Educational Material on
Ind AS 110, Consolidated Financial Statements

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
NEW DELHI

This Educational Material has been formulated in accordance with the Ind AS notified by the Ministry of Corporate Affairs (MCA) as Companies (Indian Accounting Standards) Rules, 2015 vide Notification dated February 16, 2015 and other amendments finalised and notified till March 2018.

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Foreword

To enable our nation with robust financial reporting framework, the ICAI has always identified the evolving needs of our developing and emerging economy. ICAI played a proactive role in formulating and implementing Indian Accounting Standards (Ind AS). Ind AS has become a reality now as both Phase I and Phase II companies have implemented Ind AS. This implementation has provided better insights into the financial affairs of the companies and Ind AS based financial statements reflect the underlying economics of the transactions in a transparent and unbiased manner.

The Ind AS Implementation Group of ICAI is playing a dynamic role in providing guidance on practical issues that are being faced by the members and other stakeholders while implementing Ind AS. As a step in this direction, the Group has brought out this Educational Material covering Ind AS 110, *Consolidated Financial Statements*. The purpose of this Educational Material is to provide guidance by way of Frequently Asked Questions (FAQs) and illustrations explaining the principles enunciated in the Standards. This publication will provide guidance to the stakeholders in how an entity prepares and presents consolidated financial statements and suggested descriptive disclosures for entities having interests in other entities.

I sincerely acknowledge the untiring efforts put in by CA. Nihar Niranjan Jambusaria, Convenor, CA. Dhinal Ashvinbhai Shah, Deputy Convenor, convenor as well as convenor of the Study Group and other members of the Ind AS Implementation Group for their valuable technical contribution and cooperation. I also congratulate CA. S.B. Zaware, Chairman and CA. M P Vijay Kumar, Vice-chairman, Accounting Standards Board of ICAI for their support. I am sure that this Educational Material will be useful for all who are implementing Ind AS and also for those who will audit the financial statements in accordance with Ind AS.

I believe that all these persistent efforts of Ind AS Implementation Group will provide sufficient guidance to members while implementing the Standards.

New Delhi **CA. Naveen N.D. Gupta**
December 22, 2018 ***President, ICAI***

Preface

The implementation of Indian Accounting Standards (Ind AS) by Indian Companies is a monumental step in the accounting history of India. The Institute of Chartered Accountants of India (ICAI) being a critical wheel in the accounting standard-setting framework of India, through its Ind AS Implementation Group is playing a pivotal role to ensure that Ind AS is implemented in the same spirit in which these have been formulated. For this purpose, the Ind AS Implementation Group is working to provide guidance to the members and other stakeholders by issuing Educational Materials on Ind AS, issuing timely clarifications on issues being faced by the members through Ind AS Technical Facilitation Group (ITFG) Clarification Bulletins, addressing queries through Support-desk for implementation of Ind AS, conducting Certificate Course on Ind AS, developing e-learning modules on Ind AS, organising workshops, seminars, awareness programmes on Ind AS etc.

We are pleased that the Group has brought out this Educational Material covering Indian Accounting Standard (Ind AS) 110, *Consolidated Financial Statements*. Ind AS 110 establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. The standard defines the principles of control and how to apply the same and explains the accounting requirements for preparing consolidated financial statements.

This Educational Material contains summary of Ind AS 110 discussing the key requirements of the Standards and the Frequently Asked Questions (FAQs) and illustrations covering the issues, which are expected to be encountered frequently while implementing these Standards. We may mention that the views expressed in this publication are the views of the Ind AS Implementation Group and are not necessarily the views of the Council of the Institute. The purpose of this publication is to provide guidance for implementing this Ind AS effectively by explaining the principles enunciated in the Standard with the help of examples. However, while applying Ind AS in a practical situation, reference should be made to the full text of the Standards.

We express heartfelt gratitude to our Hon'ble President, CA. Naveen N D Gupta and Vice-President, CA. Prafulla Premsukh Chhajed for providing us

this opportunity of bringing out implementation guidance on Ind AS in the form of Educational Materials. We deeply appreciate the efforts put in by CA. Sandip Khetan, Co-convenor and members of the Group CA. Archana Bhutani, CA. Deepa Dev, CA. Rohit Kumar, CA. Sanjeev Kumar and CA. Amit Jain for preparing the draft of this Educational Material. We would also like to thank all the members of the Ind AS Implementation Group for their valuable & technical contributions in finalising this publication.

We also acknowledge the technical and administrative support provided by CA. Geetanshu Bansal, Secretary, Ind AS Implementation Group and CA. Prachi Jain, Executive Officer in bringing out this publication. We would also like to extend special thanks to CA. Vidhyadhar Kulkarni, Head, Technical Directorate, for his guidance.

We are sure that this Educational Material will be of great help in understanding the provisions of consolidation of financial statements and their practical implementation.

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Educational Material on Indian Accounting Standard (Ind AS) 110 *Consolidated Financial Statements*

Indian Accounting Standard (Ind AS) 110, Consolidated Financial Statements, was notified as part of the Companies (Indian Accounting Standards) Rules, 2015 issued by the Government of India, Ministry of Corporate Affairs, vide notification no. G.S.R. 111(E) dated February 16, 2015. These Rules came into force on 1 April 2015. Further, Ind AS 110 (or 'the Standard') has been amended as a part of Companies (Indian Accounting Standards) (Amendment) Rules, 2016 vide notification no. No. G.S.R. 365(E) dated March 30, 2016.

I. Summary of Ind AS 110

Objective

[The purpose of this summary is to help the reader gain a broad understanding of the principal requirements of the Standard. Reference should be made to the completed text of the Standard for a fuller understanding of these requirements or in dealing with a practical situation.]

The objective of Ind AS 110 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

To meet the above objective, Ind AS 110 requires an entity (the *parent*) that controls one or more other entities (*subsidiaries*) to present consolidated financial statements:

(a) defines the principle of *control*, and establishes control as the basis for consolidation;

(b) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;

(c) sets out the accounting requirements for the preparation of consolidated financial statements; and

(d) defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

Scope

Barring the following exceptions specified in this Standard, an entity that is a parent is required to present consolidated financial statements:

- A parent need not present consolidated financial statements if it is a wholly-owned subsidiary, its debt or equity instruments are not traded in a public market; it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and its ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind AS.

  The above exception also applies in the case of a partially-owned subsidiary, if its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements

- Ind AS 110 does not apply to **post-employment benefit plans or other long-term employee benefit** plans to which Ind AS 19, *Employee Benefits,* applies.

A parent that is an **investment entity** shall not present consolidated financial statements if it is required by this Standard to measure all of its subsidiaries at fair value through profit or loss.

Consolidated financial statements are 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.

Control

An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee. An investor controls an investee when the investor is exposed, or has rights, to **variable returns** from its involvement with the investee; and has the **ability** to affect those returns through its power over the investee.

An investor shall consider all facts and circumstances when assessing whether it controls an investee. The investor shall reassess whether it control an investee if facts and circumstances indicate that there are changes to one or more elements of control mentioned above.

The following factors may assist in determining whether an investor controls an investee:

(a) the purpose and design of the investee;

(b) what the relevant activities (of the investee) are and how decisions about those activities are made;

(c) whether the rights of the investor give it the current ability to direct the relevant activities;

(d) whether the investor is exposed, or has rights, to variable returns from its involvement with the investee; and

(e) whether the investor has the ability to use its power over the investee to affect the amount of the investor's return.

Appendix B to Ind AS 110 contains guidance for application of the standard, including guidance on assessment of control. The Appendix is an integral part of the Standard and has the same authority as other parts of the Standard.

Power

The determination about whether an investor has power depends on the **relevant activities**, the way decisions about the relevant activities are made and the rights the investor and other parties have in relation to the investee.

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the ***relevant activities***, i.e., the activities of the investee that significantly affect the investee's returns.

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. An investor with the current ability to direct the relevant activities has power even if its rights to direct have yet to be exercised. Evidence that the investor has been directing relevant activities can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether the investor has power over an investee.

If two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

An investor can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities, for example when another entity has *significant influence*. However, an investor that holds only protective rights does not have power over an investee, and consequently does not control the investee.

Relevant activities

For many investees, a range of operating and financing activities significantly affect their returns. Example of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

(a) selling and purchasing of goods or services;

(b) managing financial assets during their life (including upon default);

(c) selecting, acquiring or disposing of assets;

(d) researching and developing new products or processes; and

(e) determining a funding structure or obtaining funding.

Examples of decisions about relevant activities include but are not limited to:

(a) establishing operating and capital decisions of the investee, including budgets; and

(b) appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment.

Rights that given an investor power over an investee

The rights that may give an investor power can differ between investees.

Examples of rights that, either individually or in combination, can give an investor power include but are not limited to:

(a) rights in the form of voting rights (or potential voting rights) of an investee;

(b) rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities;

(c) rights to appoint or remove another entity that directs the relevant activities;

(d) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and

(e) other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

Substantive rights

An investor considers only substantive rights relating to an investee (held by the investor and others) when assessing control. For a right to be substantive, the holder must have the practical ability to exercise that right. Determining whether rights are substantive requires judgement, taking into account all facts and circumstances. To be substantive, rights also need to be exercisable when decisions about the direction of the relevant activities need to be made. Usually, to be substantive, the rights need to be currently exercisable. However, sometimes rights can be substantive, even though they are not currently exercisable.

Protective rights

In evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective.

Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over an investee.

Power without a majority of the voting rights

An investor can have power even if it holds less than a majority of the voting rights of an investee. An investor can have power with less than a majority of the voting rights of an investee, for example, through:

(a) a contractual arrangement between the investor and other vote holders;

(b) rights arising from other contractual arrangements;

(c) the investor's voting rights;

(d) potential voting rights; or

(e) a combination of (a)–(d).

An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to direct the relevant activities unilaterally.

When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

(a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:

 (i) the more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

 (ii) the more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

 (iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(b) potential voting rights held by the investor, other vote holders or other parties;

(c) rights arising from other contractual arrangements; and

(d) any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

If it is not clear, having considered the factors listed in paragraph B42(a)–(d), that the investor has power, the investor does not control the investee.

Returns

An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or both positive and negative.

Although only one investor can control an investee, more than one party can share in the returns of an investee. For example, holders of non-controlling interests can share in the profits or distributions of an investee.

Exposure, or rights, to variable returns from an investee

When assessing whether an investor has control of an investee, the investor determines whether it is exposed, or has rights, to variable returns from its involvement with the investee.

Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. Variable returns can be only positive, only negative or both positive and negative.

An investor assesses whether returns from an investee are variable and how variable those returns are on the basis of the substance of the arrangement and regardless of the legal form of the returns. For example, an investor can hold a bond with fixed interest payments. The fixed interest payments are variable returns for the purpose of the Standard because they are subject to **default risk** and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (ie how variable those returns are) depends on the credit risk of the bond. Similarly, fixed performance fees for managing an investee's assets are variable returns because they expose the investor to the **performance risk** of the investee. The amount of variability depends on the investee's ability to generate sufficient income to pay the fee.

Link between power and returns

An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

Delegated power

An investor with decision-making rights shall determine whether it is a principal or an agent. An investor that is an agent does not control an investee when it exercises decision-making rights delegated to it.

When an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. It shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties [the principal(s)] and therefore does not control the investee when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes.

An investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the investee by considering the requirements in paragraphs B5–B54 of the Standard. Paragraphs B60–B72 of the Standard provide guidance on determining whether a decision maker is an agent or a principal.

Relationship with other parties

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those other parties are acting on the investor's behalf (ie they are 'de facto agents'). The determination of whether other parties are acting as de facto agents requires judgement, considering not only the nature of the relationship but also how those parties interact with each other and the investor.

