- ✓ **Activities** like Purchases/sales, working capital, investments, R&D and financing
- ✓ Activities that **most significantly affect** the returns
- ✓ **Predetermined** activities (structured entities)

Control Assessment – Example (Relevant activities)

Develop and obtain regulatory approval of the medical product

Investor A

Investor B

Manufacture and market the medical product

Entity X

Objective: develop and market a medical product

More facts:

- Investor A has **unilateral ability** to make all decisions relating to the development of the product and to obtaining regulatory approval
- Investor B has **unilateral ability** to make all decisions about the manufacture and marketing of the product

Which investor (A or B) directs the relevant activities of Entity X?

Control Assessment – Example (Relevant activities) – contd.

Depends!

If **all the activities**—developing and obtaining regulatory approval as well as manufacturing and marketing of the medical product—are relevant activities, each investor needs to determine whether it is able to direct the activities that **most significantly affect** the investee's returns.

During the R&D phase of the entity it may be seen that the **R&D activities** are the relevant activities that **most significantly affect** the returns. Hence the investor that controls the R&D activities would direct the relevant activities and therefore, control the entity.

Once the R&D phase is complete and the manufacture of the drug begins it may be seen that the **manufacturing activities** are the relevant activities that **most significantly affect** the returns. Hence the investor that controls the manufacturing activities would direct the relevant activities and therefore, control the entity.

Control Assessment – Example (Relevant Activities)

Facts

- A securitization vehicle has been created.
- Its only assets are receivables

Issue

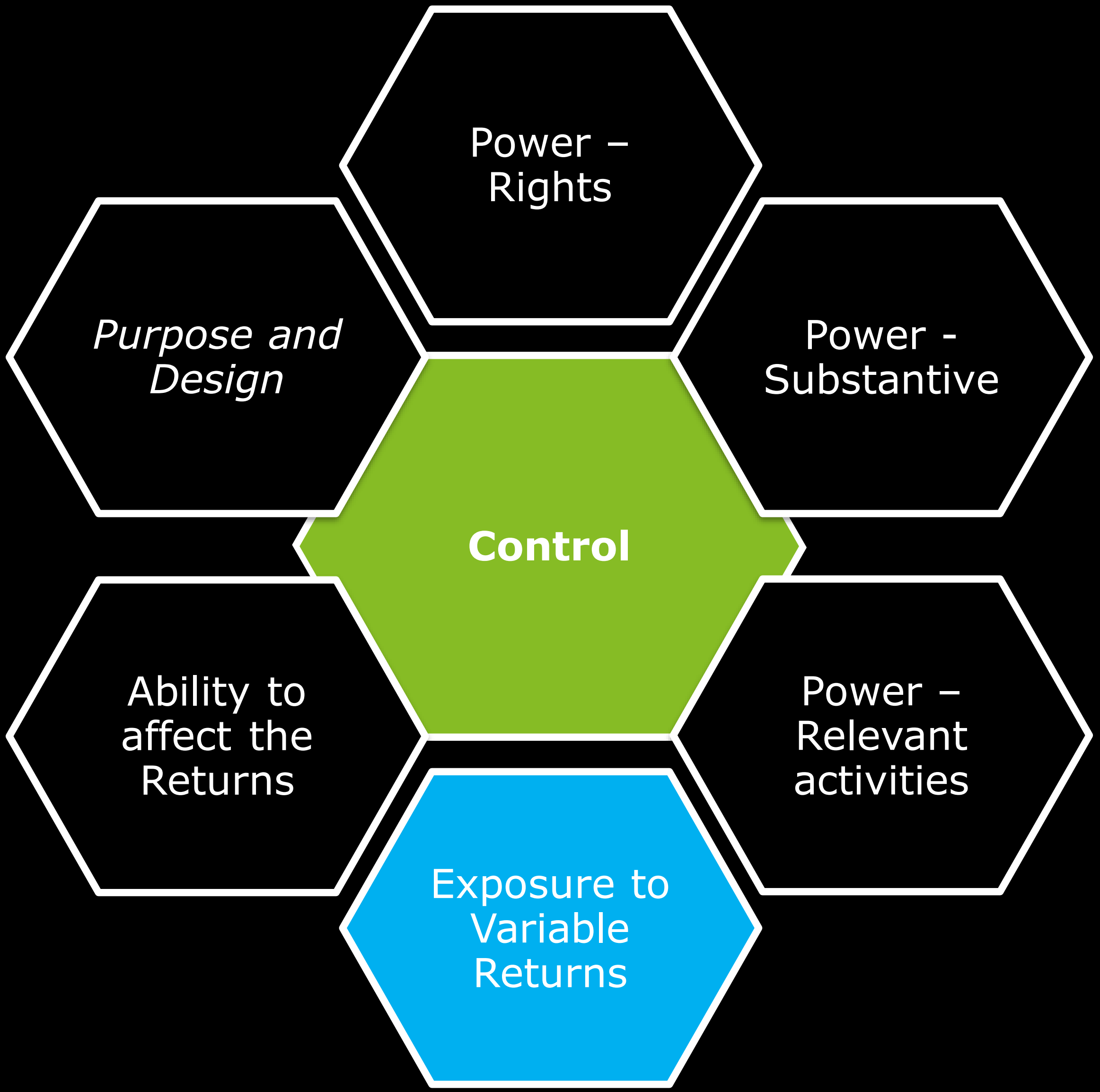
- Does the securitization vehicle has any relevant activity(ies)?

