Intensive Refresher Course on Practical Aspects of Accounting Standards

Group related standards

AS 21, 23, 27 & 14

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AS 21: Consolidated financial statements

Introduction

Significance of preparing consolidated financial statements:

Users of the financial statements of a parent are usually concerned with and need to be informed about, the financial position and results of operations of not only the enterprise itself but also of the group as a whole.

This need is served by providing the users –

(a) separate financial statements of the parent; and
(b) consolidated financial statements, which present financial information about the group as that of a single enterprise without regard to the legal boundaries of the separate legal entities.

Definitions

Holding company

Holding company [Section 2(46)]:-
Holding company, in relation to one or more other **companies**, means a company of which such companies are **subsidiary companies**.

Parent [AS 21:5.3]:-
A parent is an **enterprise** that has one or more **subsidiaries**.

Subsidiary

Subsidiary company [Section 2(87)]:-

Subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company—

(i) **controls** the composition of the Board of Directors; **or**

(ii) **exercises or controls** more than one-half of the **total share capital** either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed **shall not have layers of subsidiaries beyond such numbers as may be prescribed**.

Subsidiary [AS 21:5.2]:-

A subsidiary is an enterprise that **is controlled** by another enterprise (known as the parent).

Total share capital

Total share capital [Rule 2(r) of Companies (Specification of Definition Details) Rules, 2014]:-

"Total Share Capital", for the purposes of sub-sections (6) and (87) of section 2, means aggregate of the:-

(a) paid-up equity share capital- and

(b) **<u>convertible</u>** preference share capital.

Companies (Restriction on number of layers) Rules, 2017 [1/2]

- Not more than two layers of subsidiaries permitted.

- Foreign subsidiaries beyond two layers as per the laws of such country- Permitted.

- One layer which consists of one or more wholly owned subsidiary/(subsidiaries)- Not taken into account for computing layers.

- <u>Restriction not applicable to</u>-
  - Banking company
  - Systematically important NBFC
  - Insurance company &
  - Government company

Companies (Restriction on number of layers) Rules, 2017 [2/2]

Example:

Ultimate holding company – A Ltd

Subsidiaries of A Ltd – B Ltd [100%], Z Ltd [60%]

Subsidiary of B Ltd – C Ltd

Subsidiary of C Ltd – D Ltd

While counting 2 layers of subsidiaries for A Ltd, the wholly owned subsidiary B Ltd will not be counted. So, A Ltd has not breached the rule for restriction on number of layers of subsidiaries.

However, D Ltd cannot now have a subsidiary.

Layers of companies [Sec.186]

A company can make investment through **<u>not more than two layers</u>** of investment companies.

Exceptions:

(i) Investment in a foreign company.

(ii) Having any investment subsidiary for the purposes of meeting the requirements under any law/ rule/ regulation.

Control

Control [Section 2(27)]:-
Control **shall include** the **right to appoint** majority of the directors or to **control the management or policy decisions** exercisable by a person or persons acting individually or in concert, directly or indirectly, including **by virtue of their shareholding** or **management rights** or **shareholders agreements** or **voting agreements** or in **any other manner**.

Control [AS 21:5.1]:-
(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or
(b) **control of the composition of the board of directors** in the case of a company or of the composition of the corresponding governing body in case of any other enterprise **so as to obtain economic benefits from its activities**.

Scope of definitions under AS & under Companies Act

Section 2 of the Companies Act, which provides definitions, begins with the words: "In this Act, **unless the context otherwise requires**……"

Significance of these wordings:

- ❖ Primarily, the definitions provided under section 2 will have precedence over any other meaning assigned to the relevant terms.

- ❖ However, if there is any indication of the context requiring a deviation from the definition, the definitions under Accounting Standards would become relevant.

Application

Consolidated financial statements AS 21 perspective

AS 21:5.5:-

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

AS 21:5.4:-

A group is a parent and **all its subsidiaries**.