Such a relationship need not involve a contractual arrangement. A party is a de facto agent when the investor has, or those that direct the activities of the investor have, the ability to direct that party to act on the investor's behalf. In these circumstances, the investor shall consider its de facto agent's decision-making rights and its indirect exposure, or rights, to variable returns through the de facto agent together with its own when assessing control of an investee.

Accounting Requirements

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

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.

Non-controlling interests in subsidiaries shall be presented in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e., transactions with owners in their capacity as owners).

If a parent losses control over the subsidiary, the parent shall:

(a) derecognise the assets and liabilities of the former subsidiary;

(b) recognise any investment retained in the subsidiary at its fair value when control is lost and subsequently account for it 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 a joint venture.;

(c) recognise gain and loss associated with the loss of control.

Application guidance on accounting requirements

Paragraphs B86 to B99 of the Standard provide detailed application guidance on accounting requirements such as consolidation procedures, uniform accounting policies, measurement, potential voting rights, reporting date, non-controlling interests and loss of control. Some of the important aspects are discussed below:

Consolidation procedures

In its consolidated financial statements, an entity shall:

(a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.

(b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (Ind AS 103 explains how to account for any related goodwill).

(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and property, plant and equipment, are eliminated in full). Ind AS 12, Income Taxes, applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform accounting policies

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.

Measurement

An entity includes income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. For example, depreciation expense recognised in the consolidated statement of profit and loss is based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date.

Non-controlling interests

In consolidated financial statements, an entity shall attribute the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The entity shall also attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit (i.e., negative) balance.

If a subsidiary has outstanding cumulative preference shares that are classified as equity and are held by non-controlling interests, the entity shall compute its share of profit or loss after adjusting for the dividends on such shares, whether or not such dividends have been declared.

Investment entities

Barring an exception (discussed later), an investment entity shall not consolidate its subsidiaries or apply Ind AS 103, *Business Combinations*, when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109.

An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

Paragraphs B85A-B85M provide application guidance for determining whether an entity is an investment entity.

The following are typical characteristics of an investment entity:

(a) it has more than one investment;

(b) it has more than one investor;

(c) it has investors that are not related parties of the entity; and

(d) it has ownership interests in the form of equity or similar interests

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity.

If an investment entity has a subsidiary that is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities, it shall consolidate that subsidiary and apply Ind AS 103 to the acquisition of any such subsidiary.

A parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Change in investment entity status

If facts and circumstances indicate that there are changes to one or more of the three elements that make up the definition of an investment entity or the typical characteristics of an investment entity, a parent shall reassess whether it is an investment entity.

When an entity ceases to be an investment entity, it shall apply Ind AS 103 to any subsidiary that was previously measured at fair value through profit or loss.

The date of the change of status shall be the deemed acquisition date.

The fair value of the subsidiary at the deemed acquisition date shall represent the transferred deemed consideration when measuring any goodwill or gain from a bargain purchase that arises from the deemed acquisition. All subsidiaries shall be consolidated from the date of change of status.

When an entity becomes an investment entity, it shall cease to consolidate its subsidiaries at the date of the change in status, except for any subsidiary providing investment-related services (see discussion above) that shall continue to be consolidated. The investment entity shall apply the requirements of the Standard relating to 'loss of control' to those subsidiaries that it ceases to consolidate as though the investment entity had lost control of those subsidiaries at that date.

II. Frequently Asked Questions

Scope

Question 1

Ind AS 110, *Consolidated Financial Statements* as well as the Companies Act, 2013 require companies to present consolidated financial statements. However, under both the regulations criteria for determining relationship with other entities (i.e., subsidiary, joint venture and associate companies) are different.

Whether a company should follow the requirements of Ind AS 110 or the Companies Act, 2013 for the purpose of preparation of financial statements?

Response

Rule 4A of the Companies (Accounts) Rules, 2014 issued by the Ministry of Corporate Affairs states as follows:

"***4A. Forms and items contained in financial statements***

The financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or Indian Accounting Standards as applicable.

Provided that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards, as the case may be."

Thus, it is evident from the above that for the purposes of preparation of financial statements, the definitions and other requirements given under Ind AS should be considered and applied by the entity.

Accordingly, a company should follow the requirements prescribed under Ind AS 110 for the purpose of preparation of financial statements.

Question 2

AB Limited holds majority voting shares in several companies. All of these investee companies qualify as subsidiaries of AB Limited within the meaning of the Companies Act, 2013. All of these investee companies also qualify as subsidiaries of AB Limited within the meaning of Ind AS 110*, Consolidated Financial Statements*, since all decisions are taken by these companies on the basis of simple majority of votes.

AB Limited holds 48 per cent of the voting shares in Z Limited. As AB Limited neither controls the composition of the Board of Directors of Z limited nor it exercises or controls more than one-half of the total voting power of Z Limited therefore Z Limited does not qualify as a subsidiary of AB Limited within the meaning of the Companies Act, 2013.

The voting rights in Z Limited other than those held by AB Limited are held by thousands of shareholders, none individually holding more than 1 per cent of the voting rights. None of the shareholders has any arrangements to consult any of the others or make collective decisions. On the basis of the relative size of the other shareholdings, AB Limited has determined that a 48 per cent interest is sufficient to give it 'de facto control' over Z Limited within the meaning of this term under Ind AS 110. Consequently, Z Limited qualifies as its subsidiary under Ind AS 110.

In preparing its consolidated financial statements as per Ind AS, should AB Limited also consolidate Z Limited?

Response

Rule 4A of the Companies (Accounts) Rules, 2014 issued by the Ministry of Corporate Affairs states as follows:

"4A. Forms and items contained in financial statements

The financial statements shall be in the form specified in Schedule III to the Act and comply with Accounting Standards or Indian Accounting Standards as applicable.

Provided that the items contained in the financial statements shall be prepared in accordance with the definitions and other requirements specified in the Accounting Standards or the Indian Accounting Standards, as the case may be."

Thus, it is clear from the above that for the purposes of preparation of financial statements, the definitions and other requirements specified under Ind AS should be applied. As Z Limited qualifies as a subsidiary of AB Limited under Ind AS 110, it should also be consolidated by AB Limited in preparing its consolidated financial statements.

Question 3

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?

Response

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.

Question 4

Whether a parent is required to consolidate a subsidiary which has been acquired with intent to dispose it of in the near future?

Response

There is no exception in Ind AS 110 for excluding from consolidated financial statements a subsidiary(ies) that has been acquired with an intent to dispose it of in the near future. Accordingly, such a subsidiary is required to be consolidated by the parent.

Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations,* lays down, *inter alia*, requirements relating to classification, measurement, presentation and disclosure of non-current assets and disposal groups that meet the criteria to be classified as 'held for sale' (or 'held for distribution to owners').

Accordingly, if on acquisition, a subsidiary acquired with intention of its disposal in near future meets the criteria of classification laid down in Ind AS 105 for classification as held for sale, the said standard (i.e., Ind AS 105) shall apply in consolidating the subsidiary, i.e., the disposal group (comprising the assets that are to be disposed of and directly related liabilities) shall be measured in accordance with the requirements of Ind AS 105 and presented in the consolidated financial statements as held for sale.

Question 5

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?

Response

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".

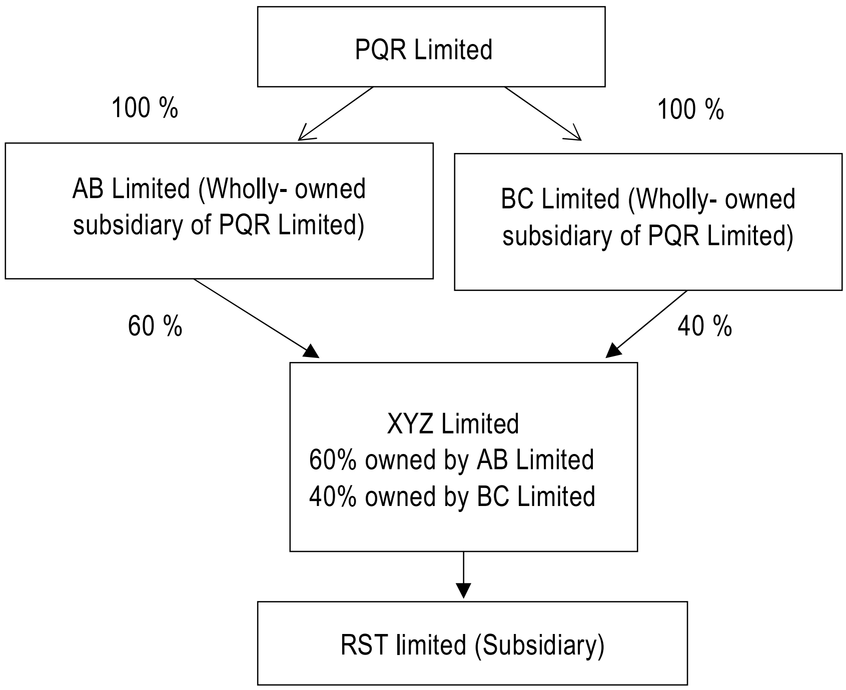
As per the above, where a parent disposes of the investment in subsidiary(ies) during the reporting period, it is required to consolidate such subsidiary(ies) until the date it loses the control of such subsidiary(ies) during the reporting period. This requirement applies in all cases of loss of control 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.

Likewise, in case if the entity had investment in an associate or interest in a joint venture during the reporting period but the said relationship ceases to exist as at the end of the reporting period, then also it is required to apply Ind AS 28 and/or Ind AS 111 to those investments in its financial statements for the reporting period, if not otherwise exempted from doing so.

Question 6

As per paragraph 4(a) of Ind AS 110, a parent entity need not present consolidated financial statements if it meets certain conditions specified in this behalf. One of the conditions [contained in paragraph 4(a)(i)] is that the entity is “a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements”.

Scenario I- Following is the structure of a group headed by PQR Limited



Whether XYZ Limited can avail the exemption from the preparation and presentation of consolidated financial statements?

Scenario II- The facts are the same as above except that, AB Limited and BC Limited are both owned by an Individual (Mr. X) instead of PQR Limited.

Under both the scenarios, XYZ Limited wishes to avail the exemption provided in paragraph 4(a) of Ind AS 110 from the presentation of consolidated financial statements. Assuming other conditions of paragraph 4(a) for such exemption are fulfilled, whether XYZ Limited is required to inform its other owner BC Limited (owning 40%) of its intention to not prepare consolidated financial statements as mentioned in paragraph 4(a)(i)?

Response

Paragraph 4 of Ind AS 110 states as follows:

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

(a) A parent need not present consolidated financial statements if it meets all the following conditions:

  (i) it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

  (ii) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

  (iii) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

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

In accordance with the above, it may be noted that as per paragraph 4(a)(i) above, a parent need not present consolidated financial statements if it is a:

— wholly-owned subsidiary; or

— is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements.

Scenario I

Although XYZ Limited is a partly-owned subsidiary of AB Limited, it is the wholly-owned subsidiary of PQR Limited (and therefore satisfies the condition 4(a)(i) of Ind AS 110 without regard to the relationship with its immediate owners, i.e. AB Limited and BC Limited). Thus, XYZ Limited being the wholly owned subsidiary fulfils the conditions as mentioned under paragraph 4(a)(i) and is not required to inform its other owner BC Limited of its intention not to prepare the consolidated financial statements.

Thus, in accordance with the above, XYZ Limited may take the exemption given under paragraph 4(a) of Ind AS 110 from presentation of consolidated financial statements.