Solution

Yes, the only relevant activity of the vehicle is managing the receivables upon default.

- The purpose and design of the vehicle need to be considered.
- The party that manages these receivables upon default has power over the vehicle, irrespective of whether any of the receivable have defaulted.

Control Assessment – Exposure to Variable Returns



- ✓ **Vary** in response to performance
- ✓ **Positive, negative or both**
- ✓ **Broad definition** – returns can be outside of the investee
- ✓ **Can be a fixed return** – variability introduced by default or credit risk

Control Assessment – Example (Exposure to Variable Returns)

Facts : An investor holds a bond with fixed interest payments

Issue : Are these returns fixed or variable in nature for the purposes of Ind AS 110?

Facts : An investor receives fixed performance fees in return for managing assets of the investee

Issue : Are these returns fixed or variable in nature for the purposes of Ind AS 110?

Solution

The fixed interest payments are fixed in form but, variable in substance for the purposes of Ind AS 110 because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability will depend on the credit risk of the bond.

Solution

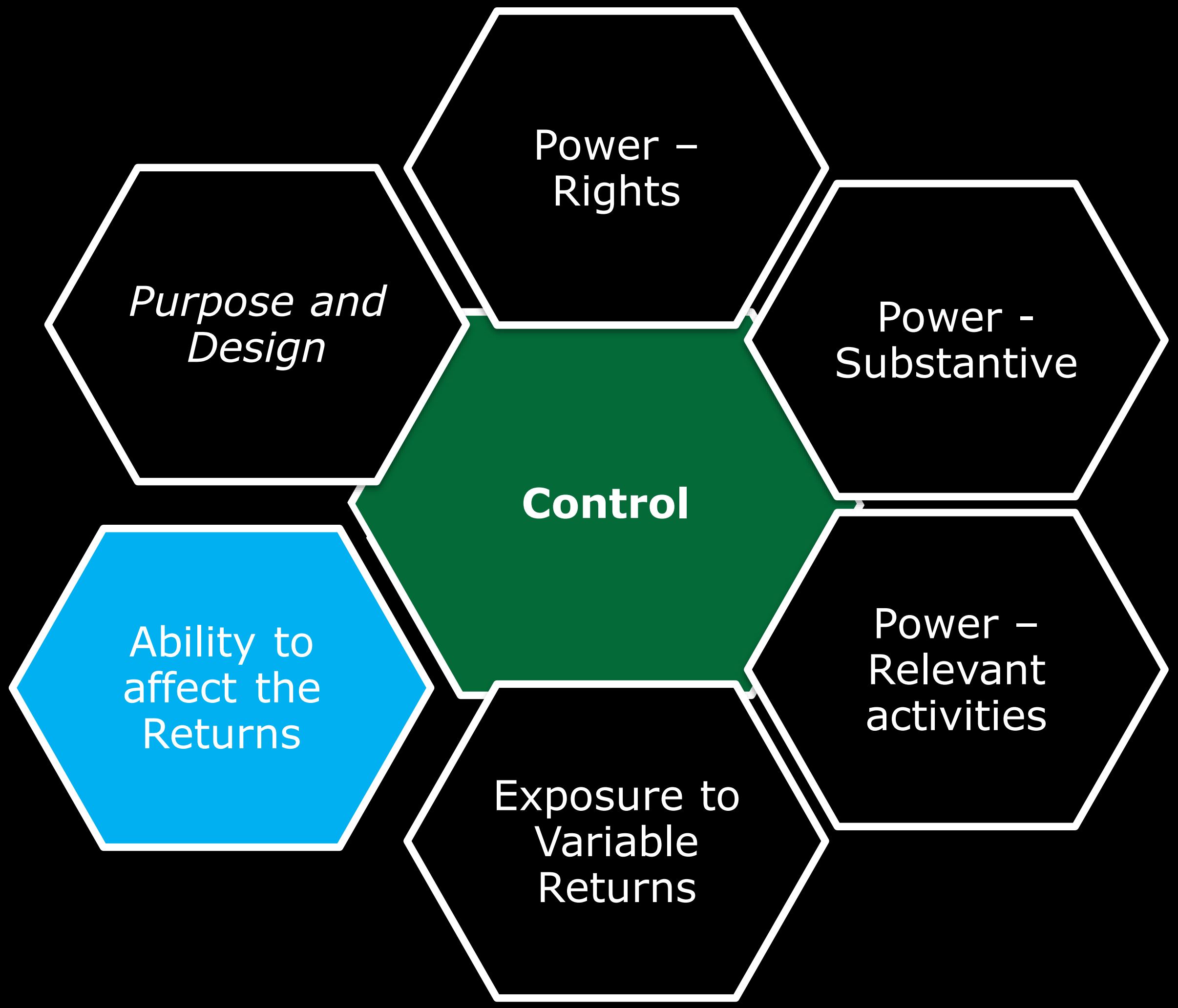
The fixed performance fees are fixed in form but, variable in substance because they expose the investor to the performance risk of the investee. The amount of variability will depend on the investee's ability to generate sufficient income to pay the fee.