Consolidated financial statements
Companies Act perspective [1/4]

Section 129(3):-

Consolidated financial statements to be prepared

- of all the subsidiaries
- in the same form and manner as that of its own
- shall also be laid before the annual general meeting of the company

Also attach along with its financial statement

a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries

[prescribed Form AOC-1 under Rule 5, Companies (Accounts) Rules, 2014]

The Central Government may provide for the manner of consolidation of accounts of companies

Consolidated financial statements
Companies Act perspective [2/4]

Rule 6 of Companies (Accounts) Rules, 2014: Manner of consolidation of accounts:-

- ❖ In accordance with the provisions of Schedule III of the Act and the applicable accounting standards

- ❖ For company exempted from preparing CFS under the Accounting Standards-
  - It is sufficient if the company complies with provisions on CFS provided in Schedule III of the Act.

Consolidated financial statements
Companies Act perspective [3/4]

Exemption from preparing CFS [Rule 6 of Companies Accounts (Amendment) Rules, 2014]
Intermediate subsidiary is not required to prepare CFS.
However, the exemption is not available to foreign intermediate subsidiary.

Example to explain the requirement:
A Ltd----------- Ultimate parent
B Ltd----------- 100% subsidiary of A Ltd [Intermediate subsidiary]
C Ltd----------- 100% subsidiary of B Ltd
B Ltd need not prepare CFS. A Ltd. Will prepare CFS of the whole group.
However, if A Ltd is incorporated outside India, then this exemption is not available to B Ltd.

Consolidated financial statements Companies Act perspective [4/4]

Explanation to section 129(3):-
'Subsidiary' shall include **associate company** and **joint venture**.

Section 129(4):-
The provisions of this Act applicable to the **preparation, adoption and audit** of the financial statements of a holding company are applicable to the consolidated financial statements.

Guidance under Schedule III to the Companies Act, 2013 [1/2]

GENERAL INSTRUCTIONS FOR THE PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

Requirements of this Schedule as applicable in the preparation of balance sheet and statement of profit and loss apply to CFS.

CFS shall disclose the information as per the requirements specified in the applicable Accounting Standards including the following:

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

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

Disclose the list of subsidiaries or associates or joint ventures which have not been consolidated in CFS & the reasons of not consolidating

Guidance under Schedule III to the Companies Act, 2013 [2/2]

Name of the entity	Net assets [Total assets – liabilities]		Share in profit/ loss	
	As % of consolidated Net assets	Amount	As % of consol. P/L	Amount
Parent				
Subsidiaries: Indian Foreign				
M.I. in all subsidiaries				
Associates [Equity mth] Indian Foreign				
JVs [Propor. Consol mth] Indian Foreign				

Guidance under AS 21

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

- **All the notes** appearing in the separate financial statements of the parent enterprise and its subsidiaries **need not be included** in the notes to CFS.

- Only the **notes involving items which are material** need to be disclosed.

- **Additional statutory information** disclosed in separate financial statements of the subsidiary and/or a parent having no bearing on the true and fair view of CFS, **need not be disclosed** in the CFS.

General principles of consolidation

General principles of consolidation [1/2]

AS 21:13:-

The financial statements of the parent and its subsidiaries **should be combined on a line by line basis** by adding together like items of assets, liabilities, income and expenses.

AS 21:18:-

- The financial statements used in the consolidation should be **drawn up to the same reporting date**.
- If that is not practicable and so, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates.
- In any case, **the difference** between reporting dates **should not be more than six months**.

General principles of consolidation [2/2]

AS 21: 20, 21:-

- CFS should be prepared using **uniform accounting policies**.
- If that is not practicable, that fact should be disclosed together with the proportions of the items in the CFS to which the different accounting policies have been applied.
- If a member of the group uses accounting policies other than those adopted in the CFS, **appropriate adjustments are made to its financial statements** when they are used in preparing the CFS.

Consolidation procedure [1/10]

Pre- acquisition & post-acquisition profits:-

- ❖ Date of acquiring control by the parent over the subsidiary is the key factor.
- ❖ Reserves & profits existing with the subsidiary as on the date of acquisition of control are the pre-acquisition profits.
- ❖ Profits earned by the subsidiary after the date of acquisition of control are the post- acquisition profits.

