Indian Accounting Standards Refresher Course

Ind AS 110 *Consolidated Financial Statements*, Ind AS 111 *Joint Arrangements* and Ind AS 28 *Investments in Associates and Joint Ventures*

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Ind AS 110 Key Concepts

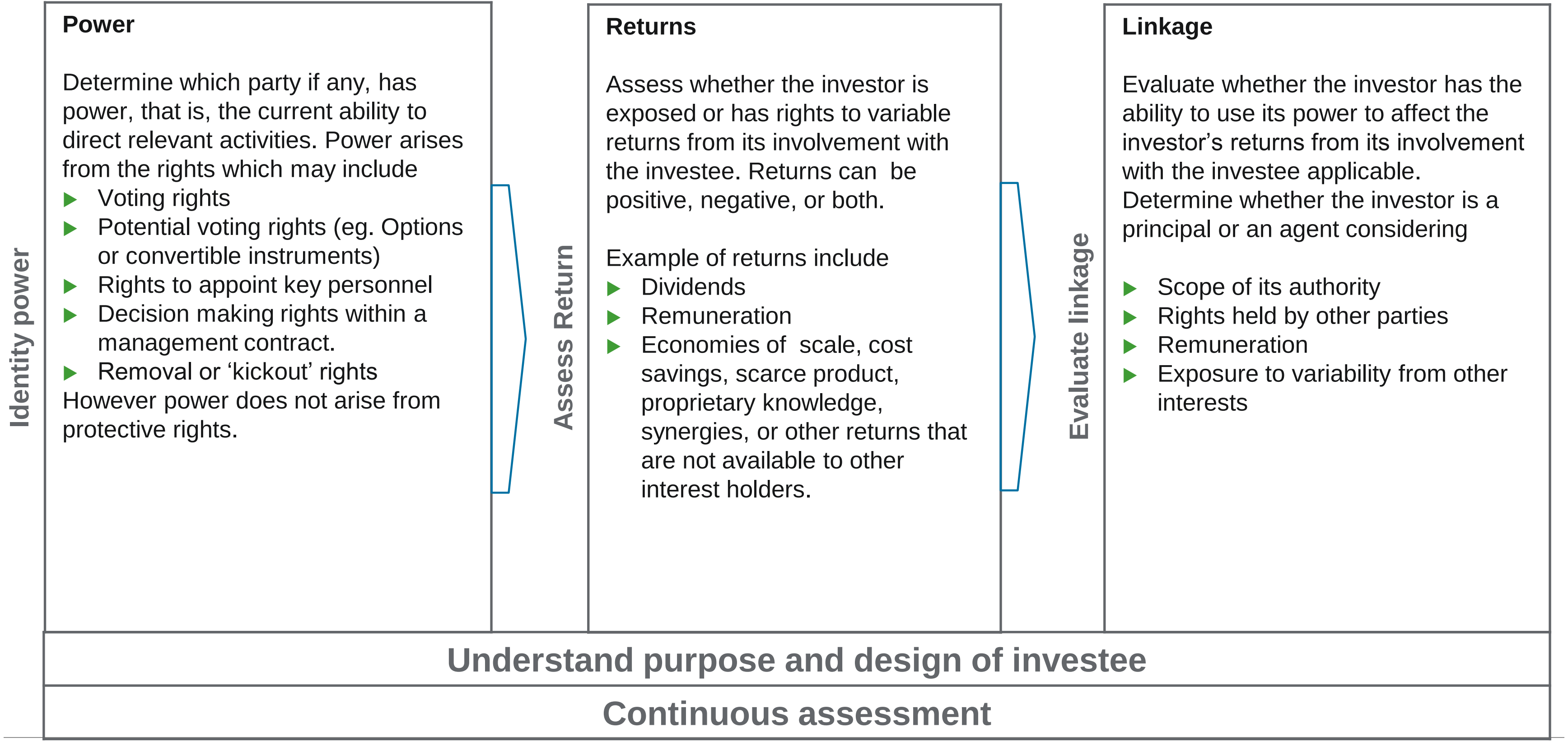
Core principle:

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.

Objectives: single model for consolidation for all entities

- Enhance disclosures for subsidiaries, joint ventures, associates, and structured entities

Key Concepts under Ind AS: Assessing control under Ind AS - 110



Identity power

Power

Determine which party if any, has power, that is, the current ability to direct relevant activities. Power arises from the rights which may include

- Voting rights
- Potential voting rights (eg. Options or convertible instruments)
- Rights to appoint key personnel
- Decision making rights within a management contract.
- Removal or ‘kickout’ rights

However power does not arise from protective rights.

Assess Return

Returns

Assess whether the investor is exposed or has rights to variable returns from its involvement with the investee. Returns can be positive, negative, or both.

Example of returns include

- Dividends
- Remuneration
- Economies of scale, cost savings, scarce product, proprietary knowledge, synergies, or other returns that are not available to other interest holders.

Evaluate linkage

Linkage

Evaluate whether the investor has the ability to use its power to affect the investor’s returns from its involvement with the investee applicable. Determine whether the investor is a principal or an agent considering

- Scope of its authority
- Rights held by other parties
- Remuneration
- Exposure to variability from other interests

Understand purpose and design of investee

Continuous assessment

Key Concepts under Ind AS:” Subsidiary” and “control”: Ind AS vs Companies Act

S/2(87) 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 voting capital**
either at its own or together with one or more of its subsidiary companies

S/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;

New Definition of Control: Identifying Relevant Activities

Relevant activities are those that significantly affect the investee’s returns

- Examples:
  - Establishing operating, capital and financing policies
  - Appointing, remunerating, and terminating employment of service providers or key management personnel
- Understand purpose and design of the investee
- If two investors direct different relevant activities
  - Identify which investor can direct the activities that most significantly affect returns