Scenario II

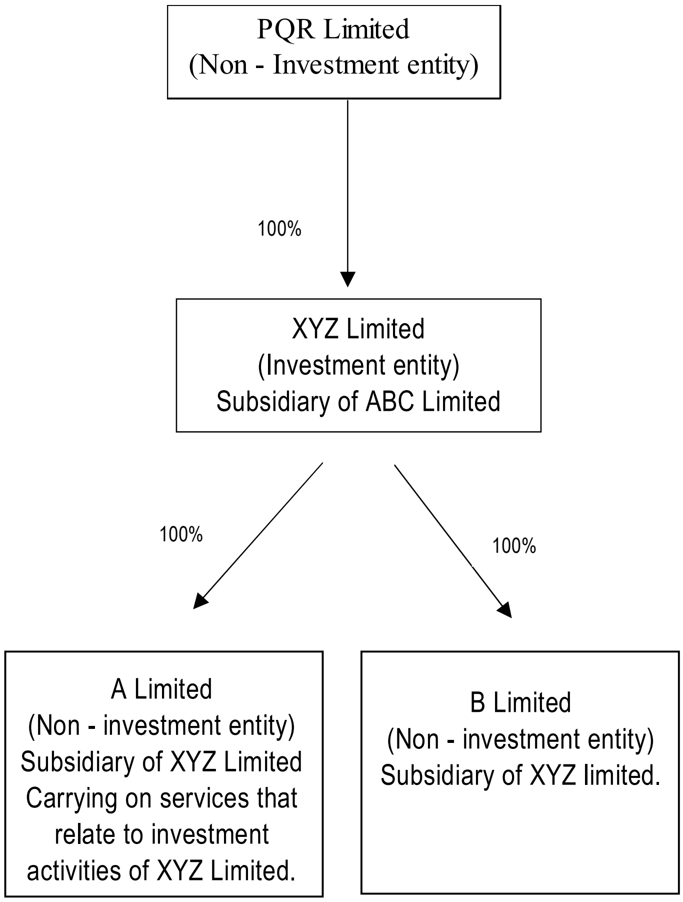
In case, both AB Limited and BC Limited are owned by an individual Mr. X, then XYZ Limited is ultimately wholly in control of Mr. X (i.e., an individual) and hence it cannot be considered as a wholly owned subsidiary of an entity.

This is because Ind AS 110 makes use of the term 'entity' and the word 'entity' includes a company as well as any other form of entity. Since, Mr. X is an 'individual' and not an 'entity', therefore, XYZ Limited cannot be considered as wholly owned subsidiary of an entity.

Therefore, in the given case, XYZ Limited is a partially-owned subsidiary of another entity. Accordingly, in order to avail the exemption under paragraph 4(a), its other owner, BC Limited should be informed about and do not object to XYZ Limited not presenting consolidated financial statements. Further, for the purpose of consolidation of AB Limited and BC Limited, XYZ Limited will be required to provide relevant financial information as per Ind AS.

Question 7

Following is the structure of a group headed by PQR Limited:



In view of the above structure whether PQR Limited and XYZ Limited are required from their respective reporting standpoint) to present consolidated financial statements?

For the above purpose, assume that the other conditions mentioned under paragraph 4(a)(i) to 4(a)(iii) related to such exceptions are satisfied for above entities.

Response

As per paragraph 4(a) of Ind AS 110, a parent need not present consolidated financial statements if it meets all the conditions specified therein. One of the condition as mentioned under paragraph 4(a)(iv) for the exemption from the presentation of consolidated financial statements is if ultimate or any intermediate parent of the parent entity produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss (FVTPL) in accordance with Ind AS 110.

Further, paragraph 4B of Ind AS 110 specifically provides that an investment entity shall not present consolidated financial statements if it is required by the Standard to measure all of its subsidiaries at FVTPL as provided in paragraph 31 of Ind AS 110.

Paragraphs 31 and 32 of Ind AS 110 provide that an investment entity shall measure an investment in a subsidiary at FVTPL in accordance with Ind AS 109. However, if the subsidiary is not itself an investment entity and whose main purpose and activities are providing services that relate to the investment entity's investment activities, then the investment entity shall consolidate that subsidiary.

Paragraph 33 further provides that, a parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Accordingly, in the present case, the following position regarding preparation of consolidated financial statements emerges:

From the perspective of PQR Limited

There are no exemptions under paragraph 4 from the presentation of consolidated financial statements to a non-investment entity which is the ultimate parent entity in the group. Further, paragraph 33 of Ind AS 110 provides that a parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Accordingly, PQR Limited is required to present its consolidated financial statements.

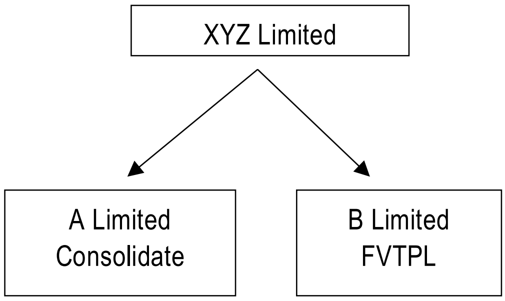
From the perspective of XYZ Limited

Application of requirement of paragraph 31- It is an investment entity and has two subsidiaries, A Limited and B Limited. Subsidiary A Limited is a non-investment entity which provides the services that relate to the investment activities undertaken by XYZ Limited.

In accordance with the requirements of paragraphs 4B, 31 and 32 of Ind AS 110, XYZ Limited is required to:

(i) consolidate A Limited [in accordance with the application guidance given under paragraphs B86 - B88 of Appendix B to Ind AS 110 (i.e. combining the like items of assets, liabilities and equity etc.)]; and

(ii) measure investments in B Limited at FVTPL.



Application of exemption under paragraph 4(a)(iv) - Since the ultimate parent company of XYZ Limited i.e., PQR Limited presents consolidated financial statements under Ind AS, XYZ Limited is eligible for exemption from the presentation of consolidated financial statements under paragraph 4(a)(iv) of Ind AS 110 as its ultimate parent entity, i.e., PQR Limited produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss (FVTPL) as appropriate, in accordance with Ind AS 110.

However, for the purpose of internal reporting to parent entity, XYZ Limited will be required to provide financial information data prepared as per Ind AS.

Question 8

Whether trusts or similar entities established for the purpose pension or gratuity plans etc. are covered under the scope exception under paragraph 4A of Ind AS 110?

Response

Paragraph 4A of Ind AS 110 provides an exemption to post-employment benefit plans or other long-term employment benefit plans to which Ind AS 19, *Employee Benefits,* applies. Thus, a parent entity, does not consolidate such plans. However, the entity should evaluate the accounting for trust in its standalone financial statements.

It is important to note that paragraph 4A is restricted to post-employment benefit plans or other long-term employment benefit plans to which Ind AS 19, *Employee Benefits,* applies.

Control

Question 9

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?

Response

The following paragraphs from Ind AS 110 may be noted-

B41 An investor with less than a majority of the voting rights has rights that are sufficient to give it power when the investor has the practical ability to direct the relevant activities unilaterally.

B42 When assessing whether an investor's voting rights are sufficient to give it power, an investor considers all facts and circumstances, including:

(a) the size of the investor's holding of voting rights relative to the size and dispersion of holdings of the other vote holders, noting that:

   (i) the more voting rights an investor holds, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

   (ii) the more voting rights an investor holds relative to other vote holders, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

   (iii) the more parties that would need to act together to outvote the investor, the more likely the investor is to have existing rights that give it the current ability to direct the relevant activities;

(b) potential voting rights held by the investor, other vote holders or other parties (see paragraphs B47–B50);

(c) rights arising from other contractual arrangements (see paragraph B40); and

(d) any additional facts and circumstances that indicate the investor has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

B43 When the direction of relevant activities is determined by majority vote and an investor holds significantly more voting rights than any other vote holder or organised group of vote holders, and the other shareholdings are widely dispersed, it may be clear, after considering the factors listed in paragraph B42 (a)–(c) alone, that the investor has power over the investee.

B40 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. However, in the absence of any other rights, economic dependence of an investee on the investor (such as relations of a supplier with its main customer) does not lead to the investor having power over the investee."

In the present case, 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.

Question 10

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?

Response

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".

Further, paragraph B40 of Appendix B to Ind AS 110 *inter alia* states 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 instant case, 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.

Question 11

Entity N, a non-banking financial company, 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?

Response

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.

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?

Question 12

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?

Response

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).

Further, paragraph 10 of Ind AS 110 states that, "an investor has power over an investee when the investor has existing rights that give it the current ability to direct the *relevant activities*, ie the activities that significantly affect the investee's returns".

In the present case, 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.

Question 13

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

BC Limited holds 85% preference shares, having an aggregate face value of Rs. 1,70,000, in ABC Limited 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?

Response

According to paragraphs 6 and 7 of Ind AS 110, 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. Thus, 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.

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.

Question 14

Can an investor have power if it can make decisions concerning the relevant activities of the investee only upon the occurrence of a contingent event and cannot make such decisions currently?

Response

Paragraph B13 of Ind AS 110 provides that, "in some situations, an activity both before and after a particular set of circumstances arises or event occurs may be relevant activities. When two or more investors have the current ability to direct relevant activities and those activities occur at different times, the investors shall determine which investor is able to direct the activities that most significantly affect those returns consistently with the treatment of concurrent decision making rights. The investors shall reconsider this assessment over time if relevant facts or circumstances change".

Paragraph B26 of Ind AS 110 states that, "in evaluating whether rights give an investor power over an investee, the investor shall assess whether its rights, and rights held by others, are protective rights. Protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective".

Further, paragraph B53 of Ind AS 110 states that, "for some investees, relevant activities occur only when particular circumstances arise or events occur. The investee may be designed so that the direction of its activities and its returns are predetermined unless and until those particular circumstances arise or events occur. In this case, only the decisions about the investee's activities when those circumstances or events occur can significantly affect its returns and thus be relevant activities. The circumstances or events need not have occurred for an investor with the ability to make those decisions to have power. The fact that the right to make decisions is contingent on circumstances arising or an event occurring does not, in itself, make those rights protective".

As per the above, there can be situations where an investor has power even though it can make decisions about the investee's activities only when particular circumstances or events occur.

To illustrate, an investee's only business activity, is to purchase receivables and service them on a day-to-day basis for its investors. The servicing on a day-to-day basis includes the collection and passing on of principal and interest payments as they fall due. Upon default of a receivable the investee automatically puts the receivable to an investor X as agreed separately in an agreement between the investor and the investee. In the given case, X can exercise its power only in case of a contingent event, i.e. in case of default. In this case, the only relevant activity is managing the receivables upon default because it is the only activity that can significantly affect the investee's returns. Managing the receivables before default is not a relevant activity because it does not require substantive decisions to be made that could significantly affect the investee's returns. Hence, default is the only time when decisions are required and X has the decision making authority at the time when such decisions are required and therefore it has power even though it may not be able to make decisions currently.

Question 15

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?

Response

Paragraph B19 of Ind AS 110, provides that sometimes there will be indications that the investor has a special relationship with the investee, which suggests that the investor has more than a passive interest in the investee. The existence of any individual indicator, or a particular combination of indicators, does not necessarily mean that the power criterion is met. However, having more than a passive interest in the investee may indicate that the investor has other related rights sufficient to give it power or provide evidence of existing power over an investee. For example, the fact that investee depends on the investor for critical services, technology, supplies or raw materials or that a significant portion of the investee's activities either involve or are conducted on behalf of the investor, suggests that the investor has more than a passive interest in the investee and, in combination with other rights, may indicate power.

In the present case, 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.

Question 16

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?

Response

Paragraph B23 of Appendix B to Ind AS 110 states that, "determining whether rights are substantive requires judgement, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:

(a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:

  (i) …

  (ii) an exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights.