Consolidation procedure [2/10]

❖ Eliminate:-
(A) cost* to the parent of its investment in each subsidiary; and
(B) parent's portion of equity of each subsidiary.
[at the date on which investment in each subsidiary is made]

❖ Parent's portion of equity means the aggregate of the following:-
a) Share capital of the subsidiary held by the parent;
b) Share of the parent in the pre-acquisition profits of the subsidiary.

*Where the carrying amount of the investment in the subsidiary is different from its cost, the carrying amount is considered.

(A) > (B) = Goodwill; (A) < (B) = Capital Reserve

Consolidation procedure [3/10]

Analysis of profits of subsidiary for computation of Goodwill/ Capital Reserve

Particulars	Pre- acqn. profits	Post- acqn. profits
Balance in Reserves on the date of acquisition of control	xxx	
Balance in P/L on the date of acquisition of control	xxx	
Profits earned after the date of acquisition of control		xxx
TOTAL		
Less:- Minority interest	xxx	xxx
Share of parent	xxx	xxx
Considered in the computation of amount of	Gdw/ CR	Cosol. P/L

Consolidation procedure [4/10]
Computation of amount of Goodwill/ Capital Reserve

Particulars	Amount
Cost/ carrying amount to the parent of its investment in the subsidiary	xxx
Less:- <u>Parents' portion of equity of the subsidiary</u> a)Share capital of the subsidiary held by the parent b)Share of the parent in the pre-acquisition profits of the subsidiary	 xxx <u>xxx</u>
Goodwill/ (Capital Reserve) as the case may be	<u>xxx</u>

Consolidation procedure [5/10]
Minority Interest [A]

Minority interests in the net assets consist of:

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

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

Particulars	Amount
Share capital of the subsidiary held by the minority shareholders	xxx
Share of minority holders in the pre- acquisition profits of the subsidiary	xxx
Share of minority holders in the post acquisition profits of the subsidiary	xxx
Minority interest to be presented in the consolidated balance sheet	xxx

Consolidation procedure [6/10]
Minority Interest [B]

- Minority interests in the net income of consolidated subsidiaries- Identified and adjusted against the income of the group in order to arrive at the net income attributable to the owners of the parent.

- Minority interests in the net assets of consolidated subsidiaries – Identified and presented in the consolidated balance sheet separately from liabilities and the equity of the parent's shareholders.

- Minority interests in the income of the group- Separately presented.

Consolidation procedure [7/10]
Minority Interest [C]

Negative figure of Minority Interest

- ❖ Such figure and any further losses applicable to the minority-
  Adjusted against the majority interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses.

- ❖ If the subsidiary subsequently reports profits-
  All such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Consolidation procedure [8/10]
Elimination of intra- group balances

- Intragroup balances and intragroup transactions and resulting unrealized profits should be eliminated in full.

- Unrealized losses resulting from intragroup transactions should also be eliminated unless cost cannot be recovered.

Consolidation procedure [9/10]
Consolidated tax expense & consolidated reserves

- Current tax and deferred tax to be shown in the consolidated financial statements-
  It is the aggregate of the amounts of tax expense appearing in the separate financial statements of the parent and its subsidiaries.

- The parent's share in the post-acquisition reserves of a subsidiary, forming part of the corresponding reserves in the consolidated balance sheet –
  It is not required to be disclosed separately in the consolidated balance sheet.

Consolidation procedures [10/10]
Disclosures under AS 21

1) The reasons for not consolidating a subsidiary.
2) If it is not practicable to use uniform accounting policies in preparing the CFS, that fact should be disclosed together with the proportions of the items in the CFS to which the different accounting policies have been applied.
3) A list of all subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held.
4) The nature of the relationship between the parent and a subsidiary, if the parent does not own, directly or indirectly through subsidiaries, more than one-half of the voting power of the subsidiary.
5) The effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period.
6) The names of the subsidiary(ies) of which reporting date(s) is/are different from that of the parent and the difference in reporting dates.

Some critical issues

Some critical issues

Issue 1:- Is it mandatory to include each & every subsidiary in the process of consolidation?

Response:-
Section 129(3) provides that a company shall prepare a consolidated financial statement of the company and of **<u>all the subsidiaries</u>**.
AS 21 provides that Consolidated financial statements are the financial statements of a group presented as those of a single enterprise. A group is a parent and **<u>all its subsidiaries</u>**.