New Definition of Control: Identifying Relevant Activities: Example

- Two investors form an investee to develop and market a medical product
  - One investor is responsible for developing and obtaining regulatory approval
  - Other investor is responsible for manufacturing and marketing
- Determine which activity most significantly affects returns
  - Purpose and design of the investee
  - Factors that affect profit margin, revenue, etc.
  - Effect on returns from each decision-maker’s authority
  - Investors’ exposure to variability of returns

New Definition of Control: Evaluating Power

Power is having existing rights that give an investor the current ability to direct the relevant activities

- Main aspects of power:
  - Arises from rights
  - Need not be exercised
  - Does not arise from protective rights
  - Can exist even if others participate in directing the relevant activities (e.g., they have significant influence)
- Evidence that an investor directed activities in the past is an indicator of power, but is not conclusive

New Definition of Control: Assessing Returns

Returns can be only positive, only negative or positive and negative, but must have the potential to vary as a result of the investee's performance

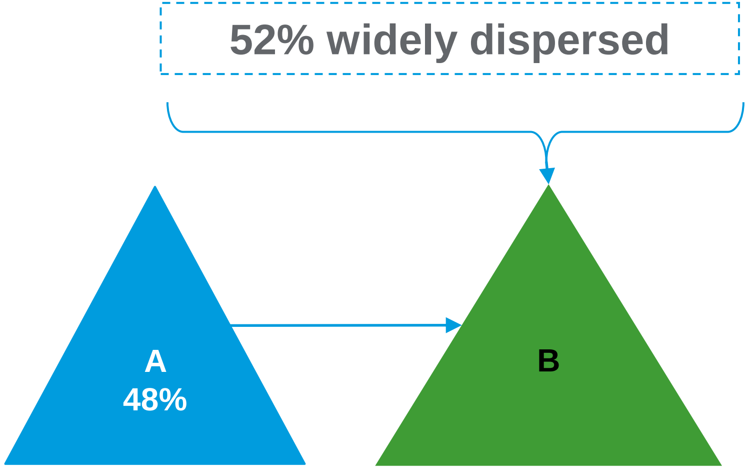
- Examples:
  - Dividends, distributions of economic benefits, changes in the value of an investment
  - Remuneration, fees, residual interests, tax benefits, exposure from providing support
  - Synergies, cost savings, economies of scale, scarce resources, proprietary knowledge

New Definition of Control: New Concepts

- Protective rights
- De facto control
- Potential voting rights
- Delegated rights (principal-agency relationships)
- Relationships with other parties (“*de facto* agents”)
- Control of specified assets (“silos”)
- Increased use of judgement
- Continuous assessment

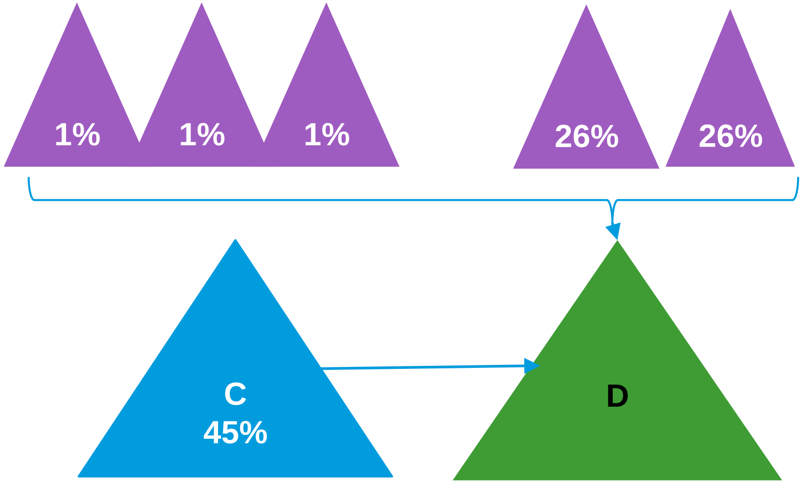
Key Concepts under Ind AS: Can an investor have control with less than half of the voting rights? – De facto control