  (iii) …"

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.

Question 17

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?

Response

Paragraph B34 of Ind AS 110 provides that an investor often has the current ability, through voting or similar rights, to direct the relevant activities. An investor considers the requirements in paragraphs B35-B50 of Ind AS 110 to identify if the relevant activities of an investee are directed through voting rights.

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.

Question 18

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?

Response

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.

Further, according to paragraphs B14 and B15 power arises from rights. To have power over an investee, an investor must have existing rights that give the investor the current ability to direct the relevant activities which may include rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor.

Whether a veto right held by an investor is merely a protective right or a right that may convey power to the veto holder depends on the nature of the veto right. If the veto right relates to changes to operating and financing policies that significantly affect 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.

Question 19

AB Limited (a Franchisor) enters into an agreement with an entity BC Limited (the Franchisee), which provides BC Limited with the exclusive rights to run the well-established food chain of AB Limited for 6 years (franchise business). AB Limited has retained the power to set the selling price for the products, branding requirements and determine the suppliers for key supplies and negotiation of related prices. BC Limited is entitled to the residual profits after paying an initial franchise fee, continuing royalties at 10% of its gross revenues and advertising fees etc.

Under the terms of the franchisee agreement, which is renewable at the option of BC Limited, BC Ltd. is responsible for all other operational aspects including:

(a) financing the franchisee, including the determination of appropriate sources of financing

(b) fit-outs, equipment purchasing and negotiating lease rental and other terms for premises. However, fit-outs are subject to AB Limited's approval from branding perspective.

(c) hiring or terminating key management and employees and negotiating wages and other employment terms

(d) determining detailed operating procedures

Whether AB Limited has the current ability to direct the relevant activities of BC Limited?

Response

According to paragraphs B29 and B31 of Ind AS 110, a franchise agreement for which the investee is the franchisee often gives the franchisor rights that are designed to protect the franchise brand and some decision-making rights with respect to the operations of the franchisee. It is necessary to distinguish between having the current ability to make decisions that significantly affect the franchisee's returns and having the ability to make decisions that protect the franchise brand.

Paragraph B33 of Appendix B to Ind AS 110 states that, control over such fundamental decisions as the legal form of the franchisee and its funding structure may be determined by parties other than the franchisor and may significantly affect the returns of the franchisee. The lower the level of financial support provided by the franchisor and the lower the franchisor's exposure to variability of returns from the franchisee the more likely it is that the franchisor has only protective rights.

According to paragraph B11, for many investees, a range of operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

(a) selling and purchasing of goods or services;

(b) managing financial assets during their life (including upon default);

(c) selecting, acquiring or disposing of assets;

(d) researching and developing new products or processes; and

(e) determining a funding structure or obtaining funding.

Also, paragraph B12 states that examples of decisions about relevant activities include but are not limited to:

(a) establishing operating and capital decisions of the investee, including budgets; and

(b) appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment.

Paragraph 13 of Ind AS 110 states that if two or more investors each have existing rights that give them the unilateral ability to direct different relevant activities, the investor that has the current ability to direct the activities that most significantly affect the returns of the investee has power over the investee.

In the present case, both the franchisor and franchisee have rights, and exposure, to variable returns and decision-making rights over some relevant activities. Accordingly, an assessment needs to be made as to which activities most significantly affect the returns of the franchisee. For example, if it is determined that the most relevant activities are financing the franchise, hiring or terminating the key management and other employees, renewal of the franchise agreement, then it may be concluded that AB limited does not has control the franchise business.

Question 20

AB Limited owns 45% of the equity shares of BC Limited. It also has an agreement with some other shareholders holding 20% equity shares of BC Limited that they will always vote in the same manner as AB Limited. The relevant activities of BC Limited's are controlled through voting rights and a simple majority vote is required on all decisions about the relevant activities.

Whether the voting rights owned by AB Limited together with its contractual arrangement with the other shareholders referred to above give control of BC Limited to AB Limited?

Response

Paragraph B39 of Ind AS 110 states that, "a contractual arrangement between an investor and other vote holders can give the investor the right to exercise voting rights sufficient to give the investor power. Even if the investor does not have voting rights sufficient to give it power without the contractual arrangement, a contractual arrangement might ensure that the investor can direct enough other vote holders on how to vote to enable the investor to make decisions about the relevant activities".

In the present case, the contractual arrangement of AB Limited with other shareholders holding 20% voting rights and its own holding of 45% voting power entitles it to majority voting rights, i.e., 65%. Thus, it has power to direct the relevant activities of BC Limited. Hence, AB Limited controls BC Limited.

Question 21

Investors A Ltd., B Ltd. and C Ltd. have invested 15%, 30% and 55% respectively in a fund that is being managed by an external fund manager. The fund manager has wide powers to make investment decisions and the investors cannot direct or veto those decisions. The fund manager can be removed only by a unanimous vote of all the three investors and has been assessed to be an agent under Ind AS 110.

Should investors A Ltd., B Ltd. and C Ltd. attribute the fund manager's decision making powers to themselves when they each consider whether they have power over the fund?

Response

Paragraph B58 of Ind AS 110 states that, "when an investor with decision-making rights (a decision maker) assesses whether it controls an investee, it shall determine whether it is a principal or an agent. An investor shall also determine whether another entity with decision-making rights is acting as an agent for the investor. An agent is a party primarily engaged to act on behalf and for the benefit of another party or parties (the principal(s)) and therefore does not control the investee when it exercises its decision-making authority. Thus, sometimes a principal's power may be held and exercisable by an agent, but on behalf of the principal. A decision maker is not an agent simply because other parties can benefit from the decisions that it makes".

Paragraph B59 of Ind AS 110 provides that, "an investor may delegate its decision-making authority to an agent on some specific issues or on all relevant activities. When assessing whether it controls an investee, the investor shall treat the decision-making rights delegated to its agent as held by the investor directly. In situations where there is more than one principal, each of the principals shall assess whether it has power over the investee (by considering the requirements laid down in this behalf in the Standard)."

Paragraph B65 of Ind AS 110 states that when a single party holds substantive removal rights and can remove the decision maker without cause, this, in isolation, is sufficient to conclude that the decision maker is an agent. If more than one party holds such rights (and no individual party can remove the decision maker without the agreement of other parties) those rights are not, in isolation, conclusive in determining that a decision maker acts primarily on behalf and for the benefit of others. In addition, the greater the number of parties required to act together to exercise rights to remove a decision maker and the greater the magnitude of, and variability associated with, the decision maker's other economic interests (ie remuneration and other interests), the less the weighting that shall be placed on this factor.

An agent does not control an investee and therefore, the fund manager does not control the fund. Rather, it is primarily acting on behalf of the other investors (the principals). However, although an agent is a party primarily engaged to act on behalf of and for the benefit of another party or parties [the principal(s)], this does not necessarily mean that any one of the principals controls the entity.

Where there are multiple principals, each principal should assess whether it has power over the investee by considering all the three elements of control, i.e., power, exposure to variable returns and the ability to use power to affect returns.

Therefore, in the given case, the investors should not attribute the fund manager's decision powers to themselves. The fund manager is an agent for all three investors. As the agent acts for multiple principals, each of the principals must assess whether it has power. None of the investors has the unilateral power to direct or remove the fund manager. Therefore, none of them on their own have the ability to direct the relevant activities of the fund.

Further, A Ltd., B Ltd. and C Ltd. should evaluate the applicability of Ind AS 111, *Joint Arrangements* and Ind AS 28, *Investments in Associates and Joint Ventures*.

Accounting requirements

Question 22

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?

Response

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. The Standard also requires elimination, in full, of profits or losses resulting from intra-group transactions that are recognised in assets such as inventories. The resultant consolidated financial statements reflect the effects of only those transactions that have been carried out by the group (that is, by any member of the group) with parties external to the group.

In the present case, 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.

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".

Paragraph 15 of Ind AS 23 states that, "in some circumstances, it is appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each subsidiary to use a weighted average of the borrowing costs applicable to its own borrowings".

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.

Question 23

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?

Response

In the instant case, 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.

Question 24

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?

Response

In the present case, 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 profit or loss, other comprehensive income and net assets of Venus Limited shall be attributed to the non-controlling 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).

Question 25

Entity A parent owns 80 per cent of the equity interest in its subsidiary Entity S. It also owns 30 per cent 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 non-controlling 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?

Response

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.

The above accounting of interest in associate is further supported by paragraph 26 of Ind AS 28 which provides that many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in Ind AS 110 which includes elimination of intragroup balances such as the associate's investment in the investor. As per paragraph B86(c) of Ind AS 110, income arising on an investment held by a subsidiary in a parent is eliminated. Therefore, in applying consolidation procedures in equity accounting, income arising from associate's investment in the investor is also eliminated.

In the present case, 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.

Question 26

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

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

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

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

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

Response

From a group perspective, elimination of an unrealised intragroup profit or loss on consolidation gives rise to a temporary difference where the profit or loss arises on a transaction that alters the tax base of the item(s) subject to the transaction. Such an alteration in the tax base creates a temporary difference because, due to the intra-group eliminations, there is no corresponding change in the carrying amount of the related assets or liabilities in the consolidated financial statements.

Paragraph B86 of Ind AS 110 states that Ind AS 12, *Income Taxes*, applies to temporary differences that arise from the elimination of profits and losses resulting from intra-group transactions.

Ind AS 12, *Income Taxes* does not specifically address the measurement of deferred taxes attributable to intra-group eliminations in consolidated financial statements. However, paragraph 10 of Ind AS 12 read with paragraph 51A thereof requires an entity, in measuring deferred tax, to consider the expected manner of recovery or settlement of the tax. It would generally be consistent with this requirement to measure deferred tax on temporary differences arising from elimination of intra-group transfers at the tax rates and laws applicable to the 'transferee' company rather than those applicable to the 'transferor' company, since it is the 'transferee' company that will be taxed when the asset or liability subject to the transfer is realised or sold.

In both of the above scenarios, in the consolidated financial statements, the gain of Rs. 20,000 on the intragroup transfer is eliminated and consequently, the carrying amount of the inventory in consolidated financial statements is Rs. 100,000. The tax base of the inventory held by the parent, on the other hand, changes to Rs. 1,20,000, due to the intra-group transfer.

According to paragraph 24 of Ind AS 12, a deferred tax asset in respect of a temporary difference shall be recognised only to the extent that it is probable that taxable profit will be available against which the temporary difference can be utilised,

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

A current tax expense/liability of Rs. 6,800 (being 34% of subsidiary profit of Rs. 20,000) is recognised in consolidated financial statements. The consolidated financial statements also recognise a deferred tax income/asset on the temporary difference of Rs. 20,000 (carrying amount of Rs. 1,00,000 -

tax base of Rs. 1,20,000) provided it is probable that taxable profit will be available against which the temporary difference can be utilised. As the new tax base of Rs. 1,20,000 is deductible in the hands of the parent (transferee) when the inventory is sold the tax rate applicable to the parent is used to calculate the deferred tax asset of Rs. 6,000 (being 30% of Rs. 20,000). The assessment as to whether it is probable that taxable profit will be available against which the temporary difference of Rs 20,000 can be utilised is made by considering the expected taxable profits of the parent considering the tax laws of the jurisdiction of the parent.

In summary, the net additional tax of Rs. 800 payable by the subsidiary is recognised as income tax expense in the consolidated profit and loss for Year 5. This reflects the fact that, by transferring the inventory from one tax jurisdiction to another with a lower tax rate, the group has effectively exposed itself to additional tax of Rs. 800 (i.e., Rs. 20,000 at the tax rate differential of 4%). The transferor pays a tax of 34% on its profit of Rs 20,000 whereas the transferee would get a deduction of 30% of Rs. 20,000 when it sells the inventory.