Control Assessment – Example (Exposure to Variable Returns)

Instruments that embody a right to variable returns. Yes or No?

Instruments	**Yes**	**No**
Ordinary shares carrying a right to dividends and a proportionate share of residual assets	✓	
Preferred shares carrying a right to dividends (non-cumulative)	✓	
Loan provided to the entity providing the investors with interest income (variable rate)	✓	
Loan provided to the entity providing the investors with interest income (fixed rate)	✓	
Service contracts entitling the service provider with a fixed fee	✓	
Upfront fees received in connection with an ongoing service contract		✓

Control Assessment – Ability to affect the Returns (Principal v/s Agent)



- ✓ Consider investment in shares by decision maker.
- ✓ Can the majority shareholder change the decision maker without cause?
- ✓ Who has the decision over the relevant activities?
- ✓ How is the decision maker remunerated?
- ✓ The greater the variability in the return for the decision maker, the more likely the decision maker is the principal.

Control Assessment – Ability to affect the Returns (Principal v/s Agent)

Does a single party hold substantive rights to "**kick out**" the decision-maker without cause?

Yes → **Decision-maker is an agent**

No ↓

Is decision maker's **remuneration** commensurate with the services provided?

No → **Decision-maker *cannot be* an agent**

Yes ↓

Are the terms, conditions and amounts of **remuneration** customary for similar services?

No → **Decision-maker *cannot be* an agent**

Yes ↓

Analyze:

a. Scope of decision-maker's authority
b. Rights held by other parties
c. Decision-maker's remuneration (except as above)
d. Decision-maker's exposure to variable returns from other interests it holds

↓

Decision-maker is a principal or an agent

Control Assessment – Ability to affect the Returns (Principal v/s Agent)

Agent		Principal
	a. **Scope of decision maker's authority**	
	• Significant activities permitted by decision-making agreements & law	✓
	• Broad discretion of decision-maker when making decisions	✓
	• Decision-maker is significantly involved in design of investee & determining scope of the decision-making authority	✓
	b. **Rights held by other parties**	
✓	• If substantive rights to "kick out" decision-maker are held by more than one party and a small number are required to agree	
✓	• Decision-maker is required to obtain approval from small # of parties	
	c. **Decision-maker's remuneration**	
	• Greater the magnitude and variability of remuneration relative to expected returns of investee	✓
	d. **Exposure to variable returns from other interests held**	
	• Greater the magnitude and variability associated with other economic interests	✓

Control Assessment – Ability to affect the Returns (Principal v/s Agent)

Does the investor, or those that direct the activities of the investor, have the ability to direct that party to act on the investor’s behalf?

No → Party is **not** a de-facto agent

Examples of parties that might act as “de facto” agents include:

- Investor’s related parties
- Party that received its interest in investee as contribution/loan from investor
- Party that will not sell, transfer, encumber its interest without investor’s approval (with permitted exception)
- Party cannot finance its operations without subordinated financial support from investor

Yes ↓

Party is a de-facto agent

Control Assessment – Principal vs. Agent (Structured Entity)- Example

Facts

- Entity A creates a Structured Entity X to manage all of its receivables.
- The Structured Entity X's manager M will manage all of the receivables of Entity A and the collection thereof, unless the receivables default

- On default, Entity A will manage the collection process going forward.
- All amounts collected by Structured Entity X are paid to Entity A without delay.

- The Structured Entity X's manager M receives a fixed fee for managing the receivables and can only be replaced due to gross negligence

Who controls the structured entity X – Entity A or Manager M?

Control Assessment – Principal vs. Agent Structured Entity) – Example (Contd.)