Example 1



52% widely dispersed

Example 2



1%
1%
1%
26%
26%
C
45%
D

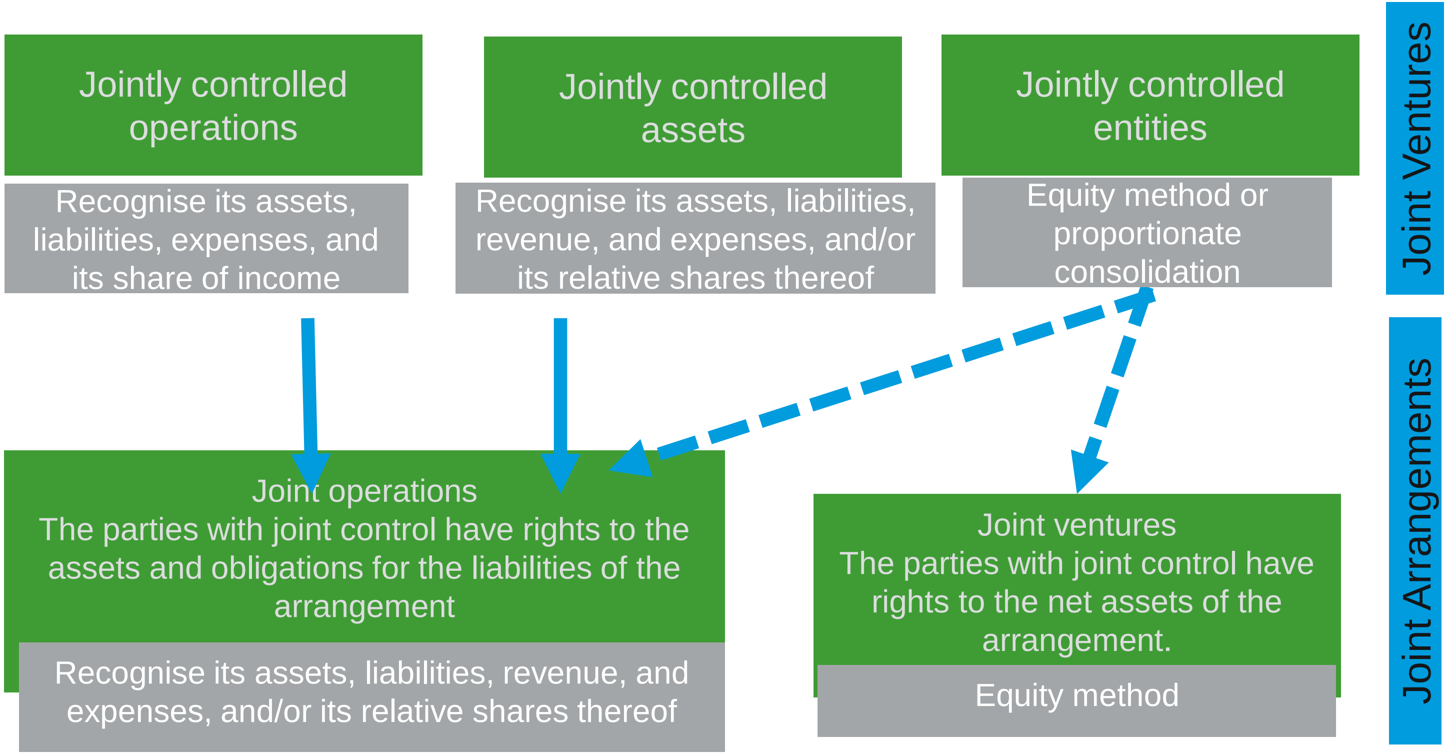
Key Ind AS impact – De facto control

Group	Extracts from Annual Financial Statements
Asian Paints	*The group holds 50% interest in Asian Paints PPG Private Limited. In the financial statements prepared under Previous GAAP, group had proportionately consolidated its interest in the Asian Paints PPG Private Limited in the Consolidated Financial Statement. On transition to Ind AS the group has assessed and determined that Asian Paints PPG Private Limited is a Subsidiary and accordingly consolidated under Ind AS. Consolidation of Asian Paints PPG Private Limited has resulted into change in the Balance Sheet, Statement of Profit and Loss and cash flow statement which is reflected line by line in the reconciliation. The above transaction has impacted an increase in equity by **Rs.45.14crores** as at the transition date and by **Rs.48.54 crores**.*

Other impacted groups

- Reliance Infrastructure
- Zensar
- Maruti Suzuki
- HCL Technologies
- Lanco Infratech
- United Phosphorous
- Fortis Healthcare
- Tata Chemicals
- Larson and Toubro
- Thermax Ltd.

Ind AS 111: Joint arrangements



Jointly controlled operations

Recognise its assets, liabilities, expenses, and its share of income

Jointly controlled assets

Recognise its assets, liabilities, revenue, and expenses, and/or its relative shares thereof

Jointly controlled entities

Equity method or proportionate consolidation

Joint Ventures

Joint operations
The parties with joint control have rights to the assets and obligations for the liabilities of the arrangement

Recognise its assets, liabilities, revenue, and expenses, and/or its relative shares thereof

Joint ventures
The parties with joint control have rights to the net assets of the arrangement.

Equity method

Joint Arrangements

Ind AS 28 Investments in Associates and Joint Ventures

An **associate** is an entity over which the investor has significant influence. **Significant influence** is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

- When an entity holds, directly or indirectly (e.g. through subsidiaries), 20% or more of the voting power of the investee, it is presumed that the entity has significant influence.
  - In case the investor clearly demonstrates that the holding does not give significant influence over investee then this would not apply.
- Conversely, if the entity holds, directly or indirectly (e.g. through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the entity does not have significant influence.
- In such case, if the investor clearly demonstrates that the holding gives it a significant influence over the investee then this would not apply.

Ind AS 28 Investments in Associates and Joint Ventures- Significant Influence

- Existence of significant influence is usually evidenced in one or more of the following:
  - Representation on the board of directors or equivalent governing body of the investee;
  - Participation in policy-making processes, including participation in decisions about dividends or other distributions;
  - Material transactions between the entity and its investee;
  - Interchange of managerial personnel; or
  - Provision of essential technical information.
- Existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence.
- In making this assessment the entity examines all facts and circumstances that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.

Ind AS 28 Investments in Associates and Joint Ventures- Equity Method

- Under the equity method, on initial recognition the investment in an associate or a JV is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.
- The investor's share of the investee's profit or loss is recognised in the investor's P&L.
- Distributions received from an investee reduce the carrying amount of the investment.
- Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's OCI.
- When potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights unless an entity has, in substance, an existing ownership as a result of a transaction that currently gives it access to the returns associated with an ownership interest.
- In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the returns.

Case Study 1: Consolidation of LLP and Partnership Firm

Whether a company H Limited is required to consolidate its subsidiary which is a Limited Liability Partnership (LLP) or a partnership firm?

Would the answer be different if LLP is an associate or joint venture of H Limited?

Solution 1: Consolidation of LLP and Partnership Firm

As per Rule 6 of the Companies (Accounts) Rules, 2014, under the heading ‘Manner of consolidation of accounts’, it is provided that consolidation of financial statements of a company shall be done in accordance with the provisions of Schedule III to the Companies Act, 2013 and the applicable Accounting Standards.

Paragraph 2 of Ind AS 110 requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements.

From the above, it may be noted that under Ind AS 110, any entity that is controlled by an investor is its ‘subsidiary’, irrespective of whether such an entity is a company or another type of entity such as a limited liability partnership firm, a partnership firm (other than LLP). Accordingly, in the given case, H Limited is required to consolidate its subsidiary which is an LLP or a partnership firm.

Even if the LLP or partnership firm is an associate or joint venture of H Limited, then also the LLP and partnership firm is required to be consolidated. Method of consolidation as prescribed under Ind AS 28, *Investments in Associates and Joint Ventures* and Ind AS 111, *Joint Arrangements,* for associates and joint ventures shall be followed.