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

A current tax expense/liability of Rs. 6,000 (being 30% of the subsidiary's profit of Rs. 20,000) is recognised in consolidated financial statements. The consolidated financial statement also recognises a deferred tax income/asset on the temporary difference of Rs. 20,000 (carrying amount of Rs. 1,00,000 – tax base of Rs. 1,20,000), provided it is probable that taxable profit will be available against which the temporary difference can be utilised. Because the new tax base of Rs. 1,20,000 is deductible in the hands of the parent (transferee) when the inventory is sold to an unrelated party, then the parent's tax rate is used to calculate the deferred tax asset of Rs. 6,800 (being 34% of Rs. 20,000). The assessment as to whether it is probable that taxable profit will be available against which the temporary difference of Rs 20,000 can be utilised is made by considering the expected taxable profits of the parent considering the tax laws of the jurisdiction of the parent.

In summary, a net tax income of Rs. 800 is recognised in consolidated profit and loss for Year 5. This reflects the fact that, by transferring the inventory from one tax jurisdiction to another with a higher tax rate, the group has effectively increased the amount of the future tax deduction associated with the asset by Rs. 800 (i.e. Rs. 20,000 at the tax rate differential of 4%). The transferor pays a tax of 30% on its profit of Rs 20,000 whereas the transferee would get a deduction of 34% of Rs. 20,000 when it sells the inventory.

Question 27

Entity A holds a 20% equity interest in Entity B (an associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of Rs. 1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for Rs. 300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of Rs. 100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements			
Assets	**Rs.**	**Liabilities**	**Rs.**
Investment in B	200	Equity	200
Total	200	Total	200
B's consolidated financial statements			
Assets	**Rs.**	**Liabilities**	**Rs.**
Assets (from C)	1000	Equity	1000
Total	1000	Total	1000

The financial statements of B after the transaction are summarised below:

After

B's consolidated financial statements				
Assets	**Rs.**	**Liabilities**	**Rs.**	
Assets (from C)	1000	Equity	1000	
Cash	300	Equity transaction with non-controlling interest	100	
		Equity attributable to owners		1100
		Non-controlling interest		200
Total	1300	Total		1300

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now Rs. 220 (20% of Rs. 1,100) i.e., Rs. 20 in addition to its previous share.

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

Response

Ind AS 28, *Investments in Associates and Joint Ventures,* defines the equity method as "a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income."

Paragraph 27 of Ind AS 28, states, *inter alia*, that when an associate or joint venture has subsidiaries, associates or joint ventures, the profit or loss, other comprehensive income, and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies.

The change of interest in the net assets/equity of the associate as a result of the investee's equity transaction is reflected in the investor's financial statements as 'share of other changes in equity of investee' (in the statement of changes in equity) instead of gain in Statement of profit and loss, since it reflects the post-acquisition change in the net assets of the investee as per paragraph 3 of Ind AS 28 and also faithfully reflects the investor's share of the associate's transaction as presented in the associate's consolidated financial statements as per paragraph 27 of Ind AS 28.

Thus, in the given case, Entity A recognises Rs. 20 as change in other equity instead of in statement of profit and loss and maintains the same classification as of its associate, Entity B, i.e., a direct credit to equity as in its consolidated financial statements.

Question 28

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?

Response

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."

It may be noted that the above mentioned paragraphs requires an entity to apply uniform accounting policies "for like transactions and events in similar circumstances". If any member of the group follows a different accounting policy for like transactions and events in similar circumstances, appropriate adjustments are to be made in preparing consolidated financial statements.

Paragraph 5 of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors* defines accounting policies as "the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements."

Paragraph 8 of Ind AS 2, *Inventories* requires that "Inventories shall be measured at the lower of cost and net realisable value."

Paragraph 25 of Ind AS 2 states the following:

"The cost *of* inventories, other than those dealt with in paragraph 23, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified."

Elaborating on the requirements of paragraph 25, paragraph 26 of Ind AS 2 states the following-

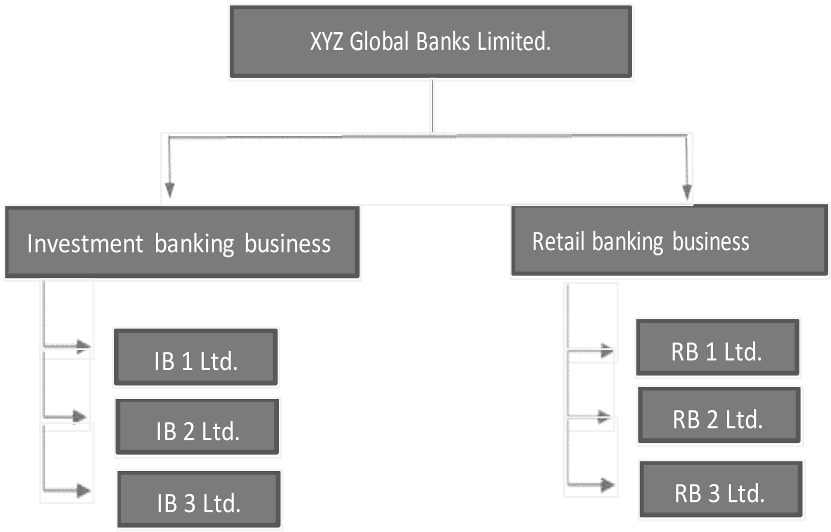
"For example, inventories used in one operating segment may have a use to the entity different from the same type of inventories used in another operating segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas."

Paragraph 36(a) of Ind AS 2 requires disclosure of "the accounting policies adopted in measuring inventories, including the cost formula used". Thus, as per Ind AS 2, the cost formula applied in valuing inventories is also an accounting policy.

As mentioned earlier, 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.

Question 29

XYZ Global Banks Limited heads, a global banking group which operates two business lines, retail banking and investment banking. Each of these business lines operates from three locations by means of separate subsidiaries.



In the separate financial statements of IB 1 Limited., IB 2 Limited., and IB 3 Limited., the financial assets are measured at fair value through profit or loss, as the business model of each of the companies is to actively trade these financial assets. RB 1 Limited and RB 2 Limited hold debt securities to collect contractual cash flows and the contractual terms of the debt securities give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. RB 1 Limited and RB 2 Limited therefore measure the debt securities at amortised cost in their separate financial statements. However, RB 3 Limited holds a portfolio of debt securities (the contractual terms of the which give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding) that it expects to sell before maturity. These assets are not held for trading and are classified and measured as at fair value through OCI in its separate financial statements. Further, XYZ Global Bank Limited holds debt securities to collect contractual cash flows and the contractual terms of the debt securities give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; it therefore measures the same at amortised cost in its separate financial statements.

Whether classification and measurement of financial assets based on respective business models at subsidiary level as described above represents application of different accounting policies which need to be adjusted to achieve uniformity of accounting policies in consolidated financial statements of XYZ Global Bank Limited?

Response

Ind AS 109, *Financial Instruments* requires an entity to classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

(a) the entity's business model for managing the financial assets; and

(b) the contractual cash flow characteristics of the financial asset.

A financial asset shall be measured at **amortised cost** if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset shall be measured at **fair value through other comprehensive income** if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset shall be measured at **fair value through profit or loss** unless it is measured at amortised cost or at fair value through other comprehensive. Therefore, classification as FVTPL is a residual category.

Ind AS 109 gives an entity an option to may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income

The following application guidance contained in paragraph B4.1.2 is particularly relevant in the context of the issue under discussion:

"B4.1.2 An entity's business model is determined at a level that reflects how groups of financial assets are managed together to achieve a particular business objective. The entity's business model does not depend on management's intentions for an individual instrument. Accordingly, this condition is not an instrument-by instrument approach to classification and should be determined on a higher level of aggregation. However, a single entity may have more than one business model for managing its financial instruments. Consequently, classification need not be determined at the reporting entity level. For example, an entity may hold a portfolio of investments that it manages in order to collect contractual cash flows and another portfolio of investments that it manages in order to trade to realise fair value changes. Similarly, in some circumstances, it may be appropriate to separate a portfolio of financial assets into sub-portfolios in order to reflect the level at which an entity manages those financial assets. For example, that may be the case if an entity originates or purchases a portfolio of mortgage loans and manages some of the loans with an objective of collecting contractual cash flows and manages the other loans with an objective of selling them."

It would be noted that the application guidance specifically recognises that a reporting entity may have more than one business model and consequently, classification of financial assets need not be determined at the reporting entity level.

In the given case, the reporting entity (i.e., the Group from the perspective of consolidated financial statements) has three different business models as detailed below and classification of financial assets even in the consolidated financial statements should be made accordingly:

(i) Debt securities held at the level of RB 1 Limited and RB 2 Limited are for collecting contractual cash flows and the contractual terms of the debt securities give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, Therefore, as in separate financial statements of RB 1 Limited and RB 2 Limited, in consolidated financial statements too, these securities should be classified and measured at amortised cost.

(ii) Debt securities held at the level of RB 3 Limited expected to be sold before maturity but are not held for trading. Further, the contractual terms of the debt securities give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. Therefore, as in separate financial statements of RB 3 Limited, in consolidated financial statements too, these securities should be classified and measured as at fair value through OCI.

(iii) As in the respective separate financial statements of IB 1 Limited., IB 2 Limited., and IB 3 Limited, the financial assets held at the level of these entities should be classified and measured at fair value through profit and loss in consolidated financial statements too as these financial assets are held within a business model to actively trade these financial assets.

Question 30

Entity A holds 49 per cent of the equity shares of Entity B. The remaining 51 per cent of the equity shares of Entity B are owned by three entities, P, Q and R, each owning 17 per cent respectively. None of the entities A, B, C or D is related to any of the other entities.

Entity A has entered into a forward contract with Entity P to acquire an additional five per cent of the equity shares of Entity B held by Entity P. The forward contract will be settled in two years' time. The terms of the forward contract give Entity A the right to receive dividends, if any, relating to the five per cent shares during the two-year intervening period. Entity P is also obliged to vote in accordance with the instructions of Entity A on the five per cent of equity shares subject to the forward contract during the two-year intervening period.

Whether Entity A exercises control over Entity B? If yes, whether potential voting rights would be taken into account by it while consolidating Entity B?

Response

Paragraph B22 of Ind AS 110 states that, “an investor, in assessing whether it has power, considers only substantive rights relating to an investee (held by the investor and others). For a right to be substantive, the holder must have the practical ability to exercise that right”.

Paragraph B47 states that, “when assessing control, an investor considers its potential voting rights as well as potential voting rights held by other parties, to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. Those potential voting rights are considered only if the rights are substantive".

Paragraph B90 further states that, "in some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns".

In accordance with the above, in the given case, right to dividends on the five percent shares gives Entity A, in-substance current access to the returns associated with the five per cent shareholding. Accordingly, the rights available under forward contract are substantive rights and those rights together with its 49 per cent holding gives ownership interest in Entity B. Thus, it can be concluded that Entity A controls Entity B (i.e. Entity A is the parent of Entity B). The proportion of profit or loss and other comprehensive income allocated between Entity A i.e., owner and the non-controlling interests of Entity B are 54 per cent and 46 per cent respectively. Thus, potential voting rights should be taken into account while consolidating Entity B.

Paragraph B91 further states that, "Ind AS 109 does not apply to interests in subsidiaries that are consolidated. When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in a subsidiary, the instruments are not subject to the requirements of Ind AS 109. In all other cases, instruments containing potential voting rights in a subsidiary are accounted for in accordance with Ind AS 109".