Entity A		Structured Entity X's Manager M
Entity A's rights are the ability to transfer the receivables into the Structured Entity.	**Rights**	M does not hold any interest in the Structured Entity.
Entity A can only change or remove the Structured Entity X's manager M due to gross negligence.	**Substantive**	M can only be removed due to gross negligence.
As Entity A manages receivables on default, it manages the relevant activities of the Structured Entity.	**Relevant activities**	M only manages the receivables that are not in default and, thus, does not manage the relevant activities of the Structured Entity.
Entity A's returns are variable as any variation of the return through default accrues to Entity A.	**Variable Returns**	M receives a fixed fee for managing the Structured Entity.
As Entity A manages the process on default, it does have the ability to affect its returns.	**Ability to affect returns**	M cannot influence its return as it receives a fixed fee.
Thus, Entity A **controls** the Structured Entity.	**Control**	Hence, M does **not control** the Structured Entity.

Control Assessment – Principal vs. Agent – Example (Considerations)

Issue

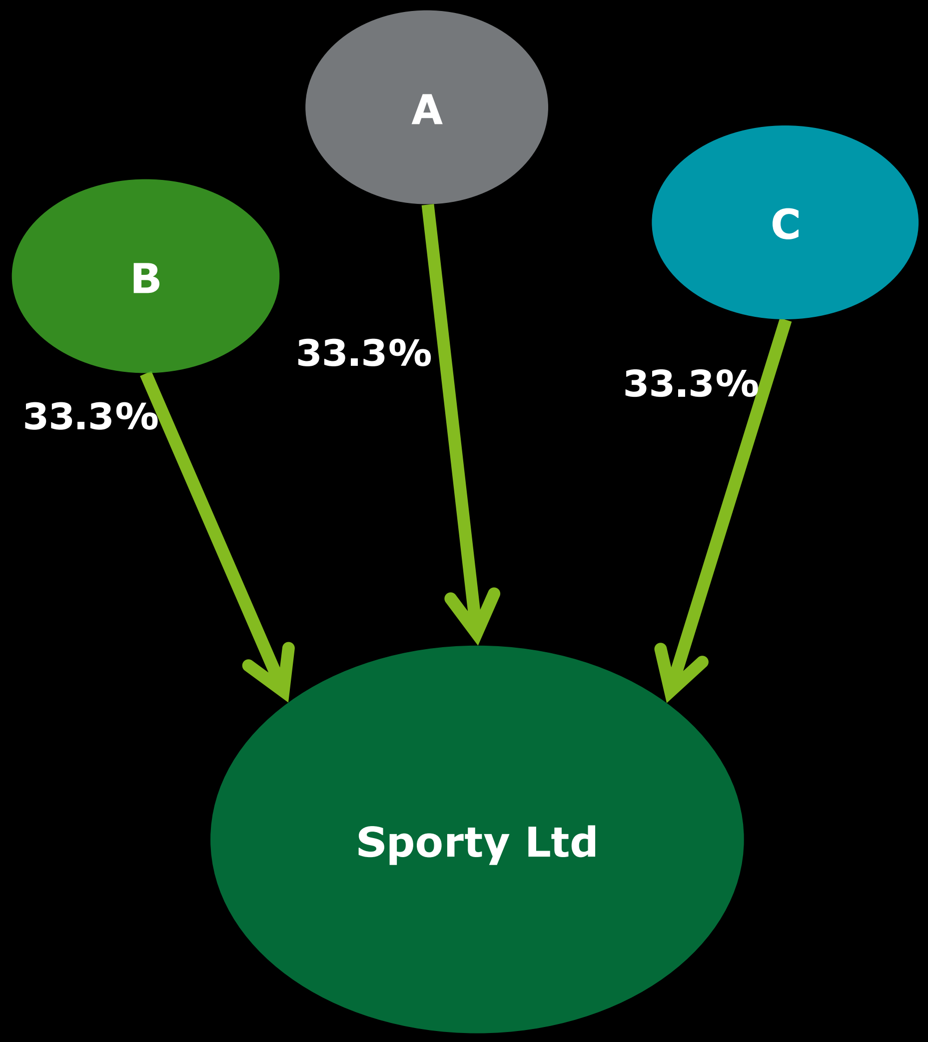
What is important for a decision maker to consider when determining whether it is an agent or a principal?

Solution

- The scope of its decision making authority over the investee.
- The rights held by other parties.
- The remuneration to which it is entitled in accordance with the remuneration agreement(s).
- The decision maker’s exposure to variability of returns from other interests that it holds in the investee.
- All factors above requires evaluation unless a single party holds substantive rights to remove the decision maker (removal rights) and can remove the decision maker without cause.

Assessing Control

Assessing Control: Basic principles- Example



Does shareholder A have control over Sporty?

Key Facts:

- Sporty Ltd. is owned by three shareholders (i.e., A, B, and C); each shareholder holds a third of the voting rights in Sporty Ltd.
- Shareholder A also holds debt instruments that are convertible into Sporty's ordinary shares at any time for a fixed price that is out of the money (but is not deeply out of the money).
- If the debt instruments were converted, shareholder A would hold 60% of the voting rights of Sporty.
- Sporty's business activity is closely related to shareholder A (i.e., manufacturing sports equipment).
- Investor A would benefit from realising synergies, if the debt instruments were converted into ordinary shares.