Case Study 2: Consolidation Requirement when Subsidiary is disposed off

Entity X had two subsidiaries at the end of its previous reporting period which it consolidated in its consolidated financial statements prepared in accordance with Ind AS.

During its current reporting period, Entity X disposes of its investment in both the subsidiaries and consequently does not have any subsidiary at the end of the reporting period.

Is Entity X exempt from the requirement to present consolidated financial statements in view of not having any subsidiary at the end of the reporting period?

Solution 2: Consolidation Requirement when Subsidiary is disposed off

- Paragraph 20 of Ind AS 110 states that, “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”.
- Where a parent disposes of the investment in subsidiary(ies) during the reporting period, it is required to consolidate such subsidiary(ies) until the date it loses the control of such subsidiary(ies) during the reporting period.
- This requirement applies in all cases of loss of control or disposal of subsidiaries, including cases where the disposal results in the parent not having any subsidiary at the end of the reporting period.
- The requirement of presenting consolidated financial statements would apply in those cases also where an entity does not have any subsidiary either at the beginning or at the end of the reporting period but has acquired and disposed of a subsidiary (that is required to be consolidated as per Ind AS 110) during the reporting period.

Case Study 3: Assessment of Control

- Entity H holds 40 per cent, and six other investors each hold ten per cent, of the voting rights of Entity S.
- An agreement among all the shareholders grants Entity H the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities of Entity S.
- To change the agreement, two-third majority vote of the shareholders is required.
- Thus, Entity H cannot be divested of its contractual right since the combined voting power of all the other shareholders falls short of the three fourths majority required for this purpose.

Does Entity H have power over Entity S?

Solution 3: Assessment of Control

- The absolute size of Entity H’s holding and the relative size of the other shareholdings alone are not conclusive in determining whether Entity H has rights sufficient to give it power.
- However, Entity H has contractual right to appoint, remove and set the remuneration of management responsible for directing the relevant activities of Entity S.
- The contractual right of H to appoint, remove and set the remuneration of management of Entity S gives it power over Entity S.
- The fact that Entity H might not have exercised this right or the likelihood of Entity H exercising its right to select, appoint or remove management shall not be considered when assessing whether Entity H has power.

Case Study 4: Assessment of Control

- AB Limited owns 50% voting shares in XY Limited.
- The board of directors of XY Limited consists of six members of which three directors are nominated by AB Limited and three other investors nominate one director each pursuant to a Shareholders' Agreement among them.
- All decisions concerning 'relevant activities' of XY Limited are taken at its board meeting by a simple majority.
- As per the articles of association, one of the directors nominated by AB Limited chairs the board meetings and has a casting vote in the event that the directors cannot reach a majority decision.

Whether AB Limited has control over XY Limited?

Solution 4: Assessment of Control

- Paragraph 11 of Ind AS 110 states that, “power arises from rights. Sometimes assessing power is straightforward, such as when power over an investee is obtained directly and solely from the voting rights granted by equity instruments such as shares, and can be assessed by considering the voting rights from those shareholdings. In other cases, the assessment will be more complex and require more than one factor to be considered, for example when power results from one or more contractual arrangements”.
- AB Limited has (though its nominee director who chairs board meetings) a casting vote at the board meetings which along with its 50% (three out of six) of the normal voting rights gives it power to take decisions concerning relevant activities, even if the nominee directors of other investors do not concur with it on any matter.
- Thus, AB Limited has the current ability to direct the relevant activities of XY Limited through control over board decisions and hence it controls XY Limited.

Case Study 5: Assessment of Control

- Entity N, a NBFC , extended a loan to Entity X a few years back. The loans has become distressed, resulting in its restructuring during the current year.
- As part of the restructuring, a part of the loan has been replaced with equity shares of Entity X which amount to about 20% of the total outstanding equity shares of Entity X.
- Besides, Entity N has nominated some directors on the board of Entity X whose concurrence is necessary for a number of specified decisions.

Whether such restructuring of debt will give control to the Entity N over the entity X?

Solution 5: Assessment of Control

Paragraph 7 of Ind AS 110 states that, “an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor’s returns”.

- The loan extended by Entity N to Entity X and its equity shareholding in Entity X both provide Entity N with exposure to variable returns.
- An assessment will, however, be required as to whether Entity N has power over Entity X, and whether its exposure to variability of returns is sufficient to indicate that it is a principal which has control.
- Although, Entity N's involvement may be intended to just protect it from further loss, if Entity N has the power to make decisions concerning relevant activities and is considered to have sufficient exposure to variability, it has control.
- It may also be useful to consider what decisions are in the nature of participation in the management of the business as contrasted to those that are protective in nature.

Solution 5: Assessment of Control

Following are the illustrative indicators which may be evaluated, where restructuring resulted in the Entity N obtaining control over the Entity X:

(a) Is the management team of Entity X acting in the capacity of an agent for Entity N. (e.g., does Entity N have the ability to remove/replace or veto the management team).

(b) Does the requirement of obtaining consent of nominee directors of Entity N represent a substantive (or participating) right or a protective right. Involvement in decision-making process represents substantive rights when those decisions relate to operating and financial policy decisions made in the ordinary course of business such as approval of annual operating budgets, approval of capex, disposals, etc. that would be expected to be in the ordinary course of the entity's business, etc.

(c) In case Entity N vetoes certain decisions and there is a deadlock, what is the mechanism for resolving the deadlock?

Case Study 6: Assessment of Control

AB Limited grants a loan to BC Limited. BC Limited provides the shares held by it in AC Limited as security for the loan.

However, AB Limited does not gain the voting rights associated with the shares in AC Limited unless BC Limited defaults on the loan.

BC Limited owns 80% voting shares in AC Limited and consolidates AC Limited as a subsidiary.