However, AS 21:9 provides that a parent which presents consolidated financial statements should consolidate all subsidiaries, domestic as well as foreign, other than those referred to in paragraph 11.

Continued

Some critical issues

AS 21:11 provides that A subsidiary should be excluded from consolidation when:

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

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

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

In-scope companies are required to prepare their financial statements as per Companies (Accounting Standards) Rules, 2006, AS 21 will have to be considered & accordingly, in the circumstances covered (but not otherwise), such subsidiaries can be excluded from the process of consolidation.

Continued

Some critical issues

However, the following points should be borne in mind.

- The meaning of the words '**near future**' should be considered as **not more than twelve months from acquisition of relevant investments** unless a longer period can be justified on the basis of facts and circumstances of the case. The **intention with regard to disposal of the relevant investment** should be considered at the time of acquisition of the investment.

- Exclusion of a subsidiary from consolidation on the ground that its **business activities are dissimilar** from those of the other enterprises within the group is not justified.

Some critical issues

Issue 2:- Whether a special purpose entity [SPE] should be included in the process of consolidation?

Response:-

<u>**The basis of considering an entity to be a subsidiary is 'control**</u>'. An SPE shall be included in consolidation process when the substance of the relationship between an entity & its SPE indicates that the SPE is controlled by that entity.

The control in substance may be in circumstances like the activities of the SPE are being conducted on behalf of the entity, the entity has the power to control through decision making to obtain the majority of the benefits of the activities of the SPE, entity retains the majority of the residual or the ownership risks related to the SPE etc.

However, in the case of the entities such as gratuity trust, provident fund trust etc., <u>**the objective of control over such entities is not to obtain economic benefits**</u> from their activities. Hence, such entities are not included in the consolidation process.

Some critical issues

Issue 3:- If A Ltd. Holds 51% of the equity share capital of X Ltd. & B Ltd., as per some agreement, controls the composition of board of directors of X Ltd. Which company is the parent of X Ltd.? While preparing the consolidated financial statements of which group of companies will X Ltd. be included as a subsidiary?

Response:-
As per the definition of 'control' under the Companies Act, 2013, as well as under AS 21, the two tests are independent. So it is possible that an entity can be a subsidiary of one entity based on equity shareholding & also subsidiary of another entity based on control over composition of board of directors.
In the present case, both A Ltd. & B Ltd. would be considered as parent/ holding company. So, in the preparation of consolidated financial statements of A Ltd. group as well as B Ltd. group, X Ltd. will be included as a subsidiary.

Some critical issues

Issue 4:- Is it mandatory to amortize goodwill arising in the process of consolidation while preparing the consolidated financial statements?

Response:-

Goodwill arising in the process of consolidation, though an intangible asset, is scoped out of AS 26: Intangible assets.

AS 21 does not provide for or prohibit amortization of goodwill.

The appropriate course is to test it for impairment & if impaired, then reduce it to the extent it is found impaired.

Some critical issues

Issue 5: Can goodwill & capital reserve arising on consolidation of different subsidiaries be set off or should they be recorded & disclosed separately at gross amounts?

Response:

There is no specific requirement under AS 21 to either net off the amounts or to report them separately. So, it is permissible to net off the amounts.

However, the gross amounts of goodwill & capital reserve may be disclosed in the notes to the consolidated financial statements, if desired.

Some critical issues

Issue 6: Whether all the notes appearing in the separate financial statements of the parent & its subsidiaries should be included in the notes to the consolidated financial statements?

Response:

- The basic principle is that the **benefits derived from information** included in the financial statements **should exceed the cost of providing it**.
- It is not necessary to include each & every note from the separate financial statements in the consolidated financial statements.
- Notes which are necessary for presenting true & fair view of the consolidated financial statements should be included.
- Only notes involving items which are material need to be disclosed.
- Additional statutory information disclosed in separate financial statements which have no bearing on the true & fair view of consolidated financial statements need not be disclosed.