Key implementation issues

Scenarios:

1. **Assessing control: Substantive vs. Protective Rights**
2. **Power with less than majority of voting rights**
3. **Potential voting rights (Evaluate option is in Money)**

Accounting response: Control analysis- Example (contd.)

1. Power

- Relevant activities – Manufacturing
- Purpose and design – closely related to A
- Rights:
  i. 33% equity (not majority of voting rights)
  ii. Potential voting rights via debt instrument held by A. A holds majority of voting rights (i.e., 60%) if converted
- Rights held are substantive

2. Exposure to variable returns

- Exposure via equity holdings in Sporty

3. Ability to use power to affect the returns

- A has the ability to use its power (via voting rights and substantive potential voting rights) to direct the relevant activities of Sporty, which in turn affects its returns

CONTROL

- A controls Sporty – Three elements of control met

Assessing control: Substantive vs. Protective Rights
The challenges…

Assessing control: Substantive vs. Protective Rights

SUBSTANTIVE RIGHTS

- Existing rights that give the investor the current ability to direct the relevant activities of the investee
- For a right to be substantive:
  - the holder must have the practical ability to exercise that right
  - the rights need to be exercisable when decisions on relevant activities need to be made

POWER

PROTECTIVE RIGHTS

- Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate
- Relate to fundamental changes to the activities of an investee or apply in exceptional circumstances

Held by Investor → Can give investor power

Held by Others → Can take power away

Held by Investor → Cannot give investor power

Held by Others → Cannot take power away

Assessing control: Substantive vs. Protective Rights

An investor is required to reassess whether it still controls an investee when facts and circumstances change

Entity A obtains a loan from a bank. The loan agreement specifies certain rights to the bank in event of Entity A breaching a loan covenant and/or defaulting on payments due under the loan agreement. Such rights are regarded as protective in nature as those rights do not currently give the lender power over Entity A.

Entity A defaults on its payment to the bank and breaches the loan covenant.

The lender’s rights become enforceable upon the default by Entity A.

Power with less than majority voting rights
The challenges…

Access to information in determining whether the investor has the practical ability to direct the relevant activities despite holding less than majority of the voting rights:

- Whether some of the vote holders are related parties
- Whether there are any contractual arrangements in place which allow some of vote holders to make decisions collectively
- Voting patterns at meetings

Accounting for changes in ownership interests

Changes in ownership interests

Increase in ownership interests

Apply:
- Ind AS 28
- Ind AS 111
- Ind AS 109

Business combination:
- Fair value existing holding
- Fair value acquired net assets
- Calculate goodwill / discount on acquisition (bargain purchase)

Equity transaction:
- No adjustment to goodwill
- No gain/loss

Initial investment

Control obtained

Buy out NCIs

0%

50%

100%

Obtaining control is a significant economic event
that triggers remeasurement

Loss of control

On loss of control, parent shall

Derecognize

- the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost
- the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them)

Recognize

- the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control
- if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution
- any investment retained in the former subsidiary at its fair value at the date when control is lost

Consolidation Procedures

Consolidation procedures

1 Combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

2 Offset (eliminate) the carrying amount of the parent’s investment in each subsidiary and the parent’s portion of equity of each subsidiary.

3 Eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognized in assets, such as inventory and fixed assets, are eliminated in full).

Accounting Requirement

- It is mandatory to follow uniform accounting policies for preparing CFS.
- Appropriate adjustments are made statements in preparing the CFS to that group member's financial ensure conformity with the group's accounting policies.
- Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee.
- Difference between the reporting date of the subsidiary and the parent should not be more than three months and appropriate adjustment must be made for all significant transaction during this differential period

Non controlling Interest

- Equity in a subsidiary not attributable directly or indirectly to the parent.
- In the Consolidated Statement of Financial Position, NCI is presented within equity but recorded separately from the parent's equity interest.
- Profit or Loss and Total Comprehensive Income for the period should be allocated to the parent and NCI.
- Changes in a parent's ownership interest that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

Non controlling interest Adjustment

Initial Measurement	Accounting policy choice: –Measured at fair value, or; –Proportionate share of acquiree's net asset on acquisition date.
Subsequent Measurement	Proportion of income, share in losses and other items of OCI allocated to the parent and the NCI solely on the basis of their present ownership.
Share in lossmaking subsidiaries	Subsidiary's earnings and losses to be allocated between the parent and NCI even if it results in debit balance of NCI within total equity.
Treatment of Dividends paid to NCI	Cash is reduced in the consolidated balance sheet . Carrying amount of NCI is reduced for the dividend paid.