Whether shares provided as security for loan provide power to AB Limited
over AC Limited?

Solution 6: Assessment of Control

Paragraph 8 of Ind AS 110 requires, an investor to consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control (i.e., power over the investee, exposure, or rights, to variable returns from its involvement with the investee and the ability to use its power over
the investee to affect the amount of the investor's returns).

BC Limited retains the power over the voting rights in AC Limited (unless and until it defaults) even though the shares are held by AB Limited as security for the loan extended by it to BC Limited.

Therefore, AB Limited does not have the current ability to direct the relevant activities of AC Limited.

However, in the event BC Limited defaults on said loan, AB Limited shall gain majority voting rights in AC Limited and thus, AB Limited shall exercise judgement based on the facts and circumstances including evaluation of factors as mentioned in the paragraphs 8, B80-B85 of Ind AS 110, to conclude if AB Limited has the current ability to direct the activities that most significantly affect the returns of AC Limited.

Case Study 7: Assessment of Control

AB Ltd holds 90% equity shares, having an aggregate face value of Rs. 90,000, in ABC Ltd out of its (ABC Limited's) total issued and (fully) paid up equity capital of Rs. 1,00,000. The relevant activities of ABC Ltd are decided upon by a simple majority vote and thus AB Ltd exercises control over ABC Ltd.

BC Limited holds 85% preference shares, having an aggregate face value of Rs. 1,70,000, in ABC Ltd out of its (ABC Limited's) total issued and (fully) paid-up preference share capital of Rs. 2,00,000. In the facts of the case, the voting rights of BC Limited as a preference shareholder are governed exclusively by the provisions of the Companies Act 2013.

The second proviso to section 47(2) of the Companies Act, 2013 provides that where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company. As per, the first proviso to section 47(2), the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares.

ABC Limited has not made the payment of dividend on its preference shares for the last two years. Whether the resulting voting rights available to BC Limited require reassessment of AB Limited's control?

Solution 7: Assessment of Control

- Paragraph 8 of Ind AS 110 requires an investor to reassess whether it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.
- In the present case, upon non-payment by ABC Limited of dividend on preference shares for two years, BC Limited becomes entitled to 56% of total voting rights over ABC Limited (1,70,000/3,00,000) and voting rights of AB Limited in ABC Limited stand reduced from 90% to 30% (90,000/3,00,000).
- Hence in the given case, in view of the change in the percentage holding of voting rights and considering other factors of control as enunciated under Ind AS 110, AB Limited and BC Limited should reassess control over ABC Limited.

Case Study 8: Assessment of Control

- A Limited manufactures a single product P. It supplies almost 85% of quantity of product P manufactured by it to B Limited.
- Remaining 15% is supplied to other retail customers. B Limited neither has any decision making powers regarding the manufacturing operations of A Limited nor any other involvement in A Limited except placing purchase orders with it.
- The contract period is three years and can be renewed by mutual consent. If the contract is not renewed, then either of the entity is able to seek other customers and suppliers respectively.
- However, in case of early termination, penalties are levied on the terminating entity.
- The board of A Limited operates and makes key decisions about its business independently. Further, A Limited is actively looking for new customers.

Whether B Limited has power over A Limited?

Solution 8: Assessment of Control

- It seems that A Limited is economically dependent on B Limited for its sales. However, other factors needs to be evaluated to assess B Limited’s control over the A Limited, e.g. power to direct the day to day operations making the key decisions, seeking customers and suppliers etc.
- In the given case, A Limited has unilateral decision making powers over how to manufacture the product and is actively engaged in seeking new customers.
- Further, the key decisions about the business of A Limited are also made by the Board of A Limited without any involvement of B Limited.
- Thus, upon assessment of these factors it is evident that B Limited does not have power over A Limited.

Case Study 9: Assessment of Control

X Limited, Y Limited, Z Limited hold 33.33% each of the voting rights in ABC Limited and each of them has the right to appoint two directors to the board of ABC Limited.

Apart from its equity shareholding in ABC Limited, X Limited also holds call options that are exercisable at a fixed price at any time and if exercised would give it all of the voting rights in ABC Limited.

The call options are in the money. However, X Limited’s management does not intend to exercise the call options even if Y Limited and Z Limited do not vote in the same manner as X Limited.

Whether the call option (potential voting rights) held by X Limited constitute substantive rights for the purpose of assessing power over ABC Limited, considering the management’s intention of not exercising the call options?

Solution 9: Assessment of Control

Ind AS 110 is silent on whether the option holder’s intention to exercise or not exercise the option is to be considered in the assessment of potential voting rights.

However, paragraph B14 of the Standard states that “power arises from rights”.

The intention of the management of X Limited with regard to not exercising the call options does not affect the assessment of whether the options are substantive unless such intention is caused by barriers (economic or otherwise) or other practical difficulties, as identified in the above-mentioned paragraph B23 of Appendix B to Ind AS 110 which may prevent (or deter) X Limited from exercising the options.

Since the options are in the money, in the absence of any barriers, the potential voting rights held by X Limited appear to be substantive rights.

Case Study 10: Assessment of Control

Investors A and B each own 50% voting shares in a manufacturing company (investee). The investors enter into a shareholders’ agreement which specifies the following:
(a) All decisions relating to the investee shall be are taken by its board of directors. At all times, the board shall have two nominees of each investor, i.e., a total of four members.

(b) Unanimous consent of all directors shall be required to take any decision.

(c) In the event that either of the investor enters into negotiations with a third party to sell its interest, then that investor can exercise its ‘drag along rights’ or other investor can exercise its tag along rights.

Do the tag along or drag along rights represent potential voting rights which might provide either of the investors with power over the investee?

Solution 10: Assessment of Control

Paragraph B40 of Ind AS 110 provides that other decision-making rights, in combination with voting rights, can give an investor the current ability to direct the relevant activities.