Some critical issues

Issue 7: A Ltd is an Indian company preparing financial statements under IGAAP. It has a foreign subsidiary preparing financial statements under local GAAP. How should A Ltd prepare its CFS?

Response:-
Section 129(3) of the Companies Act, 2013 provides that the consolidated financial statements should be prepared of all the subsidiaries **in the same form and manner as that of its own**.
AS 21 requires that CFS are presented, to the extent possible, in the **same format as that adopted by the parent** for its separate financial statements.
Hence it would be essential to prepare the financial statements of the foreign subsidiary under Indian GAAP & then to use such I-GAAP statements for the purpose of consolidation.

AS 23: Accounting for investments in associates in consolidated financial statements

Definitions

Associate [1/2]

Section 2(6):-

Associate **company** in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation.—For the purposes of this clause, significant influence means **control of at least twenty per cent of total share capital, or of business decisions under an agreement**.

AS 23:3.1:-

An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

AS 23:3.2:-

Significant influence is the **power to participate in the financial and/ or operating policy decisions** of the investee but not control over those policies.

Associate [2/2]

AS 23:4:-

For the purpose of this Standard, significant influence **does not extend to power to govern** the financial and/or operating policies of an enterprise. Significant influence may be **gained by share ownership, statute or agreement**.

As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, **it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case**.

Conversely, if the investor holds, directly or indirectly through subsidiary(ies), less than 20% of the voting power of the investee, **it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated**.

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

Explanation:- In considering the share ownership, **the potential equity shares of the investee held by the investor are not taken into account** for determining the voting power of the investor.

Application & general principles

Equity method

- The equity method is a method of accounting whereby the **investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition**. The carrying amount of the investment is **adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee**.
- The consolidated statement of profit and loss reflects the investor's share of the results of operations of the investee.
- Distributions received from an investee reduce the carrying amount of the investment.
- Adjustments to the carrying amount may also be necessary for alterations in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the statement of profit and loss.
- Such changes include those arising from the revaluation of fixed assets and investments, from foreign exchange translation differences and from the adjustment of differences arising on amalgamations.

Rationale behind using Equity method

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

Application of Equity method

- Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in AS 21.

- The broad concepts underlying the consolidation procedures used in the acquisition of a subsidiary are adopted on the acquisition of an investment in an associate.

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

Elimination of unrealized profit

- In using equity method for accounting for investment in an associate, unrealized profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated **to the extent of the investor 's interest in the associate**.

- Unrealized losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.

Impairment of investment in associate

- The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment.

- Such reduction being determined and made for each investment individually.

Disclosures under AS 23 [1/2]

- In addition to the disclosures required by paragraph 7 [The reasons for not applying the equity method] and 12 [Goodwill or capital reserve in relation to associate], an appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements.

- Investments in associates accounted for using the equity method should be **classified as long-term investments** and disclosed separately in the consolidated balance sheet.

- The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss.

- The investor's share of any extraordinary or prior period items should also be separately disclosed.

Disclosures under AS 23 [2/2]

- ❖ The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements.

- ❖ In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies.

Some critical issues

Issue 1:- While determining whether there is a significant influence, whether potential voting rights with the investor should be taken into account?

Response:-

AS 23:3.1:-

An associate is an enterprise in which the investor **has** significant influence and which is neither a subsidiary nor a joint venture of the investor.

Having significant influence at present & not potentially in future is what is relevant.

So, potential voting rights should not be considered.

Some critical issues

Issue 2:- A Ltd holds 25% of the equity shares of B Ltd. The balance 75% are held by a group of X Ltd & its 100% subsidiaries who have substantial business interest in the operations of B Ltd. Can it be said that B Ltd. Is an associate of A Ltd?

Response:-

AS 23:3.1:-

An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

AS 23:3.2:-

Significant influence is the **power to participate in the financial and/ or operating policy decisions** of the investee but not control over those policies.

Continued

Some critical issues

AS23:4:-

As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, **it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case**.

Conversely, if the investor holds, directly or indirectly through subsidiary(ies), less than 20% of the voting power of the investee, **it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.**

In the present case, though A Ltd holds 25% of the equity of B Ltd, another group holds the balance 75%. That group has a substantial business interest in the operations of B Ltd.