Example: Calculation of profit attributable to non-controlling interest subsequent to acquisition

Issue

A parent entity acquires a 60% subsidiary for INR 300 million at the beginning of the year. The fair value of the subsidiary's identifiable net assets at the date of acquisition is INR 370 million .In its first year after purchase, the subsidiary's income statement, as it is included in the group's consolidated financial statements (that is, after all consolidation adjustments, such as the amortization of intangible assets), is as follows:

Particulars	**INR'm**
Profit Before taxation	26
Tax	(1)
Profit for the year	**25**
Profit attributable to the NCI (40% * 25m)	10
Profit attributable to parent's equity holders	15

What would be the carrying amount of the non-controlling interest at the date of acquisition and at the end of the first year after purchase? Assume that there is no control premium.

Example: Calculation of profit attributable to non-controlling interest subsequent to acquisition

Solution

The non-controlling interest at the date of acquisition is stated at either:

- the initial amount of INR 200 million, if the parent entity recognizes the non - controlling interest at fair value which, assuming there is no control premium, is calculated as follows (40% × (INR 300 m / 60 %)); or
- the initial amount of INR 148million, if the parent entity recognizes the non – controlling interest at its proportionate share of the acquiree’s net assets at acquisition (calculated as 40 % × INR 370 m).

Then on-controlling interest’s share of changes in equity at the year end (which are all due to the profit for the year) is INR 10 million. Depending on the basis used for the initial recognition, the non-controlling interest will be carried at INR 210 million or INR 158 million at the end of the first year after the subsidiary’s purchase.

Calculation of Goodwill

Ind AS 103 specifies the goodwill calculation as follows:

Acquisition date fair value of the consideration transferred	XX
Amount of any non-controlling interests in the entity acquired	XX
Less: Acquisition date fair value of identifiable assets acquired, and liabilities assumed measured in accordance with Ind AS 103	(XX)
Goodwill	**XX**

Inter Company adjustments

Intercompany balances	All the inter company transactions (income and expenses) and balances (receivables and payables) are to be netted off i.e. cancelled.
Unrealized Profits	Adjustment is only to be made for the closing stock in hand as at the year end -reduce the value of inventory in the CFS –BS &P&L Adjustments are to be made in the books of the group company that made the sale to the other group company. –"Down stream" –Parent sells to a subsidiary: Debit P&L of Parent –"Up stream" –Subsidiary sells to its parent: Debit P&L of Parent and NCI
Non Current Asset Transfer	The group entity selling the NCA would recognize a profit / loss on the sale. The purchasing group entity would record the NCA at the purchase price and the subsequent depreciation would be charged on that amount. In consolidated FS account for the NCA as if the sale has never happened. In consolidation: –Remove the profit or loss from the sale –Correct the depreciation charge
Income taxes	Ind AS 12 Income Taxes applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Example :Inter Company adjustments –Deferred taxes

Question:

How should deferred taxes on temporary differences arising from intragroup transfers be accounted for in consolidated financial statements in the below mentioned scenarios?

Scenario 1 – Tax rate applicable to the transferor is higher than tax rate applicable to the transferee

A parent, an entity taxed at 30%, has a subsidiary that is taxed at 34%. Towards the end of its financial year (say Year 5), the subsidiary sells inventory with a cost of Rs. 1,00,000 to the parent for Rs. 1,20,000, giving rise to a taxable profit of Rs. 20,000 and tax at 34% of Rs. 6,800. The inventory remains unsold with the parent at the end of the financial year. In the subsequent financial year (Year 6), the parent sells the inventory to a third party for Rs. 1,50,000, giving rise to taxable profit (at the parent entity level) of Rs. 30,000 and tax of Rs. 9,000. In the consolidated financial statements of the parent entity for Year 5, the profit made by the subsidiary on sale to the parent is eliminated.

Scenario 2- Tax rate applicable to the transferor is lower than tax rate applicable to the transferee

The facts are the same as in scenario 1, except that the tax applicable to the parent is 34% and the tax rate applicable to the subsidiary is 30%

Example :Inter Company adjustments –Deferred taxes

Answer:

In both above scenarios, in the consolidated financial statements, the gain of the 20,000 on the intragroup transfer is eliminated and consequently, the carrying amount of the inventory in consolidated financial statements is Rs. 1,00,000. The tax base of the inventory held by the parent, on the other hand, changes to Rs. 1,20,000, due to intra-group transfer.

Scenario 1 – Tax rate applicable to the transferor is higher than tax rate applicable to the transferee

A current tax expenses/liability of Rs. 6,800 (being 34% of subsidiary profit of Rs. 20,000) is recognized in consolidated financial statement.