For example, the rights specified in a contractual arrangement in combination with voting rights may be sufficient to give an investor the current ability to direct the manufacturing processes of an investee or to direct other operating or financing activities of an investee that significantly affect the investee’s returns.

In the given case, the tag along or drag along rights represent a symmetrical exit right that could be exercised by either of the investor.

Thus, they do not give either of the investors the ability to obtain the voting rights of the other party.

Therefore, the said rights in the given case do not represent potential voting rights.

Case Study 11: Assessment of Control

An investor has determined that approving the annual operating budget of an investee is most relevant activity.

The operating budget is detailed and management has little latitude to deviate from the budget.

The investor has the right to veto this annual operating budget.

If that investor does veto the budget, management of the investee must re-draft and re-propose the budget and re-submit the budget to the investor holding the veto right.

Whether the veto right is merely a protective right of the investor?

Solution 11: Assessment of Control

Paragraph B12 of Appendix B to Ind AS 110 lists “establishing operating and capital decisions of the investee, including budgets” as an example of decisions about relevant activities. The investee's returns, the veto right may not merely be a protective right. Evaluating whether approving an annual operating budget is the most relevant activity will depend on facts and circumstances and requires exercise of judgement. Factors that may be considered are (but are not limited to):

- the level of detail of the budget that is required to be approved;
- whether the budget covers the relevant activities of the entity;
- whether previous budgets have been challenged and if so, the practical method of resolution;
- whether there are any consequences of budgets not being approved (e.g. may the operator/directors be removed?);
- whether the entity operates in a specialised business for which only the operator/directors have the specialised knowledge required to draw up the budget;
- the nature of the counterparty with budget approval rights and their practical involvement in the business.

In the present case, since approving the annual operating budget is the activity that significantly affects the investee’s returns, a veto right over the annual operating budget would not be considered as a protective right.

Case Study 12: Borrowing Cost at Group Level

- AB Limited obtains a term loan from PQR Bank.
- The loan has been raised by AB Limited specifically for the purpose of making a further equity investment in BC Limited, its wholly-owned subsidiary, which is in need of funds for construction of an asset.
- The said asset meets the definition of a qualifying asset under Ind AS 23, Borrowing Costs and is not excluded from the scope of Ind AS 23. Since, equity investment made by AB Limited using the proceeds of the borrowing does not qualify as a qualifying asset from its perspective; it expenses the associated borrowing costs in its stand-alone financial statements.
- On the other hand, since the proceeds of borrowing made by AB Limited have been provided by AB Limited to BC Limited as an equity investment and not as a loan, BC Limited does not have any associated borrowing costs from the perspective of its stand-alone financial statements.

How should AB Limited deal with the borrowing costs associated with the term loan in its consolidated financial statements?

Solution 12: Borrowing Cost at Group Level

- Ind AS 23 states that an entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Paragraph 10 of Ind AS 23 states that borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the expenditure on the qualifying asset had not been made.
- Ind AS 110 defines 'consolidated financial statements' as "the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity."
- The stand-alone financial statements of members of a group contain, inter alia, assets and liabilities, equity, income, expenses and cash flows relating to transactions with other members of the group. As part of the consolidation exercise, Ind AS 110 requires these assets and liabilities, equity, income, expenses and cash flows to be eliminated in full.
- From the perspective of the consolidated financial statements, the reporting entity (i.e., the group) has raised a loan from an external party and has used the proceeds of the loan to finance the construction of a qualifying asset. Hence, to the extent the borrowing costs associated with the loan are directly attributable to the construction of the qualifying asset, they should be included in the cost of the asset in the consolidated financial statements of AB Limited.

Solution 12: Borrowing Cost at Group Level

- In determining the amount of borrowing costs to be capitalised, the conditions laid down in Ind AS 23 regarding commencement, suspension and cessation of capitalisation should be followed. The following requirements of Ind AS 23 may also be particularly noted.
- According to paragraph 10 of Ind AS 23, when an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.
- Paragraph 11 of Ind AS 23 also inter-alia states that, “it may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. Difficulties also arise when a group uses a range of debt instruments to borrow funds at varying rates of interest, and lends those funds on various bases to other entities in the group”.
- Thus, it must capitalise the borrowing cost incurred in relation to the construction of the qualifying asset in the consolidated financial statements of AB Limited.

Solution 13: Associates of Wholly Owned Subsidiaries

Entity A has 4 wholly-owned subsidiaries that hold 25% equity shares each in Entity Z.

Entity A has no direct shareholding in Entity Z.

How should Entity Z be consolidated by Entity A. i.e., whether by applying equity accounting by the intermediary subsidiaries and then consolidation by Entity A, or direct consolidation by Entity A?

Solution 13: Associates of Wholly Owned Subsidiaries

- Entity A shall directly consolidate Entity Z as it exercises control over 100% of the voting rights in Entity Z indirectly through its wholly owned subsidiaries.
- However, if each wholly-owned subsidiary applies equity accounting for the respective shares in Entity Z and thereafter consolidating each intermediate wholly owned subsidiary on line by line basis in the consolidated financial statements (CFS) of Entity A would result in 100% of its indirect investment in Entity Z in the consolidated financial statements.
- The above approach will not reflect all the assets and liabilities of entity Z in the consolidated financial statements of Entity A and hence the indirect approach of consolidating the same may not be appropriate.

Solution 14: Assessment of Indirect Holding for Consolidation

- Solar Limited has an 80% interest in its subsidiary, Mars Limited.
- Solar Limited holds a direct interest of 25% in Venus Limited.
- Mars Limited also holds a 30% interest in Venus Limited.
- The decisions concerning relevant activities of Venus Limited require a simple majority of votes.

How should Solar Limited account for its investment in Venus Limited in its consolidated financial statements?