As stated above, the forward contract entered into by Entity A in the given case, gives it access to dividends on the five percent shares, i.e., it has in-substance current access to the returns associated with the five per cent shareholding. Accordingly, the forward contract shall not be subject to the requirements of Ind AS 109.

Question 31

How should a parent make the intragroup elimination in its consolidated financial statements when parent and its subsidiary do not have the same reporting period end?

Response

Paragraph B86(c) of Appendix B to Ind AS 110 requires that in consolidated financial statements, intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group should be eliminated in full.

Paragraph B92 deals with preparation of consolidated financial statements in a case where parent and subsidiary have different reporting period As per the said paragraph, in such a case, the subsidiary provides additional information as of the same date as the date of consolidated financial statements.

Further, paragraph B93 provides that, if it is impracticable to provide additional information, the parent shall consolidate the financial information of the subsidiary using the most recent financial statements of the subsidiary adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. In any case, the difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall not more than three months, and the length of the reporting periods and any difference between the dates of the financial statements shall be the same from period to period.

In accordance with the above, in the given case, if it is impracticable[1] for the entity to provide information, then it shall use the most recent financial statements of the subsidiary which should be adjusted for the effects of significant intragroup transactions that have occurred between the periods, for the purpose of elimination as required under paragraph B86(c).

Question 32

How should assets and liabilities be classified into current or non-current in consolidated financial statements when parent and subsidiary have different reporting dates?

Response

Paragraphs B92 and B93 of Ind AS 110 require subsidiaries with reporting

[1] Ind AS 1, *Presentation of Financial Statements* states that, "Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so."

period end different from parent, to provide additional information or details of significant transactions or events if it is impracticable to provide additional information to enable the parent entity to consolidate such financial information at group's reporting period end.

The appropriate classification of the assets and liabilities as current or non-current in the consolidated financial statements has to be determined by reference to the reporting period end of the group. Accordingly, when a subsidiary's financial statements are for a different reporting period end, it is necessary to review the subsidiary's balance sheet to ensure that items are correctly classified as current or non-current as at the end of the group's reporting period.

For example, a subsidiary with the financial year end of December 31, 2017 has a payable outstanding that is due for payment on January 01, 2019, and has accordingly classified it as non-current in its balance sheet. The financial year end of the parent's consolidated financial statements is March 31, 2018. Due to the time lag, the subsidiary's payable falls due within 12 months from the end of the parent's reporting period.

Accordingly, in this case, the payable should be classified as a current liability in the consolidated financial statements of the parent because the amount is repayable within nine months of the end of the parent's reporting period.

Question 33

A Limited, an Indian Company has a foreign subsidiary, B Inc. Subsidiary B Inc. has taken a long term loan from a foreign bank, which is repayable after in the year 2025. However, during the year, it breached one of the conditions of the loan, as a consequence of which the loan became repayable on demand on the reporting date. Subsequent to year end but before the approval of the financial statements, B Inc. rectified the breach and the bank agreed not to demand repayment and to let the loan run for its remaining period to maturity as per the original loan terms. While preparing its standalone financial statements as per IFRS, B Inc. has classified this loan as a current liability in accordance with IAS 1, *Presentation of Financial Statements*.

Whether A limited is required to classify such loan as current while preparing its consolidated financial statement under Ind AS?

Response

As per paragraph 74 of Ind AS 1, where there is a breach of a material provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand on the reporting date, the entity does not classify the liability as current, if the lender agreed, after the reporting period and before the approval of the financial statements for issue, not to demand payment as a consequence of the breach.

The above position under Ind AS 1 differs from the corresponding position under IAS 1. As per paragraph 74 of IAS 1, when an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.

Accordingly, the loan liability recognised as current liability by B Inc. in its standalone financial statements prepared as per IFRS, should be aligned as per Ind AS in the consolidated financial statements of A Limited and should be classified as non-current in the consolidated financial statements of A Limited in accordance with Ind AS 1.

Question 34

In consolidated financial statements, how does a parent entity account for transaction costs incurred to acquire the whole or a part of outstanding non-controlling interests (NCI) in a subsidiary, or transaction costs incurred to sell a part of interest held in a subsidiary without loss of control?

Response

As per paragraph 23 of Ind 110, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

While Ind AS 110 does not specifically address how to account for related transaction costs, the following requirements in this regard contained in other standards may be noted.

— Paragraph 35 of Ind AS 32, *Financial Instruments: Presentation* states that "transaction costs of an equity transaction shall be accounted for as a deduction from equity."

— As per paragraph 109 of Ind AS 1, *Presentation of Financial Statements* transaction costs directly related to transactions with owners in their capacity as owners are not items of expenses. This implies that such transaction costs should be taken directly to equity.

Thus, any directly attributable incremental transaction costs incurred to acquire the whole of any part of outstanding non-controlling interest in a subsidiary or to sell a part of interest in a subsidiary without loss of control should be deducted from equity.

Question 35

Entity A sells a 30% interest in its wholly-owned subsidiary to outside investors in an arm's length transaction for Rs. 500 crore in cash and retains a 70% controlling interest in the subsidiary. At the time of the sale, the carrying value of the subsidiary's net assets in the consolidated financial statements of Entity A is Rs. 1,300 crore, additionally, there is a goodwill of Rs. 200 crore that arose on the subsidiary's acquisition. Entity A initially accounted for NCI representing present ownership interests in the subsidiary at fair value and it recognises subsequent changes in NCI in the subsidiary at NCI's proportionate share in aggregate of net identifiable assets and associated goodwill. How should Entity A account for the transaction?

Response

As per paragraph 23 of Ind AS 110, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). Thus, changes in ownership interest that do not result in loss of control do not impact goodwill associated with the subsidiary or the statement of profit and loss.

Paragraph B96 of Ind AS 110 states that, "when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent".

Thus, at the time of sale of 30% of its equity interest, consolidated financial statements include an amount of Rs. 1500 crore in respect of the subsidiary. Accordingly, in the present case, the accounting entry on the date of sale of the 30% interest would be as follows:

		(Rupees in crore)	
Cash	Dr	500	
To NCI (30% of 1,500 crore)	Cr		450
To Equity	Cr		50

Question 36

A parent company gives an interest free loan of Rs. 100 crore to its subsidiary in which it holds 80% equity interest. The loan is not required to be repaid by the subsidiary. No additional equity securities have been issued by the subsidiary to the parent in connection with the receipt of loan by it. The non-controlling interests (NCI) in the subsidiary make no matching contribution.

What is the impact of such loan on NCI in consolidated financial statements of the parent?

Response

Interest free loan made by a parent are primarily contributions where no financial or non-financial obligation exists. The amount received should be accounted for by subsidiary in accordance with its substance as follows:

- A liability should be recognised for the contribution amount, if there is any possibility of having to repay the amount received;
- Amount shall be recognised as equity, if there is no requirement to repay the amount under any circumstances. E.g. Interest free portion of a loan received from parent or fair value of guarantee by parent on behalf of subsidiary with no charge to subsidiary for same. Such amount may be recognised separately under the head "Contribution from Parent" under equity.

Paragraph B96 of Ind AS 110 states that, when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Hence, when non-reciprocal capital contribution which is not required to be repaid is made by a parent to a non-wholly owned subsidiary, then that should be allocated proportionately to NCI - i.e., they should be accounted for as transactions between shareholders, which have a direct impact on equity.

Thus, in the instant case, of the total contribution of Rs.100 crore, Rs. 20 crore should be allocated to NCI in the consolidated financial statements of the parent.

Question 37

H Limited holds 80% share in its subsidiary S Limited at the beginning of the financial year, i.e., 1 April 2017. On 31 December 2017, H Limited sold its 5% stake in S Limited reducing its share from 80% to 75%, and as a result non-controlling interest (NCI) increased from 20% to 25%.

Assume that the net assets of S Limited and goodwill associated with acquisition of S Limited have a carrying amount of Rs. 20,000 on 1 April 2017. Assume further that the profit earned by S Limited during the 9-months ended 31 December 2017 is Rs. 1,000 and the profit earned during the next 3 months ended 31 March 2018 is Rs. 300. The consideration received by H Limited for sale of the 5% interest is Rs. 1,400 There is no item of other comprehensive income

In view of the above change, how would the profit or loss and other comprehensive income be apportioned between the parent and non-controlling interest in the consolidated financial statements of H Limited for the financial year 2017-18?

Response

As per paragraph 23 of Ind AS 110 any changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

Further, paragraph B96 of Ind AS 110 states that, "when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amounts by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent".

As at the date of sale of 5% interest, the carrying amount of net assets of S Limited (and goodwill associated with acquisition of S Limited) in the consolidated financial statements is Rs. 21,000, i.e., opening balance of Rs. 20,000 and profit of Rs. 1,000 earned during the first 9-months of financial year 2017-18. The 5% increase in non-controlling interests thus means an increase of Rs. 1,050 in NCI. As against this, the consideration received by H Limited for sale of the 5% interest is Rs. 1,400. Thus, H Limited has made a gain of Rs. 350 (Rs. 1,400 *minus* Rs. 1,050) which would be recognised directly in equity and attributed to owners of the parent in the consolidated financial statements.

The profits or losses or other comprehensive income arising after the date of sale of the 5% interest would be apportioned between the owners of the parent and the NCI in the proportion of 75:25.

Question 38

As at the beginning of its current financial year, AB Limited holds 90% equity interest in BC Limited.

During the financial year, AB Limited sells 70% interest to a third party for a total consideration of Rs. 56 crore and consequently loses control of BC Limited.

At the date of disposal, fair value of the 20% interest retained by AB Limited is Rs. 16 crore. The carrying amount of net assets of BC Limited in the consolidated financial statements of AB Limited as at the date of disposal of the 70% interest is Rs. 60 crore.

The aforementioned net assets include, inter alia, the following:

(a) Investments in debt instruments classified as at fair value through other comprehensive income (FVTOCI) of Rs. 12 crore. Related cumulative fair value gain recognised in OCI is Rs. 6 crore.

(b) Net defined benefit liability of Rs. 6 crore. This amount includes effect of cumulative loss of Rs. 3 crore on account of remeasurement of the net defined benefit liability that has been recognised in OCI.

(c) Investments in equity instruments (not held for trading) of Rs. 10 crore for which irrevocable option of recognising the changes in fair value in OCI has been availed. Related cumulative fair value gain recognised in OCI is Rs. 4 crore.

(d) Net assets of a foreign operation of Rs. 20 crore. Related cumulative exchange gain of Rs 8 crore arising on translating the financial statements of the foreign operation from its functional currency to the Group's presentation currency has been recognised in OCI.

In consolidated financial statements of AB Limited, 90% of the cumulative gains mentioned in (a), (c) and (d) above has been included in separate components of equity and 90% of the cumulative loss mentioned in (b) above has been included in retained earnings as required by Ind AS Schedule III to the Companies Act, 2013; the remaining 10% attributable to the non-controlling interests (NCI) has been included as part of the carrying amount of the NCI. Carrying amount of NCI at the date of disposal of 70% interest is Rs. 6 crore.

What would be the accounting treatment on loss of control of the subsidiary in the consolidated financial statements of AB Limited?

Response

Paragraph 25 of Ind AS 110 states that, "if a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated balance sheet.

(b) 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.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest."

Paragraph B98(a)(ii) of Ind AS 110 states that on loss of control of a subsidiary, a parent shall derecognise the carrying amount of any non-controlling interests in the former subsidiary (including any components of other comprehensive income attributable to them).

Paragraph B98(b)(i) of Ind AS 110 states that on loss of control of a subsidiary, a parent shall recognise the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in loss of control.

Paragraph B98(c) of Ind AS 110 states that, on loss of control of a subsidiary, a parent shall reclassify to profit or loss, or transfer directly to retained earnings if required by other Ind ASs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis specified in paragraph B99.