The consolidated financial statement also recognize a deferred tax income/asset on the temporary difference of Rs. 20,000 (carrying amount of Rs. 1,00,000 – tax base of Rs. 1,20,000) provided it is probable that taxable profit will be available against which the temporary differences can be utilized. The tax rate applicable to the parent is used to calculate the deferred tax asset of Rs. 6,000 (being 30% of Rs. 20,000).

In summary , the net additional tax of Rs. 800 payable by the subsidiary is recognized as income tax expenses in the consolidated profit and loss for Year 5.

Example :Inter Company adjustments –Deferred taxes

Scenario 2- Tax rate applicable to the transferor is lower than tax rate applicable to the transferee

A current tax expenses/liability of Rs. 6,000 (being 30% of subsidiary profit of Rs. 20,000) is recognized in consolidated financial statement.

The consolidated financial statement also recognize a deferred tax income/asset on the temporary difference of Rs. 20,000 (carrying amount of Rs. 1,00,000 – tax base of Rs. 1,20,000) provided it is probable that taxable profit will be available against which the temporary differences can be utilized. The tax rate applicable to the parent is used to calculate the deferred tax asset of Rs. 6,800 (being 34% of Rs. 20,000).

In summary , the net tax income of Rs. 800 is recognized in the consolidated profit and loss for Year 5.

Example: Elimination of intra-group profit on sale of assets (Upstream)

Issue

A parent owns 60% of a subsidiary. Th subsidiary sells some inventory to the parent for INR 70,000, and it makes a profit of INR 30,000 on the sale. The inventory is unsold in the parent’s balance sheet at the year end.

How would unrealized profits arising on sale of inventory by the subsidiary to its parent be considered in the consolidated financial statements?

Solution

Particulars	Amount’000
Revenue A/c Dr.	70
To Cost of Sales A/c	(40)
To Inventory A/c	(30)

The reduction of group profit of INR 30,000 is allocated between the parent company and non-controlling interest in the ratio of their interests: 60% and 40%.

Example: Elimination of intra-group profit on sale of assets (Downstream)

Issue

A parent owns 60% of a subsidiary. Th parent sells some inventory to the subsidiary for INR 70,000, and it makes a profit of INR 30,000 on the sale. The inventory is unsold in the subsidiary’s balance sheet at the year end.

How would unrealized profits arising on sale of inventory by the parent to its subsidiary be considered in the consolidated financial statements?

Solution

Particulars	**Amount’000**
Revenue A/c Dr.	70
To Cost of Sales A/c	(40)
To Inventory A/c	(30)

NCI will be calculated without regard to the elimination entry because the unearned profit is in the parent’s financial statements. This is notwithstanding the fact that the unearned profit is included in the carrying amount of the inventory in the subsidiary's own financial statements.

Example :Sale of 20% interest in wholly owned subsidiary

Issue

Entity A sells a 20% interest in a wholly owned subsidiary to outside investors for INR 200 million in cash. It still maintains an 80 % controlling interest in the subsidiary. The carrying value of the subsidiary's net assets is INR 600 million, including goodwill of INR 130 million from the subsidiary's initial acquisition.

How does entity A record the sale of the 20% interest in its wholly owned subsidiary?

Solution

The carrying value of the 20% non-controlling interest that is recognized is calculated as the proportionate interest in the subsidiary's carrying value / net assets.

Particulars	Amount'Mn
Cash A/c Dr.	200
To Non-Controlling Interest (20% * 600 Mn)	120
To Equity A/c	80

Presentation and Disclosure

Presentation and disclosure

Disclosure (General)

The significant judgements and assumptions in determining that:-

- it has control of another entity;
- it controls another entity even though it holds less than half of the voting rights of the other entity;
- it is an agent or a principal.

Disclosure Requirements (Subsidiaries)

An entity shall disclose:

- the composition of the group
- the interest that NCI has in the group's activities and cash flows;
- the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;

Disclosure Requirements (controlling interests)

For each subsidiary that has NCI which is material to the reporting entity:-

- The name of the subsidiary;
- The principal place of business (and country of incorporation if different from the principal place of business) of the subsidiary;
- The proportion of ownership interests as well as voting rights (if not the same as ownership interests) held by NCI;

Presentation and disclosure (cont'd)

Disclosure Requirements (Subsidiaries – cont'd)

- the nature of, and changes in, the risks associated with interests in consolidated structured entities;
- the consequences of changes in ownership interest in a subsidiary that do not result in a loss of control;
- the consequences of losing control of a subsidiary during the reporting period

Disclosure Requirements (controlling interests – cont'd)

- The profit or loss allocated to NCI of that subsidiary during the period;
- Accumulated NCI of that subsidiary at the end of the period;
- Summarized financial information about the subsidiary.