Solution 14: Assessment of Indirect Holding for Consolidation

- Solar Limited controls Mars Limited (since it holds 80% of its voting rights). Consequently, it also controls the voting rights associated with 30% equity interest held by Mars Limited in Venus Limited.
- Solar Limited also has 25% direct equity interest and related voting power in Venus Limited. Thus, Solar Limited controls 55% (30% + 25%) voting power of Venus Limited. As the decisions concerning relevant activities of Venus Limited require a simple majority of votes. Solar Limited controls Venus Limited and should therefore consolidate it in accordance with Ind AS 110.
- Although, Solar Limited controls Venus Limited, its entitlement to the subsidiary's economic benefits is determined on the basis of its actual ownership interest. For the purposes of the consolidated financial statements, Solar Limited's share in Venus Limited is determined as 49% [25% + (80% × 30%)].
- As a result, 51% of P&L, OCI and net assets of Venus Limited shall be attributed to the noncontrolling interests in the consolidated financial statements (this comprises 6% attributable to holders of non-controlling interests in Mars Limited [reflecting 20% interest of non-controlling shareholders of Mars Limited in 30% of Venus Limited] and 45% to holders of non-controlling interests in Venus Limited).

Case Study 15: Non Controlling Interest held by Associate

Entity A parent owns 80% of the equity interest in its subsidiary Entity S. It also owns 30% of equity interest in Entity L over which it has significant influence and which it consequently accounts for as an associate (i.e., using the equity method) in its consolidated financial statements.

Entity L owns the remaining 20 per cent of equity interest in Entity S. Further, Entity L does not have any subsidiary or joint venture or any associate other than Entity S.

In the above scenario, how should Entity A (parent) determine the noncontrolling interest (NCI) in the subsidiary for the purposes of its consolidated financial statements when part of the interest in subsidiary is held by parent’s associate?

Solution 15: Non Controlling Interest held by Associate

- Ind AS 110 defines non-controlling interest as “equity in a subsidiary not attributable, directly or indirectly, to a parent”.
- Therefore, when a part of the interest in subsidiary is held by parent’s associate, for the purpose of computing NCI interest, the parent should include the percentage of ownership interest in subsidiary that is directly or indirectly held through associate; that is, it should determine the NCI after accounting for indirect interest in subsidiary through associate.
- This would imply that parent’s interest in associate shall be taken ignoring the interest held by that associate in parent’s subsidiary.
- Parent should determine the NCI as the proportion not held by parent, its subsidiaries, joint ventures or associates wherein the proportion of equity and total comprehensive income of subsidiary allocated to the NCI in parent’s consolidated financial statements is 14 per cent (i.e., 20% × 70%), accordingly parent’s interest in the subsidiary is 86%, i.e., 80% (direct) + 30% of 20% (indirect through associate).
- Consequently, the parent company shall account for its stake in associate by considering associate’s separate financial statements and not the consolidated financial statements.

Case Study 16: Different Accounting Policies

H Limited has a subsidiary, S Limited and an associate, A Limited. The three companies are engaged in different lines of business.

These companies are using the following cost formulas for their valuation in accordance with Ind AS 2, Inventories:

Name of the Company	Cost formula used
H Limited	FIFO
S Limited, A Limited	Weighted average cost

Whether H Limited is required to value inventories of S Limited and A Limited also using FIFO formula in preparing its consolidated financial statements?

Solution 16: Different Accounting Policies

Paragraph 19 and paragraph B87 of Ind AS 110, Consolidated Financial Statements states as follows:

“19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member’s financial statements in preparing the consolidated financial statements to ensure conformity with the group’s accounting policies.”

As per Ind AS 2, different cost formulas may be justified for inventories of a different nature or use. Thus, if inventories of S Limited and A Limited differ in nature or use from inventories of H Limited, then use of cost formula (weighted average cost) different from that applied in respect of inventories of H Limited (FIFO) in consolidated financial statements may be justified. In ~~other words, in such a case, no adjustment needs to be made to align the cost formula applied~~ by S Limited and A Limited to cost formula applied by H Limited.

Case Study 17: Initial Cost of Associate for Equity Method

- An entity A owns 100% shares of the investee company X which were originally purchased for Rs.700 crores and had incurred directly attributable cost of Rs.50 crores.
- Entity A sells 60% of the shares in the company X to Entity B for Rs.1,500 crores. As a result of the sale, Entity B obtains control over company X. Entity A retains 40% interest and determines that it has significant influence over company X.
- At the date of disposal, the fair value of the identifiable assets and liabilities of company X including intangible assets is Rs. 1,800 crores and the fair value of Entity A's retained interest of 40% of the shares of Company X is Rs. 800 crores, which includes goodwill.

How entity A should measure the initial carrying amount of the investment in company X following disposal of its 60% interest?

Solution 17: Initial Cost of Associate for Equity Method

Paragraph 25 of Ind AS 110, inter-alia, states that, “if a parent loses control of a subsidiary the parent recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant Ind ASs.

That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with Ind AS 109 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture”.

Accordingly, in the given case, upon loss of control, entity A should deconsolidate the Company X and account for its remaining interest in Company X, as an associate or joint venture using the equity method of accounting.

Entity A's initial carrying amount of the associate should be based on the fair value of the retained interest, i.e. Rs.800 crores.

Solution 17: Initial Cost of Associate for Equity Method (Contd.)