So, practically in every financial & operating policy decisions, A Ltd is likely to be sidetracked by the other group. Hence it does not appear that A Ltd has a significant influence over B Ltd despite 25% equity holding.

Consequently, B Ltd can not be considered as associate of A Ltd.

AS 27: Financial Reporting of Interests in Joint Ventures

Definitions under AS 27

- **Joint venture**:-
  It is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

- **Joint control**:-
  It is the contractually agreed sharing of control over an economic activity.

- **A venturer**:-
  It is a party to a joint venture and has joint control over that joint venture.

- **An investor in a joint venture**:-
  It is a party to a joint venture and does not have joint control over that joint venture.

Forms of joint venture

Three broad types of joint ventures:-

- Jointly controlled operations
- Jointly controlled assets
- Jointly controlled entities

Interaction between AS 21, 23 & 27

Issue 1:- If A Ltd. has a jointly controlled entity B Ltd & A Ltd. controls more than 25% of the voting power of B Ltd. A Ltd. is preparing consolidated financial statements as it has many subsidiaries. How should the investment in B Ltd. be accounted for by A Ltd?
Response:- It should be under AS 21. The fact that B Ltd. is a subsidiary should have precedence over the fact that B Ltd. is a jointly controlled entity also.

Issue 2:- If A Ltd. has a significant influence over B Ltd. & B Ltd. is also a jointly controlled entity of A Ltd. A Ltd. is preparing consolidated financial statements as it has many subsidiaries. How should the investment in B Ltd. be accounted for by A Ltd?
Response:- It should be under AS 27. The fact that B Ltd. is jointly controlled by A Ltd., should have precedence over the fact that A Ltd. has a significant influence also over B Ltd.

Accounting in the case of jointly controlled operations

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

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

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

Accounting in case of jointly controlled assets

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

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities which it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses which it has incurred in respect of its interest in the joint venture.

Accounting in case of jointly controlled entity

Nature of jointly controlled entity

- A jointly controlled entity is a joint venture which involves the establishment of a corporation, partnership or other entity in which each venturer has an interest.

- The entity operates in the same way as other enterprises, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

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

Proportionate consolidation method

- In its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using proportionate consolidation.

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

Disclosures under As 27

- A venturer should disclose the aggregate amount of the contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities.
- A venturer should disclose the aggregate amount of the commitments in respect of its interests in joint ventures separately from other commitments.
- A venturer should disclose a list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also disclose the proportion of ownership interest, name and country of incorporation or residence.
- A venturer should disclose, in its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities.

AS 14:- Accounting for Amalgamations

What is scoped out from the standard

- This standard does not deal with cases of acquisitions.
- Acquisition arise when there is a purchase by one company of the whole or part of the shares, or the whole or part of the assets, of another company in consideration for payment in cash or by issue of shares or other securities in the acquiring company or partly in one form and partly in the other.
- The distinguishing feature of an acquisition is that the acquired company is not dissolved and its separate entity continues to exist.

Types of amalgamation & methods for accounting

Type of amalgamation	Method of accounting
Amalgamation in the nature of merger	Pooling of interests method
Amalgamation in the nature of purchase	Purchase method

Amalgamation in the nature of merger

<u>It is an amalgamation which satisfies all the following conditions</u>:

1. All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
2. Shareholders holding not less than 90% of the face value of the equity shares of the transferor company* become equity shareholders of the transferee company.
3. The consideration is discharged wholly by the issue of equity shares except cash in respect of any fractional shares.
4. The business of the transferor company is intended to be carried on.
5. No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company except to ensure uniformity of accounting policies.

* Other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees.

Amalgamation in the nature of purchase

An amalgamation should be considered to be an amalgamation in the nature of purchase, when **any one or more of the conditions** specified in relation to amalgamation in the nature of merger **is not satisfied**.