Presentation and disclosure (cont'd)

Disclosure Requirements (Significant restrictions)

- Significant restrictions (e.g. statutory, contractual and regulatory restrictions) on ability to access or use the assets and settle the liabilities of the group, such as:-
  - ✓ Those that restrict the ability of a parent or its subsidiaries to transfer cash or other assets to (or from) other entities within the group;
  - ✓ guarantees or other requirements that may restrict dividends and other capital distributions being paid, or loans and advances being made or repaid, to (or from) other entities within the group;

Disclosure Requirements (Investment entities)

- Significant judgements and assumptions made in determining that the reporting entity meets the definition of an investment entity
- If it does not exhibit one or more of the typical characteristics of an investment entity, description of why it nevertheless meets the definition of an investment entity
- Fact of change in status, reasons for the change and impact on the financial statements

Presentation and disclosure (cont'd)

Disclosure Requirements (Significant restrictions – cont'd)

- The nature and extent to which protective rights of NCIs can significantly restrict the entity's ability to access or use the assets and settle the liabilities of the group (such as when a parent is obliged to settle liabilities of a subsidiary before settling its own liabilities, or approval of NCIs is required either to access the assets or to settle the liabilities of a subsidiary); and

- The carrying amounts in the consolidated financial statements of the assets and liabilities to which those restrictions apply.

Disclosure Requirements (Investment entities – cont'd)

- Fact that the entity has applied the exception to consolidation
- Explicit or implicit financial support provided to entities that it controls
- Nature and extent of any significant restrictions on the ability of investees to transfer funds to the investment entity.

Consolidation of AIF

Guidance on Consolidation of AIF

When should a fund manager consolidate its managed funds?

It is difficult for a fund manager (or the "manager") to determine control in relation to funds that it manages. The manager generally has some degree of power through the management agreement and some exposure to variable returns through management and incentive fees and any ownership interests held; but the manager's degree of power does not generally change with its exposure to variable returns. Referring to Ind AS 110, consolidation is triggered only when the fund manager has the ability to use its power to affect its returns.

The linkage test between power and exposure to return determines whether power is deemed to be used:

for oneself, in which case the fund manager is a principal and will consolidate the fund; or	for others, in which case the fund manager is an agent and will not consolidate the fund.

The analysis for fund managers is a combined assessment of just two key indicators:

kick-out rights and	aggregate economic interests

Key indicators

Indicator	Aggregate economic interest	Kick-out rights
Meaning	The aggregate economic interest is made up of remuneration plus other interests. The fund manager's remuneration includes items such as management fees. The key attribute of aggregate economic interest is the fund manager's variability at the expected level of fund performance.	Kick-out rights represent the power held by another party to remove the fund manager. The key attribute of the strength of kick-out rights is the number of investors who need to act together to exercise such a right.
Relevance	The greater the variability of a fund manager's interest in a fund, then: • the greater the weighting placed on its aggregate economic interest; and • the higher the likelihood that the fund manager is a principal.	The smaller the number of investors who must act together, then: • the greater the weighting placed on their kick-out rights; and • the lower the likelihood that the fund manager is a principal.

Stronger kick-out rights favour a conclusion of agent, and a larger aggregate economic interest favours a conclusion of principal. The basic relationship between these two indicators is easily understood, however the challenge is in determining how to apply the relationship to specific cases and conclude whether the fund manager is principal or agent.

The standard **does not provide any guidance relating to the significant variability** that may lead to a conclusion that the Investment manager is a principal. **Another feature of the aggregate economic interest** referred in the standard is the **magnitude**. The standard suggests for the evaluation of the magnitude of the manager's economic interest, which is performed primarily based on the returns that are expected from the activities of the investee. <u>The greater the magnitude and variability, the more likely the decision maker is a principal</u>

Example

Computation of Variability

Assume that an investment manager has:

- a 1% management fee calculated on net asset value (NAV); plus
- a performance fee paying 20% of total profits once an 8% (profits after management fee) hurdle is reached on profits.

Compute Variability at 10% of investment by the investment manager.

Solution:

The variability at any level of return at which a performance fee is due can be calculated as follows:

	Total	**Investment managers share**
Marginal return, say 1	1.000	
Less: management fees (1% of 1)	(0.010)	0.010
Less: performance fee as hurdle is met (20% of (1-0.010)	(0.198)	0.198
Available to investors	0.792	0.079 (at 10%)
Total Investment managers share		0.287
Therefore, variability		**28.7%**

Example

Computation of Magnitude

Assume that the fund in previous example begins with a value of 100, and then has a performance level of 10%.

Compute magnitude at 10% of investment by the investment manager.

Solution:

	Total	Investment managers share
Return	10.00	
Less: management fees (1% of 110)	(1.10)	1.10
Less: performance fee as hurdle is met (20% of (10-1.10-8*)	(0.18)	0.18
Available to investors	8.72	0.87 (at 10%)
Total Investment managers share		2.15
Therefore, magnitude		**21.5%**

*The hurdle below which no performance fee is received being 8%.

Q&A

Thank You