As per paragraph B98(d) of Ind AS 110,while accounting for loss of control of a subsidiary, any resulting difference shall be recognised as a gain or loss in profit or loss attributable to the parent.

As per paragraph B99, if a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

In view of the above, the treatment for loss of control of the subsidiary in consolidated financial statements of AB Limited will be:

(a) to derecognise carrying amount of the net assets and NCI of BC Limited.

(b) to recognise the fair value of the consideration received.

(c) to recognise the retained interest in BC Limited at its fair value at the date of loss of control of BC Limited which should be treated as the fair value on initial recognition of a financial asset under Ind AS 109 or the cost on initial recognition of an investment in an associate or joint venture, as the case may be.

(d) to reclassify the accumulated fair value gain on the investments in debt instruments at FVTOCI attributable to the owners of the parent (Rs. 5.4 crore, i.e., 90% of Rs. 6 crore) to profit or loss in accordance with paragraph B5.7.1A of Ind AS 109, *Financial Instruments* which requires that the cumulative gains or losses previously recognised in OCI shall be reclassified to profit and loss upon derecognition of the related financial asset. Remaining 10% (i.e., Rs. 0.6 crore) relating to non-controlling interest (NCI) is included as part of the carrying amount of the non-controlling interest that is derecognised. It is not reclassified to profit or loss.

(e) not to reclassify to profit or loss the cumulative amount of the remeasurement loss of the defined benefit liability attributable to the owners of the parent (Rs. 2.7 crore, i.e., 90% of Rs. 3 crore) previously included in retained earnings since such reclassification is prohibited by paragraph 122 of Ind AS 19, *Employee Benefits*. The remaining 10% (i.e., Rs. 0.3 crore) attributable to the NCI is included as part of the carrying amount of NCI that is derecognised. It is not reclassified to profit or loss.

(f) to transfer the accumulated fair value gain on investments in equity instruments at FVTOCI attributable to the owners of the parent (Rs. 3.6 crore, i.e., 90% of Rs. 4 crore) from relevant reserve to retained earnings as per paragraph B5.7.1 of Ind AS 109 which provides that in case an entity has made an irrevocable election to recognise the changes in the fair value of an investment in an equity instrument not held for trading in OCI, it may subsequently transfer the cumulative gain or loss within equity. Remaining 10% (i.e., Rs. 0.4 crore) attributable to the NCI is included as part of the carrying amount of NCI that is derecognised. It is not reclassified to profit or loss.

(g) to reclassify the exchange gain accumulated in foreign currency translation reserve in respect of translation of financial statements of the foreign operation attributable to the owners of the parent (Rs. 7.2 crore, i.e., 90% × Rs. 8 crore) to profit or loss as per paragraph 48 of Ind AS 21, *The Effects of Changes in Foreign Exchange Rates*, which specifies that the cumulative amount of exchange differences relating to the foreign operation, recognised in OCI and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss when the gain or loss on disposal of foreign operation is recognised. As per paragraph 48A(a) of Ind AS 21, this treatment applies even in case of a partial disposal involving loss of control of a subsidiary that includes a foreign operation. Remaining 10% (i.e., Rs. 0.8 crore) relating to the NCI is included as part of the carrying amount of the NCI that is derecognised but is not reclassified to profit or loss pursuant to paragraph 48B of Ind AS 21.

(h) to recognise resulting difference in profit or loss.

The impact of loss of control of BC Limited on the consolidated financial statements of AB Limited is summarised below:

(Rupees in crore)

Particular	Dr	Cr	PL Impact	RE Impact
Derecognition of carrying amounts of net assets and NCI and recognition of consideration received and retained interest				
Bank	56			
Non-controlling interest (derecognised)	6			
Investment in BC Limited (20% interest retained)	16			
To Net assets of the subsidiary (derecognised)		60		
To Profit or loss (balancing figure)		18	18	
Reclassification of accumulated FV gain on investments in debt instruments at FVTOCI to profit or loss				

Particular	Dr	Cr	PL Impact	RE Impact
OCI (Reserve in respect of investments in debt instruments*) (6 cr. x 90%)	5.4			
To Profit or loss		5.4	5.4	
Transfer of reserve in respect of investments in equity instruments at FVTOCI to retained earnings				
Reserve in respect of investments in equity instruments* (4 cr.x 90%)	3.6			
To Retained earnings*		3.6		3.6
Reclassification of accumulated foreign exchange gain to profit or loss				
OCI (Foreign currency translation reserve*) [8 cr. x 90%)	7.2			
To Profit or loss		7.2	7.2	
Total			**30.6**	**3.6**

* It may be noted that these components of equity are presented in the Statement of Changes in Equity in accordance with the format prescribed in Ind AS Schedule III to the Companies Act 2013.

Question 39

A Limited holds investments in both equity instruments and debt instruments (having fixed maturity date). The business purpose of A Limited is to provide investment management services to its investors, and invest funds received from investors solely for returns from capital appreciation and/or investment income. A Limited has a documented exit strategy for substantially all of its equity investments; but it has no documented exit strategy for its debt instruments.

Assuming that A Limited has all other characteristics of an Investment entity as per Ind AS 110, does it meet the definition of an investment entity under the said Standard?

Response

Paragraphs 27 and 28 of Ind AS 110 state as follows:

"27 A parent shall determine whether it is an investment entity. An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.

Paragraphs B85A–B85M provide related application guidance.

28 In assessing whether it meets the definition described in paragraph 27, an entity shall consider whether it has the following typical characteristics of an investment entity:

(a) it has more than one investment (see paragraphs B85O–B85P);

(b) it has more than one investor (see paragraphs B85Q–B85S);

(c) it has investors that are not related parties of the entity (see paragraphs B85T–B85U); and

(d) it has ownership interests in the form of equity or similar interests (see paragraphs B85V–B85W).

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity. An investment entity that does not have all of these typical characteristics provides additional disclosure required by paragraph 9A of Ind AS 112, *Disclosure of Interests in Other Entities*."

Furthermore, as per paragraph B85F of Ind AS 110, one feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity should have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments. An investment entity should also have an exit strategy for any debt instruments that have the potential to be held indefinitely, for example perpetual debt investments.

In the given case, A Limited has a documented exit strategy for substantially all of its equity investments. While it has no documented exit strategy for its debt investments as they have a fixed maturity date and therefore do not have the potential to be held indefinitely. Consequently, the absence of a documented exit strategy for these debt investments does not per se disqualify A Limited from being an investment entity.

Assuming that A Limited has all the other characteristics of an investment entity as enunciated in Ind AS 110, A Limited is an investment entity as per Ind AS 110.

Question 40

An entity, X Limited, is formed by Z Limited to invest in start-up technology companies for capital appreciation. Z Limited holds a 75% interest in X Limited and controls it; the other 25% ownership interest is held by 10 unrelated investors. Z Limited holds options to acquire investments held by X Limited, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Z Limited.

Whether X Limited meet the definition of an investment entity as per Ind AS 110?

Response

Paragraph 27 of Ind AS 110 states as follows:

"27 A parent shall determine whether it is an investment entity. An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis."

Further, paragraph B85I *inter-alia* states that, "an entity is not investing solely for capital appreciation, investment income or both, if the entity or another member of the group containing the entity obtains, or has the objective of obtaining, other benefits from the entity's investments that are not available to other parties that are not related to the investee. Such benefits include:

(a) the acquisition, use, exchange or exploitation of the processes, assets or technology of an investee. This would include the entity or another group member having disproportionate, or exclusive, rights to acquire assets, technology, products or services of any investee; for example, by holding an option to purchase an asset from an investee if the asset's development is deemed successful."

Additionally, paragraph B85F of Ind AS 110 *inter-alia* states that, "an entity's investment plans also provide evidence of its business purpose. One feature that differentiates an investment entity from other entities is that an investment entity does not plan to hold its investments indefinitely; it holds them for a limited period. Because equity investments and non-financial asset investments have the potential to be held indefinitely, an investment entity shall have an exit strategy documenting how the entity plans to realise capital appreciation from substantially all of its equity investments and non-financial asset investments".

The absence of an exit strategy for investments in subsidiaries also suggests that the investments are made not only for investment returns (capital appreciation, investment income or both) but also other benefits (such as those arising from synergies).

In the instant case, although X's business purpose is investing for capital appreciation and it provides investment management services to its investors, X Limited is not an investment entity since:

— Z Limited, the parent of X Limited, has an option to acquire investments in investees held by X Limited, if assets developed by the investees would benefit the operations of Z Limited. This provides other benefits in addition to capital appreciation and investment income; and

— the investment plans of X Limited do not include exit strategies for its investments, which are equity instruments. The options held by Z Limited are not controlled by X Limited and do not constitute an exit strategy.

Since X Limited is not an investment entity, it will be required to consolidate its subsidiaries.

Appendix I[2]

Issues addressed in ITFG Clarification Bulletins

Accounting Treatment of loss of investment in subsidiary

***Issue 1*: Parent had 70% stake in subsidiary. The other investor invested additional funds in the subsidiary reducing the parent's stake to 60%. However, there was no loss of control by the Parent. How this partial deemed disposal should be accounted in the separate financial statements of the parent assuming that investment in subsidiary is measured at cost. Also, state the accounting treatment in the consolidated financial statements?**

***Response*: Treatment in Separate Financial Statements of the Parent entity**

In the given case, in the separate financial statements of the parent entity there will not be any impact and investment in the subsidiary will continue to be recognised at its carrying amount. However, the fact that its shareholding has been reduced from 70% to 60% should be disclosed appropriately in the financial statements.

Treatment in Consolidated Financial Statements

As per paragraph 23 of Ind AS 110 *Consolidated Financial Statements*, changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners).

Thus, such transactions have no impact on goodwill or the statement of profit and loss.

Paragraph B96 of Appendix B to Ind AS 110 further provides that, when the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling

[2] Clarifications given or views expressed by the Ind AS Technical Facilitation Group (ITFG) represent the views of the members of the ITFG and are not necessarily the views of the Ind AS Implementation Group or any Committee/Board or the Council of the Institute. The clarifications/views are based on the accounting principles as on the date the Group finalises the particular clarification. The date of finalisation of each clarification Bulletin is indicated along with the clarification Bulletin. The clarification must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of clarifications by the Group.

interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

Non-controlling interests (NCI) are recorded at fair value (or proportionate share in the recognised amounts of the acquiree's identifiable net assets, if chosen) only at the date of the business combination. Subsequent purchases or sales of ownership interests when control is maintained are recorded at the non-controlling interest's proportionate share of the net assets.

As per paragraph 18 of Ind AS 112, *Disclosure of Interests in Other Entities*, an entity is required to present a schedule that shows the effects on the equity attributable to owners of the parent of any changes in its ownership interest in a subsidiary that do not result in a loss of control.

(ITFG Clarification Bulletin 13, Issue 7)
(Date of finalisation: January 16, 2018)

Accounting treatment of dividend distribution tax in the consolidated financial statements in case of partly-owned subsidiary - different scenarios

***Issue 2*: What will be the accounting treatment of dividend distribution tax in the consolidated financial statements in case of partly-owned subsidiary in the following scenarios:**

Scenario 1: H Limited (holding company) holds 12,000 equity shares in S Limited (Subsidiary of H Limited) with 60% holding. Accordingly, S Limited is a partly-owned subsidiary of H Limited. During the year 2017, S Limited paid a dividend @ Rs. 10 per share, amounting to Rs. 200,000 and DDT @ 20% amounting to Rs. 40,000.