Pooling of interests method

- In preparing the transferee company's financial statements, the **assets, liabilities and reserves** (whether capital or revenue or arising on revaluation) **of the transferor company should be recorded at their existing carrying amounts and in the same form** as at the date of the amalgamation.
- The balance of the Profit and Loss Account of the transferor company should be aggregated with the corresponding balance of the transferee company or transferred to the General Reserve, if any.
- The difference between the amount recorded as share capital issued (plus any additional consideration in the form of cash or other assets) and the amount of share capital of the transferor company should be adjusted in reserves.
- If, at the time of the amalgamation, the transferor and the transferee companies have conflicting accounting policies, a uniform set of accounting policies should be adopted following the amalgamation. The effects on the financial statements of any changes in accounting policies should be reported accordingly.

Purchase method

- ❖ The assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.
- ❖ Any difference between the amount of the consideration over the value of the net assets of the transferor company acquired should be recognised as goodwill or capital reserve as the case may be.
- ❖ The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life. The amortization period should not exceed five years unless a somewhat longer period can be justified.
- ❖ Reserves (capital/ revenue nature or from revaluation) of the transferor company, except statutory reserves [SRs], should not be recognised by transferee entity. SRs are recognised & maintained till the expiry of the period mentioned in the statute.

Some critical issues
Raised before the Expert Advisory Committee [EAC] of ICAI

Some critical issues

Issue 1:- A Listed Service Company finalized a scheme of merger for its wholly owned 3 subsidiaries. The businesses of subsidiary companies were intended to be carried by amalgamated company. Parent company recorded all the assets and liabilities, including any intangible assets, transferred to and vested in amalgamated company pursuant to the Scheme, at their fair value. Inter company balances were cancelled and an amount corresponding to net assets transferred were credited to Capital Reserve/Goodwill as the case maybe. The condition relating to no changes to be made to the book values of assets was not met, since the assets were to be transferred at fair values. What should be the classification of this amalgamation?

Response:- The EAC analyzed all the facts of the case, and stated that AS 14 is clear in its conditions to evaluate whether a transaction was in the nature of merger or purchase. As the Company did not meet one of the five conditions i.e. recording the assets and liabilities at book values and hence the Company has to account the transaction as amalgamation in the nature of purchase.

Some critical issues

Issue 2:- There was an amalgamation in the nature of merger of three companies. The company approached the Expert Advisory Committee (EAC) of ICAI to determine:
(a) What was the nature of the 'reserves' (whether capital or general reserves) for the purpose of AS 14 and for the purpose of giving effect to the scheme of amalgamation of Company D in its books of account?
(b) Whether such reserves were available for the purpose of distribution to shareholders as dividends and/or bonus shares.

Response:- The EAC was of the view that in order to decide whether the reserve for the purpose of paragraph 35 should be reflected as capital or general reserve in the books of account of Company D, the nature of the transaction had to be determined.

Continued

Some critical issues

The EAC opined as follows:

(a) The difference between the issued share capital of the transferee company and the share capital of the transferor companies should be treated as capital reserve for the purpose of AS 14 and for the purpose of giving effect to the scheme of amalgamation of the company in its books of account.

(b) Reserve created on amalgamation was not available for the purpose of distribution to shareholders as dividend and/or bonus shares.

Some critical issues

Issue 3:- A Ltd. is amalgamating with B Ltd. under the scheme of amalgamation filed with a High Court on 1st January, 2021 under the provisions of the Companies Act.
The appointed date as per arrangement scheme is 1st Dec, 2020.The scheme was filed with the Registrar of Companies (ROC) on 5th April, 2021, which is the effective date. The date of approval of accounts by the Board of Directors of both such companies is 30th April, 2021. When the 'Effective Date' of amalgamation is after balance sheet date but before issuance of financial statements of either party to amalgamation, whether the companies are required or not to incorporate the effect of amalgamation in such balance sheet for the year ending on 31st March, 2021 or only provide disclosure in relation to events occurring after the balance sheet date.

Continued

Some critical issues

Response:-

The EAC is of the following opinion on the issues raised:-

(i) In the present case, amalgamation is effected from the date when the assets and liabilities of the transferor company vest with the transferee company as per the approved scheme of amalgamation.

(ii) Since the effective date for accounting would be prior to the balance sheet date, the incorporation of the effect of amalgamation in the balance sheet for 31st March. 2021, would be in compliance with the requirements of AS 14.

Thank You

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