The analysis of investment in Company X is as follows: (Rs in crores)

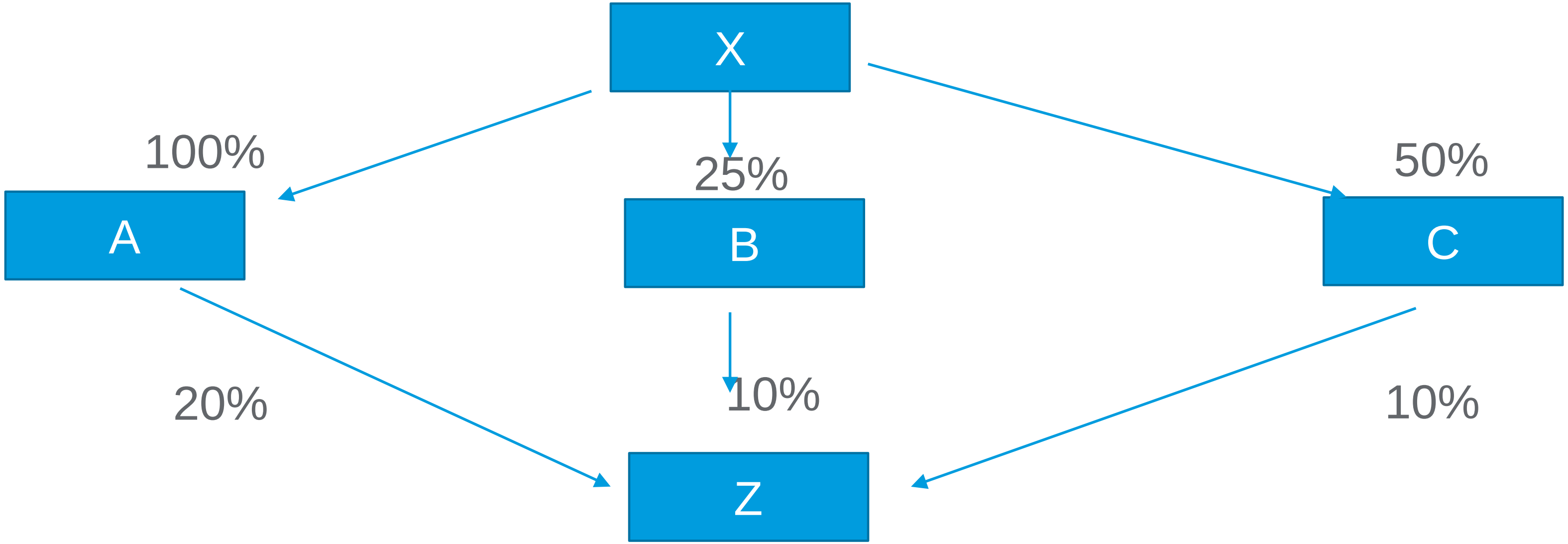
Goodwill	Identifiable net assets	Total Investment in Company X
80	720	800

Note 1: Calculation of Goodwill: 800 –720 = 80

Note 2: Calculation of identifiable net assets: 720= 40% of Rs. 1,800 , i.e., fair value of the identifiable assets and liabilities of the Company X.

Case Study 18: Equity Method

An entity X holds 100% investment in subsidiary A, which in turn holds a 20% investment in associate Z. In addition, entity X also holds a 25% investment in associate B and a 50% investment in joint venture C, each of which holds a 10% investment in associate Z.



What shall be the entity X's share in entity Z?

Solution 18: Equity Method

Paragraph 27 of Ind AS 28, inter-alia, states that, “a group’s share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the parent and its subsidiaries. The holdings of the group’s other associates or joint ventures are ignored for this purpose”.
Therefore, in its consolidated financial statements entity X accounts for a 20% investment in associate Z under the equity method because:

□ the investments in associate Z held by associate B and joint venture C should not be taken into account; and

□ entity X fully consolidates the assets of its subsidiary A, which include a 20% investment in associate Z. Entity X should consolidate such 20% holding in entity Z under equity method.

Solution 19: Step Increase under Equity Method

How should goodwill / capital reserve be computed on step increase in an existing associate / joint venture?

Is there a need for re-measurement of existing ownership interest at the time of the increase?

Solution 19: Step Increase under Equity Method

- An entity may acquire an additional interest in an existing associate or joint venture that continues to be an associate or joint venture accounted for under the equity method. Ind AS 28 doesn’t provide explicit guidance for such transaction.
- Paragraph 10 of Ind AS 28 which deals with initial recognition of investment requires that on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor’s share of the profit or loss of the investee after the date of acquisition. Paragraph 32 of Ind AS 28 states that, “an investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture.
- On acquisition of the investment, any difference between the cost of the investment and the entity’s share of the net fair value of the investee’s identifiable assets and liabilities is accounted for as follows:

(a) Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

(b) Any excess of the entity’s share of the net fair value of the investee’s identifiable assets and liabilities over the cost of the investment is recognised directly in equity as capital reserve in the period in which the investment is acquired.

Solution 19: Step Increase under Equity Method (Contd.)

- The existing ownership interests are accounted for under paragraphs 10 and 32 of Ind AS 28, whereby the carrying value is adjusted only for the investor's share of the associate or joint venture's profits or losses and other recognised equity transactions.
- No entry is recognised to reflect changes in the fair value of assets and liabilities that are not recognised under the accounting policies applied for the associate or joint venture.
- Hence, the purchase price paid for the additional interest should be added to the existing carrying amount of the associate or the joint venture and the existing interest in the associate or joint venture should not be remeasured.
- The additional interest acquired should be notionally split between goodwill and the additional interest in the fair value of the net assets of the associate
- This split is based on the fair value of the net assets at the date of the increase in the associate or joint venture. However, no remeasurement should be made for previously unrecognised changes in the fair values of identifiable net assets. Therefore, goodwill / capital reserve will be computed based on fair value of identified assets and liabilities on the date of further acquisition.

Solution 20: Associates with Different Year End

Whether the financial statements of an associate which is prepared as on a date subsequent to the reporting date of an entity, can be used for the purpose of applying the equity method of accounting under Ind AS 28?

Solution 20: Associates with Different Year End

- Paragraph 33 of Ind AS 28 provides that, “the most recent available financial statements of the associate or joint venture are used by the entity in applying the equity method. When the end of the reporting period of the entity is different from that of the associate or joint venture, the associate or joint venture prepares, for the use of the entity, financial statements as of the same date as the financial statements of the entity unless it is impracticable to do so”.
- When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor (or its consolidated subsidiaries) and the associate that occur between the date of the associate's financial statements and the date of the investor's consolidated financial statements.

Thank You!