Should the share of H Limited in DDT paid by S Limited amounting to Rs. 24,000 (60% of Rs. 40,000) be charged as expense in the consolidated profit and loss of H Limited?

***Response*:** Since H Limited is holding 12,000 shares it has got Rs. 1,20,000 as dividend from S Limited. In the consolidated financial statements of H Ltd., dividend income earned by H Ltd. and dividend recorded by S Ltd. in its equity will both get eliminated as a result of consolidation adjustments. Dividend paid by S Ltd. to the 40% non-controlling interest (NCI) shareholders will be recorded in the Statement of Changes in Equity as reduction of NCI balance (as shares are classified as equity as per Ind AS 32).

DDT of Rs. 40,000 paid to tax authorities has two components- One Rs. 24,000 (related to H Limited's shareholding and other Rs. 16,000 belong to non-controlling interest (NCI) shareholders of S Limited). DDT of Rs. 16,000 (pertaining to non-controlling interest (NCI) shareholders) will be recorded in the Statement of Changes in Equity along with dividend. DDT of Rs. 24,000 paid outside the consolidated Group shall be charged as tax expense in the consolidated statement of profit and loss of H Ltd.

It may be noted that Issue 1 of ITFG Clarification Bulletin 9 provides that-

> *"In the consolidated financial statements of P Ltd., the dividend income earned by P Ltd. from S Ltd. and dividend recorded by S Ltd. in its equity will both get eliminated as a result of consolidation adjustments. DDT of Rs. 20,000 paid outside the consolidated Group i.e. to the tax authorities should be charged as expense in the consolidated statement of Profit and Loss of P Ltd."*

The similar accounting treatment would be done in case of the partly-owned subsidiary:

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	H Ltd.	S Ltd.	Consol Adjustments	CFS H Ltd
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity by way of reduction of NCI)	-	(200,000)	120,000	(80,000)
DDT (in Statement of Changes in Equity by way of reduction of NCI)	-	(40,000)	24,000	(16,000)
DDT (in Statement of P&L)	-	-	(24,000)	(24,000)

Scenario 2 (A): Extending the situation given in scenario 1, H Limited also pays dividend of Rs. 300,000 to its shareholders and DDT liability @ 20% thereon amounts to Rs. 60,000. As per the tax laws, DDT paid by S Ltd. of Rs. 24,000 is allowed as set off against the DDT liability of H Ltd., resulting in H Ltd. paying Rs. 36,000 (Rs. 60,000 – Rs. 24,000) as DDT to tax authorities.

***Response*:** If DDT paid by the subsidiary S Ltd. is allowed as a set off against the DDT liability of its parent H Ltd. (as per the tax laws), then the amount of such DDT should be recognised in the consolidated statement of changes in equity of parent H Ltd.

In the given case, share of H Limited in DDT paid by S Limited is Rs. 24,000 and entire Rs. 24,000 was utilised by H Limited while paying dividend to its own shareholders.

Accordingly, DDT of Rs. 76,000 (Rs. 40,000 of DDT paid by S Ltd. (of which Rs. 16,000 is attributable to NCI) and Rs. 36,000 of DDT paid by H Ltd.) should be recognised in the consolidated statement of changes in equity of parent H Ltd. No amount will be charged to consolidated statement of profit and loss. The basis for such accounting would be that due to Parent H Ltd's transaction of distributing dividend to its shareholders (a transaction recorded in Parent H Ltd's equity) and the related DDT set-off, this DDT paid by the subsidiary is effectively a tax on distribution of dividend to the shareholders of the parent company.

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	**H Ltd**	**S Ltd**	**Consol Adjustments**	**CFS H Ltd**
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity)	(300,000)	(200,000)	120,000	(380,000)*
DDT (in Statement Changes in Equity)	(36,000)	(40,000)	-	(76,000)*

*Dividend of Rs. 80,000 and DDT of Rs. 16,000 will be reflected as reduction from non-controlling interest.

(B) If in (A) above, H Limited pays dividend amounting to Rs. 100,000 with DDT liability @ 20% amounting to Rs. 20,000.

Response**:** In the given case, share of H Limited in DDT paid by S Limited is Rs. 24,000 out of which only Rs. 20,000 was utilised by H Limited while paying dividend by its own. Therefore, balance Rs. 4,000 should be charged in the consolidated statement of profit and loss.

In accordance with the above, in the given case, CFS of H limited will be as under:

Transactions	**H Ltd**	**S Ltd**	**Consol Adjustments**	**CFS H Ltd**
Dividend Income (P&L)	120,000	-	(120,000)	-
Dividend (in Statement of Changes in Equity)	(100,000)	(200,000)	120,000	(180,000)*
DDT (in Statement of Changes in Equity)	-	(40,000)	4,000	(36,000)*
DDT (in Statement of P&L)	-	-	(4000)	(4000)

*Dividend of Rs. 80,000 and DDT of Rs. 16,000 will be reflected as reduction from non- controlling interest.

Scenario (3): Will the answer be different for the treatment of dividend distribution tax paid by associate in the consolidated financial statement of investor, if as per tax laws the DDT paid by associate is not allowed set-off against the DDT liability of the investor?

Response**:** Considering that as per tax laws, DDT paid by associate is not allowed set off against the DDT liability of the investor, the investor's share of DDT would be accounted by the investor company by crediting its investment account in the associate and recording a corresponding debit adjustment towards its share of profit or loss of the associate.

(ITFG Clarification Bulletin 13, Issue 9)
(Date of finalisation: January 16, 2018)

Treatment of depreciation in consolidated financial statements when different method of depreciation applied by entities

<u>*Issue 3*</u>: PQR Ltd. is the subsidiary company of MNC Ltd. In the stand-alone financial statements prepared in accordance with Ind AS, PQR Ltd. has adopted Straight-line method (SLM) of depreciation and MNC Ltd. has adopted Written-down value method (WDV) for depreciating its property, plant and equipment. As per Ind AS 110, *Consolidated Financial Statements*, a parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

How will these property, plant and equipment be depreciated in the consolidated financial statements of MNC Ltd. prepared as per Ind AS?

<u>*Response*</u>: 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."

It may be noted that the above mentioned paragraphs require an entity to apply uniform accounting policies for like transactions and events in similar circumstances. It does not apply to accounting estimates made while preparing financial statements.

Further, paragraphs 60 & 61 of Ind AS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* state as follows:

"60 The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. ***Such***

a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8*."(Emphasis added)*

In accordance with the above, it may be noted that the selection of the method of depreciation is an accounting estimate and not an accounting policy.

Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods of estimating depreciation for property, plant and equipment, if their expected pattern of consumption is different. The method once selected in the stand-alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

Accordingly, in the given case, the property, plant and equipment of PQR Ltd. (subsidiary company) may be depreciated using straight line method and property, plant and equipment of parent company (MNC Ltd.) may be depreciated using written down value method, if such method closely reflects the expected pattern of consumption of future economic benefits embodied in the respective assets.

(ITFG Clarification Bulletin 11, Issue 6)
(Date of finalisation: July 31, 2017)

Accounting treatment of the outstanding retired partners' capital balances

***Issue 4*: A Company has investment in a partnership firm and it has established that it has control over the firm as per the requirements of Ind AS 110, *Consolidated Financial Statements*. Accordingly, as per Ind AS, the company is required to consolidate the firm as its subsidiary and its financial statement is required to be in compliance with Ind AS. There are amounts outstanding towards retired partners' capitals, which are repayable by the partnership firm on demand. What would be the accounting treatment of these outstanding retired partners' capital balances? Whether these are required to be discounted?**

Response: In the given case, since the company has assessed and established control over the partnership firm as per Ind AS 110, accordingly, it will be required to consolidate the partnership firm as per the requirements of Ind AS. Though Ind AS would not be applicable to the partnership firm nevertheless its financial statements to be consolidated by the company is required to be in compliance with Ind AS.

In the given case, since the amounts outstanding towards retired partners' capitals can be demanded by those retired partners anytime and it meets the definition of a financial liability under Ind AS 32(i.e. it is firm's contractual obligation to deliver cash or another financial asset), accordingly, the same shall be measured at its fair value.

Paragraph 47 of Ind AS 113 states that 'the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.'

Accordingly, in the given case based on the facts provided these amounts are considered as repayable on demand at any time, and therefore, no discounting would be required on initial recognition and subsequent measurement.

(ITFG Clarification Bulletin 15, Issue 9)

(Date of finalisation: April; 04, 2018)

Appendix II

Major differences between Ind AS 110, *Consolidated Financial Statements* and AS 21, *Consolidated Financial Statements*

(i) Ind AS 110 makes the preparation of consolidated financial statements mandatory for a parent (subject to limited exceptions). AS 21 does not mandate the preparation of consolidated financial statements by a parent. However, if a parent presents consolidated financial statements, it is required to apply AS 21 in preparing and presenting such financial statements.

(ii) As per AS 21, control is the ownership of more than one-half of the voting power of an enterprise or control of the composition of the board of directors or other similar governing body of another enterprise so as to obtain economic benefits from its activities. Thus, AS 21, lays down quantitative parameters for determining whether an entity controls another entity. The definition of control in Ind AS 110, on the other hand, is principle based - 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. Due to differences in the definitions of control under the two standards, in some cases, the assessment as to whether an entity controls another entity can differ between the two standards.

(iii) There can occasionally be situations where application of the definition of 'control' as per AS 21 results in there being two parents of an entity. In such a case, both the parents are required to consolidate the entity in their respective consolidated financial statements. On the other hand, as per the definition of 'control' under Ind AS 110 control of an entity can be with one entity only.

(iv) As per AS 21, a subsidiary is excluded from consolidation when control is intended to be temporary or when it operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent. Ind AS 110 does not permit exclusion of a subsidiary from consolidation on either of these grounds.

(v) As per AS 21, difference between the date of the subsidiary's financial statements and that of the consolidated financial statements cannot

not exceed six months. Under Ind AS 110 such difference cannot exceed three months.

(vi) Unlike AS 21 Ind AS 110 specifically lays down accounting requirements applicable to changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary.

(vii) Both AS 21 and Ind AS 110, require the use of uniform accounting policies. However, unlike Ind AS 110, AS 21 allows the use of non-uniform accounting policies if it is not practicable to use uniform accounting policies disclosure is, however, required of, that fact together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

(viii) For considering share ownership, potential equity shares of the investee held by investor are not taken into account as per existing AS 21. However, as per Ind AS 110, potential voting rights that are substantive are also considered when assessing whether an entity has control over another entity.

(ix) According to AS 21, the tax expense (comprising current tax and deferred tax) to be shown in the consolidated financial statements should be the aggregate of the amounts of tax expense appearing in the separate financial statements of the parent and its subsidiaries. This means that under AS 21, deferred taxes are not recognised in consolidated financial statements in respect of timing differences that arise from the elimination of profits and losses resulting from intra-group transactions in consolidated financial statements. On the other hand, Ind AS 110, read with Ind AS 12, *Income Taxes* requires recognition of deferred taxes in respect of temporary differences that arise from such elimination in consolidated financial statements.

Appendix III

Major differences between Ind AS 110 and IFRS 10, *Consolidated Financial Statements*

One of the essential requirements (under both IFRS 10 and Ind AS 110) for an entity to qualify as an investment entity is that the entity measures and evaluates the performance of substantially all of its investments on a fair value basis. In this context, IFRS 10 paragraph B85L(a) provides that to meet this requirement, an entity would need to elect to account for any investment property using the fair value model in IAS 40, *Investment Property*. Ind AS 40, *Investment Property*, requires investment property to be measured using cost model, i.e., at cost initially and at cost less depreciation subsequently; fair value model is not permitted. Consequently, paragraph B85L(a) of IFRS 10 has not been included in Ind AS 110.